

OFG BANCORP
Form 10-Q
November 07, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

or

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

For the transition period from _____ to _____

Commission File Number 001-12647

OFG Bancorp

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

Principal Executive Offices:

254 Muñoz Rivera Avenue

San Juan, Puerto Rico 00918

Telephone Number: (787) 771-6800

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

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

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

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

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

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

44,678,475 common shares (\$1.00 par value per share) outstanding as of October 31, 2014

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FORWARD-LOOKING STATEMENTS

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

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

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

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

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

ITEM 1. FINANCIAL STATEMENTS

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF SEPTEMBER 30, 2014 AND DECEMBER 31, 2013

| | | September 30, | | December 31, |
|---|----|------------------|----|------------------|
| | | 2014 | | 2013 |
| | | (In thousands) | | |
| ASSETS | | | | |
| Cash and cash equivalents: | | | | |
| Cash and due from banks | \$ | 663,462 | \$ | 614,302 |
| Money market investments | | 7,777 | | 6,967 |
| Total cash and cash equivalents | | 671,239 | | 621,269 |
| Restricted cash | | 32,907 | | 82,199 |
| Securities purchased under agreements to resell | | - | | 60,000 |
| Investments: | | | | |
| Trading securities, at fair value, with amortized cost of \$2,419 (December 31, 2013 - \$2,448) | | 1,687 | | 1,869 |
| Investment securities available-for-sale, at fair value, with amortized cost of \$1,249,769 (December 31, 2013 - \$1,575,043) | | 1,273,879 | | 1,588,425 |
| Investment securities held-to-maturity, at amortized cost, with fair value of \$144,217 | | 144,305 | | - |
| Federal Home Loan Bank (FHLB) stock, at cost | | 21,189 | | 24,450 |
| Other investments | | 65 | | 65 |
| Total investments | | 1,441,125 | | 1,614,809 |
| Loans: | | | | |
| Mortgage loans held-for-sale, at lower of cost or fair value | | 16,757 | | 46,529 |
| Non-covered loans, net of allowance for loan and lease losses of \$64,859 (December 31, 2013 - \$54,298) | | 4,528,452 | | 4,615,929 |
| Covered loans, net of allowance for loan and lease losses of \$62,227 (December 31, 2013 - \$52,729) | | 311,693 | | 356,961 |
| Total loans, net | | 4,856,902 | | 5,019,419 |
| Other assets: | | | | |
| FDIC indemnification asset | | 120,619 | | 189,240 |
| Foreclosed real estate covered under shared-loss agreements with the FDIC | | 49,814 | | 33,209 |
| Foreclosed real estate not covered under shared-loss agreements with the FDIC | | 50,750 | | 56,815 |
| Accrued interest receivable | | 19,665 | | 18,734 |

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|--|--|----|------------------|--|----|------------------|
| Deferred tax asset, net | | | 121,217 | | | 137,564 |
| Premises and equipment, net | | | 82,099 | | | 82,903 |
| Customers' liability on acceptances | | | 21,077 | | | 23,042 |
| Servicing assets | | | 13,986 | | | 13,801 |
| Derivative assets | | | 8,445 | | | 20,502 |
| Goodwill | | | 86,069 | | | 86,069 |
| Other assets | | | 97,425 | | | 98,440 |
| Total assets | | \$ | 7,673,339 | | \$ | 8,158,015 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Deposits: | | | | | | |
| Demand deposits | | \$ | 2,132,073 | | | 2,138,005 |
| Savings accounts | | | 1,263,115 | | | 1,194,567 |
| Time deposits | | | 1,673,987 | | | 2,050,693 |
| Total deposits | | | 5,069,175 | | | 5,383,265 |
| Borrowings: | | | | | | |
| Securities sold under agreements to repurchase | | | 1,012,228 | | | 1,267,618 |
| Advances from FHLB | | | 334,787 | | | 336,143 |
| Subordinated capital notes | | | 101,190 | | | 100,010 |
| Other borrowings | | | 3,872 | | | 3,663 |
| Total borrowings | | | 1,452,077 | | | 1,707,434 |
| Other liabilities: | | | | | | |
| Securities purchased but not yet received | | | 30,057 | | | - |
| Derivative liabilities | | | 11,414 | | | 14,937 |
| Acceptances executed and outstanding | | | 21,077 | | | 23,042 |
| Accrued expenses and other liabilities | | | 159,541 | | | 144,424 |
| Total liabilities | | | 6,743,341 | | | 7,273,102 |
| Commitments and contingencies (See Note 18) | | | | | | |
| 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, 2013 - 1,340,000; 1,380,000; and 960,000) \$25 liquidation value | | | 92,000 | | | 92,000 |
| 84,000 shares of Series C issued and outstanding (December 31, 2013 - 84,000); \$1,000 liquidation value | | | 84,000 | | | 84,000 |
| Common stock, \$1 par value; 100,000,000 shares authorized; 52,761,295 shares issued: | | | | | | |
| 45,059,988 shares outstanding (December 31, 2013 - 52,707,023; 45,676,922) | | | 52,761 | | | 52,707 |
| Additional paid-in capital | | | 539,522 | | | 538,071 |
| Legal surplus | | | 68,437 | | | 61,957 |
| Retained earnings | | | 170,519 | | | 133,629 |
| | | | (90,652) | | | (80,642) |

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|---|--|----|------------------|--|----|------------------|
| Treasury stock, at cost, 7,701,307 shares (December 31, 2013 - 7,030,101 shares) | | | | | | |
| Accumulated other comprehensive income, net of tax of \$1,867 (December 31, 2013 -\$831) | | | 13,411 | | | 3,191 |
| Total stockholders' equity | | | 929,998 | | | 884,913 |
| Total liabilities and stockholders' equity | | \$ | 7,673,339 | | \$ | 8,158,015 |
| See notes to unaudited consolidated financial statements. | | | | | | |

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2014 AND 2013

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|--|-----------------------------|----------------|------|----------------|---------------------------------------|----------------|------|----------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| (In thousands, except per share data) | | | | | | | | |
| Interest income: | | | | | | | | |
| Non-covered loans | \$ | 87,662 | \$ | 87,655 | \$ | 260,969 | \$ | 259,567 |
| Covered loans | | 20,886 | | 21,657 | | 69,153 | | 65,884 |
| Total interest income from loans | | 108,548 | | 109,312 | | 330,122 | | 325,451 |
| Mortgage-backed securities | | 10,842 | | 9,662 | | 35,243 | | 29,559 |
| Investment securities and other | | 911 | | 2,127 | | 3,910 | | 6,564 |
| Total interest income | | 120,301 | | 121,101 | | 369,275 | | 361,574 |
| Interest expense: | | | | | | | | |
| Deposits | | 7,661 | | 11,334 | | 25,804 | | 30,757 |
| Securities sold under agreements to repurchase | | 7,453 | | 7,211 | | 22,238 | | 21,569 |
| Advances from FHLB and other borrowings | | 2,314 | | 2,321 | | 6,896 | | 6,275 |
| Subordinated capital notes | | 1,002 | | 1,144 | | 2,990 | | 3,973 |
| Total interest expense | | 18,430 | | 22,010 | | 57,928 | | 62,574 |
| Net interest income | | 101,871 | | 99,091 | | 311,347 | | 299,000 |
| Provision for non-covered loan and lease losses | | 16,142 | | 9,900 | | 39,424 | | 55,343 |
| Provision for covered loan and lease losses, net | | 1,115 | | 3,074 | | 4,339 | | 4,957 |
| Total provision for loan and lease losses | | 17,257 | | 12,974 | | 43,763 | | 60,300 |
| Net interest income after provision for loan and lease losses | | 84,614 | | 86,117 | | 267,584 | | 238,700 |
| Non-interest income: | | | | | | | | |
| Banking service revenue | | 9,753 | | 12,146 | | 30,305 | | 36,491 |
| Wealth management revenue | | 7,113 | | 7,394 | | 21,316 | | 23,084 |
| Mortgage banking activities | | 2,097 | | 2,334 | | 5,346 | | 9,299 |
| Total banking and financial service revenues | | 18,963 | | 21,874 | | 56,967 | | 68,874 |
| FDIC shared-loss expense, net: | | | | | | | | |
| | | (16,059) | | (15,198) | | (51,180) | | (46,623) |

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|--|------------------|--|------------------|--|------------------|--|------------------|--|--|
| FDIC indemnification asset expense | | | | | | | | | |
| Change in true-up payment obligation | (875) | | (767) | | (2,596) | | (2,178) | | |
| | (16,934) | | (15,965) | | (53,776) | | (48,801) | | |
| Net gain (loss) on: | | | | | | | | | |
| Sale of securities | - | | - | | 4,366 | | - | | |
| Derivatives | 7 | | (811) | | (463) | | (1,746) | | |
| Early extinguishment of debt | - | | - | | - | | 1,061 | | |
| Other non-interest income | 455 | | (1,775) | | 1,133 | | 575 | | |
| Total non-interest income, net | 2,491 | | 3,323 | | 8,227 | | 19,963 | | |
| Non-interest expense: | | | | | | | | | |
| Compensation and employee benefits | 18,592 | | 22,590 | | 61,086 | | 69,927 | | |
| Professional and service fees | 3,807 | | 4,409 | | 11,525 | | 16,262 | | |
| Occupancy and equipment | 8,770 | | 8,270 | | 25,684 | | 25,552 | | |
| Insurance | 2,099 | | 1,828 | | 6,506 | | 7,229 | | |
| Electronic banking charges | 4,637 | | 3,694 | | 14,085 | | 11,458 | | |
| Information technology expenses | 1,289 | | 2,729 | | 4,589 | | 7,708 | | |
| Advertising, business promotion, and strategic initiatives | 1,825 | | 1,471 | | 5,274 | | 4,550 | | |
| Merger and restructuring charges | - | | 2,252 | | - | | 13,060 | | |
| Foreclosure, repossession and other real estate expenses | 7,842 | | 5,703 | | 20,783 | | 12,603 | | |
| Loan servicing and clearing expenses | 1,870 | | 2,133 | | 5,598 | | 5,493 | | |
| Taxes, other than payroll and income taxes | 3,494 | | 4,024 | | 11,005 | | 11,778 | | |
| Communication | 820 | | 782 | | 2,590 | | 2,481 | | |
| Printing, postage, stationary and supplies | 620 | | 824 | | 1,820 | | 2,841 | | |
| Director and investor relations | 250 | | 230 | | 794 | | 843 | | |
| Other | 3,660 | | 2,295 | | 9,488 | | 6,749 | | |
| Total non-interest expense | 59,575 | | 63,234 | | 180,827 | | 198,534 | | |
| Income before income taxes | 27,530 | | 26,206 | | 94,984 | | 60,129 | | |
| Income tax expense (benefit) | 7,998 | | 6,585 | | 30,396 | | (18,223) | | |
| Net income | 19,532 | | 19,621 | | 64,588 | | 78,352 | | |
| Less: dividends on preferred stock | (3,465) | | (3,465) | | (10,396) | | (10,396) | | |
| Income available to common shareholders | \$ 16,067 | | \$ 16,156 | | \$ 54,192 | | \$ 67,956 | | |
| Earnings per common share: | | | | | | | | | |

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|--|----|--------|----|--------|----|--------|----|--------|
| Basic | \$ | 0.36 | \$ | 0.35 | \$ | 1.20 | \$ | 1.49 |
| Diluted | \$ | 0.34 | \$ | 0.34 | \$ | 1.14 | \$ | 1.39 |
| Average common shares outstanding and equivalents | | 52,362 | | 53,322 | | 52,440 | | 53,053 |
| Cash dividends per share of common stock | \$ | 0.08 | \$ | 0.06 | \$ | 0.24 | \$ | 0.18 |
| See notes to unaudited consolidated financial statements. | | | | | | | | |

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2014 AND 2013

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|--|-----------------------------|----------------|------|----------------|---------------------------------------|---------------|------|-----------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| | (In thousands) | | | | | | | |
| Net income | \$ | 19,532 | \$ | 19,621 | \$ | 64,588 | \$ | 78,352 |
| Other comprehensive income (loss) before tax: | | | | | | | | |
| Unrealized gain (loss) on securities available-for-sale | | (9,410) | | (5,779) | | 15,094 | | (52,346) |
| Realized gain on investment securities included in net income | | - | | - | | (4,366) | | - |
| Unrealized gain on cash flow hedges | | 1,798 | | 233 | | 2,189 | | 4,711 |
| Other comprehensive income (loss) before taxes | | (7,612) | | (5,546) | | 12,917 | | (47,635) |
| Income tax effect | | (732) | | 611 | | (2,697) | | 2,587 |
| Other comprehensive income (loss) after taxes | | (8,344) | | (4,935) | | 10,220 | | (45,048) |
| Comprehensive income | \$ | 11,188 | \$ | 14,686 | \$ | 74,808 | \$ | 33,304 |
| See notes to unaudited consolidated financial statements. | | | | | | | | |

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

| | Nine-Month Period Ended September 30, | | | |
|--|---------------------------------------|-----------------|------|-----------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Preferred stock: | | | | |
| Balance at beginning of period | \$ | 176,000 | \$ | 176,000 |
| Balance at end of period | | 176,000 | | 176,000 |
| Common stock: | | | | |
| Balance at beginning of period | | 52,707 | | 52,671 |
| Exercised stock options | | 54 | | 20 |
| Balance at end of period | | 52,761 | | 52,691 |
| Additional paid-in capital: | | | | |
| Balance at beginning of period | | 538,071 | | 537,453 |
| Stock-based compensation expense | | 1,248 | | 1,360 |
| Exercised stock options | | 589 | | 187 |
| Lapsed restricted stock units | | (386) | | (728) |
| Common stock issuance costs | | - | | (16) |
| Preferred stock issuance costs | | - | | (25) |
| Balance at end of period | | 539,522 | | 538,231 |
| Legal surplus: | | | | |
| Balance at beginning of period | | 61,957 | | 52,143 |
| Transfer from retained earnings | | 6,480 | | 7,724 |
| Balance at end of period | | 68,437 | | 59,867 |
| Retained earnings: | | | | |
| Balance at beginning of period | | 133,629 | | 70,734 |
| Net income | | 64,588 | | 78,352 |
| Cash dividends declared on common stock | | (10,822) | | (8,219) |
| Cash dividends declared on preferred stock | | (10,396) | | (10,396) |
| Transfer to legal surplus | | (6,480) | | (7,724) |
| Balance at end of period | | 170,519 | | 122,747 |
| Treasury stock: | | | | |
| Balance at beginning of period | | (80,642) | | (81,275) |
| Stock repurchased | | (10,394) | | - |
| Lapsed restricted stock units | | 384 | | 556 |
| Stock used to match defined contribution plan | | - | | 77 |
| Balance at end of period | | (90,652) | | (80,642) |
| Accumulated other comprehensive income, | | | | |

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|--|-----------|----------------|--|-----------|----------------|
| net of tax: | | | | | |
| Balance at beginning of period | | 3,191 | | | 55,880 |
| Other comprehensive income (loss), net of tax | | 10,220 | | | (45,048) |
| Balance at end of period | | 13,411 | | | 10,832 |
| Total stockholders' equity | \$ | 929,998 | | \$ | 879,726 |
| See notes to unaudited consolidated financial statements. | | | | | |

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2014 AND 2013

| | Nine-Month Period Ended September 30, | | | |
|---|---------------------------------------|-----------|------|-----------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Cash flows from operating activities: | | | | |
| Net income | \$ | 64,588 | \$ | 78,352 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Amortization of deferred loan origination fees, net of costs | | 2,065 | | 733 |
| Amortization of fair value premiums, net of discounts, on acquired loans | | 9,914 | | 8,239 |
| Amortization of investment securities premiums, net of accretion of discounts | | 1,048 | | 17,116 |
| Amortization of core deposit and customer relationship intangibles | | 1,627 | | 1,932 |
| Amortization of fair value premiums on acquired deposits | | 4,349 | | 12,032 |
| FDIC shared-loss expense, net | | 53,776 | | 48,801 |
| Depreciation and amortization of premises and equipment | | 7,415 | | 7,703 |
| Deferred income tax expense (benefit), net | | 20,418 | | (18,816) |
| Provision for covered and non-covered loan and lease losses, net | | 43,763 | | 60,300 |
| Stock-based compensation | | 1,248 | | 1,360 |
| (Gain) loss on: | | | | |
| Sale of securities | | (4,366) | | - |
| Sale of mortgage loans held-for-sale | | (3,891) | | (2,009) |
| Derivatives | | 584 | | 224 |
| Early extinguishment of debt | | - | | (1,061) |
| Foreclosed real estate | | 9,185 | | 5,321 |
| Sale of other repossessed assets | | 4,506 | | 1,813 |
| Sale of premises and equipment | | (11) | | - |
| Originations of loans held-for-sale | | (130,547) | | (239,804) |
| Proceeds from sale of loans held-for-sale | | 72,211 | | 125,245 |
| Net (increase) decrease in: | | | | |
| Trading securities | | 182 | | (1,629) |
| Accrued interest receivable | | (931) | | (4,802) |

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|--|--|----------------|--|----------------|
| Servicing assets | | (185) | | (2,856) |
| Other assets | | 8,538 | | 15,984 |
| Net increase (decrease) in: | | | | |
| Accrued interest on deposits and borrowings | | (1,811) | | (1,658) |
| Accrued expenses and other liabilities | | (3,099) | | 13,937 |
| Net cash provided by operating activities | | 160,576 | | 126,457 |
| Cash flows from investing activities: | | | | |
| Purchases of: | | | | |
| Investment securities available-for-sale | | (219,027) | | (32,874) |
| Investment securities held-to-maturity | | (115,396) | | - |
| FHLB stock | | (84,375) | | (32,562) |
| Maturities and redemptions of: | | | | |
| Investment securities available-for-sale | | 429,939 | | 477,610 |
| Investment securities held-to-maturity | | 1,045 | | - |
| FHLB stock | | 87,636 | | 46,503 |
| Proceeds from sales of: | | | | |
| Investment securities available-for-sale | | 189,249 | | 120,526 |
| Foreclosed real estate and other repossessed assets | | 33,915 | | 44,754 |
| Loans held-for-investment | | 9,378 | | - |
| Premises and equipment | | 25 | | 896 |
| Origination and purchase of loans, excluding loans held-for-sale | | (545,776) | | (911,443) |
| Principal repayment of loans, including covered loans | | 561,479 | | 806,676 |
| Reimbursements from the FDIC on shared-loss agreements | | 31,537 | | 32,732 |
| Additions to premises and equipment | | (6,626) | | (6,747) |
| Net change in securities purchased under agreements to resell | | 60,000 | | (5,000) |
| Net change in restricted cash | | 49,292 | | (2,517) |
| Net cash provided by investing activities | | 482,295 | | 538,554 |
| | | | | |

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2014 AND 2013 – (Continued)

| | Nine-Month Period Ended September 30, | | | |
|--|---------------------------------------|------------------|-----------|------------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Cash flows from financing activities: | | | | |
| Net increase (decrease) in: | | | | |
| Deposits | | (306,917) | | (96,552) |
| Short term borrowings | | - | | (92,210) |
| Securities sold under agreements to repurchase | | (255,000) | | (427,931) |
| FHLB advances, federal funds purchased, and other borrowings | | (1,142) | | (199,731) |
| Subordinated capital notes | | 1,180 | | (45,491) |
| Exercise of stock options and restricted units lapsed, net | | 641 | | 207 |
| Purchase of treasury stock | | (10,394) | | - |
| Termination of derivative instruments | | - | | 1,483 |
| Dividends paid on preferred stock | | (10,396) | | (10,226) |
| Dividends paid on common stock | | (10,873) | | (8,219) |
| Net cash used in financing activities | | (592,901) | | (878,670) |
| Net change in cash and cash equivalents | | 49,970 | | (213,659) |
| Cash and cash equivalents at beginning of period | | 621,269 | | 855,235 |
| Cash and cash equivalents at end of period | \$ | 671,239 | \$ | 641,576 |
| Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities: | | | | |
| Interest paid | \$ | 63,082 | \$ | 64,272 |
| Income taxes paid | \$ | 1,839 | \$ | 378 |
| Mortgage loans securitized into mortgage-backed securities | \$ | 71,466 | \$ | 117,687 |
| Securities purchased but not yet received | \$ | 30,057 | \$ | - |
| Transfer from loans to foreclosed real estate and other repossessed assets | \$ | 67,296 | \$ | 65,716 |
| Reclassification of loans held-for-investment portfolio to held-for-sale portfolio | \$ | 5,268 | \$ | 42,289 |
| Reclassification of loans held-for-sale portfolio to held-for-investment portfolio | \$ | 25,801 | \$ | - |
| | | | | |
| See notes to unaudited consolidated financial statements. | | | | |

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION, CONSOLIDATION AND BASIS OF PRESENTATION

Nature of Operations

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

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

Recent Accounting Developments

In August 2014, the Financial Accounting Standard Board (“FASB”) issued a new going concern standard, which requires management to assess at each interim and annual reporting period whether substantial doubt exists about the company’s ability to continue as a going concern. Substantial doubt exists if it is probable (the same threshold that is used for contingencies) that the company will be unable to meet its obligations as they become due within one year after the date the financial statements are issued or available to be issued (assessment date). Management needs to consider known (and reasonably knowable) events and conditions at the assessment date. For all entities, this standard is effective for annual periods and interim periods within those annual periods beginning after December 15, 2016, with earlier adoption permitted. The adoption of this standard will have no material impact on our financial position or results of operations.

In August 2014, FASB issued new guidance requiring creditors to classify certain foreclosed, government-guaranteed, mortgage loans as receivables. The receivable is measured at the amount expected to be recovered under the guarantee, which is not treated as a separate unit of account. For public business entities, this guidance is effective for annual periods and interim periods within those annual periods beginning after December 15, 2014, with earlier adoption permitted if the entity already has adopted Accounting Standards Update (“ASU”) 2014-04. An entity should adopt the amendments in this update using either a prospective transition method or a modified retrospective transition method. We are currently evaluating the impact that the adoption of this guidance will have on our financial position and results of operations.

Other than the accounting pronouncements disclosed above, there was no other new accounting pronouncement issued during the third quarter of 2014 that could have a material impact on the Company’s financial position, operating results or financials statement disclosures.

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

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

| | September 30, | | December 31, | |
|---|-----------------------|---------------|---------------------|---------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Cash pledged as collateral to other financial institutions to secure: | | | | |
| Securities sold under agreements to repurchase | \$ | 24,500 | \$ | 67,029 |
| Derivatives | | 2,980 | | 2,980 |
| Obligations under agreement of loans sold with recourse | | 5,427 | | 12,190 |
| | \$ | 32,907 | \$ | 82,199 |

The Company delivers cash as collateral to meet margin calls for some long term securities sold under agreements to repurchase. At September 30, 2014 and December 31, 2013, the Company had cash pledged as collateral for securities sold under agreements to repurchase amounting to \$24.5 million and \$67.0 million, respectively.

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

As part of the BBVAPR Acquisition, the Company assumed various contracts with the Federal National Mortgage Association ("FNMA") which required collateral to guarantee the repurchase, if necessary, of certain mortgage loans sold with recourse. At September 30, 2014 and December 31, 2013, the Company had \$5.4 million and \$12.2 million, respectively, of cash pledged as collateral for such recourse obligations.

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

The Company considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months or less at the date of acquisition. At September 30, 2014 and December 31, 2013, money market instruments included as part of cash and cash equivalents amounted to \$7.8 million and \$7.0 million, respectively.

Securities Purchased Under Agreements to Resell

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

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

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Investment Securities

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

| | September 30, 2014 | | | | | | Weighted Average Yield |
|--|---------------------|------------------------------|-------------------------------|---------------------|----------------|--------------|------------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | | | |
| | | | | | (In thousands) | | |
| | | | | | | | |
| Available-for-sale | | | | | | | |
| Mortgage-backed securities | | | | | | | |
| FNMA and FHLMC certificates | \$ 1,023,303 | \$ 36,414 | \$ 3,082 | \$ 1,056,635 | | 3.13% | |
| GNMA certificates | 5,241 | 348 | 21 | 5,568 | | 4.92% | |
| CMOs issued by US government-sponsored agencies | 189,142 | 206 | 4,390 | 184,958 | | 1.80% | |
| Total mortgage-backed securities | 1,217,686 | 36,968 | 7,493 | 1,247,161 | | 2.93% | |
| Investment securities | | | | | | | |
| Obligations of US government-sponsored agencies | 7,795 | - | 34 | 7,761 | | 1.32% | |
| Obligations of Puerto Rico government and political subdivisions | 20,915 | - | 5,469 | 15,446 | | 5.41% | |
| Other debt securities | 3,373 | 138 | - | 3,511 | | 2.91% | |
| Total investment securities | 32,083 | 138 | 5,503 | 26,718 | | 4.15% | |
| Total securities available for sale | \$ 1,249,769 | \$ 37,106 | \$ 12,996 | \$ 1,273,879 | | 2.96% | |
| Held-to-maturity | | | | | | | |
| Mortgage-backed securities | | | | | | | |
| FNMA and FHLMC certificates | 144,305 | 82 | 170 | 144,217 | | 1.95% | |
| Total | \$ 1,394,074 | \$ 37,188 | \$ 13,166 | \$ 1,418,096 | | 2.86% | |

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

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | September 30, 2014 | | | | | | | |
|--|--------------------|------------------|------------|------------------|------------------|----------------|------------|----------------|
| | Available-for-sale | | | | Held-to-maturity | | | |
| | Amortized Cost | | Fair Value | | Amortized Cost | | Fair Value | |
| | (In thousands) | | | | (In thousands) | | | |
| Mortgage-backed securities | | | | | | | | |
| Due after 5 to 10 years | | | | | | | | |
| FNMA and FHLMC certificates | \$ | 22,896 | \$ | 23,243 | \$ | - | \$ | - |
| Total due after 5 to 10 years | | 22,896 | | 23,243 | | - | | - |
| Due after 10 years | | | | | | | | |
| FNMA and FHLMC certificates | | 1,000,407 | | 1,033,392 | | 144,305 | | 144,217 |
| GNMA certificates | | 5,241 | | 5,568 | | - | | - |
| CMOs issued by US government-sponsored agencies | | 189,142 | | 184,958 | | - | | - |
| Total due after 10 years | | 1,194,790 | | 1,223,918 | | 144,305 | | 144,217 |
| Total mortgage-backed securities | | 1,217,686 | | 1,247,161 | | 144,305 | | 144,217 |
| Investment securities | | | | | | | | |
| Due from 1 to 5 years | | | | | | | | |
| Obligations of Puerto Rico government and political subdivisions | | 10,450 | | 8,628 | | - | | - |
| Total due from 1 to 5 years | | 10,450 | | 8,628 | | - | | - |
| Due after 5 to 10 years | | | | | | | | |
| Obligations of US government and sponsored agencies | | 7,795 | | 7,761 | | - | | - |
| Total due after 5 to 10 years | | 7,795 | | 7,761 | | - | | - |
| Due after 10 years | | | | | | | | |
| Obligations of Puerto Rico government and political subdivisions | | 10,465 | | 6,818 | | - | | - |

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| | | | | | | | | | | | |
|--|-----------|------------------|--|-----------|------------------|--|-----------|----------------|--|-----------|----------------|
| Other debt securities | | 3,373 | | | 3,511 | | | - | | | - |
| Total due after 10 years | | 13,838 | | | 10,329 | | | - | | | - |
| Total investment securities | | 32,083 | | | 26,718 | | | - | | | - |
| Total securities available-for-sale | \$ | 1,249,769 | | \$ | 1,273,879 | | \$ | 144,305 | | \$ | 144,217 |

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

The Company, as part of its asset/liability management, may purchase U.S. Treasury securities and U.S. government-sponsored agency discount notes close to their maturities as alternatives to cash deposits at correspondent banks or as a short term vehicle to reinvest the proceeds of sale transactions until investment securities with attractive yields can be purchased. During the nine-month period ended September 30, 2014, the Company sold \$74.1 million of available-for-sale Government National Mortgage Association (“GNMA”) certificates that were sold as part of its recurring mortgage loan origination and securitization activities. These sales did not realize any gains or losses during such period.

In addition, during the nine-month period ended September 30, 2014, the Company sold \$110.8 million of available-for-sale FNMA and FHLMC certificates because the Company believed 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 recorded a net gain on sale of these securities of \$4.4 million. The table below presents the gross realized gains by category for such period. There was no realized gain or loss for the nine-month period ended September 30, 2013.

| Description | Nine-Month Period Ended September 30, 2014 | | | | | | | |
|--|--|----------------|------------|----------------|-----------|--------------|-----------|----------|
| | Sale Price | | Book Value | | Gross | | Gross | |
| | at Sale | | at Sale | | Gains | | Losses | |
| | (In thousands) | | | | | | | |
| Sale of securities available-for-sale | | | | | | | | |
| Mortgage-backed securities | | | | | | | | |
| FNMA and FHLMC certificates | \$ | 115,158 | \$ | 110,792 | \$ | 4,366 | \$ | - |
| GNMA certificates | | 74,091 | | 74,091 | | - | | - |
| Total | \$ | 189,249 | \$ | 184,883 | \$ | 4,366 | \$ | - |

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | September 30, 2014 | | | | | |
|--|---------------------|----------------|------------|---------------|-------|----------------|
| | 12 months or more | | | | | |
| | Amortized | | Unrealized | | Fair | |
| | Cost | | Loss | | Value | |
| | (In thousands) | | | | | |
| Securities available-for-sale | | | | | | |
| CMOs issued by US government-sponsored agencies | \$ | 149,957 | \$ | 4,242 | \$ | 145,716 |
| FNMA and FHLMC certificates | | 183,479 | | 3,049 | | 180,430 |
| Obligations of Puerto Rico government and political subdivisions | | 20,915 | | 5,469 | | 15,446 |
| GNMA certificates | | 197 | | 22 | | 176 |
| | \$ | 354,548 | \$ | 12,782 | \$ | 341,768 |
| | | | | | | |
| | Less than 12 months | | | | | |
| | Amortized | | Unrealized | | Fair | |
| | Cost | | Loss | | Value | |
| | (In thousands) | | | | | |
| Securities available-for-sale | | | | | | |
| CMOs issued by US government-sponsored agencies | \$ | 15,746 | \$ | 148 | \$ | 15,598 |
| FNMA and FHLMC certificates | | 26,220 | | 33 | | 26,187 |
| Obligations of US government and sponsored agencies | | 7,796 | | 34 | | 7,761 |
| Securities held-to-maturity | | | | | | |
| FNMA and FHLMC Certificates | | 95,598 | | 170 | | 95,428 |
| | \$ | 145,359 | \$ | 385 | \$ | 144,974 |
| | | | | | | |
| | Total | | | | | |
| | Amortized | | Unrealized | | Fair | |
| | Cost | | Loss | | Value | |
| | (In thousands) | | | | | |
| Securities available-for-sale | | | | | | |
| CMOs issued by US government-sponsored agencies | \$ | 165,703 | \$ | 4,390 | \$ | 161,314 |
| FNMA and FHLMC certificates | | 209,699 | | 3,082 | | 206,617 |
| Obligations of Puerto Rico government and political subdivisions | | 20,915 | | 5,469 | | 15,446 |
| Obligations of US government and sponsored agencies | | 7,796 | | 34 | | 7,761 |

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| | | | | | | | | |
|------------------------------------|----|----------------|--|----|---------------|--|----|----------------|
| GNMA certificates | | 197 | | | 22 | | | 176 |
| | | 404,309 | | | 12,996 | | | 391,314 |
| Securities held-to-maturity | | | | | | | | |
| FNMA and FHLMC Certificates | | 95,598 | | | 170 | | | 95,428 |
| | \$ | 499,907 | | \$ | 13,166 | | \$ | 486,742 |

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

Most of the investment (\$479.0 million or 96%) with an unrealized loss position at September 30, 2014 consist of securities issued or guaranteed by the U.S. Treasury or U.S. government-sponsored agencies, all of which are highly liquid securities that have a large and efficient secondary market. Their aggregate losses and their variability from period to period are the result of changes in market conditions, and not due to the repayment capacity or creditworthiness of the issuers or guarantors of such securities.

The remaining investments (\$20.9 million or 4%) with an unrealized loss position at September 30, 2014 consist of obligations issued or guaranteed by the government of Puerto Rico and its political subdivisions or instrumentalities. The recent decline in the market value of these securities is mainly attributed to an increase in volatility as a result of changes in market conditions that reflect the significant economic and fiscal challenges that Puerto Rico is facing, including a protracted economic recession, sizable government debt-service obligations and structural budget deficits, high unemployment and a shrinking population. Moreover, uncertainty in regards to the impact of the recently enacted Public Corporation Debt Enforcement and Recovery Act (the “Recovery Act”) and the related subsequent negative rating decisions taken by the credit rating agencies has affected the market value of these securities.

As of September 30, 2014, the Company applied a discounted cash flow analysis to the Puerto Rico government bonds to calculate the cash flows expected to be collected and determine if any portion of the decline in market value of these investments was considered an other-than-temporary impairment. The analysis derives an estimate of value based on the present value of risk-adjusted future cash flows of the underlying investments, and included the following components:

- The contractual future cash flows of the bonds are projected based on the key terms as set forth in the official statements for each investment. Such key terms include among others the interest rate, amortization schedule, if any, and maturity date.

- The risk-adjusted cash flows are calculated based on monthly default probability and recovery rate assumptions based on the credit rating of each investment. Constant monthly default rates are assumed throughout the life of the bonds which are based on the respective security's credit rating as of the date of the analysis.
- The adjusted future cash flows are then discounted at the original effective yield of each investment based on the purchase price and expected risk-adjusted future cash flows as of the purchase date of each investment.

The discounted cash flow analysis for the investments showed at maturity in the range of 2.509% to 15.340%, thus reflecting that it is more likely than not that the bonds will not default at all during their remaining terms (range between 84.660% and 97.491%). Based on this analysis, the Company determined that it is more likely than not that it will recover all interest and principal invested in the Puerto Rico government bonds and is therefore not required to recognize a credit loss as of September 30, 2014.

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 4 - LOANS

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

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

| | September 30, | | December 31, | |
|---|----------------|------------------|--------------|------------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Non-covered loans: | | | | |
| Originated and other loans and leases held for investment: | | | | |
| Mortgage | \$ | 791,106 | \$ | 766,265 |
| Commercial | | 1,217,235 | | 1,127,657 |
| Consumer | | 175,882 | | 127,744 |
| Auto and leasing | | 542,892 | | 379,874 |
| | | 2,727,115 | | 2,401,540 |
| Acquired loans: | | | | |
| Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium) | | | | |
| Commercial | | 26,984 | | 77,681 |
| Consumer | | 47,284 | | 56,174 |
| Auto | | 210,808 | | 301,584 |
| | | 285,076 | | 435,439 |
| Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy) | | | | |
| Mortgage | | 670,188 | | 717,904 |
| Commercial | | 485,444 | | 545,117 |
| Construction | | 108,694 | | 126,427 |

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| | | | | |
|---|-----------|------------------|-----------|------------------|
| Consumer | | 36,470 | | 63,620 |
| Auto | | 276,749 | | 379,145 |
| | | 1,577,545 | | 1,832,213 |
| | | 4,589,736 | | 4,669,192 |
| Deferred loan cost , net | | 3,575 | | 1,035 |
| Loans receivable | | 4,593,311 | | 4,670,227 |
| Allowance for loan and lease losses on non-covered loans | | (64,859) | | (54,298) |
| Loans receivable, net | | 4,528,452 | | 4,615,929 |
| Mortgage loans held-for-sale | | 16,757 | | 46,529 |
| Total non-covered loans, net | | 4,545,209 | | 4,662,458 |
| Covered loans: | | | | |
| Loans secured by 1-4 family residential properties | | 121,658 | | 121,748 |
| Construction and development secured by 1-4 family residential properties | | 18,947 | | 17,304 |
| Commercial and other construction | | 228,410 | | 264,249 |
| Consumer | | 4,905 | | 6,119 |
| Leasing | | - | | 270 |
| Total covered loans | | 373,920 | | 409,690 |
| Allowance for loan and lease losses on covered loans | | (62,227) | | (52,729) |
| Total covered loans, net | | 311,693 | | 356,961 |
| Total loans, net | \$ | 4,856,902 | \$ | 5,019,419 |

During the nine-month period ended September 30, 2014, the Company reclassified \$25.8 million in mortgage loans held-for-sale to held-for-investment.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

| | September 30, 2014 | | | | | | | | |
|---------------------------------------|--------------------|---------------|----------|------------|-----------|-------------|----|-----|--------------|
| | | | | | | | | | Loans 90+ |
| | | | | | | | | | Days Past |
| | | | | | | | | | Due and |
| | 30-59 Days | 60-89 Days | 90+ Days | Total Past | | | | | Still |
| | Past Due | Past Due | Past Due | Due | Current | Total Loans | | | Accruing |
| | (In thousands) | | | | | | | | |
| Mortgage | | | | | | | | | |
| Traditional (by origination year): | | | | | | | | | |
| Up to the year 2002 | \$ 5,996 | \$ 3,283 | \$ 3,424 | \$ 12,703 | \$ 55,635 | \$ 68,338 | \$ | 141 | |
| Years 2003 and 2004 | 6,679 | 1,730 | 3,471 | 11,880 | 50,464 | 62,344 | | - | |
| Year 2005 | 7,368 | 3,295 | 8,258 | 18,921 | 69,510 | 88,431 | | 89 | |
| Year 2006 | 10,274 | 5,678 | 6,041 | 21,993 | 91,218 | 113,211 | | 114 | |
| Years 2007, 2008 | | | | | | | | | |
| and 2009 | 3,285 | 3,095 | 7,647 | 14,027 | 83,036 | 97,063 | | 59 | |

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| | | | | | | | |
|---|---------------|---------------|---------------|----------------|------------------|------------------|--------------|
| Years 2010, 2011, 2012, 2013 and 2014 | 4,938 | 1,368 | 5,706 | 12,012 | 181,550 | 193,562 | 509 |
| | 38,540 | 18,449 | 34,547 | 91,536 | 531,413 | 622,949 | 912 |
| Non-traditional | 1,084 | 783 | 3,022 | 4,889 | 32,886 | 37,775 | - |
| Loss mitigation program | 10,022 | 7,358 | 14,625 | 32,005 | 57,578 | 89,583 | 5,773 |
| | 49,646 | 26,590 | 52,194 | 128,430 | 621,877 | 750,307 | 6,685 |
| Home equity secured personal loans | - | - | 126 | 126 | 607 | 733 | - |
| GNMA's buy-back option program | - | - | 40,066 | 40,066 | - | 40,066 | - |
| | 49,646 | 26,590 | 92,386 | 168,622 | 622,484 | 791,106 | 6,685 |
| Commercial | | | | | | | |
| Commercial secured by real estate: | | | | | | | |
| Corporate | - | - | - | - | 113,976 | 113,976 | - |
| Institutional | - | - | - | - | 37,177 | 37,177 | - |
| Middle market | - | 1,071 | 638 | 1,709 | 142,830 | 144,539 | - |
| Retail | 1,164 | 129 | 7,258 | 8,551 | 153,091 | 161,642 | - |
| Floor plan | - | - | - | - | 1,666 | 1,666 | - |
| Real estate | - | - | - | - | 11,878 | 11,878 | - |
| | 1,164 | 1,200 | 7,896 | 10,260 | 460,618 | 470,878 | - |
| Other commercial and industrial: | | | | | | | |
| Corporate | - | - | - | - | 60,402 | 60,402 | - |
| Institutional | - | - | - | - | 482,277 | 482,277 | - |
| Middle market | - | - | 628 | 628 | 82,577 | 83,205 | - |
| Retail | 267 | 144 | 809 | 1,220 | 79,592 | 80,812 | - |
| Floor plan | - | - | - | - | 39,661 | 39,661 | - |
| | 267 | 144 | 1,437 | 1,848 | 744,509 | 746,357 | - |
| | 1,431 | 1,344 | 9,333 | 12,108 | 1,205,127 | 1,217,235 | - |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| September 30, 2014 | | | | | | | | | | | | |
|--------------------------------|------------------|------------------|-------------------|-------------------|---------------------|---------------------|-----------------|--|--|--|--|--------------|
| | | | | | | | | | | | | Loans 90+ |
| | | | | | | | | | | | | Days Past |
| | | | | | | | | | | | | Due and |
| | 30-59 Days | 60-89 Days | 90+ Days | Total Past | | | | | | | | Still |
| | Past Due | Past Due | Past Due | Due | Current | Total Loans | Accruing | | | | | |
| (In thousands) | | | | | | | | | | | | |
| Consumer | | | | | | | | | | | | |
| Credit cards | 238 | 189 | 408 | 835 | 17,022 | 17,857 | - | | | | | |
| Overdrafts | 20 | 2 | 1 | 23 | 317 | 340 | - | | | | | |
| Personal lines of credit | 67 | 132 | 29 | 228 | 1,823 | 2,051 | - | | | | | |
| Personal loans | 1,666 | 627 | 604 | 2,897 | 135,711 | 138,608 | - | | | | | |
| Cash collateral personal loans | 214 | 132 | 36 | 382 | 16,644 | 17,026 | - | | | | | |
| | 2,205 | 1,082 | 1,078 | 4,365 | 171,517 | 175,882 | - | | | | | |
| Auto and leasing | 43,537 | 15,956 | 8,279 | 67,772 | 475,120 | 542,892 | - | | | | | |
| Total | \$ 96,819 | \$ 44,972 | \$ 111,076 | \$ 252,867 | \$ 2,474,248 | \$ 2,727,115 | \$ 6,685 | | | | | |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

At September 30, 2014 and December 31, 2013, the Company had \$458.0 million and \$515.4 million, respectively, in loans granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities as part of the institutional commercial loan segment. This entire amount was current at September 30, 2014.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

| | September 30, 2014 | | | | | | | | | | Loans 90+ | | | |
|-----------------------------------|--------------------|---|---------------|---|----------|-----|------------|-----|---------|-------|-------------------------|--------------|----|---|
| | | | | | | | | | | | | Days Past | | |
| | | | | | | | | | | | | Due and | | |
| | 30-59 Days | | 60-89 Days | | 90+ Days | | Total Past | | | | Still | | | |
| | Past Due | | Past Due | | Past Due | | Due | | Current | | Total Loans Accruing | | | |
| | (In thousands) | | | | | | | | | | | | | |
| Commercial | | | | | | | | | | | | | | |
| Commercial secured by real estate | | | | | | | | | | | | | | |
| Corporate | \$ | - | \$ | - | \$ | - | \$ | - | \$ | 3,746 | \$ | 3,746 | \$ | - |
| Retail | | - | | - | | 342 | | 342 | | 482 | | 824 | | - |
| Floor plan | | - | | - | | 101 | | 101 | | 3,972 | | 4,073 | | - |
| | | - | | - | | 443 | | 443 | | 8,200 | | 8,643 | | - |
| Other commercial and industrial | | | | | | | | | | | | | | |

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| | | | | | | | |
|-------------------|------------------|-----------------|-----------------|------------------|-------------------|-------------------|-------------|
| Corporate | - | - | - | - | 2,915 | 2,915 | - |
| Retail | 169 | 73 | 451 | 693 | 7,328 | 8,021 | - |
| Floor plan | 97 | 40 | 108 | 245 | 7,160 | 7,405 | - |
| | 266 | 113 | 559 | 938 | 17,403 | 18,341 | - |
| | 266 | 113 | 1,002 | 1,381 | 25,603 | 26,984 | - |
| Consumer | | | | | | | |
| Credit cards | 1,625 | 678 | 1,328 | 3,631 | 40,051 | 43,682 | - |
| Personal loans | 160 | 83 | 66 | 309 | 3,293 | 3,602 | - |
| | 1,785 | 761 | 1,394 | 3,940 | 43,344 | 47,284 | - |
| Auto | 11,372 | 4,137 | 1,537 | 17,046 | 193,762 | 210,808 | - |
| Total | \$ 13,423 | \$ 5,011 | \$ 3,933 | \$ 22,367 | \$ 262,709 | \$ 285,076 | \$ - |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

| | September 30, | | December 31, |
|---|----------------|--|--------------|
| | 2014 | | 2013 |
| | (In thousands) | | |
| Contractual required payments receivable | \$ 2,505,662 | | \$ 2,929,353 |
| Less: Non-accretable discount | 523,987 | | 579,587 |
| Cash expected to be collected | 1,981,675 | | 2,349,766 |
| Less: Accretable yield | 404,130 | | 517,553 |
| Carrying amount, gross | 1,577,545 | | 1,832,213 |
| Less: allowance for loan and lease losses | 10,120 | | 2,863 |
| Carrying amount, net | \$ 1,567,425 | | \$ 1,829,350 |

During the quarter ended September 30, 2014, the Company sold non-performing residential mortgage loans that were accounted for under ASC 310-30 with a carrying amount of \$19.7 million. No gain or loss was realized in the transaction in accordance to ASC 310-30 accounting.

At September 30, 2014 and December 31, 2013, the Company had \$168.7 million and \$180.5 million, respectively, in loans granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities as part of its non-covered acquired loans accounted for under ASC 310-30. This entire amount was current at September 30, 2014.

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

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|--|-----------------------------|----------------|------|----------------|---------------------------------------|----------------|------|----------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| (In thousands) | | | | | | | | |
| Accretable Yield Activity | | | | | | | | |
| Balance at beginning of period | \$ | 444,606 | \$ | 561,485 | \$ | 517,553 | \$ | 655,833 |
| Accretion | | (38,340) | | (48,352) | | (118,323) | | (150,447) |
| Transfer from (to) non-accretable discount | | (2,136) | | 6,010 | | 4,900 | | 13,757 |
| Balance at end of period | \$ | 404,130 | \$ | 519,143 | \$ | 404,130 | \$ | 519,143 |
| | | | | | | | | |
| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
| | 2014 | | 2013 | | 2014 | | 2013 | |
| (In thousands) | | | | | | | | |
| Non-Accretable Discount Activity | | | | | | | | |
| Balance at beginning of period | \$ | 554,724 | \$ | 686,231 | \$ | 579,587 | \$ | 714,462 |
| Principal losses | | (32,873) | | (44,301) | | (50,700) | | (64,785) |
| Transfer from (to) accretable yield | | 2,136 | | (6,010) | | (4,900) | | (13,757) |
| Balance at end of period | \$ | 523,987 | \$ | 635,920 | \$ | 523,987 | \$ | 635,920 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Covered Loans

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

| | September 30, | | December 31, | |
|---|----------------|----------------|--------------|----------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Contractual required payments receivable | \$ | 561,844 | \$ | 702,126 |
| Less: Non-accretable discount | | 77,940 | | 129,477 |
| Cash expected to be collected | | 483,904 | | 572,649 |
| Less: Accretable yield | | 109,984 | | 162,959 |
| Carrying amount, gross | | 373,920 | | 409,690 |
| Less: Allowance for covered loan and lease losses | | 62,227 | | 52,729 |
| Carrying amount, net | \$ | 311,693 | \$ | 356,961 |

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

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|---|-----------------------------|----------------|-----------|----------------|---------------------------------------|----------------|-----------|----------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| | (In thousands) | | | | | | | |
| Accretable Yield Activity | | | | | | | | |
| Balance at beginning of period | \$ | 128,061 | \$ | 167,132 | \$ | 162,959 | \$ | 188,008 |
| Accretion | | (20,886) | | (21,657) | | (69,154) | | (65,884) |
| Transfer from non-accretable discount | | 2,809 | | 23,070 | | 16,179 | | 46,421 |
| Balance at end of period | \$ | 109,984 | \$ | 168,545 | \$ | 109,984 | \$ | 168,545 |
| | | | | | | | | |
| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
| | 2013 | | 2013 | | 2014 | | 2013 | |
| | (In thousands) | | | | | | | |
| Non-Accretable Discount Activity | | | | | | | | |

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| | | | | | | | | |
|---------------------------------|-----------|---------------|-----------|----------------|-----------|---------------|-----------|----------------|
| Balance at beginning of period | \$ | 85,224 | \$ | 192,259 | \$ | 129,477 | \$ | 237,555 |
| Principal losses | | (4,475) | | (7,762) | | (35,358) | | (29,707) |
| Transfer to accretable yield | | (2,809) | | (23,070) | | (16,179) | | (46,421) |
| Balance at end of period | \$ | 77,940 | \$ | 161,427 | \$ | 77,940 | \$ | 161,427 |

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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 September 30, 2014 and December 31, 2013:

| | September 30, | | December 31, | |
|--|----------------|---------------|--------------|---------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Originated and other loans and leases held for investment | | | | |
| Mortgage | | | | |
| Traditional (by origination year): | | | | |
| Up to the year 2002 | \$ | 3,613 | \$ | 3,428 |
| Years 2003 and 2004 | | 3,749 | | 1,845 |
| Year 2005 | | 9,117 | | 4,922 |
| Year 2006 | | 7,019 | | 4,418 |
| Years 2007, 2008 and 2009 | | 9,817 | | 4,511 |
| Years 2010, 2011, 2012, 2013 and 2014 | | 6,244 | | 7,818 |
| | | 39,559 | | 26,942 |
| Non-traditional | | 3,022 | | 2,311 |
| Loss mitigation program | | 17,636 | | 18,792 |
| | | 60,217 | | 48,045 |
| Home equity secured personal loans | | 125 | | 138 |
| | | 60,342 | | 48,183 |
| Commercial | | | | |
| Commercial secured by real estate | | | | |
| Middle market | | 10,608 | | 11,895 |
| Retail | | 8,942 | | 7,208 |
| | | 19,550 | | 19,103 |
| Other commercial and industrial | | | | |
| Middle market | | 628 | | 1,134 |
| Retail | | 2,112 | | 2,485 |
| Floor plan | | - | | 108 |
| | | 2,740 | | 3,727 |
| | | 22,290 | | 22,830 |
| Consumer | | | | |
| Credit cards | | 408 | | 232 |
| Overdrafts | | 1 | | - |

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| | | | | | |
|--------------------------------|----|---------------|--|----|---------------|
| Personal lines of credit | | 35 | | | 84 |
| Personal loans | | 761 | | | 485 |
| Cash collateral personal loans | | 36 | | | 4 |
| | | 1,241 | | | 805 |
| Auto and leasing | | 9,008 | | | 5,089 |
| | \$ | 92,881 | | \$ | 76,907 |

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| | September 30, | | December 31, | |
|--|----------------|---------------|--------------|---------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Acquired loans accounted under ASC 310-20 | | | | |
| Commercial | | | | |
| Commercial secured by real estate | | | | |
| Retail | \$ | 342 | \$ | 956 |
| Floor plan | | 101 | | 101 |
| | | 443 | | 1,057 |
| Other commercial and industrial | | | | |
| Corporate | | - | | 97 |
| Retail | | 455 | | 1,371 |
| Floor plan | | 121 | | 18 |
| | | 576 | | 1,486 |
| | | 1,019 | | 2,543 |
| Consumer | | | | |
| Credit cards | | 1,326 | | 2,068 |
| Personal loans | | 76 | | 151 |
| | | 1,402 | | 2,219 |
| Auto | | 1,746 | | 1,608 |
| | | 4,167 | | 6,370 |
| Total non-accrual loans | \$ | 97,048 | \$ | 83,277 |

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.

Delinquent residential mortgage loans insured or guaranteed under applicable FHA and VA programs are placed in non-accrual when they become 18 months or more past due, since they are insured loans.

At September 30, 2014 and December 31, 2013, loans whose terms have been extended and which are classified as troubled-debt restructurings that are not included in non-accrual loans amounted to \$273.6 million and \$66.5 million, respectively, as they are performing under their new terms. During the quarter ended September 30, 2014, the revolving line of credit to finance the purchase of fuel for the day to day power generation activities of the Puerto Rico Electric Power Authority (“PREPA”) was classified substandard and a troubled-debt restructuring. Based on our analysis, the loan is being maintained in accrual status requiring no impairment. At September 30, 2014 this line of

credit had an unpaid principal balance of \$200.0 million.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Impaired Loans

The Company evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. The total investment in impaired commercial loans was \$226.8 million and \$28.4 million at September 30, 2014 and December 31, 2013, respectively. Impaired commercial loans at September 30, 2014 included the PREPA line of credit with an unpaid principal balance of \$200.0 million. The impaired commercial loans were measured based on the fair value of collateral or the present value of cash flows, including those identified as troubled-debt restructurings. The valuation allowance for impaired commercial loans amounted to \$1.1 million and \$1.4 million at September 30, 2014 and December 31, 2013, respectively. The total investment in impaired mortgage loans was \$91.7 million and \$84.5 million at September 30, 2014 and December 31, 2013, respectively. Impairment on mortgage loans assessed as troubled-debt restructurings was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately \$7.9 million and \$8.7 million at September 30, 2014 and December 31, 2013, respectively.

Originated and Other Loans and Leases Held for Investment

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

| | September 30, 2014 | | | | | | | |
|--|--------------------|----------------|------------|----------------|-----------|--------------|----------|-----------|
| | Unpaid | | Recorded | | Related | | | |
| | Principal | | Investment | | Allowance | | Coverage | |
| | (In thousands) | | | | | | | |
| Impaired loans with specific allowance: | | | | | | | | |
| Commercial | \$ | 5,297 | \$ | 4,731 | \$ | 1,108 | | 23% |
| Residential troubled-debt restructuring | | 97,289 | | 91,692 | | 7,932 | | 9% |
| Impaired loans with no specific allowance: | | | | | | | | |
| Commercial | | 228,968 | | 221,852 | | N/A | | N/A |
| Total investment in impaired loans | \$ | 331,554 | \$ | 318,275 | \$ | 9,040 | | 3% |

| | December 31, 2013 | | | | | | | |
|---|-------------------|----------------|------------|----------------|-----------|---------------|----------|-----------|
| | Unpaid | | Recorded | | Related | | | |
| | Principal | | Investment | | Allowance | | Coverage | |
| | (In thousands) | | | | | | | |
| Impaired loans with specific allowance | | | | | | | | |
| Commercial | \$ | 6,600 | \$ | 5,553 | \$ | 1,431 | | 26% |
| Residential troubled-debt restructuring | | 89,539 | | 84,494 | | 8,708 | | 10% |
| Impaired loans with no specific allowance | | | | | | | | |
| Commercial | | 27,914 | | 22,592 | | N/A | | N/A |
| Total investment in impaired loans | \$ | 124,053 | \$ | 112,639 | \$ | 10,139 | | 9% |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

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

| September 30, 2014 | | | | | | | | | |
|---------------------------|--|--|--|--|--|--|--|--|--|
|---------------------------|--|--|--|--|--|--|--|--|--|

| | | | | | | | | | Coverage |
|--|----------------|----------------|------------|----------------|-----------|---------------|--|--|------------|
| | Unpaid | | Recorded | | | | | | to |
| | Principal | | Investment | | Allowance | | | | Recorded |
| | | | | | | | | | Investment |
| | (In thousands) | | | | | | | | |
| Impaired non-covered loan pools: | | | | | | | | | |
| Commercial | \$ | 294,966 | \$ | 257,234 | \$ | 4,613 | | | 2% |
| Construction | | 52,367 | | 45,770 | | 5,502 | | | 12% |
| Consumer | | 42,897 | | 36,463 | | 5 | | | 0% |
| Total investment in impaired non-covered loan pools | \$ | 390,230 | \$ | 339,467 | \$ | 10,120 | | | 3% |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

| | Quarter Ended September 30, | | | | | | | |
|--|-----------------------------|--------------|-----------------------------|----------------|----------------------------|------------|-----------------------------|----------------|
| | 2014 | | | | 2013 | | | |
| | Interest Income Recognized | | Average Recorded Investment | | Interest Income Recognized | | Average Recorded Investment | |
| (In thousands) | | | | | | | | |
| Impaired loans with specific allowance | | | | | | | | |
| Commercial | \$ | 28 | \$ | 5,103 | \$ | 5 | \$ | 9,039 |
| Residential troubled-debt restructuring | | 666 | | 91,293 | | 712 | | 82,388 |
| Impaired loans with no specific allowance | | | | | | | | |
| Commercial | | 1,728 | | 89,029 | | 146 | | 28,805 |
| Total interest income from impaired loans | \$ | 2,422 | \$ | 185,425 | \$ | 863 | \$ | 120,232 |

| | Nine-Month Period Ended September 30, | | | | | | | | | | |
|--|---------------------------------------|--------------|-----------------------------------|--|-----------|----------------------------------|-----------|-----------------------------------|--|-----------|----------------|
| | 2014 | | | | | 2013 | | | | | |
| | Interest Income Recognized | | Average Recorded Investment | | | Interest Income Recognized | | Average Recorded Investment | | | |
| | (In thousands) | | | | | | | | | | |
| Impaired loans with specific allowance | | | | | | | | | | | |
| Commercial | \$ | 83 | | | \$ | 6,187 | \$ | 16 | | \$ | 14,872 |
| Residential troubled-debt restructuring | | 1,876 | | | | 89,597 | | 1,942 | | | 81,406 |
| Impaired loans with no specific allowance | | | | | | | | | | | |
| Commercial | | 5,185 | | | | 44,203 | | 438 | | | 26,471 |
| Total interest income from impaired loans | \$ | 7,144 | | | \$ | 139,987 | \$ | 2,396 | | \$ | 122,749 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Covered Loans

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 September 30, 2014 and December 31, 2013 are as follows:

| | September 30, 2014 | | | | | | | |
|---|--------------------|----------------|------------|----------------|-----------|---------------|----------|------------|
| | Unpaid | | Recorded | | Specific | | Coverage | |
| | Principal | | Investment | | Allowance | | to | |
| | | | | | | | Recorded | |
| | | | | | | Investment | | |
| (In thousands) | | | | | | | | |
| Impaired covered loan pools: | | | | | | | | |
| Loans secured by 1-4 family residential properties | \$ | 138,029 | \$ | 106,823 | \$ | 15,252 | | 14% |
| Construction and development secured by 1-4 family residential properties | | 61,562 | | 20,249 | | 8,679 | | 43% |
| Commercial and other construction | | 105,542 | | 73,424 | | 37,907 | | 52% |
| Consumer | | 8,408 | | 4,844 | | 389 | | 8% |
| Total investment in impaired covered loan pools | \$ | 313,541 | \$ | 205,340 | \$ | 62,227 | | 30% |

| | December 31, 2013 | | | | | | | |
|---|-------------------|--------|------------|--------|-----------|------------|----------|-----|
| | Unpaid | | Recorded | | Specific | | Coverage | |
| | Principal | | Investment | | Allowance | | to | |
| | | | | | | | Recorded | |
| | | | | | | Investment | | |
| (In thousands) | | | | | | | | |
| Impaired covered loan pools with specific allowance | | | | | | | | |
| Loans secured by 1-4 family residential properties | \$ | 52,142 | \$ | 38,179 | \$ | 12,495 | | 33% |
| Construction and development secured by 1-4 family residential properties | | 66,037 | | 17,304 | | 6,866 | | 40% |

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| | | | | | | | | | | |
|--|-----------|----------------|--|-----------|----------------|--|-----------|---------------|--|------------|
| Commercial and other construction | | 209,566 | | | 111,946 | | | 32,753 | | 29% |
| Consumer | | 10,512 | | | 5,857 | | | 615 | | 11% |
| Total investment in impaired covered loan pools | \$ | 338,257 | | \$ | 173,286 | | \$ | 52,729 | | 30% |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Modifications

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

| Quarter Ended September 30, 2014 | | | | | | | |
|--|---------------------|--|--|--|---|---|---|
| | Number of contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Weighted Average Rate | Pre-Modification Weighted Average Term (in Months) | Post-Modification Outstanding Recorded Investment | Post-Modification Weighted Average Rate | Post-Modification Weighted Average Term (in Months) |
| (Dollars in thousands) | | | | | | | |
| Mortgage | 26 | \$ 3,016 | 5.62% | 347 | \$ 2,965 | 4.22% | |
| Commercial | 20 | 200,007 | 7.25% | 3 | 200,007 | 7.25% | |
| Consumer | 6 | 58 | 10.00% | 61 | 68 | 9.66% | |
| | | | | | | | |
| | | | | | | | |
| Nine-Month Period Ended September 30, 2014 | | | | | | | |
| | Number of contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Weighted Average Rate | Pre-Modification Weighted Average Term (in Months) | Post-Modification Outstanding Recorded Investment | Post-Modification Weighted Average Rate | Post-Modification Weighted Average Term (in Months) |
| (Dollars in thousands) | | | | | | | |
| Mortgage | 113 | \$ 14,562 | 5.99% | 349 | \$ 14,162 | 4.21% | |
| Commercial | 21 | 200,080 | 7.25% | 3 | 200,080 | 7.25% | |
| Consumer | 13 | 123 | 11.77% | 66 | 136 | 11.48% | |
| | | | | | | | |
| | | | | | | | |
| Quarter Ended September 30, 2013 | | | | | | | |
| | Number of contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Weighted Average Rate | Pre-Modification Weighted Average Term (in Months) | Post-Modification Outstanding Recorded Investment | Post-Modification Weighted Average Rate | Post-Modification Weighted Average Term (in Months) |
| (Dollars in thousands) | | | | | | | |
| Mortgage | 21 | \$ 2,887 | 6.74% | 352 | \$ 3,066 | 6.74% | |
| | | | | | | | |
| | | | | | | | |
| Nine-Month Period Ended September 30, 2013 | | | | | | | |
| | | | | | | | |
| | | | | | | | |

| | Number of contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Weighted Average Rate | Pre-Modification Weighted Average Term (in Months) | Post-Modification Outstanding Recorded Investment | Post-Modification Weighted Average Rate | Post-Modification Weighted Average Term (in Months) |
|------------------------|---------------------|--|--|--|---|---|---|
| (Dollars in thousands) | | | | | | | |
| Mortgage | 102 | \$ 12,828 | 6.43% | 334 | \$ 13,685 | 5.15% | |
| Commercial | 2 | 1,842 | 8.99% | 87 | 1,842 | 4.00% | |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | Twelve-Month Period Ended September 30, | | | | | | | | |
|----------|---|--|------------------------|-------|------------------------|----|------------------------|----|-------|
| | 2014 | | | | 2013 | | | | |
| | Number of Contracts | | Recorded Investment | | Number of Contracts | | Recorded Investment | | |
| | (Dollars in thousands) | | | | | | | | |
| Mortgage | 15 | | \$ | 1,739 | | 30 | | \$ | 3,097 |
| Consumer | 2 | | \$ | 5 | | - | | \$ | - |

Credit Quality Indicators

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

The Company uses the following definitions for risk ratings:

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

Special Mention: Loans classified as “special mention” have a potential weakness that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution’s credit position at some future date.

Substandard: Loans classified as “substandard” are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as “doubtful” have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, questionable and improbable.

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | September 30, 2014 | | | | | | | | | | | | |
|--|--------------------|-----------|-----------|-------------|----------|------------|-------------|--|--|----------|--|--|--------------|
| | Risk Ratings | | | | | | | | | | | | |
| | Balance | | | Special | | | Substandard | | | Doubtful | | | Individually |
| | Outstanding | Pass | Mention | Substandard | Doubtful | Impairment | | | | | | | |
| | (In thousands) | | | | | | | | | | | | |
| Commercial - originated and other loans held for investment | | | | | | | | | | | | | |
| Commercial secured by real estate: | | | | | | | | | | | | | |
| Corporate | \$ 113,976 | \$ 90,006 | \$ 23,970 | \$ - | \$ - | \$ - | | | | | | | |
| Institutional | 37,177 | 27,232 | 9,702 | - | - | 243 | | | | | | | |
| Middle market | 144,539 | 127,640 | 3,707 | - | - | 13,192 | | | | | | | |
| Retail | 161,642 | 147,034 | 3,020 | 2,441 | - | 9,147 | | | | | | | |
| Floor plan | 1,666 | 594 | 971 | 101 | - | - | | | | | | | |
| Real estate | 11,878 | 11,878 | - | - | - | - | | | | | | | |
| | 470,878 | 404,384 | 41,370 | 2,542 | - | 22,582 | | | | | | | |
| Other commercial and industrial: | | | | | | | | | | | | | |
| Corporate | 60,402 | 60,402 | - | - | - | - | | | | | | | |
| Institutional | 482,275 | 282,293 | - | - | - | 199,982 | | | | | | | |
| Middle market | 83,206 | 77,504 | 3,144 | - | - | 2,558 | | | | | | | |
| Retail | 80,813 | 76,684 | 308 | 2,360 | - | 1,461 | | | | | | | |
| Floor plan | 39,661 | 38,301 | 1,147 | 213 | - | - | | | | | | | |
| | 746,357 | 535,184 | 4,599 | 2,573 | - | 204,001 | | | | | | | |
| Total | 1,217,235 | 939,568 | 45,969 | 5,115 | - | 226,583 | | | | | | | |
| Commercial - acquired loans (under ASC 310-20) | | | | | | | | | | | | | |

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| | | | | | | | | | | | | | | |
|------------------------------------|-----------|------------------|-----------|----------------|-----------|---------------|-----------|--------------|-----------|----------|-----------|----------------|--|---|
| Commercial secured by real estate: | | | | | | | | | | | | | | |
| Corporate | | 3,746 | | 3,746 | | - | | - | | - | | | | - |
| Retail | | 824 | | 467 | | - | | 357 | | - | | | | - |
| Floor plan | | 4,073 | | 4,073 | | - | | - | | - | | | | - |
| | | 8,643 | | 8,286 | | - | | 357 | | - | | | | - |
| Other commercial and industrial: | | | | | | | | | | | | | | |
| Corporate | | 2,915 | | 2,915 | | - | | - | | - | | | | - |
| Retail | | 8,021 | | 7,612 | | 9 | | 400 | | - | | | | - |
| Floor plan | | 7,405 | | 7,405 | | - | | - | | - | | | | - |
| | | 18,341 | | 17,932 | | 9 | | 400 | | - | | | | - |
| Total | | 26,984 | | 26,218 | | 9 | | 757 | | - | | | | - |
| Total | \$ | 1,244,219 | \$ | 965,786 | \$ | 45,978 | \$ | 5,872 | \$ | - | \$ | 226,583 | | |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

All loans individually measured for impairment are classified as substandard as of September 30, 2014.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

At September 30, 2014 and December 31, 2013, we had approximately \$647.9 million and \$763.4 million, respectively, of credit facilities granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities, of which \$626.8 million and \$696.0 million, respectively, were outstanding as of such dates. A substantial portion of our credit exposure to the government of Puerto Rico consists of collateralized loans or obligations that have a specific source of income or revenues identified for its repayment. Some of these obligations consist of senior and subordinated loans to public corporations that obtain revenues from rates charged for services, such as water and electric power utilities. Public corporations have varying degrees of independence from the central government and many have received appropriations or are due other payments from it. We also have loans to various municipalities for which the good faith, credit and unlimited taxing power of the applicable municipality has been pledged to their repayment. These municipalities are required by law to levy special property taxes in such amounts as shall be required for the payment of all their general obligation bonds and notes. Another portion of these loans consists of special obligations of various municipalities that are payable from the basic real and personal property taxes collected within such municipalities. The good faith and credit obligations of the municipalities have a first lien on the basic property taxes.

In the second quarter of 2014, the government enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the “Recovery Act”), which establishes procedures for the adjustment of certain public corporations’ debts. The Recovery Act states in its preamble that it further promotes the central government’s public policy objectives of no longer providing financial support to public corporations and promoting their economic independence. The Recovery Act, which is without precedent and is being challenged in federal court on constitutional grounds, has increased the level of uncertainty as to the rights of the affected public corporation’s creditors. As of September 30, 2014, we had approximately \$382.1 million of credit facilities granted to public corporations authorized to initiate proceedings under the Recovery Act.

Oriental Bank is part of a four bank syndicate providing a \$550 million dollar revolving line of credit to finance the purchase of fuel for the day to day power generation activities of PREPA, a public corporation authorized to seek relief under the Recovery Act. The Bank’s participation in the line of credit has an unpaid principal balance of \$200.0 million as of September 30, 2014. The Company, as part of the bank syndicate, agreed during the quarter to extend its credit facility with PREPA to March 31, 2015. In connection with such extension, PREPA appointed a Chief Restructuring Officer to work alongside the Executive Director to develop, organize and manage a financial and operational restructuring of PREPA subject to the approval of PREPA’s Board. PREPA also committed to delivering a comprehensive business plan by December 15, 2014 and a full debt restructuring plan by March 2, 2015. After the extension, the Company classified the credit as substandard and a troubled-debt restructuring. The Company conducted an impairment analysis considering the probability of collection of principal and interest. Based on the experience and knowledge of the borrower, independent scenarios were developed to assess the collectability of the Company’s current credit exposure to PREPA. Such scenarios project very probable outcomes based on a conservative set of assumptions related to PREPA’s ability for future cash flow generation. The Company concluded that the loan should be maintained in accrual status requiring no impairment.

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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 September 30, 2014 and December 31, 2013, and based on the most recent analysis performed, the risk category of non-covered gross originated and other loans and acquired loans accounted for under ASC 310-20 not subject to risk rating by class of loans is as follows:

| | September 30, 2014 | | | | | | | | | |
|--|--------------------|------------|------------|-------------|--------------|-----------|------------|--------|--|---------------------------|
| | Delinquency | | | | | | | | | |
| | Balance | | | | | | | | | Individually Measured for |
| Outstanding | 0-29 days | 30-59 days | 60-89 days | 90-119 days | 120-364 days | 365+ days | Impairment | | | |
| (In thousands) | | | | | | | | | | |
| Originated and other loans and leases held for investment | | | | | | | | | | |
| Mortgage | | | | | | | | | | |
| Traditional (by origination year) | | | | | | | | | | |
| Up to the year 2002 | \$ 68,338 | \$ 54,931 | \$ 5,831 | \$ 3,160 | \$ 537 | \$ 999 | \$ 1,888 | \$ 992 | | |
| Years 2003 and 2004 | 62,344 | 49,747 | 6,309 | 1,730 | 221 | 1,623 | 1,489 | 1,225 | | |
| Year 2005 | 88,431 | 66,895 | 6,451 | 3,236 | 831 | 3,768 | 3,659 | 3,591 | | |
| Year 2006 | 113,211 | 90,157 | 9,821 | 5,471 | 1,740 | 2,479 | 1,759 | 1,784 | | |
| Years 2007, 2008 and 2009 | 97,063 | 79,950 | 2,874 | 2,774 | 839 | 3,181 | 3,352 | 4,093 | | |
| Years 2010, 2011, 2012 | 193,562 | 180,558 | 4,088 | 1,224 | 106 | 1,597 | 1,281 | 4,708 | | |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 5 – ALLOWANCE FOR LOAN AND LEASE LOSSES

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

| | September 30, | | December 31, | |
|---|----------------|----------------|--------------|----------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Allowance for loans and lease losses on non-covered loans: | | | | |
| Originated and other loans and leases held for investment: | | | | |
| Mortgage | \$ | 18,872 | \$ | 19,937 |
| Commercial | | 9,112 | | 14,897 |
| Consumer | | 8,709 | | 6,006 |
| Auto and leasing | | 13,404 | | 7,866 |
| Unallocated | | 182 | | 375 |
| | | 50,279 | | 49,081 |
| Acquired loans: | | | | |
| Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium) | | | | |
| Commercial | | 270 | | 926 |
| Consumer | | 1,031 | | - |
| Auto | | 3,159 | | 1,428 |
| | | 4,460 | | 2,354 |
| Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy) | | | | |
| Commercial | | 10,115 | | 1,713 |
| Consumer | | 5 | | 418 |
| Auto | | - | | 732 |
| | | 10,120 | | 2,863 |
| | | 64,859 | | 54,298 |
| Allowance for loans and lease losses on covered loans: | | | | |
| Loans secured by 1-4 family residential properties | | 15,252 | | 12,495 |
| Commercial and other construction | | 46,586 | | 39,619 |
| Consumer | | 389 | | 615 |
| | | 62,227 | | 52,729 |
| Total allowance for loan and lease losses | \$ | 127,086 | \$ | 107,027 |

Non-Covered Loans

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

Originated and Other Loans and Leases Held for Investment

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

| | Quarter Ended September 30, 2014 | | | | | | | | | |
|--|--|------------|----------|-----------|-------------|-----------|----------|----------|--|--|
| | | | | | | | | Auto and | | |
| | Mortgage | Commercial | Consumer | Leasing | Unallocated | Total | | | | |
| | (In thousands) | | | | | | | | | |
| Allowance for loan and lease losses for non-covered originated and other loans: | | | | | | | | | | |
| Balance at beginning of period | \$ 19,062 | \$ 12,423 | \$ 7,887 | \$ 11,127 | \$ 139 | \$ 50,638 | | | | |
| Charge-offs | (1,563) | (1,081) | (1,585) | (7,393) | - | (11,622) | | | | |
| Recoveries | 138 | 56 | 66 | 2,434 | - | 2,694 | | | | |
| Provision (recapture) for non-covered originated and other loan and lease losses | 1,235 | (2,286) | 2,341 | 7,236 | 43 | 8,569 | | | | |
| Balance at end of period | \$ 18,872 | \$ 9,112 | \$ 8,709 | \$ 13,404 | \$ 182 | \$ 50,279 | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | Nine-Month Period Ended September 30, 2014 | | | | | | | | | |
| | | | | | | | Auto and | | | |
| | Mortgage | Commercial | Consumer | Leasing | Unallocated | Total | | | | |
| | (In thousands) | | | | | | | | | |

| | | | | | | | | | | | | | |
|--|----|---------------|----|--------------|----|--------------|----|---------------|----|------------|----|---------------|--|
| Allowance for loan and lease losses for non-covered originated and other loans: | | | | | | | | | | | | | |
| Balance at beginning of period | \$ | 19,937 | \$ | 14,897 | \$ | 6,006 | \$ | 7,866 | \$ | 375 | \$ | 49,081 | |
| Charge-offs | | (3,764) | | (2,043) | | (3,820) | | (17,994) | | - | | (27,621) | |
| Recoveries | | 374 | | 269 | | 457 | | 6,094 | | - | | 7,194 | |
| Provision (recapture) for non-covered originated and other loan and lease losses | | 2,325 | | (4,011) | | 6,066 | | 17,438 | | (193) | | 21,625 | |
| Balance at end of period | \$ | 18,872 | \$ | 9,112 | \$ | 8,709 | \$ | 13,404 | \$ | 182 | \$ | 50,279 | |

| | September 30, 2014 | | | | | | | | | | | | |
|---|---------------------------|---------------|-------------------|--------------|-----------------|--------------|-------------------------|---------------|--------------------|------------|--------------|---------------|--|
| | Mortgage | | Commercial | | Consumer | | Auto and Leasing | | Unallocated | | Total | | |
| | (In thousands) | | | | | | | | | | | | |
| Allowance for loan and lease losses on non-covered originated and other loans: | | | | | | | | | | | | | |
| Ending allowance balance attributable to loans: | | | | | | | | | | | | | |
| Individually evaluated for impairment | \$ | 7,932 | \$ | 1,108 | \$ | - | \$ | - | \$ | - | \$ | 9,040 | |
| Collectively evaluated for impairment | | 10,940 | | 8,004 | | 8,709 | | 13,404 | | 182 | | 41,239 | |
| Total ending allowance balance | \$ | 18,872 | \$ | 9,112 | \$ | 8,709 | \$ | 13,404 | \$ | 182 | \$ | 50,279 | |
| Loans: | | | | | | | | | | | | | |
| Individually evaluated for impairment | \$ | 91,692 | \$ | 226,583 | \$ | - | \$ | - | \$ | - | \$ | 318,275 | |
| Collectively evaluated for impairment | | 699,414 | | 990,652 | | 175,882 | | 542,892 | | - | | 2,408,840 | |

| | | | | | | | | | | | |
|----------------------------------|-------------------|--|---------------------|--|-------------------|--|-------------------|--|-------------|--|---------------------|
| Total ending loan balance | \$ 791,106 | | \$ 1,217,235 | | \$ 175,882 | | \$ 542,892 | | \$ - | | \$ 2,727,115 |
|----------------------------------|-------------------|--|---------------------|--|-------------------|--|-------------------|--|-------------|--|---------------------|

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| | Quarter Ended September 30, 2013 | | | | | | | | | | | |
|--|--|----------|------------|---------|----------|---------|------------------|---------|-------------|-----|-------|----------|
| | Mortgage | | Commercial | | Consumer | | Auto and Leasing | | Unallocated | | Total | |
| | (In thousands) | | | | | | | | | | | |
| Allowance for loan and lease losses for non-covered originated and other loans: | | | | | | | | | | | | |
| Balance at beginning of period | \$ | 21,375 | \$ | 17,624 | \$ | 2,341 | \$ | 3,641 | \$ | 720 | \$ | 45,701 |
| Charge-offs | | (1,758) | | (2,234) | | (465) | | (1,305) | | - | | (5,762) |
| Recoveries | | - | | 28 | | 37 | | 639 | | - | | 704 |
| Provision for non-covered originated and other loan and lease losses | | 1,374 | | (703) | | 2,915 | | 3,143 | | 201 | | 6,930 |
| Balance at end of period | \$ | 20,991 | \$ | 14,715 | \$ | 4,828 | \$ | 6,118 | \$ | 921 | \$ | 47,573 |
| | | | | | | | | | | | | |
| | | | | | | | | | | | | |
| | | | | | | | | | | | | |
| | Nine-Month Period Ended September 30, 2013 | | | | | | | | | | | |
| | Mortgage | | Commercial | | Consumer | | Auto and Leasing | | Unallocated | | Total | |
| | (In thousands) | | | | | | | | | | | |
| Allowance for loan and lease losses for non-covered originated and other loans: | | | | | | | | | | | | |
| Balance at beginning of period | \$ | 21,092 | \$ | 17,072 | \$ | 856 | \$ | 533 | \$ | 368 | \$ | 39,921 |
| Charge-offs | | (33,465) | | (5,678) | | (1,034) | | (2,105) | | - | | (42,282) |
| Recoveries | | - | | 291 | | 143 | | 855 | | - | | 1,289 |
| Provision for non-covered originated and other loan and lease | | 33,364 | | 3,030 | | 4,863 | | 6,835 | | 553 | | 48,645 |

| | | | | | | | | | | | | | | |
|---------------------------------|----|---------------|----|---------------|----|--------------|----|--------------|----|------------|----|---------------|--|--|
| losses | | | | | | | | | | | | | | |
| Balance at end of period | \$ | 20,991 | \$ | 14,715 | \$ | 4,828 | \$ | 6,118 | \$ | 921 | \$ | 47,573 | | |

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

| | Quarter Ended September 30, 2014 | | | | | | | | | |
|---|--|------------|----------|--------------|------|--------------|-------------|----------|-------|--------------|
| | Commercial | | Consumer | | Auto | | Unallocated | | Total | |
| | (In thousands) | | | | | | | | | |
| Allowance for loan and lease losses | | | | | | | | | | |
| for non-covered acquired loans | | | | | | | | | | |
| accounted for under ASC 310-20: | | | | | | | | | | |
| Balance at beginning of period | \$ | 464 | \$ | 338 | \$ | 2,642 | \$ | - | \$ | 3,444 |
| Charge-offs | | (228) | | (1,432) | | (1,748) | | - | | (3,408) |
| Recoveries | | 35 | | 139 | | 519 | | - | | 693 |
| Provision (recapture) for non-covered acquired loan and lease losses accounted for under ASC 310-20 | | (1) | | 1,986 | | 1,746 | | - | | 3,731 |
| Balance at end of period | \$ | 270 | \$ | 1,031 | \$ | 3,159 | \$ | - | \$ | 4,460 |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | Nine-Month Period Ended September 30, 2014 | | | | | | | | | |
| | Commercial | | Consumer | | Auto | | Unallocated | | Total | |
| | (In thousands) | | | | | | | | | |
| Allowance for loan and lease losses | | | | | | | | | | |

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| | Quarter Ended September 30, 2013 | | | | | | | | | |
|---|--|-------|----------|---------|------|---------|-------------|---|-------|---------|
| | Commercial | | Consumer | | Auto | | Unallocated | | Total | |
| | (In thousands) | | | | | | | | | |
| Allowance for loan and lease losses for non-covered acquired loans accounted for under ASC 310-20: | | | | | | | | | | |
| Balance at beginning of period | \$ | 924 | \$ | - | \$ | - | \$ | - | \$ | 924 |
| Charge-offs | | - | | (1,233) | | (1,598) | | - | | (2,831) |
| Recoveries | | 6 | | 88 | | 884 | | - | | 978 |
| Provision (recapture) for non-covered acquired loan and lease losses accounted for under ASC 310-20 | | 431 | | 1,145 | | 1,394 | | - | | 2,970 |
| Balance at end of period | \$ | 1,361 | \$ | - | \$ | 680 | \$ | - | \$ | 2,041 |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | Nine-Month Period Ended September 30, 2013 | | | | | | | | | |
| | Commercial | | Consumer | | Auto | | Unallocated | | Total | |
| | (In thousands) | | | | | | | | | |
| Allowance for loan and lease losses for non-covered acquired loans accounted for under ASC 310-20: | | | | | | | | | | |
| Balance at beginning of period | \$ | - | \$ | - | \$ | - | \$ | - | \$ | - |
| Charge-offs | | (25) | | (3,847) | | (4,723) | | - | | (8,595) |

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| | | | | | | | | | | |
|---|----|--------------|----|----------|----|------------|----|----------|----|--------------|
| Recoveries | | 6 | | 932 | | 3,000 | | - | | 3,938 |
| Provision (recapture) for non-covered acquired loan and lease losses accounted for under ASC 310-20 | | 1,380 | | 2,915 | | 2,403 | | - | | 6,698 |
| Balance at end of period | \$ | 1,361 | \$ | - | \$ | 680 | \$ | - | \$ | 2,041 |

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

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| | | | | | | | | | | | | | | |
|--|----|---|----|---------------|----|---|----|----------|----|---|----|---------------|--|--|
| loan and lease losses accounted for | | | | | | | | | | | | | | |
| under ASC 310-30 | | | | | | | | | | | | | | |
| Balance at end of period | \$ | - | \$ | 10,115 | \$ | - | \$ | 5 | \$ | - | \$ | 10,120 | | |

Non-covered acquired loans 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 during the nine-month period ended September 30, 2013.

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Covered Loans

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

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

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|---|-----------------------------|---------------|------|---------------|---------------------------------------|---------------|------|---------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| (In thousands) | | | | | | | | |
| Balance at beginning of the period | \$ | 59,515 | \$ | 53,992 | \$ | 52,729 | \$ | 54,124 |
| Provision for covered loan and lease losses, net | | 1,115 | | 3,074 | | 4,339 | | 4,956 |
| FDIC shared-loss portion of provision for (recapture of) covered loan and lease losses, net | | 1,597 | | (511) | | 5,159 | | (2,525) |
| Balance at end of the period | \$ | 62,227 | \$ | 56,555 | \$ | 62,227 | \$ | 56,555 |

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

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

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|---|-----------------------------|----------------|------|----------------|---------------------------------------|----------------|------|----------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| | (In thousands) | | | | | | | |
| FDIC indemnification asset: | | | | | | | | |
| Balance at beginning of period | \$ | 143,660 | \$ | 253,379 | \$ | 189,240 | \$ | 302,295 |
| Shared-loss agreements reimbursements from the FDIC | | (12,837) | | (14,036) | | (31,537) | | (32,732) |
| Increase (decrease) in expected credit losses to be covered under shared-loss agreements, net | | 1,597 | | (510) | | 5,159 | | (2,525) |
| FDIC indemnification asset expense | | (16,059) | | (15,198) | | (51,180) | | (46,623) |
| Incurring expenses to be reimbursed under shared-loss agreements | | 4,258 | | 1,947 | | 8,937 | | 5,167 |
| Balance at end of period | \$ | 120,619 | \$ | 225,582 | \$ | 120,619 | \$ | 225,582 |

| | | | | | | | | | | |
|---------------------------------------|----|---------------|----|---------------|--|--|----|---------------|----|---------------|
| | | | | | | | | | | |
| True-up payment obligation: | | | | | | | | | | |
| Balance at beginning of period | \$ | 20,231 | \$ | 16,907 | | | \$ | 18,510 | \$ | 15,496 |
| Change in true-up payment obligation | | 875 | | 767 | | | | 2,596 | | 2,178 |
| Balance at end of period | \$ | 21,106 | \$ | 17,674 | | | \$ | 21,106 | \$ | 17,674 |

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

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

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

The FDIC indemnification asset expense of \$16.1 million and \$51.2 million for the quarter and nine-month period ended September 30, 2014 increased when compared to \$15.2 million and \$46.6 million for the same periods in 2013. These changes were caused by the ongoing evaluation of expected cash flows of the covered loan portfolio, which resulted in reduced projected losses expected to be collected from the FDIC and the improved accretible yield on the covered loans. Forecasted losses show a decreasing trend during the nine-month period ended September 30, 2014 as compared to the projections in 2013. The reduction in claimable losses amortizes the FDIC indemnification asset through the shorter of the life of the shared loss agreement or the loan holding period. This amortization is net of the accretion of the discount recorded to reflect the expected claimable loss at its net present value. During the quarter and nine-month period ended September 30, 2014, the net amortization included \$2.6 million and \$7.7 million of additional amortization of the FDIC indemnification asset from stepped up cost recoveries on certain construction, commercial, and leasing loan pools. Additional amortization of the FDIC indemnification asset may be recorded, should the Company continue to experience reduced expected losses. The majority of the FDIC indemnification asset, \$84.3 million, is recorded for projected claimable losses on non-single family residential loans whose loss share period ends in the second quarter of 2015, although the period during which recoveries are shared extends for an additional three-years.

Also in connection with the FDIC assisted acquisition, the Bank agreed to make a true-up payment, also known as clawback liability or clawback provision, to the FDIC on the date that is 45 days following the last day (such day, the “True-Up Measurement Date”) of the final shared-loss month, or upon the final disposition of all covered assets under the shared-loss agreements in the event losses thereunder fail to reach expected levels. Under the shared-loss agreements, the Bank will pay to the FDIC 50% of the excess, if any, of: (i) 20% of the Intrinsic Loss Estimate of \$906.0 million (or \$181.2 million) (as determined by the FDIC) less (ii) the sum of: (A) 25% of the asset discount (per bid) (or \$227.5 million); plus (B) 25% of the cumulative shared-loss payments (defined as the aggregate of all of the payments made or payable to the Bank minus the aggregate of all of the payments made or payable to the FDIC); plus (C) the sum of the period servicing amounts for every consecutive twelve-month period prior to and ending on the True-Up Measurement Date in respect of each of the shared-loss agreements during which the shared-loss provisions of the applicable shared-loss agreement is in effect (defined as the product of the simple average of the principal amount of shared-loss loans and shared-loss assets at the beginning and end of such period times 1%). The true-up payment represents an estimated liability of \$21.1 million and \$18.5 million, net of discount, as of September 30, 2014 and December 31, 2013, respectively. The estimated liability is included within accrued expenses and other liabilities in the unaudited consolidated statements of financial condition.

The true-up payment obligation, also known as clawback liability, may increase if actual and expected losses decline. The Company measures the true-up payment obligation at fair value. During the quarter and nine-month period ended September 30, 2014, the fair value of the true-up payment obligation increased by \$875 thousand and \$2.6 million, respectively, compared to increases of \$767 thousand and \$2.2 million for the same periods in 2013. These changes in fair value are included as change in true-up payment obligation within FDIC shared-loss expense, net in the unaudited consolidated statements of operations.

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The following table provides the fair value and the undiscounted amount of the true-up payment obligation at September 30, 2014 and December 31, 2013:

| | September 30, | | December 31, | |
|------------------------------|-----------------------|--------|---------------------|--------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Carrying amount (fair value) | \$ | 21,106 | \$ | 18,510 |
| Undiscounted amount | \$ | 40,638 | \$ | 40,199 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 7 — DERIVATIVES

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

| | September 30, | | December 31, | |
|--|----------------|---------------|--------------|---------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Derivative assets: | | | | |
| Options tied to S&P 500 Index | \$ | 5,762 | \$ | 16,430 |
| Interest rate swaps designated as cash flow hedges | | - | | 850 |
| Interest rate swaps not designated as hedges | | 2,451 | | 2,861 |
| Interest rate caps | | 224 | | 319 |
| Other | | 8 | | 42 |
| | \$ | 8,445 | \$ | 20,502 |
| Derivative liabilities: | | | | |
| Interest rate swaps designated as cash flow hedges | | 8,717 | | 11,757 |
| Interest rate swaps not designated as hedges | | 2,451 | | 2,861 |
| Interest rate caps | | 224 | | 319 |
| Other | | 22 | | - |
| | \$ | 11,414 | \$ | 14,937 |

Interest Rate Swaps

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| Type | Notional Amount | Fixed Rate | Variable Rate Index | Trade Date | Settlement Date | Maturity Date |
|---------------------|--------------------|---------------|------------------------|---------------|--------------------|------------------|
| (In thousands) | | | | | | |
| Interest Rate Swaps | \$ 25,000 | 2.4365% | 1-Month LIBOR | 05/05/11 | 05/04/12 | 05/04/16 |
| | 25,000 | 2.6200% | 1-Month LIBOR | 05/05/11 | 07/24/12 | 07/24/16 |
| | 25,000 | 2.6350% | 1-Month LIBOR | 05/05/11 | 07/30/12 | 07/30/16 |
| | 50,000 | 2.6590% | 1-Month LIBOR | 05/05/11 | 08/10/12 | 08/10/16 |
| | 100,000 | 2.6750% | 1-Month LIBOR | 05/05/11 | 08/16/12 | 08/16/16 |
| | 39,641 | 2.4210% | 1-Month LIBOR | 07/03/13 | 07/03/13 | 08/01/23 |
| | \$ 264,641 | | | | | |

An unrealized loss of \$8.7 million was recognized in accumulated other comprehensive income related to the valuation of these swaps at September 30, 2014, and the related asset and liability are being reflected in the accompanying unaudited consolidated statements of financial condition.

At September 30, 2014 and December 31, 2013, interest rate swaps not designated as hedging instruments that were offered to clients represented an asset of \$2.5 million and \$2.9 million, respectively, and were included as part of derivative assets in the unaudited consolidated statements of financial position. The credit risk to these clients stemming from these derivatives, if any, is not material. At September 30, 2014 and December 31, 2013, interest rate swaps not designated as hedging instruments that are the mirror-images of the derivatives offered to clients represented a liability of \$2.5 million and \$2.9 million, respectively, and were included as part of derivative liabilities in the unaudited consolidated statements of financial condition.

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

| Type | Notional Amount | Fixed Rate | Variable Rate Index | Settlement Date | Maturity Date |
|--|--------------------|---------------|------------------------|--------------------|------------------|
| (In thousands) | | | | | |
| Interest Rate Swaps - Derivatives Offered to Clients | \$ 4,003 | 5.1300% | 1-Month LIBOR | 07/03/06 | 07/03/16 |

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| | | | | | | |
|---|----|---------------|---------|---------------|----------|----------|
| | | 12,500 | 5.5050% | 1-Month LIBOR | 04/11/09 | 04/11/19 |
| | \$ | 16,503 | | | | |
| | | | | | | |
| Interest Rate Swaps - Mirror Image Derivatives | \$ | 4,003 | 5.1300% | 1-Month LIBOR | 07/03/06 | 07/03/16 |
| | | 12,500 | 5.5050% | 1-Month LIBOR | 04/11/09 | 04/11/19 |
| | \$ | 16,503 | | | | |

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

The Company has offered its customers certificates of deposit with an option tied to the performance of the S&P 500 Index. The Company uses option agreements with major broker-dealers to manage its exposure to changes in this index. Under the terms of the option agreements, the Company receives the average increase in the month-end value of the index in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings. At September 30, 2014 and December 31, 2013, the purchased options used to manage exposure to the S&P 500 Index on stock indexed deposits represented an asset of \$5.8 million (notional amount of \$12.0 million) and \$16.4 million (notional amount of \$28.0 million), respectively, and the options sold to customers embedded in the certificates of deposit and recorded as deposits in the unaudited consolidated statements of financial condition, represented a liability of \$5.6 million (notional amount of \$11.6 million) and \$15.7 million (notional amount of \$26.9 million), respectively.

Interest rate caps

The Company has entered into interest rate cap transactions with various clients with floating-rate debt who wish to protect their financial results against increases in interest rates. In these cases, the Company simultaneously enters into mirror-image interest rate cap transactions with financial counterparties. None of these cap transactions qualify for hedge accounting, and therefore, they are marked to market through earnings. The outstanding total notional amount of interest rate caps was \$110.0 million at September 30, 2014 and \$94.0 million at December 31, 2013. At September 30, 2014 and December 31, 2013, the interest rate caps sold to clients represented a liability of \$224 thousand and \$319 thousand, respectively, and were included as part of derivative liabilities in the unaudited consolidated statements of financial condition. At September 30, 2014 and December 31, 2013, the interest rate caps purchased as mirror-images represented an asset of \$224 thousand and \$319 thousand, respectively, and were included as part of derivative assets in the unaudited consolidated statements of financial condition.

NOTE 8 — ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

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

| | September 30, | | December 31, |
|--|----------------|--|--------------|
| | 2014 | | 2013 |
| | (In thousands) | | |

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| | | | | |
|-------------------|----|---------------|----|---------------|
| Non-covered loans | \$ | 15,260 | \$ | 13,378 |
| Investments | | 4,405 | | 5,356 |
| | \$ | 19,665 | \$ | 18,734 |

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

| | | September 30, | | December 31, |
|--|----|----------------------|----|---------------------|
| | | 2014 | | 2013 |
| (In thousands) | | | | |
| Prepaid expenses | \$ | 18,375 | \$ | 15,439 |
| Core deposit and customer relationship intangibles | | 10,285 | | 11,912 |
| Other repossessed assets | | 21,733 | | 12,583 |
| Mortgage tax credits | | 8,706 | | 8,706 |
| Investment in Statutory Trust | | 1,083 | | 1,083 |
| Accounts receivable and other assets | | 37,243 | | 48,717 |
| | \$ | 97,425 | \$ | 98,440 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Prepaid expenses amounting to \$18.4 million and \$15.4 million at September 30, 2014 and December 31, 2013, respectively, include prepaid municipal, property and income taxes aggregating to \$12.8 million and \$8.6 million, respectively.

In connection with the FDIC-assisted acquisition and the BBVAPR Acquisition, the Company recorded a core deposit intangible representing the value of checking and savings deposits acquired. At September 30, 2014 and December 31, 2013, this core deposit intangible amounted to \$6.8 million and \$7.8 million, respectively. In addition, the Company recorded a customer relationship intangible amounting to \$5.0 million representing the value of customer relationships acquired with the acquisition of the securities broker-dealer and insurance agency in the BBVAPR Acquisition as of December 31, 2012. At September 30, 2014 and December 31, 2013, this customer relationship intangible amounted to \$3.5 million and \$4.1 million, respectively.

Other repossessed assets totaled \$21.7 million and \$12.6 million at September 30, 2014 and December 31, 2013, respectively, include repossessed automobiles amounting to \$21.0 million and \$12.3 million, respectively, which are recorded at their net realizable value.

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

NOTE 9— DEPOSITS AND RELATED INTEREST

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

| | September 30, | | December 31, | |
|--|----------------|------------------|--------------|------------------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Non-interest bearing demand deposits | \$ | 734,449 | \$ | 744,327 |
| Interest-bearing savings and demand deposits | | 2,566,952 | | 2,489,971 |
| Individual retirement accounts | | 314,813 | | 347,262 |
| Retail certificates of deposit | | 455,286 | | 568,367 |
| Institutional certificates of deposit | | 328,031 | | 405,224 |
| Total core deposits | | 4,399,531 | | 4,555,151 |
| Brokered deposits | | 669,644 | | 828,114 |

| | | | | |
|-----------------------|----|------------------|----|------------------|
| Total deposits | \$ | 5,069,175 | \$ | 5,383,265 |
|-----------------------|----|------------------|----|------------------|

Brokered deposits include \$575.8 million in certificates of deposits and \$93.7 million in money market accounts at September 30, 2014, and \$729.8 million in certificates of deposits and \$98.3 million in money market accounts at December 31, 2013.

The weighted average interest rate of the Company's deposits was 0.75% at September 30, 2014 and 0.73% at December 31, 2013, inclusive of non-interest bearing deposits of \$734.4 million and \$744.3 million, respectively. Interest expense for the quarters and nine-month periods ended September 30, 2014 and 2013 was as follows:

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|-----------------------------|-----------------------------|--------------|------|---------------|---------------------------------------|---------------|------|---------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| | (In thousands) | | | | | | | |
| Demand and savings deposits | \$ | 4,003 | \$ | 5,596 | \$ | 13,834 | \$ | 16,994 |
| Certificates of deposit | | 3,658 | | 5,738 | | 11,970 | | 13,763 |
| | \$ | 7,661 | \$ | 11,334 | \$ | 25,804 | \$ | 30,757 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

At September 30, 2014 and December 31, 2013, demand and interest-bearing deposits and certificates of deposit included deposits of Puerto Rico Cash & Money Market Fund, Inc., which amounted to \$108.9 million and \$93.1 million, respectively, with a weighted average rate of 0.78% in both years, and were collateralized with investment securities with a fair value of \$83.4 million and \$67.5 million, respectively.

At September 30, 2014 and December 31, 2013, time deposits in denominations of \$100 thousand or higher, excluding accrued interest and unamortized discounts, amounted to \$681.6 million and \$845.8 million, including public fund time deposits from various Puerto Rico government municipalities, agencies, and corporations of \$20.8 million and \$26.7 million, respectively, at a weighted average rate of 0.53% at September 30, 2014 and 0.32% at December 31, 2013.

At September 30, 2014 and December 31, 2013, total public fund deposits from various Puerto Rico government municipalities, agencies, and corporations amounted to \$359.2 million and \$328.6 million, respectively. These public funds were collateralized with commercial loans amounting to \$416.0 million at September 30, 2014, and with investment securities with a fair value of \$97.8 million and commercial loans amounting to \$549.0 million at December 31, 2013.

Excluding equity indexed options in the amount of \$4.4 million, which are used by the Company to manage its exposure to the S&P 500 Index, and also excluding accrued interest of \$1.3 million and unamortized deposit discount in the amount of \$1.1 million, the scheduled maturities of certificates of deposit at September 30, 2014 are as follows:

| | September 30, 2014 | |
|------------------------------|---------------------------|------------------|
| | (In thousands) | |
| Within one year: | | |
| Three (3) months or less | \$ | 342,429 |
| Over 3 months through 1 year | | 590,965 |
| | | 933,394 |
| Over 1 through 2 years | | 454,186 |
| Over 2 through 3 years | | 210,567 |
| Over 3 through 4 years | | 50,067 |
| Over 4 through 5 years | | 18,926 |
| | \$ | 1,667,140 |

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

The aggregate amount of overdrafts in demand deposit accounts that were reclassified to loans amounted to \$890 thousand and \$1.8 million as of September 30, 2014 and December 31, 2013, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 10 — BORROWINGS

Securities Sold under Agreements to Repurchase

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

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

| | September 30, | | | | December 31, | | | |
|------------------------------------|---------------------|-----------|------------------|-----------|------------------|-----------|------------------|--|
| | 2014 | | | | 2013 | | | |
| | | | Fair Value of | | | | Fair Value of | |
| | Borrowing | | Underlying | | Borrowing | | Underlying | |
| | Balance | | Collateral | | Balance | | Collateral | |
| (In thousands) | | | | | | | | |
| JP Morgan Chase Bank NA | 255,000 | | 259,039 | | 255,000 | | 273,250 | |
| Credit Suisse Securities (USA) LLC | 755,000 | | 842,183 | | 755,000 | | 864,232 | |
| Deutsche Bank | - | | - | | 255,000 | | 272,053 | |
| Total | \$ 1,010,000 | \$ | 1,101,222 | \$ | 1,265,000 | \$ | 1,409,535 | |

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

| | | Weighted- | | |
|------------------|----------------|-----------|-----------------|----------|
| | Borrowing | Average | | Maturity |
| Year of Maturity | Balance | Coupon | Settlement Date | Date |
| | (In thousands) | | | |
| | | | | |

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| | | | | | |
|------|----|------------------|---------------|------------|-----------|
| 2014 | \$ | 85,000 | 0.675% | 12/3/2012 | 12/3/2014 |
| | | | | | |
| 2015 | | 255,000 | 0.840% | 12/10/2012 | 6/13/2015 |
| | | | | | |
| 2016 | | 170,000 | 1.500% | 12/6/2012 | 12/8/2016 |
| | | | | | |
| 2017 | | 500,000 | 4.780% | 3/2/2007 | 3/2/2017 |
| | \$ | 1,010,000 | 2.831% | | |
| | | | | | |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| September 30, 2014 | | | | | | | | | | | | |
|---------------------------------------|---------------------|----------|--------------|--|---------------------|--|-----------------|--|-------------|-------------|-------------|---------------------|
| Market Value of Underlying Collateral | | | | | | | | | | | | |
| | | Weighted | | | FNMA and | | CMOs | | | Obligations | | |
| | | Average | | | FHLMC | | issued by | | | of US | | |
| Repurchase | | Rate | | | Certificates | | Government | | | Government | | |
| Liability | | Rate | | | Certificates | | Sponsored | | | Sponsored | | |
| | | | | | | | Agencies | | | Agencies | | |
| (Dollars in thousands) | | | | | | | | | | | | |
| Less than 90 days | \$ 85,000 | | 0.68% | | \$ 95,420 | | \$ 2,061 | | \$ - | | \$ - | \$ 97,481 |
| Over 90 days | \$ 925,000 | | 2.83% | | \$ 1,003,070 | | \$ 671 | | \$ - | | \$ - | \$ 1,003,741 |
| Total | \$ 1,010,000 | | 2.89% | | \$ 1,098,490 | | \$ 2,732 | | \$ - | | \$ - | \$ 1,101,222 |

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

Advances from the Federal Home Loan Bank of New York

Advances are received from the Federal Home Loan Bank of New York (the “FHLB-NY”) under an agreement whereby the Company is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances. At September 30, 2014 and December 31, 2013, these advances were secured by mortgage and commercial loans amounting to \$1.2 billion and \$1.3 billion, respectively. Also, at September 30, 2014 and December 31, 2013, the Company had an additional borrowing capacity with the FHLB-NY of \$653.5 million and \$674.2 million, respectively. At September 30, 2014 and December 31, 2013, the weighted average remaining maturity of FHLB’s advances was 9.4 months and 11.3 months, respectively. The original terms of these advances range between one day and seven years, and the FHLB-NY does not have the right to exercise put options at par on any advances outstanding as of September 30, 2014.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of \$330 thousand, at September 30, 2014:

| | | | Weighted- | | |
|-------------------------|----|------------------|------------------|------------------------|-----------------|
| | | Borrowing | Average | | Maturity |
| Year of Maturity | | Balance | Coupon | Settlement Date | Date |
| | | (In thousands) | | | |
| 2014 | \$ | 25,000 | 0.36% | 9/4/2014 | 10/6/2014 |
| | | 50,000 | 0.37% | 9/10/2014 | 10/10/2014 |
| | | 100,000 | 0.36% | 9/16/2014 | 10/16/2014 |
| | | 25,000 | 0.32% | 9/24/2014 | 10/24/2014 |
| | | 25,000 | 0.30% | 9/30/2014 | 10/30/2014 |
| | | 39,641 | 0.37% | 9/2/2014 | 10/1/2014 |
| | | 264,641 | | | |
| 2017 | | 4,558 | 1.24% | 4/3/2012 | 4/3/2017 |
| 2018 | | 30,000 | 2.19% | 1/16/2013 | 1/16/2018 |
| | | 25,000 | 2.18% | 1/16/2013 | 1/16/2018 |
| | | 55,000 | | | |
| 2020 | | 10,259 | 2.59% | 7/19/2013 | 7/20/2020 |
| | \$ | 334,458 | 0.74% | | |

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

Subordinated Capital Notes

Subordinated capital notes amounted to \$101.2 million at September 30, 2014 and \$100.0 million at December 31, 2013.

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

| | Redemption fund | |
|--------------------------------------|------------------------|---------------|
| | (In thousands) | |
| Redemption fund - September 30, 2014 | \$ | 53,600 |
| 2014 | | 1,675 |
| 2015 | | 6,700 |
| 2016 | | 5,025 |
| | \$ | 67,000 |

Other borrowings

Other borrowings, presented in the unaudited consolidated statement of financial condition amounted to \$3.9 million and \$3.7 million at September 30, 2014 and December 31, 2013, respectively, which mainly consists of unsecured fixed-rate borrowings and term notes tied to the appreciation of the S&P index. For both periods, the unsecured fixed rate borrowings amounted to \$1.7 million at a fixed rate of 3.0%. The term notes tied to the S&P index amounted to \$1.0 million at both September 30, 2014 and December 31, 2013 with an index appreciation of \$1.1 million and \$957 thousand, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 11 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES

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

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

| September 30, 2014 | | | | | | | | | | | | |
|--------------------|-----------|--------------|---------------|----------|------------------|--------------|-------------|--------------|-----------|--|-----------|--------------|
| | | | | | | | | | | Gross Amounts Not Offset in the Statement of Financial Condition | | |
| | | | Gross Amounts | | Net Amount of | | | | | | | |
| | | | Offset in the | | Assets Presented | | | | | | | |
| Gross Amount | | | Statement of | | in | | Cash | | | | | |
| of Recognized | | | Financial | | of Financial | | Financial | | | Collateral | | |
| Assets | | | Condition | | Condition | | Instruments | | | Received | | |
| | | | | | | | | | | Net | | |
| | | | | | | | | | | Amount | | |
| (In thousands) | | | | | | | | | | | | |
| Derivatives | \$ | 8,445 | \$ | - | \$ | 8,445 | \$ | 2,003 | \$ | - | \$ | 6,442 |
| Total | \$ | 8,445 | \$ | - | \$ | 8,445 | \$ | 2,003 | \$ | - | \$ | 6,442 |
| December 31, 2013 | | | | | | | | | | | | |
| | | | | | | | | | | Gross Amounts Not Offset in the Statement of Financial Condition | | |
| | | | Gross Amounts | | Net amount of | | | | | | | |
| | | | Offset in the | | Assets Presented | | | | | | | |
| Gross Amount | | | Statement of | | in | | Cash | | | | | |
| of Recognized | | | Financial | | of Financial | | Financial | | | Collateral | | |
| Assets | | | Condition | | Condition | | Instruments | | | Received | | |
| | | | | | | | | | | Net | | |
| | | | | | | | | | | Amount | | |

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

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

NOTE 12 — RELATED PARTY TRANSACTIONS

The Bank grants loans to its directors, executive officers and to certain related individuals or organizations in the ordinary course of business. These loans are offered at the same terms as loans to unrelated third parties. As of September 30, 2014 and December 31, 2013, these loan balances amounted to \$25.6 million and \$19.0 million, respectively. The activity and balance of these loans for the quarters and nine-month periods ended September 30, 2014 and 2013 were as follows:

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|---|-----------------------------|---------------|-----------|---------------|---------------------------------------|---------------|-----------|---------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| (In thousands) | | | | | | | | |
| Balance at the beginning of year | \$ | 24,151 | \$ | 8,031 | \$ | 18,963 | \$ | 6,055 |
| New loans | | 319 | | 14,264 | | 14,166 | | 18,498 |
| Repayments and sales | | 1,174 | | (3,289) | | (7,485) | | (5,315) |
| Credits of persons no longer considered related parties | | - | | - | | - | | (232) |
| Balance at the end of year | \$ | 25,644 | \$ | 19,006 | \$ | 25,644 | \$ | 19,006 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 13 — INCOME TAXES

On July 1st, 2014 the Governor signed Act No. 77-2014, known as “Ley de Ajustes al Sistema Contributivo” (Act of Adjustments to the Tax System). The main purpose of the Act is to increase government collections in order to alleviate the structural deficit. The most relevant provisions of the Act, as applicable to the Company, and effective for transactions held after June 30, 2014 are as follows: (1) the capital tax rate was increased from 15% to 20% and (2) for an asset to be considered long term capital asset, the holding period must be over a year, which before was defined with a holding period of over six months.

Other provisions applicable to tax years commencing after December 31, 2013 is the additional tax on gross income (“patente nacional”) is defined as a separate tax, rather than a component of the Alternative Minimum Tax (AMT) for non-financial institutions and, therefore is not longer accounted for under the provisions of ASC 740. For financial institutions, the additional tax on gross income remained mostly unaltered at a tax rate of 1% of its gross income of a taxable year, of which fifty percent (50%) may be claimed as a credit against the financial institution’s applicable income tax of that year.

At September 30, 2014 and December 31, 2013, the Company’s net deferred tax asset amounted to \$121.2 million and \$137.6 million, respectively. In assessing the realizability of the deferred tax asset, management considers whether it is more likely than not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of the deferred tax asset is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax asset are deductible, management believes it is more likely than not that the Company will realize the entire deferred tax asset, net of the existing valuation allowances recorded at September 30, 2014 and December 31, 2013. The amount of the deferred tax asset that is considered realizable could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

At September 30, 2014 and December 31, 2013, Oriental International Bank Inc. (“OIB”), the Bank’s international banking entity subsidiary, had \$198 thousand and \$356 thousand, respectively, in income tax effect of unrecognized gain on available-for-sale securities included in other comprehensive income. Following the change in OIB’s applicable tax rate from 5% to 0% as a result of a Puerto Rico law adopted in 2011, this remaining tax balance will flow through income as these securities are repaid or sold in future periods. During the quarters ended September 30, 2014 and 2013, \$11 thousand and \$36 thousand, respectively, related to this residual tax effect from OIB was reclassified from accumulated other comprehensive income into income tax provision. During the nine-month periods ended September 30, 2014 and 2013, \$158 thousand and \$126 thousand, respectively, related to the residual effect from OIB was reclassified from accumulated other comprehensive income to income tax provision.

The Company classifies unrecognized tax benefits in income taxes payable. These gross unrecognized tax benefits would affect the effective tax rate if realized. The balance of unrecognized tax benefits at September 30, 2014 was \$2.6 million (December 31, 2013 - \$4.0 million). The Company had accrued \$430 thousand at September 30, 2014 (December 31, 2013 - \$1.2 million) for the payment of interest and penalties relating to unrecognized tax benefits. Also, during this quarter the Company recorded a reversal of an income tax contingency of \$1.0 million as a result of reviewing the positions of certain unrecognized tax benefits at the Bank.

Income tax expense was \$8.0 million for the quarter ended September 30, 2014, compared to \$6.6 million for the same period in 2013. Effective July 1, 2014, capital gains tax rate was increased from 15% to 20% as explained above.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 14 — 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 financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Pursuant to the Dodd-Frank Act, federal banking regulators have adopted new capital rules that became effective January 1, 2014 for advanced approaches banking organizations and will become effective January 1, 2015 for all other covered organizations (subject to certain phase-in periods through January 1, 2019) and that will replace their general risk-based capital rules, advanced approaches rule, market risk rule, and leverage rules. Quantitative measures established by regulation to ensure capital adequacy currently require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations) and of Tier 1 capital to average total assets (as defined in the regulations). As of September 30, 2014 and December 31, 2013, the Company and the Bank met all capital adequacy requirements to which they are subject. As of September 30, 2014 and December 31, 2013, the Bank is "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the tables presented below.

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

| | Actual | | | | Minimum Capital Requirement | | | | Minimum to be Well Capitalized | | | |
|---------------------------------------|------------------------|---------|-------|--------|-----------------------------|---------|-------|-------|--------------------------------|---------|-------|--------|
| | Amount | | Ratio | | Amount | | Ratio | | Amount | | Ratio | |
| | (Dollars in thousands) | | | | | | | | | | | |
| Company Ratios | | | | | | | | | | | | |
| As of September 30, 2014 | | | | | | | | | | | | |
| Total capital to risk-weighted assets | \$ | 858,356 | | 17.50% | \$ | 392,465 | | 8.00% | \$ | 490,581 | | 10.00% |
| | \$ | 782,797 | | 15.96% | \$ | 196,233 | | 4.00% | \$ | 294,349 | | 6.00% |

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| | | | | | | | | | | | | |
|--|----|---------|---------------|----|---------|--------------|----|---------|---------------|--|--|--|
| Tier 1 capital to risk-weighted assets | | | | | | | | | | | | |
| Tier 1 capital to average total assets | \$ | 782,797 | 10.51% | \$ | 297,984 | 4.00% | \$ | 372,480 | 5.00% | | | |
| <u>As of December 31, 2013</u> | | | | | | | | | | | | |
| Total capital to risk-weighted assets | \$ | 827,459 | 16.16% | \$ | 409,514 | 8.00% | \$ | 511,893 | 10.00% | | | |
| Tier 1 capital to risk-weighted assets | \$ | 736,106 | 14.38% | \$ | 204,757 | 4.00% | \$ | 307,136 | 6.00% | | | |
| Tier 1 capital to average total assets | \$ | 736,106 | 9.06% | \$ | 324,910 | 4.00% | \$ | 406,138 | 5.00% | | | |

| | Actual | | Minimum Capital Requirement | | Minimum to be Well Capitalized | | | | |
|--|--------|---------|-----------------------------|-------|--------------------------------|--------------|----|---------|---------------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio | | | |
| (Dollars in thousands) | | | | | | | | | |
| Bank Ratios | | | | | | | | | |
| <u>As of September 30, 2014</u> | | | | | | | | | |
| Total capital to risk-weighted assets | \$ | 813,760 | 16.66% | \$ | 390,644 | 8.00% | \$ | 488,305 | 10.00% |
| Tier 1 capital to risk-weighted assets | \$ | 738,482 | 15.12% | \$ | 195,322 | 4.00% | \$ | 292,983 | 6.00% |
| Tier 1 capital to average total assets | \$ | 738,482 | 9.99% | \$ | 295,673 | 4.00% | \$ | 369,592 | 5.00% |
| <u>As of December 31, 2013</u> | | | | | | | | | |
| Total capital to risk-weighted assets | \$ | 779,413 | 15.30% | \$ | 407,637 | 8.00% | \$ | 509,547 | 10.00% |
| Tier 1 capital to risk-weighted assets | \$ | 688,350 | 13.51% | \$ | 203,819 | 4.00% | \$ | 305,728 | 6.00% |
| Tier 1 capital to average total assets | \$ | 688,350 | 8.54% | \$ | 322,395 | 4.00% | \$ | 402,993 | 5.00% |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Additional Paid-in Capital

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

Treasury Stock

Under the Company's current stock repurchase program it is authorized to purchase in the open market up to \$70 million of its outstanding shares of common stock, of which approximately \$23.2 million of authority remains. The shares of common stock repurchased are to be held by the Company as treasury shares. During the nine-month period ended September 30, 2014, the Company purchased 707,500 shares under this program for a total of \$10.4 million, at an average price of \$14.66 per share. There were no repurchases during 2013.

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

| | Total number of | | | | Dollar amount of | |
|---|---------------------|----------------|-----------|--------------|--------------------|----------------|
| | shares purchased as | | | Average | shares repurchased | |
| | part of stock | | | price paid | (excluding | |
| | repurchase programs | | | per share | commissions paid) | |
| | | | | | | (In thousands) |
| Period | | | | | | |
| January 2014 | | 57,700 | \$ | 14.73 | \$ | 850 |
| February 2014 | | 649,700 | | 14.66 | | 9,522 |
| August 2014 | | 100 | | 15.50 | | 2 |
| Nine-Month Period Ended September 30, 2014 | | 707,500 | \$ | 14.66 | \$ | 10,374 |

The number of shares that may yet be purchased under the \$70 million program is estimated at 1,548,481 and was calculated by dividing the remaining balance of \$23.2 million by \$14.98 (closing price of the Company common stock at September 30, 2014). The Company did not purchase any shares of its common stock other than through its publicly announced stock repurchase program during the nine-months ended September 30, 2014.

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

| | Nine-Month Period Ended September 30, | | | | | | | | |
|---|---------------------------------------|--|-----------|---------------|--------|------------------|--------|-----------|---------------|
| | 2014 | | | | 2013 | | | | |
| | | | Dollar | | | | Dollar | | |
| | Shares | | Amount | | Shares | | Amount | | |
| (In thousands, except shares data) | | | | | | | | | |
| Beginning of period | 7,030,101 | | \$ | 80,642 | | 7,090,597 | | \$ | 81,275 |
| Common shares used upon lapse of restricted stock units | (36,294) | | | (384) | | (53,178) | | | (556) |
| Common shares repurchased as part of the stock repurchase program | 707,500 | | | 10,394 | | - | | | - |
| Common shares used to match defined contribution plan, net | - | | | - | | (7,318) | | | (77) |
| End of period | 7,701,307 | | \$ | 90,652 | | 7,030,101 | | \$ | 80,642 |

| | | | | | | | | | | | | | | |
|--|---------------------------|---------------|-----------------------|----------------|----------------------|---------------|---------------------------|---------------|-----------------------|-----------------|----------------------|---------------|--|--|
| comprehensive income (loss) before reclassifications | | | | | | | | | | | | | | |
| Amounts reclassified out of accumulated other comprehensive income | | 11 | | 1,656 | | 1,667 | | 37 | | 1,651 | | 1,688 | | |
| Other comprehensive income (loss) | | (9,441) | | 1,097 | | (8,344) | | (5,076) | | 142 | | (4,934) | | |
| Ending balance | \$ | 20,318 | \$ | (6,907) | \$ | 13,411 | \$ | 20,324 | \$ | (9,492) | \$ | 10,832 | | |
| Nine-Month Period Ended September 30, | | | | | | | | | | | | | | |
| 2014 | | | | | | | | | | | | | | |
| 2013 | | | | | | | | | | | | | | |
| | Net unrealized | | Net unrealized | | Accumulated | | Net unrealized | | Net unrealized | | Accumulated | | | |
| | gains on | | loss on | | other | | gains on | | loss on | | other | | | |
| | securities | | cash flow | | comprehensive | | securities | | cash flow | | comprehensive | | | |
| | available-for-sale | | hedges | | income | | available-for-sale | | hedges | | income | | | |
| (In thousands) | | | | | | | | | | | | | | |
| Beginning balance | \$ | 11,433 | \$ | (8,242) | \$ | 3,191 | \$ | 68,245 | \$ | (12,365) | \$ | 55,880 | | |
| Other comprehensive income before reclassifications | | 8,727 | | (3,584) | | 5,143 | | (48,047) | | (1,530) | | (49,577) | | |
| Amounts reclassified out of accumulated other comprehensive income | | 158 | | 4,919 | | 5,077 | | 126 | | 4,403 | | 4,529 | | |
| Other comprehensive income (loss) | | 8,885 | | 1,335 | | 10,220 | | (47,921) | | 2,873 | | (45,048) | | |
| Ending balance | \$ | 20,318 | \$ | (6,907) | \$ | 13,411 | \$ | 20,324 | \$ | (9,492) | \$ | 10,832 | | |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents reclassifications out of accumulated other comprehensive income for the quarters and nine-month periods ended September 30, 2014 and 2013:

| | Amount reclassified out of accumulated other comprehensive income | | | | |
|---|--|-----------------------|----|--------------------------------|--|
| | | | | | |
| | | Quarter Ended | | Nine-Month Period | Affected Line Item in |
| | | September 30, 2014 | | Ended September 30, 2014 | Consolidated Statement of Operations |
| | (In thousands) | | | | |
| Cash flow hedges: | | | | | |
| Interest-rate contracts | \$ | 1,656 | \$ | 4,919 | Net interest expense |
| Available-for-sale securities: | | | | | |
| Residual tax effect from OIB's change in applicable tax rate | | 11 | | 158 | Income tax expense |
| | \$ | 1,667 | \$ | 5,077 | |
| | | | | | |
| | | | | | |
| | Amount reclassified out of accumulated other comprehensive income | | | | |
| | | | | | |
| | | Quarter Ended | | Nine-Month Period | Affected Line Item in |
| | | September 30, 2013 | | Ended September 30, 2013 | Consolidated Statement of Operations |
| | (In thousands) | | | | |
| Cash flow hedges: | | | | | |
| Interest-rate contracts | \$ | 1,651 | \$ | 4,403 | Net interest expense |
| Available-for-sale securities: | | | | | |
| Residual tax effect from OIB's change in applicable tax rate | | 37 | | 126 | Income tax expense |
| | \$ | 1,688 | \$ | 4,529 | |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 16 – EARNINGS PER COMMON SHARE

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

| | Quarter ended September 30 , | | | | Nine-Month Period Ended September 30, | | | |
|--|------------------------------|---------------|------|---------------|---------------------------------------|---------------|------|---------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| (In thousands, except per share data) | | | | | | | | |
| Net income | \$ | 19,532 | \$ | 19,621 | \$ | 64,588 | \$ | 78,352 |
| Less: Dividends on preferred stock | | | | | | | | |
| Non-convertible preferred stock (Series A, B, and D) | | (1,627) | | (1,628) | | (4,882) | | (4,884) |
| Convertible preferred stock (Series C) | | (1,838) | | (1,837) | | (5,514) | | (5,512) |
| Income available to common shareholders | \$ | 16,067 | \$ | 16,156 | \$ | 54,192 | \$ | 67,956 |
| Effect of assumed conversion of the convertible preferred stock | | 1,838 | | 1,837 | | 5,514 | | 5,512 |
| Income available to common shareholders assuming conversion | \$ | 17,905 | \$ | 17,993 | \$ | 59,706 | \$ | 73,468 |
| Weighted average common shares and share equivalents: | | | | | | | | |
| Average common shares outstanding | | 45,055 | | 45,927 | | 45,131 | | 45,717 |
| Effect of dilutive securities: | | | | | | | | |
| Average potential common shares-options | | 160 | | 257 | | 162 | | 198 |
| Average potential common shares-assuming conversion of convertible preferred stock | | 7,147 | | 7,138 | | 7,147 | | 7,138 |
| Total weighted average common shares | | 52,362 | | 53,322 | | 52,440 | | 53,053 |

| | | | | | | | | | |
|--|----|-------------|----|-------------|----|-------------|----|-------------|--|
| outstanding and equivalents | | | | | | | | | |
| Earnings per common share - basic | \$ | 0.36 | \$ | 0.35 | \$ | 1.20 | \$ | 1.49 | |
| Earnings per common share - diluted | \$ | 0.34 | \$ | 0.34 | \$ | 1.14 | \$ | 1.39 | |

In computing diluted earnings per common share, the 84,000 shares of convertible preferred stock, which remain outstanding at September 30, 2014, with a conversion rate, subject to certain conditions, of 85.2719 shares of common stock per share, were included as average potential common shares from the date they were issued and outstanding. Moreover, in computing diluted earnings per common share, the dividends declared during the quarters ended September 30, 2014 and 2013 on the convertible preferred stock were added back as income available to common shareholders.

For the quarters ended September 30, 2014 and 2013, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 397,766 and 196,425, respectively. For the nine-month periods ended September 30, 2014 and 2013, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 325,994 and 233,775, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 17 – GUARANTEES

At September 30, 2014, the unamortized balance of the obligations undertaken in issuing the guarantees under standby letters of credit represented a liability of \$37.1 million (December 31, 2013 - \$38.6 million).

As a result of the BBVAPR Acquisition, the Company assumed a liability for residential mortgage loans sold subject to credit recourse, pursuant to FNMA's residential mortgage loan sales and securitization programs. At September 30, 2014 and December 31, 2013, the unpaid principal balance of residential mortgage loans sold subject to credit recourse was \$98.4 million and \$122.3 million, respectively.

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

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|---------------------------------------|-----------------------------|--------------|------|--------------|---------------------------------------|--------------|------|--------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| | (In thousands) | | | | | | | |
| Balance at beginning of period | \$ | 1,310 | \$ | 2,460 | \$ | 1,955 | \$ | 2,460 |
| Net charge-offs/terminations | | (232) | | - | | (877) | | - |
| Balance at end of period | \$ | 1,078 | \$ | 2,460 | \$ | 1,078 | \$ | 2,460 |

The estimated losses to be absorbed under the credit recourse arrangements were recorded as a liability when the credit recourse was assumed, and are updated on a quarterly basis. The expected loss, which represents the amount expected to be lost on a given loan, considers the probability of default and loss severity. The probability of default represents the probability that a loan in good standing would become 120 days delinquent, in which case the Company is obligated to repurchase the loan. At September 30, 2014, \$68.4 million or 70% of the recourse obligation will be extinguished during the next two years.

If a borrower defaults, pursuant to the credit recourse provided, the Company is required to repurchase the loan or reimburse the third party investor for the incurred loss. The maximum potential amount of future payments that the Company would be required to make under the recourse arrangements is equivalent to the total outstanding balance of the residential mortgage loans serviced with recourse and interest, if applicable. During the quarter and nine-month period ended September 30, 2014, the Company repurchased approximately \$1.9 million and \$5.6 million of unpaid principal balance in mortgage loans subject to the credit recourse provisions. If a borrower defaults, the Company has rights to the underlying collateral securing the mortgage loan. The Company suffers losses on these mortgage loans

when the proceeds from a foreclosure sale of the collateral property are less than the outstanding principal balance of the loan, any uncollected interest advanced, and the costs of holding and disposing the related property. At September 30, 2014 and December 31, 2013, the Company's liability for estimated credit losses related to loans sold with credit recourse amounted to \$1.1 million (December 31, 2013 – \$2.0 million).

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

When the Company sells or securitizes mortgage loans, it generally makes customary representations and warranties regarding the characteristics of the loans sold. The Company's mortgage operations division groups conforming mortgage loans into pools which are exchanged for FNMA and GNMA mortgage-backed securities, which are generally sold to private investors, or are sold directly to FNMA or other private investors for cash. As required under such mortgage backed securities programs, quality review procedures are performed by the Company to ensure that asset guideline qualifications are met. To the extent the loans do not meet specified characteristics, the Company may be required to repurchase such loans or indemnify for losses and bear any subsequent loss related to the loans. Repurchases during the quarter and nine-month period ended September 30, 2014 under the Company's representation and warranty arrangements, excluding mortgage loans subject to credit recourse provisions referred to above, approximated \$4.1 million and \$9.2 million, respectively, in unpaid principal balance. A substantial amount of these loans are reinstated to performing status or have mortgage insurance, and thus the ultimate losses on the loans are not deemed significant.

During the quarter and nine-month period ended September 30, 2014, the Company recognized \$115 thousand and \$261 thousand in losses from the repurchase of residential mortgage loans sold subject to credit recourse, and \$979 thousand and \$1.9 million in losses from the repurchase of residential mortgage loans as a result of breaches of the customary representations and warranties. During the quarter and nine-month period ended September 30, 2013, the Company did not recognize any losses from the repurchase of residential mortgage loans sold subject to credit recourse, but for the nine-month period ended September 30, 2013, recognized \$477 thousand in losses from the repurchase of residential mortgage loans as a result of breaches of the customary representations and warranties.

Servicing agreements relating to the mortgage-backed securities programs of FNMA and GNMA, and to mortgage loans sold or serviced to certain other investors, including the Federal Home Loan Mortgage Corporation ("FHLMC"), require the Company to advance funds to make scheduled payments of principal, interest, taxes and insurance, if such payments have not been received from the borrowers. At September 30, 2014, the Company serviced \$1.2 billion in mortgage loans for third-parties. The Company generally recovers funds advanced pursuant to these arrangements from the mortgage owner, from liquidation proceeds when the mortgage loan is foreclosed or, in the case of FHA/VA loans, under the applicable FHA and VA insurance and guarantees programs. However, in the meantime, the Company must absorb the cost of the funds it advances during the time the advance is outstanding. The Company must also bear the costs of attempting to collect on delinquent and defaulted mortgage loans. In addition, if a defaulted loan is not cured, the mortgage loan would be canceled as part of the foreclosure proceedings and the Company would not receive any future servicing income with respect to that loan. At September 30, 2014, the outstanding balance of funds advanced by the Company under such mortgage loan servicing agreements was approximately \$319 thousand (December 31, 2013 - \$243 thousand). To the extent the mortgage loans underlying the Company's servicing portfolio experience increased delinquencies, the Company would be required to dedicate additional cash resources to comply with its obligation to advance funds as well as incur additional administrative costs related to increases in collection efforts.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 18 — COMMITMENTS AND CONTINGENCIES

Loan Commitments

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

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

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

| | September 30, | | December 31, | |
|------------------------------|----------------|---------|--------------|---------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Commitments to extend credit | \$ | 476,523 | \$ | 520,269 |
| Commercial letters of credit | | 1,193 | | 1,096 |

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

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

\$900 thousand at both September 30, 2014 and December 31, 2013.

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | September 30, | | December 31, | |
|--|----------------|--------|--------------|---------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Standby letters of credit and financial guarantees | \$ | 37,145 | \$ | 38,577 |
| Loans sold with recourse | | 98,433 | | 122,291 |
| Commitments to sell or securitize mortgage loans | | 34,650 | | 80,307 |

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

Lease Commitments

The Company has entered into various operating lease agreements for branch facilities and administrative offices. Rent expense for the quarters ended September 30, 2014 and 2013 amounted to \$2.4 million and \$2.5 million, respectively, and is included in the "occupancy and equipment" caption in the unaudited consolidated statements of operations. For the nine-month periods ended September 30, 2014 and 2013, rent expense amounted to \$7.3 million and \$7.7 million, respectively. Future rental commitments under leases in effect at September 30, 2014, exclusive of taxes, insurance, and maintenance expenses payable by the Company, are summarized as follows:

| Year Ending December 31, | Minimum Rent | |
|---------------------------------|----------------|-------|
| | (In thousands) | |
| 2014 (October 1 to December 31) | \$ | 2,221 |
| 2015 | | 8,026 |

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| | | |
|------------|----|---------------|
| 2016 | | 7,435 |
| 2017 | | 6,807 |
| 2018 | | 5,928 |
| Thereafter | | 22,239 |
| | \$ | 52,656 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Contingencies

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

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

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

NOTE 19 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company follows the fair value measurement framework under GAAP.

Fair Value Measurement

The fair value measurement framework defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This framework also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable

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

Money market investments

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

Investment securities

The fair value of investment securities is based on quoted market prices, when available, or market prices provided by recognized broker-dealers. Such securities are classified as level 1 or level 2 depending on the basis for determining fair value. If listed prices or quotes are not available, fair value is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument, and such securities are classified as level 3. At December 31, 2013, the Company held two securities categorized as other debt that are classified as Level 3. At September 30, 2014, the Company did not have securities classified as Level 3. The estimated fair value of the other debt securities was determined by using a third-party model to calculate the present value of projected future cash flows. The assumptions are highly uncertain and include primarily market discount rates, current spreads, and an indicative pricing.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Securities purchased under agreements to resell

The fair value of securities purchased under agreements to resell is based on the carrying amounts reflected in the consolidated statements of financial condition as these are reasonable estimates of fair value given the short-term nature of the instruments.

Derivative instruments

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

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

Servicing assets

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

Loans receivable considered impaired that are collateral dependent

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

Foreclosed real estate

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

Other repossessed assets

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | September 30, 2014 | | | | | | | | | |
|--|-------------------------|-------|---------|-----------|---------|---------|-------|-----------|--|--|
| | Fair Value Measurements | | | | | | | | | |
| | Level 1 | | Level 2 | | Level 3 | | Total | | | |
| | (In thousands) | | | | | | | | | |
| Recurring fair value measurements: | | | | | | | | | | |
| Investment securities available-for-sale | \$ | - | \$ | 1,273,879 | \$ | - | \$ | 1,273,879 | | |
| Money market investments | | 7,777 | | - | | - | | 7,777 | | |
| Derivative assets | | - | | 2,683 | | 5,762 | | 8,445 | | |
| Servicing assets | | - | | - | | 13,986 | | 13,986 | | |
| Derivative liabilities | | - | | (11,414) | | (5,588) | | (17,002) | | |
| | \$ | 7,777 | \$ | 1,265,148 | \$ | 14,160 | \$ | 1,287,085 | | |
| Non-recurring fair value measurements: | | | | | | | | | | |
| Impaired commercial loans | \$ | - | \$ | - | \$ | 226,791 | \$ | 226,791 | | |
| Foreclosed real estate | | - | | - | | 100,564 | | 100,564 | | |
| Other repossessed assets | | - | | - | | 21,733 | | 21,733 | | |
| | \$ | - | \$ | - | \$ | 349,088 | \$ | 349,088 | | |

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarters and nine-month periods ended September 30, 2014 and 2013:

| | Quarter Ended September 30, 2014 | | | | | | | | | |
|---|--|--|--|--|------------------|--|---|--|-----------|--|
| | Other debt securities | | Derivative asset (S&P Purchased Options) | | Servicing assets | | Derivative liability (S&P Embedded Options) | | Total | |
| Level 3 Instruments Only | available-for-sale | | | | | | | | | |
| Balance at beginning of period | \$ - | | \$ 6,580 | | \$ 13,970 | | \$ (6,368) | | \$ 14,182 | |
| Gains (losses) included in earnings | - | | (818) | | - | | 675 | | (143) | |
| New instruments acquired | - | | - | | 554 | | - | | 554 | |
| Principal repayments | - | | - | | (427) | | - | | (427) | |
| Amortization | - | | - | | - | | 105 | | 105 | |
| Changes in fair value of servicing assets | - | | - | | (111) | | - | | (111) | |
| Balance at end of period | \$ - | | \$ 5,762 | | \$ 13,986 | | \$ (5,588) | | \$ 14,160 | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | Nine-Month Period Ended September 30, 2014 | | | | | | | | | |
| Level 3 Instruments Only | available-for-sale | | Derivative asset (S&P Purchased Options) | | Servicing assets | | Derivative liability (S&P Embedded Options) | | Total | |
| Balance at beginning of period | \$ 19,680 | | \$ 16,430 | | \$ 13,801 | | \$ (15,736) | | \$ 34,175 | |
| Gains (losses) included in earnings | - | | (10,668) | | - | | 9,639 | | (1,029) | |
| Changes in fair value of investment | 320 | | - | | - | | - | | 320 | |

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| | | | | | | | | | | | | |
|--|-----------|----------|----------|-----------|--------------|-----------|---------------|-----------|--|----------------|-----------|---------------|
| securities available for sale included | | | | | | | | | | | | |
| in other comprehensive income | | | | | | | | | | | | |
| New instruments acquired | | | - | | - | | 1,608 | | | - | | 1,608 |
| Principal repayments | | (20,000) | | | - | | (799) | | | - | | (20,799) |
| Amortization | | | - | | - | | - | | | 509 | | 509 |
| Changes in fair value of servicing assets | | | - | | - | | (624) | | | - | | (624) |
| Balance at end of period | \$ | | - | \$ | 5,762 | \$ | 13,986 | \$ | | (5,588) | \$ | 14,160 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| Quarter Ended September 30, 2013 | | | | | | | | | | |
|--|--------------------|------------|--|-------------|--|--|--|------------|--|-----------|
| | Other | Derivative | | Derivative | | | | Derivative | | |
| | debt | asset | | liability | | | | (S&P | | |
| | securities | (S&P | | (S&P | | | | Embedded | | |
| Level 3 Instruments | available-for-sale | Purchased | | Embedded | | | | Options) | | |
| Only | | Options) | | Options) | | | | assets | | Total |
| Balance at beginning of period | \$ 20,058 | \$ 16,020 | | \$ (15,315) | | | | \$ 12,994 | | \$ 33,757 |
| Gains (losses) included in earnings | - | 1,921 | | (1,994) | | | | - | | (73) |
| Changes in fair value of investment securities available for sale included in other comprehensive income | (552) | - | | - | | | | - | | (552) |
| New instruments acquired | - | - | | - | | | | 704 | | 704 |
| Principal repayments | - | - | | - | | | | (309) | | (309) |
| Amortization | - | - | | 110 | | | | - | | 110 |
| Changes in fair value of servicing assets | - | - | | - | | | | 262 | | 262 |
| Balance at end of period | \$ 19,506 | \$ 17,941 | | \$ (17,199) | | | | \$ 13,651 | | \$ 33,899 |
| | | | | | | | | | | |
| Nine-Month Period Ended September 30, 2013 | | | | | | | | | | |
| | Other | Derivative | | Derivative | | | | Derivative | | |
| | debt | asset | | liability | | | | (S&P | | |
| | securities | (S&P | | (S&P | | | | Embedded | | |
| | | Purchased | | Options) | | | | assets | | Total |

| Level 3 Instruments Only | available-for-sale | Options) | assets | Options) | Total |
|--|---------------------------|------------------|------------------|--------------------|------------------|
| Balance at beginning of period | \$ 20,012 | \$ 13,233 | \$ 10,795 | \$ (12,707) | \$ 31,333 |
| Gains (losses) included in earnings | - | 4,708 | - | (4,807) | (99) |
| Changes in fair value of investment securities available for sale included in other comprehensive income | (506) | - | - | - | (506) |
| New instruments acquired | - | - | 2,659 | - | 2,659 |
| Principal repayments | - | - | (855) | - | (855) |
| Amortization | - | - | - | 315 | 315 |
| Changes in fair value of servicing assets | - | - | 1,052 | - | 1,052 |
| Balance at end of period | \$ 19,506 | \$ 17,941 | \$ 13,651 | \$ (17,199) | \$ 33,899 |

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | | September 30, 2014 | | | | | |
|---|----------------|--------------------|--------------------------------------|--|--|--|-----------------|
| | Fair Value | | Valuation Technique | | Unobservable Input | | Range |
| | (In thousands) | | | | | | |
| Derivative assets (S&P Purchased Options) | \$ 5,762 | | Option pricing model | | Implied option volatility | | 25.75%-36.88% |
| | | | | | Counterparty credit risk (based on 5-year credit default swap ("CDS") spread) | | 66.90% - 69.11% |
| Servicing assets | \$ 13,986 | | Cash flow valuation | | Constant prepayment rate | | 5.60% - 13.28% |
| | | | | | Discount rate | | 10.00% - 12.00% |
| Derivative liability (S&P Embedded Options) | \$ (5,588) | | Option pricing model | | Implied option volatility | | 25.75%-36.88% |
| | | | | | Counterparty credit risk (based on 5-year CDS spread) | | 66.90% - 69.11% |
| Collateral dependant impaired loans | \$ 26,809 | | Fair value of property or collateral | | Appraised value less disposition costs | | 20.20% - 29.20% |
| Puerto Rico Electric Power | \$ 199,982 | | Cash flow valuation | | Discount rate | | 7.25 |

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| | | | | | | | |
|--------------------------|----|---------|--------------------------------------|--|--|--|-----------------|
| Authority line of credit | | | | | | | |
| Foreclosed real estate | \$ | 100,564 | Fair value of property or collateral | | Appraised value less disposition costs | | 20.20% - 29.20% |
| Other repossessed assets | \$ | 21,733 | Fair value of property or collateral | | Appraised value less disposition costs | | 20.20% - 29.20% |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Information about Sensitivity to Changes in Significant Unobservable Inputs

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

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

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

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

Fair Value of Financial Instruments

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | September 30, | | | | December 31, | | | |
|---|---------------|-----------|----------|-----------|--------------|-----------|----------|-----------|
| | 2014 | | | | 2013 | | | |
| | Fair | | Carrying | | Fair | | Carrying | |
| | Value | | Value | | Value | | Value | |
| (In thousands) | | | | | | | | |
| Level 1 | | | | | | | | |
| Financial Assets: | | | | | | | | |
| Cash and cash equivalents | \$ | 671,239 | \$ | 671,239 | \$ | 621,269 | \$ | 621,269 |
| Restricted cash | | 32,907 | | 32,907 | | 82,199 | | 82,199 |
| Level 2 | | | | | | | | |
| Financial Assets: | | | | | | | | |
| Securities purchased under agreements to resell | | - | | - | | 60,000 | | 60,000 |
| Trading securities | | 1,687 | | 1,687 | | 1,869 | | 1,869 |
| Investment securities available-for-sale | | 1,273,879 | | 1,273,879 | | 1,568,745 | | 1,568,745 |
| Investment securities held-to-maturity | | 144,217 | | 144,305 | | - | | - |
| Federal Home Loan Bank (FHLB) stock | | 21,189 | | 21,189 | | 24,450 | | 24,450 |
| Other investments | | 65 | | 65 | | 65 | | 65 |
| Derivative assets | | 2,683 | | 2,683 | | 4,072 | | 4,072 |
| Financial Liabilities: | | | | | | | | |
| Securities purchased but not yet received | | 30,057 | | 30,057 | | - | | - |
| Derivative liabilities | | 11,414 | | 11,414 | | 14,937 | | 14,937 |
| Level 3 | | | | | | | | |
| Financial Assets: | | | | | | | | |
| Investment securities available-for-sale | | - | | - | | 19,680 | | 19,680 |
| Total loans (including loans held-for-sale) | | | | | | | | |
| Non-covered loans, net | | 4,486,738 | | 4,545,209 | | 4,857,505 | | 4,662,458 |
| Covered loans, net | | 365,503 | | 311,693 | | 459,444 | | 356,961 |
| Derivative assets | | 5,762 | | 5,762 | | 16,430 | | 16,430 |
| FDIC indemnification asset | | 83,995 | | 120,619 | | 152,965 | | 189,240 |
| Accrued interest receivable | | 19,665 | | 19,665 | | 18,734 | | 18,734 |

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| | | | | | | | | | | | |
|--|--|-----------|--|--|-----------|--|--|-----------|--|--|-----------|
| Servicing assets | | 13,986 | | | 13,986 | | | 13,801 | | | 13,801 |
| Financial Liabilities: | | | | | | | | | | | |
| Deposits | | 5,053,119 | | | 5,069,175 | | | 5,409,540 | | | 5,383,265 |
| Securities sold under agreements to repurchase | | 1,058,042 | | | 1,012,228 | | | 1,323,903 | | | 1,267,618 |
| Advances from FHLB | | 340,043 | | | 334,787 | | | 335,324 | | | 336,143 |
| Other borrowings | | 3,865 | | | 3,872 | | | 3,638 | | | 3,663 |
| Subordinated capital notes | | 91,061 | | | 101,190 | | | 99,316 | | | 100,010 |
| Accrued expenses and other liabilities | | 159,541 | | | 159,541 | | | 144,424 | | | 144,424 |
| Derivative liabilities | | 5,588 | | | 5,588 | | | 15,736 | | | 15,736 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

NOTE 20 – BUSINESS SEGMENTS

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

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

| | Quarter Ended September 30, 2014 | | | | | | |
|---|----------------------------------|------------|--------------|--------------|--------------|--------------|--------------|
| | | Wealth | | Total Major | | | Consolidated |
| | Banking | Management | Treasury | Segments | Eliminations | Total | |
| (In thousands) | | | | | | | |
| Interest income | \$ 108,548 | \$ 44 | \$ 11,709 | \$ 120,301 | \$ - | \$ 120,301 | |
| Interest expense | (7,892) | - | (10,538) | (18,430) | - | (18,430) | |
| Net interest income | 100,656 | 44 | 1,171 | 101,871 | - | 101,871 | |
| Provision for non-covered loan and lease losses | (16,142) | - | - | (16,142) | - | (16,142) | |
| Provision for covered loan and lease losses | (1,115) | - | - | (1,115) | - | (1,115) | |
| Non-interest income (loss) | (3,242) | 6,208 | (475) | 2,491 | - | 2,491 | |
| Non-interest expenses | (53,669) | (4,483) | (1,423) | (59,575) | - | (59,575) | |
| Intersegment revenue | 431 | - | 290 | 721 | (721) | - | |
| Intersegment expenses | (290) | (330) | (101) | (721) | 721 | - | |
| Income before income taxes | \$ 26,629 | \$ 1,439 | \$ (538) | \$ 27,530 | \$ - | \$ 27,530 | |
| Total assets | \$ 6,494,141 | \$ 26,800 | \$ 2,098,341 | \$ 8,619,282 | (945,943) | \$ 7,673,339 | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| Quarter Ended September 30, 2013 | | | | | | | |
| | Wealth | | Total Major | | | Consolidated | |
| Banking | Management | Treasury | Segments | Eliminations | Total | | |
| (In thousands) | | | | | | | |
| Interest income | \$ 109,311 | \$ 95 | \$ 11,695 | \$ 121,101 | \$ - | \$ 121,101 | |

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|---|---------------------|------------------|---------------------|---------------------|---------------------|---------------------|
| Interest expense | (10,994) | - | (11,016) | (22,010) | - | (22,010) |
| Net interest income | 98,317 | 95 | 679 | 99,091 | - | 99,091 |
| Provision for non-covered loan and lease losses | (9,900) | - | - | (9,900) | - | (9,900) |
| Provision for covered loan and lease losses | (3,074) | - | - | (3,074) | - | (3,074) |
| Non-interest income (loss) | (3,960) | 7,114 | 169 | 3,323 | - | 3,323 |
| Non-interest expenses | (52,615) | (6,168) | (4,451) | (63,234) | - | (63,234) |
| Intersegment revenue | 562 | - | - | 562 | (562) | - |
| Intersegment expenses | - | (461) | (101) | (562) | 562 | - |
| Income before income taxes | \$ 29,330 | \$ 580 | \$ (3,704) | \$ 26,206 | \$ - | \$ 26,206 |
| Total assets | \$ 6,542,840 | \$ 40,994 | \$ 2,691,621 | \$ 9,275,455 | \$ (895,230) | \$ 8,380,225 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

| | Nine-Month Period Ended September 30, 2014 | | | | | | |
|--|--|-----------------|--------------|------------------|--------------|--|------------------|
| | | Wealth | | Total Major | | | Consolidated |
| | Banking | Management | Treasury | Segments | Eliminations | | Total |
| | (In thousands) | | | | | | |
| Interest income | \$ 330,148 | \$ 132 | \$ 38,995 | \$ 369,275 | \$ - | | \$ 369,275 |
| Interest expense | (26,235) | - | (31,693) | (57,928) | - | | (57,928) |
| Net interest income | 303,913 | 132 | 7,302 | 311,347 | - | | 311,347 |
| Provision for non-covered loan and lease losses | (39,424) | - | - | (39,424) | - | | (39,424) |
| Provision for covered loan and lease losses, net | (4,339) | - | - | (4,339) | - | | (4,339) |
| Non-interest income(loss) | (14,845) | 20,232 | 2,840 | 8,227 | - | | 8,227 |
| Non-interest expenses | (156,867) | (15,629) | (8,331) | (180,827) | - | | (180,827) |
| Intersegment revenue | 1,410 | - | 290 | 1,700 | (1,700) | | - |
| Intersegment expenses | (290) | (1,089) | (321) | (1,700) | 1,700 | | - |
| Income before income taxes | \$ 89,558 | \$ 3,646 | 1,780 | \$ 94,984 | \$ - | | \$ 94,984 |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | Nine-Month Period Ended September 30, 2013 | | | | | | |
| | | Wealth | | Total Major | | | Consolidated |
| | Banking | Management | Treasury | Segments | Eliminations | | Total |
| | (In thousands) | | | | | | |
| Interest income | \$ 325,432 | \$ 277 | \$ 35,865 | \$ 361,574 | \$ - | | \$ 361,574 |
| Interest expense | (31,490) | - | (31,084) | (62,574) | - | | (62,574) |
| Net interest income | 293,942 | 277 | 4,781 | 299,000 | - | | 299,000 |
| Provision for non-covered loan and lease losses | (55,343) | - | - | (55,343) | - | | (55,343) |
| Provision for covered loan and lease losses, net | (4,957) | - | - | (4,957) | - | | (4,957) |
| Non-interest income(loss) | (7,151) | 22,915 | 4,199 | 19,963 | - | | 19,963 |

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| | | | | | | |
|--|------------------|-----------------|-------------------|------------------|-------------|------------------|
| Non-interest expenses | (168,119) | (18,945) | (11,470) | (198,534) | - | (198,534) |
| Intersegment revenue | 1,524 | - | - | 1,524 | (1,524) | - |
| Intersegment expenses | - | (1,247) | (277) | (1,524) | 1,524 | - |
| Income (loss) before income taxes | \$ 59,896 | \$ 3,000 | \$ (2,767) | \$ 60,129 | \$ - | \$ 60,129 |

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

INTRODUCTION

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

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

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

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

OVERVIEW OF FINANCIAL PERFORMANCE

| SELECTED FINANCIAL DATA | | | | | | | | |
|--|--|------------------|--------------|-----------------|--|------------------|---------------|-----------------|
| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
| | | | | Variance | | | | Variance |
| | 2014 | 2013 | % | | 2014 | 2013 | % | |
| EARNINGS DATA: | (In thousands, except per share data) | | | | | | | |
| Interest income | \$ 120,301 | \$ 121,101 | -0.7% | | \$ 369,275 | \$ 361,574 | 2.1% | |
| Interest expense | 18,430 | 22,010 | -16.3% | | 57,928 | 62,574 | -7.4% | |
| Net interest income | 101,871 | 99,091 | 2.8% | | 311,347 | 299,000 | 4.1% | |
| Provision for non-covered loan and lease losses | 16,142 | 9,900 | 63.1% | | 39,424 | 55,343 | -28.8% | |
| Provision for covered loan and lease losses, net | 1,115 | 3,074 | -63.7% | | 4,339 | 4,957 | -12.5% | |
| Total provision for loan and lease losses, net | 17,257 | 12,974 | 33.0% | | 43,763 | 60,300 | -27.4% | |
| Net interest income after provision for loan and lease losses | 84,614 | 86,117 | -1.7% | | 267,584 | 238,700 | 12.1% | |
| Non-interest income | 2,491 | 3,323 | -25.0% | | 8,227 | 19,963 | -58.8% | |
| Non-interest expenses | 59,575 | 63,234 | -5.8% | | 180,827 | 198,534 | -8.9% | |
| Income before taxes | 27,530 | 26,206 | 5.1% | | 94,984 | 60,129 | 58.0% | |
| Income tax expense (benefit) | 7,998 | 6,585 | 21.5% | | 30,396 | (18,223) | 266.8% | |
| Net income | 19,532 | 19,621 | -0.5% | | 64,588 | 78,352 | -17.6% | |
| Less: dividends on preferred stock | (3,465) | (3,465) | 153.0% | | (10,396) | (10,396) | 153.0% | |
| Income available to common shareholders | \$ 16,067 | \$ 16,156 | -0.6% | | \$ 54,192 | \$ 67,956 | -20.3% | |
| PER SHARE DATA: | | | | | | | | |
| Basic | \$ 0.36 | \$ 0.35 | 2.9% | | \$ 1.20 | \$ 1.49 | -19.5% | |
| Diluted | \$ 0.34 | \$ 0.34 | 0.0% | | \$ 1.14 | \$ 1.39 | -18.0% | |
| Average common shares outstanding | 45,054 | 45,927 | -1.9% | | 45,170 | 45,613 | -1.0% | |
| Average common shares outstanding and equivalents | 52,362 | 53,322 | -1.8% | | 52,440 | 53,053 | -1.2% | |
| | \$ 0.08 | \$ 0.06 | 33.3% | | \$ 0.24 | \$ 0.18 | 33.3% | |

| | | | | | | | | | | | | | |
|--|----|--------|----|--------|-------|----|--------|----|--------|--------|--|--|--|
| Cash dividends declared per common share | | | | | | | | | | | | | |
| Cash dividends declared on common shares | \$ | 3,605 | \$ | 2,740 | 31.6% | \$ | 10,822 | \$ | 8,219 | 31.7% | | | |
| PERFORMANCE RATIOS: | | | | | | | | | | | | | |
| Return on average assets (ROA) | | 1.02% | | 0.93% | 9.7% | | 1.10% | | 1.22% | -9.8% | | | |
| Return on average tangible common equity | | 9.78% | | 10.71% | -8.7% | | 11.17% | | 15.12% | -26.1% | | | |
| Return on average common equity (ROE) | | 8.52% | | 9.20% | -7.4% | | 9.71% | | 12.96% | -25.1% | | | |
| Equity-to-assets ratio | | 12.12% | | 10.48% | 15.6% | | 12.13% | | 10.48% | 15.8% | | | |
| Efficiency ratio | | 49.30% | | 52.27% | -5.7% | | 49.10% | | 53.97% | -9.0% | | | |
| Interest rate spread | | 5.78% | | 5.28% | 9.5% | | 5.85% | | 5.28% | 10.8% | | | |
| Interest rate margin | | 5.84% | | 5.28% | 10.6% | | 5.90% | | 5.28% | 11.7% | | | |

| SELECTED FINANCIAL DATA - (Continued) | | | | | | |
|--|--|------------------|---------------------|------------------|-----------------|---------------|
| | September 30, | | December 31, | | Variance | |
| | 2014 | | 2013 | | % | |
| PERIOD END BALANCES AND CAPITAL RATIOS: | (In thousands, except per share data) | | | | | |
| Investments and loans | | | | | | |
| Investment securities | \$ | 1,441,125 | \$ | 1,614,809 | | -10.8% |
| Loans and leases not covered under shared-loss agreements with the FDIC, net | | 4,545,209 | | 4,662,458 | | -2.5% |
| Loans and leases covered under shared-loss agreements with the FDIC, net | | 311,693 | | 356,961 | | -12.7% |
| Total investments and loans | \$ | 6,298,027 | \$ | 6,634,228 | | -5.1% |
| Deposits and borrowings | | | | | | |
| Deposits | \$ | 5,069,175 | \$ | 5,383,265 | | -5.8% |
| Securities sold under agreements to repurchase | | 1,012,228 | | 1,267,618 | | -20.1% |
| Other borrowings | | 439,849 | | 439,816 | | 0.0% |
| Total deposits and borrowings | \$ | 6,521,252 | \$ | 7,090,699 | | -8.0% |
| Stockholders' equity | | | | | | |
| Preferred stock | \$ | 176,000 | \$ | 176,000 | | 0.0% |
| Common stock | | 52,761 | | 52,707 | | 0.1% |
| Additional paid-in capital | | 539,522 | | 538,071 | | 0.3% |
| Legal surplus | | 68,437 | | 61,957 | | 10.5% |
| Retained earnings | | 170,519 | | 133,629 | | 27.6% |
| Treasury stock, at cost | | (90,652) | | (80,642) | | -12.4% |
| Accumulated other comprehensive income | | 13,411 | | 3,191 | | 320.3% |
| Total stockholders' equity | \$ | 929,998 | \$ | 884,913 | | 5.1% |
| Per share data | | | | | | |
| Book value per common share | \$ | 16.96 | \$ | 15.74 | | 7.8% |
| Tangible book value per common share | \$ | 14.82 | \$ | 13.60 | | 9.0% |
| Market price at end of period | \$ | 14.98 | \$ | 17.34 | | -13.6% |
| Capital ratios | | | | | | |
| Leverage capital | | 10.51% | | 9.06% | | 16.0% |
| Tier 1 risk-based capital | | 15.96% | | 14.38% | | 11.0% |
| Total risk-based capital | | 17.50% | | 16.16% | | 8.3% |
| Tier 1 common equity to risk-weighted assets | | 11.86% | | 10.46% | | 13.4% |
| Financial assets managed | | | | | | |
| Trust assets managed | \$ | 2,851,815 | \$ | 2,796,923 | | 2.0% |
| Broker-dealer assets gathered | \$ | 2,483,611 | \$ | 2,493,324 | | -0.4% |

FINANCIAL HIGHLIGHTS OF THE THIRD QUARTER OF 2014

The Company achieved performance equal to the year ago quarter despite weaker economic conditions in Puerto Rico. As such, the increase in the Company's provision for loan and leases and its decreases in interest and non-interest income were substantially offset by decreases in the Company's interest and non-interest expenses. Income available to common shareholders for the quarter ended September 30, 2014 was \$16.1 million, or \$0.34 per diluted share, compared to \$16.2 million, or \$0.34 per diluted share, in the third quarter of 2013.

Net interest margin expanded to 5.84% from 5.28% primarily as a result of an increase in the yield of the Company's interest earning assets.

The Company's return on assets increased to 1.02% from 0.93%, and its return on equity decreased to 8.52% from 9.20%, from the third quarter of 2013. The Company improved its efficiency ratio, which decreased to 49.30% from 52.27% when compared with the same quarter in 2013, primarily as a result of a decrease in the Company's non-interest expenses.

Interest Income

Total interest income remained level at \$120.3 million, compared to \$121.1 million in the third quarter of 2013. The yield on interest-earning assets increased to 6.89% from 6.46%. This was offset by a decrease in earning asset volume.

Interest Expense

Total interest expense decreased 16.3% as compared to the same period in 2013. Such decrease reflects the lower cost of deposits before fair value premium amortization and core deposit intangible amortization (0.68% vs. 0.93%). Such lower cost reflects continuing progress in the repricing of the Company's core retail deposits and other reductions in its cost of funds.

Net Interest Income

Net interest income increased \$2.8 million for the third quarter of 2014. Such increase reflects an increase in net interest margin of 56 basis points to 5.84% when compared to the third quarter of 2013.

Provision for Loan and Lease Losses

Provision for non-covered loan losses increased \$6.2 million when compared to \$9.9 million for the third quarter of 2013, while provision for covered loan losses decreased \$2.0 million when compared to \$3.1 million for the same period in 2013.

Non-Interest Income

Core banking and financial services revenues decreased 13.3% to \$19.0 million as compared to the same period in 2013, primarily reflecting a decrease of \$2.4 million in banking services revenue to \$9.8 million. Decrease in banking services revenues is mostly due to the reclassification of loan late charges into interest income during the last quarter of 2013. For the quarter ended September 30, 2013 these revenues were included as part of banking activities, since the reclassification was not reflected until late 2013.

The FDIC shared-loss expense of \$16.9 million, compared to \$16.0 million for the same period in 2013, resulted from the ongoing evaluation of expected cash flows of the covered loan portfolio, which resulted in reduced projected losses expected to be collected from the FDIC and the improved accretable yield on the covered loans.

Non-Interest Expense

Non-interest expense of \$59.6 million, decreased \$3.7 million compared to the same period in 2013, mainly because during the third quarter of 2014, there were no merger and restructuring charges compared to \$2.3 million for the same period in 2013. As a result of such decrease, the Company's efficiency ratio improved to 49.30%, compared to 52.27% for the same period in 2013.

Income Tax Expense

Income tax expense was \$8.0 million, compared to an income tax expense of \$6.6 million for the same period in 2013.

Income Available to Common Shareholders

The Company's income available to common shareholders amounted to \$16.1 million, compared to \$16.2 million for the same period in 2013. Income per basic common share and fully diluted common share was \$0.36 and \$0.34, respectively, compared to income per basic common share and fully diluted common share of \$0.35 and \$0.34, respectively, for the third quarter of 2013.

Interest Earning Assets

The loan portfolio declined to \$4.857 billion at September 30, 2014, compared to \$4.936 billion at June 30, 2014, primarily due to repayments and maturities, including the strategic reduction of Puerto Rico government related debt. The investment portfolio of \$1.441 billion at September 30, 2014 decreased 2.2% compared to \$1.472 billion at June 30, 2014.

Interest Bearing Liabilities

Total deposits amounted to \$5.069 billion at September 30, 2014, a decrease of 1.4% compared to \$5.141 billion at June 30, 2014. Securities sold under agreements to repurchase remained at \$1.012 billion.

Stockholders' Equity

Stockholders' equity at September 30, 2014 was \$930.0 million compared to \$925.2 million at June 30, 2014, an increase of 0.52%. This increase reflects the net income for the quarter partially offset by a decrease in accumulated other comprehensive income. Book value per share was \$16.96 at September 30, 2014 compared to \$16.87 at June 30, 2014.

The Company maintains capital ratios in excess of regulatory requirements. At September 30, 2014, Tier 1 Leverage Capital Ratio was 10.51% (June 30, 2014 – 10.26%), Tier 1 Risk-Based Capital Ratio was 15.96% (June 30, 2014 – 15.49%), Tier 1 Common Equity to Risk- Based Assets was 11.86% (June 30, 2014-11.47%) and Total Risk-Based Capital Ratio was 17.50% (June 30, 2014 – 17.30%).

Return on Average Assets and Common Equity

Return on average common equity (“ROE”) was 8.52% compared to 9.20% for the quarter ended September 30, 2013. Return on average assets (“ROA”) was 1.02% compared to 0.93% for the same period in 2013. The decrease in ROE is mostly due to a 7.3% increase in average common stockholders’ equity to \$753.9 million, from \$702.4 million for the same period in 2013. The increase in ROA is mostly due to a 9.2% decrease in average assets to \$7.646 billion from \$8.424 billion in the same period in 2013.

Assets under Management

At September 30, 2014, total assets managed by the Company’s trust division and CPC remained level at \$2.852 billion compared to \$2.867 billion at June 30, 2014. At September 30, 2014, total assets gathered by the securities broker-dealer subsidiary from its customer investment accounts decreased 6.3% to \$2.484 billion, compared to \$2.651 billion at June 30, 2014. Changes in trust and broker-dealer related assets primarily reflect a slight increase in portfolio and differences in market values.

Lending

Total loan production of \$242.6 million decreased 55.9% for the third quarter of 2014. Total commercial loan production of \$90.1 million decreased 75.3% from \$365.3 million for the same period in 2013.

Mortgage loan production of \$55.3 million decreased 8.9% from the same period in 2013. The Company sells most of its conforming mortgage loans in the secondary market and retains the servicing rights.

In the aggregate, consumer loan and auto and leasing production totaled \$97.2 million, a decrease of 21.3% from the same period in 2013. Such decrease is mostly due to a decrease in auto and leasing production.

Total loan portfolio declined by \$79.1 million from \$4.936 billion at June 30, 2014 to \$4.857 billion at September 30, 2014, mostly as the result of scheduled pay downs and maturities in both the non-covered and covered loan portfolios.

Credit Quality on Non-Covered Loans

Net credit losses, excluding acquired loans, increased \$3.9 million to \$8.9 million, representing 1.34% of average non-acquired loans outstanding versus 1.02% in the same period in 2013. The allowance for loan and lease losses on non-covered loans at September 30, 2014, increased to \$64.9 million compared to \$60.4 million at June 30, 2014. The allowances for loan and lease losses, excluding acquired loans, increased to \$50.3 million (1.84% of total non-covered loans, excluding acquired loans) at September 30, 2014, compared to \$50.6 million (1.92% of total non-covered loans, excluding acquired loans) at June 30, 2014. The allowance for loan and lease losses on acquired loans accounted for under ASC 310-20 increased to \$4.5 million at September 30, 2014, compared to \$3.4 million at June 30, 2014.

Non-performing loans (“NPLs”), which exclude loans covered under shared-loss agreements with the FDIC and loans acquired in the BBVAPR Acquisition accounted under ASC 310-30, increased to \$103.7 million at September 30, 2014 compared to \$94.1 million at June 30, 2014. The increase is due mainly to an increase in non-performing mortgage and auto loans.

Non-GAAP Measures

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

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

During the quarter ended September 30, 2014, the Company's pre-tax pre-provision operating income increased 2.1% to \$61.3 million as compared to \$60.0 million for the same period in 2013. Pre-tax pre-provision operating income is calculated as follows:

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|--|-----------------------------|---------------|------|---------------|---------------------------------------|----------------|------|----------------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| | (In thousands) | | | | (In thousands) | | | |
| <u>PRE-TAX PRE-PROVISION OPERATING INCOME</u> | | | | | | | | |
| Net interest income | \$ | 101,871 | \$ | 99,091 | \$ | 311,347 | \$ | 299,000 |
| Core non-interest income: | | | | | | | | |
| Banking service revenue | | 9,753 | | 12,146 | | 30,305 | | 36,491 |
| Financial service revenue | | 7,113 | | 7,394 | | 21,316 | | 23,084 |
| Mortgage banking activities | | 2,097 | | 2,334 | | 5,346 | | 9,299 |
| Total core non-interest income | | 18,963 | | 21,874 | | 56,967 | | 68,874 |
| Non-interest expenses | | 59,575 | | 63,234 | | 180,827 | | 198,533 |
| Less merger and restructuring charges | | - | | (2,252) | | - | | (13,060) |
| | | 59,575 | | 60,982 | | 180,827 | | 185,473 |
| Total pre-tax pre-provision operating income | \$ | 61,259 | \$ | 59,983 | \$ | 187,487 | \$ | 182,401 |

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

At September 30, 2014, tangible common equity to total assets and tangible common equity to risk-weighted assets increased to 8.71% and 13.64%, respectively, from 8.59% and 13.26%, respectively, at June 30, 2014. Total equity to risk-weighted assets and Tier 1 common equity to risk-weighted assets at September 30, 2014 increased to 18.99% and 11.89%, respectively, from 18.52% and 11.47%, respectively, at June 30, 2014.

Ratios calculated based upon Tier 1 common equity have become a focus of regulators and investors, and management believes ratios based on Tier 1 common equity assist investors in analyzing the Company's capital

position. Furthermore, management and many stock analysts use tangible common equity in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations. Neither Tier 1 common equity nor tangible common equity or related measures should be considered in isolation or as a substitute for stockholders' equity, total assets or any other measure calculated in accordance with GAAP.

ANALYSIS OF RESULTS OF OPERATIONS

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

| TABLE 1 - QUARTERLY ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE | | | | | | | | | | | | |
|---|-----------|---------|-----------|---------|--------------|-------|-----------|-----------|-----------------|-----------|-----------|--|
| FOR THE QUARTERS ENDED SEPTEMBER 30, 2014 AND 2013 | | | | | | | | | | | | |
| | Interest | | | | Average rate | | | | Average balance | | | |
| | September | | September | | September | | September | | September | | September | |
| | 2014 | | 2013 | | 2014 | | 2013 | | 2014 | | 2013 | |
| (Dollars in thousands) | | | | | | | | | | | | |
| A - TAX EQUIVALENT SPREAD | | | | | | | | | | | | |
| Interest-earning assets | \$ | 120,301 | \$ | 121,101 | 6.89% | 6.46% | \$ | 6,923,413 | \$ | 7,438,957 | | |
| Tax equivalent adjustment | | 20,435 | | 6,092 | 1.17% | 0.32% | | - | | - | | |
| Interest-earning assets - tax equivalent | | 140,736 | | 127,193 | 8.07% | 6.78% | | 6,923,413 | | 7,438,957 | | |
| Interest-bearing liabilities | | 18,430 | | 22,011 | 1.11% | 1.18% | | 6,571,666 | | 7,389,043 | | |
| Tax equivalent net interest income / spread | | 122,306 | | 105,182 | 6.96% | 5.61% | | 351,747 | | 49,914 | | |
| Tax equivalent interest rate margin | | | | | 7.01% | 5.61% | | | | | | |
| B - NORMAL SPREAD | | | | | | | | | | | | |
| Interest-earning assets: | | | | | | | | | | | | |
| Investments: | | | | | | | | | | | | |
| Investment securities | | 11,399 | | 11,520 | 3.26% | 2.59% | | 1,388,535 | | 1,761,477 | | |
| Trading securities | | 38 | | 28 | 9.49% | 4.21% | | 1,589 | | 2,641 | | |
| Interest bearing cash and money market investments | | 316 | | 241 | 0.21% | 0.18% | | 593,391 | | 538,094 | | |

| | | | | | | | | |
|--|----------------|--|----------------|---------------|---------------|------------------|--|------------------|
| Total investments | 11,753 | | 11,789 | 2.35% | 2.03% | 1,983,515 | | 2,302,212 |
| Loans not covered under shared-loss agreements with the FDIC: | | | | | | | | |
| Originated | | | | | | | | |
| Mortgage | 10,287 | | 11,007 | 5.17% | 5.72% | 789,204 | | 763,929 |
| Commercial | 16,538 | | 10,126 | 5.51% | 4.71% | 1,190,607 | | 852,395 |
| Consumer | 4,142 | | 2,331 | 10.20% | 9.46% | 161,147 | | 97,738 |
| Auto and leasing | 13,739 | | 7,216 | 10.25% | 10.54% | 531,914 | | 271,727 |
| Total originated non-covered loans | 44,706 | | 30,680 | 6.64% | 6.13% | 2,672,872 | | 1,985,790 |
| Acquired | | | | | | | | |
| Mortgage | 9,627 | | 11,062 | 5.58% | 5.75% | 684,536 | | 763,032 |
| Commercial | 18,643 | | 26,438 | 11.83% | 9.87% | 625,472 | | 1,063,226 |
| Consumer | 3,731 | | 5,052 | 13.88% | 12.38% | 106,640 | | 161,948 |
| Auto | 10,955 | | 14,423 | 8.38% | 7.19% | 518,599 | | 796,047 |
| Total acquired non-covered loans | 42,956 | | 56,975 | 8.81% | 8.12% | 1,935,247 | | 2,784,252 |
| Total non-covered loans | 87,662 | | 87,655 | 7.55% | 7.29% | 4,608,119 | | 4,770,042 |
| Loans covered under shared loss agreements with the FDIC | 20,886 | | 21,657 | 24.98% | 23.43% | 331,779 | | 366,703 |
| Total loans | 108,548 | | 109,312 | 8.72% | 8.44% | 4,939,898 | | 5,136,745 |
| Total interest earning assets | 120,301 | | 121,101 | 6.89% | 6.46% | 6,923,413 | | 7,438,957 |

| | Interest | | | | Average rate | | | | Average balance | | | | |
|--|------------------------|----------------|-----------|---------------|--------------|--------------|-----------|--------------|-----------------|------------------|-----------|--|------------------|
| | September | | September | | September | | September | | September | | September | | |
| | 2014 | | 2013 | | 2014 | | 2013 | | 2014 | | 2013 | | |
| | (Dollars in thousands) | | | | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | | | | | |
| Deposits: | | | | | | | | | | | | | |
| Non-interest bearing deposits | | - | | - | | 0.00% | | 0.00% | | 716,681 | | | 855,094 |
| Now Accounts | | 1,817 | | 2,778 | | 0.51% | | 0.80% | | 1,413,776 | | | 1,383,070 |
| Savings and money market | | 1,780 | | 2,313 | | 0.61% | | 0.97% | | 1,154,712 | | | 941,892 |
| Individual retirement accounts | | 906 | | 1,161 | | 1.12% | | 1.32% | | 320,756 | | | 350,207 |
| Retail certificates of deposits | | 1,620 | | 2,747 | | 1.36% | | 1.67% | | 473,456 | | | 651,224 |
| Total core deposits | | 6,123 | | 8,999 | | 0.60% | | 0.85% | | 4,079,381 | | | 4,181,487 |
| Institutional deposits | | 1,244 | | 2,622 | | 1.48% | | 1.55% | | 334,121 | | | 673,064 |
| Brokered deposits | | 1,400 | | 1,679 | | 0.79% | | 0.83% | | 700,256 | | | 799,723 |
| Total wholesale deposits | | 2,644 | | 4,301 | | 1.01% | | 1.16% | | 1,034,377 | | | 1,472,787 |
| Deposits fair value premium amortization | | (1,441) | | (2,382) | | 0.00% | | 0.00% | | - | | | - |
| Core deposit intangible amortization | | 335 | | 416 | | 0.00% | | 0.00% | | - | | | - |
| Total deposits | | 7,661 | | 11,334 | | 0.59% | | 0.80% | | 5,113,758 | | | 5,654,274 |
| Borrowings: | | | | | | | | | | | | | |
| Securities sold under agreements to repurchase | | 7,453 | | 7,211 | | 2.93% | | 2.26% | | 1,010,000 | | | 1,268,544 |
| Advances from FHLB and other borrowings | | 2,314 | | 2,321 | | 2.65% | | 2.51% | | 346,977 | | | 366,964 |
| Subordinated capital notes | | 1,002 | | 1,144 | | 3.94% | | 4.57% | | 100,931 | | | 99,261 |
| Total borrowings | | 10,769 | | 10,676 | | 2.93% | | 2.44% | | 1,457,908 | | | 1,734,769 |
| Total interest bearing liabilities | | 18,430 | | 22,010 | | 1.11% | | 1.18% | | 6,571,666 | | | 7,389,043 |
| Net interest income / spread | \$ | 101,871 | \$ | 99,091 | | 5.78% | | 5.28% | | | | | |
| Interest rate margin | | | | | | 5.84% | | 5.28% | | | | | |
| Excess of average interest-earning | | | | | | | | | \$ | 351,747 | \$ | | 49,913 |

| TABLE 1/A - YEAR-TO-DATE ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE | | | | | | | | | | | | |
|--|------------------|---------|------------------|---------|---------------------|-------|------------------|-----------|------------------------|-----------|------------------|--|
| FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2014 AND 2013 | | | | | | | | | | | | |
| | Interest | | | | Average rate | | | | Average balance | | | |
| | September | | September | | September | | September | | September | | September | |
| | 2014 | | 2013 | | 2014 | | 2013 | | 2014 | | 2013 | |
| (Dollars in thousands) | | | | | | | | | | | | |
| A - TAX EQUIVALENT SPREAD | | | | | | | | | | | | |
| Interest-earning assets | \$ | 369,275 | \$ | 361,574 | 7.00% | 6.39% | \$ | 7,051,561 | \$ | 7,569,249 | | |
| Tax equivalent adjustment | | 38,290 | | 18,132 | 0.73% | 0.32% | | - | | - | | |
| Interest-earning assets - tax equivalent | | 407,565 | | 379,706 | 7.73% | 6.71% | | 7,051,561 | | 7,569,249 | | |
| Interest-bearing liabilities | | 57,929 | | 62,572 | 1.15% | 1.11% | | 6,741,332 | | 7,551,043 | | |
| Tax equivalent net interest income / spread | | 349,636 | | 317,134 | 6.58% | 5.61% | | 310,229 | | 18,206 | | |
| Tax equivalent interest rate margin | | | | | 6.63% | 5.60% | | | | | | |
| B - NORMAL SPREAD | | | | | | | | | | | | |
| Interest-earning assets: | | | | | | | | | | | | |
| Investments: | | | | | | | | | | | | |
| Investment securities | | 38,088 | | 35,255 | 3.48% | 2.44% | | 1,464,938 | | 1,933,834 | | |
| Trading securities | | 114 | | 78 | 8.56% | 6.21% | | 1,780 | | 1,679 | | |
| Interest bearing cash and money market investments | | 951 | | 791 | 0.22% | 0.19% | | 580,872 | | 562,961 | | |
| Total investments | | 39,153 | | 36,124 | 2.56% | 1.93% | | 2,047,590 | | 2,498,474 | | |
| Loans not covered under shared-loss agreements | | | | | | | | | | | | |
| with the FDIC: | | | | | | | | | | | | |
| Originated | | | | | | | | | | | | |

| | | | | | | | | |
|---|----------------|--|----------------|---------------|---------------|------------------|--|------------------|
| Mortgage | 31,085 | | 32,945 | 5.28% | 5.62% | 786,434 | | 783,172 |
| Commercial | 47,335 | | 21,063 | 5.39% | 7.36% | 1,174,220 | | 382,654 |
| Consumer | 10,923 | | 5,274 | 10.03% | 10.30% | 145,659 | | 68,480 |
| Auto and leasing | 37,378 | | 15,136 | 10.44% | 13.96% | 478,592 | | 144,995 |
| Total originated non-covered loans | 126,721 | | 74,418 | 6.55% | 7.21% | 2,584,905 | | 1,379,302 |
| Acquired | | | | | | | | |
| Mortgage | 28,359 | | 33,370 | 5.43% | 5.74% | 698,762 | | 777,229 |
| Commercial | 56,315 | | 88,679 | 11.11% | 8.29% | 677,570 | | 1,430,953 |
| Consumer | 11,939 | | 16,354 | 13.60% | 11.96% | 117,379 | | 182,806 |
| Auto | 37,635 | | 46,745 | 8.65% | 6.77% | 581,888 | | 923,135 |
| Total acquired non-covered loans | 134,248 | | 185,148 | 8.65% | 7.47% | 2,075,599 | | 3,314,122 |
| Total non-covered loans | 260,969 | | 259,566 | 7.49% | 7.39% | 4,660,504 | | 4,693,425 |
| Loans covered under shared loss agreements with the FDIC | 69,153 | | 65,884 | 26.92% | 23.34% | 343,467 | | 377,350 |
| Total loans | 330,122 | | 325,450 | 8.82% | 8.58% | 5,003,971 | | 5,070,775 |
| Total interest earning assets | 369,275 | | 361,574 | 7.00% | 6.39% | 7,051,561 | | 7,569,249 |

| | Interest | | | | Average rate | | Average balance | | | |
|--|------------------------|-------------------|-----------|---|--------------|--------------|------------------|------------------|-----------|--|
| | September | | September | | September | September | September | | September | |
| | 2014 | | 2013 | | 2014 | 2013 | 2014 | | 2013 | |
| | (Dollars in thousands) | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | | |
| Deposits: | | | | | | | | | | |
| Non-interest bearing deposits | - | - | - | - | 0.00% | 0.00% | 707,519 | 797,378 | | |
| Now Accounts | 6,349 | 8,486 | | | 0.59% | 0.81% | 1,438,818 | 1,408,649 | | |
| Savings and money market | 6,268 | 7,134 | | | 0.73% | 1.06% | 1,150,871 | 898,619 | | |
| Individual retirement accounts | 2,904 | 3,696 | | | 1.17% | 1.36% | 331,283 | 362,032 | | |
| Retail certificates of deposits | 5,301 | 8,788 | | | 1.40% | 1.79% | 506,653 | 658,080 | | |
| Total core deposits | 20,822 | 28,104 | | | 0.67% | 0.91% | 4,135,144 | 4,124,758 | | |
| Institutional deposits | 3,942 | 7,982 | | | 1.44% | 1.62% | 366,167 | 657,818 | | |
| Brokered deposits | 4,384 | 5,458 | | | 0.81% | 0.87% | 720,208 | 837,916 | | |
| | 8,326 | 13,440 | | | 1.02% | 1.20% | 1,086,375 | 1,495,734 | | |
| Deposits fair value premium amortization | (4,349) | (12,032) | | | 0.00% | 0.00% | - | - | | |
| Core deposit intangible amortization | 1,005 | 1,244 | | | 0.00% | 0.00% | - | - | | |
| Total deposits | 25,804 | 30,756 | | | 0.66% | 0.73% | 5,221,519 | 5,620,492 | | |
| Borrowings: | | | | | | | | | | |
| Securities sold under agreements to repurchase | 22,237 | 21,570 | | | 2.81% | 2.09% | 1,058,378 | 1,382,670 | | |
| Advances from FHLB and other borrowings | 6,897 | 5,366 | | | 2.56% | 1.74% | 360,884 | 412,313 | | |
| FDIC-guaranteed term notes | - | 909 | | | 0.00% | 5.56% | - | 21,875 | | |
| Subordinated capital notes | 2,990 | 3,973 | | | 3.98% | 4.67% | 100,551 | 113,693 | | |
| Total borrowings | 32,124 | 31,818 | | | 2.83% | 2.20% | 1,519,813 | 1,930,551 | | |
| Total interest bearing liabilities | 57,928 | 62,574 | | | 1.15% | 1.11% | 6,741,332 | 7,551,043 | | |
| Net interest income / spread | \$ 311,347 | \$ 299,000 | | | 5.85% | 5.28% | | | | |
| Interest rate margin | | | | | 5.90% | 5.28% | | | | |

Net Interest Income

Comparison of quarters ended September 30, 2014 and 2013

Net interest income of \$101.9 million slightly increased 2.8% compared with \$99.1 million reported in the third quarter of 2013, reflecting a decrease of 16.3% in interest expense partially offset by a slight decrease of 0.7% in interest income from loans.

Interest rate spread increased to 50 basis points from 5.28% to 5.78%. This increase is mainly due to the net effect of a 43 basis point increase in the average yield of interest-earning assets from 6.46% to 6.89%, and a 7 basis point decrease in the average cost of funds from 1.18% to 1.11%.

Interest income decreased to \$120.3 million from \$121.1 million in the same quarter in 2013. Such decrease reflects a \$6.7 million decrease in the volume of interest-earning assets partially offset by an increase of \$5.9 million in interest rate. Interest income from loans decreased 0.7% to \$108.5 million, primarily reflecting a decrease in volume of \$5.0 million, partially offset by \$4.3 million in interest rate. Interest income from investments remained level at \$11.8 million in both periods.

Interest expense decreased 16.3% to \$18.4 million, primarily because of a \$2.7 million decrease in the volume of interest-bearing liabilities and a decrease of \$891 thousand in interest rate. The decrease in interest-bearing liabilities is mostly due to the decrease in repurchase agreements volume of \$1.5 million, and a decrease in deposits volume of \$1.1 million and interest rate of \$2.6 million. The cost of deposits before fair value amortization and core deposit intangible amortization decreased 25 basis points to 0.68% for the third quarter of 2014, compared to 0.93% for the third quarter of 2013. The decrease in the cost of deposits was partially offset by an increase in the cost of borrowings, which increased 49 basis points to 2.93% from 2.44%.

The average balance of total interest-earning assets was \$6.923 billion, a decrease of 6.9% from the same period in 2013. The decrease in average balance of interest-earning assets was mainly attributable to a decrease of 13.8% in average investments, resulting from redemptions and maturities during 2014. The average yield on interest-earning assets was 6.89% compared to 6.46% for the same quarter in 2013. This was mainly due to higher average yields in the loan portfolio, which increased to 8.72% from 8.44%, and in the investment portfolio, which increased to 2.35% from 2.03%.

Comparison of nine-month periods ended September 30, 2014 and 2013

Net interest income increased 4.1% to \$311.3 million as compared to \$299.0 million for the same period in 2013. The change reflects a decrease of 7.4% in interest expense and increases of 1.4% in interest income from loans and 8.4% in interest income from investment securities.

Interest rate spread increased 57 basis points to 5.85% from 5.28% in the same period for 2013. This increase is mainly due to the net effect of a 61 basis point increase in the average yield of interest-earning assets from 6.39% to 7.00% and a 4 basis point increase in the average cost of funds from 1.11% to 1.15%.

Interest income increased 2.1% to \$369.3 million when compared to \$361.6 million for the same period in 2013. Results reflect an increase of \$22.0 million in interest-earning asset interest rate partially offset by a \$14.3 million decrease in volume. Interest income from loans increased 1.4% to \$330.1 million, reflecting an increase in interest rate of \$12.4 million, partially offset by a \$7.7 million decrease in volume. Interest income from investments increased 8.4% to \$39.2 million, reflecting an increase in interest earning rate of \$9.6 million, partially offset by a \$6.5 million decrease in volume.

Interest expense decreased 7.4% to \$57.9 million, primarily the result of an \$8.9 million decrease in the volume of interest-bearing liabilities, partially offset by a \$4.2 million increase in interest rate. The decrease in interest-bearing liabilities is mostly due to the decrease in deposit volume of \$2.2 million and a \$2.8 million increase in interest rate. The cost of deposits before fair value amortization and core deposit intangible amortization decreased 24 basis points to 0.75%, compared to 0.99% for the same period in 2013. The decrease in the cost of deposits was partially offset by an increase in the cost of borrowings, which increased 63 basis points to 2.83% from 2.20%.

Average balance of total interest-earning assets was \$7.052 billion, a decrease of 6.8% from the same period in 2013. The decrease in average balance of interest-earning assets was mainly attributable to a decrease of 18.0% in average investments, resulting from redemptions and maturities, to the sale of available for sale securities during the current period amounting to \$184.9 million, and to a reduction of 1.3% in the average loan portfolio primarily due to maturities and repayments. The average yield on interest-earning assets was 7.00% compared to 6.39% for the same period in 2013. This was mainly due to higher average yields in the investment portfolio, which increased to 2.56% from 1.93%, and in the loan portfolio, which increased to 8.82% from 8.58%.

| TABLE 2 - NON-INTEREST INCOME SUMMARY | | | | | | | | |
|--|------------------------------------|---------------|-----------------|--|---------------|-----------------|--|--|
| | Quarter Ended September 30, | | | Nine-Month Period Ended September 30, | | | | |
| | 2014 | 2013 | Variance | 2014 | 2013 | Variance | | |
| | (Dollars in thousands) | | | | | | | |
| Banking service revenue | \$ 9,753 | \$ 12,146 | -19.7% | \$ 30,305 | \$ 36,491 | -17.0% | | |
| Wealth management revenue | 7,113 | 7,394 | -3.8% | 21,316 | 23,084 | -7.7% | | |
| Mortgage banking activities | 2,097 | 2,334 | -10.2% | 5,346 | 9,299 | -42.5% | | |
| Total banking and financial service revenue | 18,963 | 21,874 | -13.3% | 56,967 | 68,874 | -17.3% | | |
| FDIC shared-loss expense, net: | | | | | | | | |
| FDIC indemnification asset expense | (16,059) | (15,198) | -5.7% | (51,180) | (46,623) | -9.8% | | |
| Change in true-up payment obligation | (875) | (767) | -14.0% | (2,596) | (2,178) | -19.2% | | |
| | (16,934) | (15,965) | -6.1% | (53,776) | (48,801) | -10.2% | | |
| Net gain (loss) on: | | | | | | | | |
| Sale of securities available for sale | - | - | 0.0% | 4,366 | - | 100.0% | | |
| Derivatives | 7 | (811) | 100.9% | (463) | (1,746) | 73.5% | | |
| Early extinguishment of debt | - | - | 0.0% | - | 1,061 | -100.0% | | |
| Other non-interest income | 455 | (1,775) | 125.6% | 1,133 | 575 | 97.0% | | |
| | (16,472) | (18,551) | 11.2% | (48,740) | (48,911) | 0.3% | | |

| | | | | | | | | |
|---------------------------------------|----|--------------|----|--------------|---------------|--------------|---------------|---------------|
| Total non-interest income, net | \$ | 2,491 | \$ | 3,323 | -25.0% | 8,227 | 19,963 | -58.8% |
|---------------------------------------|----|--------------|----|--------------|---------------|--------------|---------------|---------------|

Non-Interest Income

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

Comparison of quarters ended September 30, 2014 and 2013

As shown in Table 2 above, the Company recorded non-interest income in the amount of \$2.5 million, compared to \$3.3 million for the same period in 2013, a decrease of \$832 thousands.

The FDIC shared-loss expense, net, increased to \$16.9 million as compared to \$16.0 million for the same period in 2013, which resulted from the ongoing evaluation of expected cash flows of the covered loan portfolio and from changes in the fair value of the true-up payment obligation, also known as a clawback liability.

During the quarters ended September 30, 2014 and 2013 the FDIC indemnification asset expense increased to \$16.1 million from \$15.2 million for the same period in 2013. The majority of the FDIC indemnification asset is recorded for projected claimable losses on non-single family residential loans whose loss share period ends by the third quarter of 2015, although the recovery share period extends for an additional three-year period.

During the quarters ended September 30, 2014 and 2013 the true-up payment obligation increased to \$875 thousand as compared to \$767 thousand for the same period in 2013. The true-up payment obligation may increase if actual and expected losses decline. The Company measures the true-up payment obligation at fair value.

Banking service revenue, which consists primarily of fees generated by deposit accounts, electronic banking services, and customer services, decreased 19.7% to \$9.8 million, from \$12.1 million for the same period in 2013. The decrease in banking services revenues is mostly due to the reclassification of auto loan late charges into interest income during the last quarter of 2013 amounting to \$2.7 million. For the quarter ended September 30, 2013, these revenues were included as part of banking activities, since the reclassification was not reflected until late 2013.

Wealth management revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, decreased 3.8% to \$7.1 million, compared to \$7.4 million for the same period in 2013. This decrease is mainly due to local market conditions, which has resulted in lower investment activity.

Income generated from mortgage banking activities decreased 10.2% to \$2.1 million, compared to \$2.3 million for the same period in 2013. The decrease in mortgage banking activities is mainly due to higher losses in repurchased loans and a decrease in sales when compared to same period in 2013.

Comparison of nine-month periods ended September 30, 2014 and 2013

Non-interest income decreased \$11.7 million to \$8.2 million from \$20.0 million in the nine-month period ended September 30, 2013.

The FDIC shared-loss expense, net increased 10.2% to \$53.8 million, as compared to \$48.8 million for the same period in 2013, as a result of the ongoing evaluation of expected cash flows of the covered loan portfolio, which resulted in reduced projected losses expected to be collected from the FDIC and improved the accretable yield on the covered loans, and from changes in the fair value of the true-up payment obligation.

During the nine-month period ended September 30, 2014, the FDIC indemnification asset expense increased 9.8% to \$51.2 million, as compared to \$46.6 million for the same period in 2013. The reduction in claimable losses amortizes the FDIC indemnification asset through the life of the shared loss agreements. This amortization is net of the accretion of the discount recorded to reflect the expected claimable loss at its net present value. During the nine-month period ended September 30, 2014, the net amortization included \$7.7 million of additional amortization of the FDIC indemnification asset from stepped up cost recoveries on certain construction and leasing loan pools. Additional amortization of the FDIC indemnification asset may be recorded, should the Company continue to experience reduced expected losses.

During the nine-period ended September 30, 2014, the true-up payment obligation increased 19.2% to \$2.6 million, as compared to \$2.2 million for the same period in 2013. The Company measures the true-up payment obligation at fair value.

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

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

Banking service revenue decreased 17.0% to \$30.3 million from \$36.5 million for the same period in 2013. The decrease in banking services revenues is mostly due to the reclassification of auto loan late charges into interest income during the last quarter of 2013 amounting to \$2.7 million. For the nine-month period ended September 30, 2013, these revenues were included as part of banking activities, since the reclassification was not reflected until late 2013. In addition, a non-recurring prepayment penalty was received during the first quarter of 2013 of approximately \$1 million. Lower overdrawn and non-sufficient fund fees of \$1.1 million and lower retail checking fees of \$987 thousand also contributed to the decrease.

Wealth management revenue decreased 7.7% to \$21.3 million, compared to \$23.1 million for the same period in 2013. This decrease is mainly due to local market conditions, which has resulted in lower investment activity.

Income generated from mortgage banking activities decreased 42.5% to \$5.3 million, compared to \$9.3 million for the same period in 2013. The decrease in mortgage banking activities is mainly due to higher losses in repurchased loans and a decrease in sales when compared to same period in 2013.

Gains from the sale of securities increased to \$4.4 million from the same period in 2013, in which no gain or loss from the sale of securities was recorded. Losses from derivative activities were \$463 thousand, as compared to \$1.7 million for the same period in 2013. During the nine-month period ended September 30, 2014, the Company did not have a gain or loss on extinguishment of debt, as compared to the same period in 2013 in which the Company had a gain of \$1.1 million.

| TABLE 3 - NON-INTEREST EXPENSES SUMMARY | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | | | |
|--|-----------------------------|--------|------|--------|---------------------------------------|----|--------|----|------------|---------|
| | 2014 | | 2013 | | 2014 | | 2013 | | Variance % | |
| | | | | | | | | | | |
| (Dollars in thousands) | | | | | | | | | | |
| Compensation and employee benefits | \$ | 18,592 | \$ | 22,590 | -17.7% | \$ | 61,086 | \$ | 69,927 | -12.6% |
| Professional and service fees | | 3,807 | | 4,409 | -13.7% | | 11,525 | | 16,262 | -29.1% |
| Occupancy and equipment | | 8,770 | | 8,270 | 6.0% | | 25,684 | | 25,552 | 0.5% |
| Insurance | | 2,099 | | 1,828 | 14.8% | | 6,506 | | 7,229 | -10.0% |
| Electronic banking charges | | 4,637 | | 3,694 | 25.5% | | 14,085 | | 11,458 | 22.9% |
| Information technology expenses | | 1,289 | | 2,729 | -52.8% | | 4,589 | | 7,708 | -40.5% |
| Advertising, business promotion, and strategic initiatives | | 1,825 | | 1,471 | 24.1% | | 5,274 | | 4,550 | 15.9% |
| Merger and restructuring charges | | - | | 2,252 | -100.0% | | - | | 13,060 | -100.0% |
| Foreclosure, repossession and other real estate expenses | | 7,842 | | 5,703 | 37.5% | | 20,783 | | 12,603 | 64.9% |
| Loan servicing and clearing expenses | | 1,870 | | 2,133 | -12.3% | | 5,598 | | 5,493 | 1.9% |
| Taxes, other than payroll and income taxes | | 3,494 | | 4,024 | -13.2% | | 11,005 | | 11,778 | -6.6% |
| Communication | | 820 | | 782 | 4.9% | | 2,590 | | 2,481 | 4.4% |
| Printing, postage, stationery and supplies | | 620 | | 824 | -24.8% | | 1,820 | | 2,841 | -35.9% |

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|---|-----------|---------------|-----------|---------------|--|--------------|-----------|----------------|-----------|----------------|--|--------------|
| Director and investor relations | | 250 | | 230 | | 8.7% | | 794 | | 843 | | -5.8% |
| Other operating expenses | | 3,660 | | 2,295 | | 59.5% | | 9,488 | | 6,748 | | 40.6% |
| Total non-interest expenses | \$ | 59,575 | \$ | 63,234 | | -5.8% | \$ | 180,827 | \$ | 198,533 | | -8.9% |
| Relevant ratios and data: | | | | | | | | | | | | |
| Efficiency ratio | | 49.30% | | 52.27% | | | | 49.10% | | 53.97% | | |
| Compensation and benefits to non-interest expense | | 31.21% | | 35.72% | | | | 33.78% | | 35.22% | | |
| Compensation to average total assets owned | | 0.97% | | 1.07% | | | | 1.04% | | 1.08% | | |
| Average number of employees | | 1,574 | | 1,562 | | | | 1,564 | | 1,569 | | |
| Average compensation per employee | \$ | 11.8 | \$ | 14.5 | | | \$ | 39.1 | \$ | 44.6 | | |
| Average loans per average employee | \$ | 3,138 | \$ | 3,289 | | | \$ | 3,199 | \$ | 3,232 | | |

Non-Interest Expenses

Comparison of quarters ended September 30, 2014 and 2013

Non-interest expense reached \$59.6 million, representing a decrease of 5.8% compared to \$63.2 million for the same period in the previous year. The decrease is due mainly to the non-recurring merger and restructuring charges of \$2.3 million incurred during the quarter ended September 30, 2013 for the BBVAPR Acquisition and to the decrease of \$4.0 million in compensation and employee benefits.

Compensation and employee benefits decreased 17.7% to \$18.6 million from \$22.6 million for the same periods in 2013. The decrease is due mainly to the impact of the assessment of employee bonuses required pursuant to the BBVAPR Acquisition of \$2.1 million for the quarter ended September 30, 2013, a decrease in incentives of \$590 thousand, and a decrease of \$300 thousand in commissions paid by the securities broker-dealer.

Professional and service fees decreased 13.7% to \$3.8 million, as compared to \$4.4 million for the same period in 2013. Professional and service fees primarily comprise legal expenses and consulting and outsourcing expenses. For the quarter ended September 30, 2014, legal expenses amounted to \$1.4 million compared to \$872 thousand for the same period in 2013. The decrease in professional and service fees is mainly related consulting and outsourcing expenses which amounted to \$759 thousand, compared to \$1.3 million for the same period in 2013, and a decrease in audit fees which amounted to \$438 thousand compared to \$877 thousand for the same period in 2013.

Information technology expenses decreased 52.8% to \$1.3 million, as compared to \$2.7 million, mostly due to a decrease in data processing expenses.

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

Foreclosure, repossession and other real estate expenses increased 37.5% to \$7.8 million, as compared to \$5.7 million in the same period for the previous year, principally due to an increase in foreclosures and a decrease in the fair value of real estate as a result of current local economic conditions.

Electronic banking charges increased 25.5% to \$4.6 million, mostly due to the increase in expenses related to merchant business and card interchange transactions resulting from the continued growth of our banking business.

The decrease in non-interest expenses resulted in an improved efficiency ratio of 49.30%, from 52.27% for the same period in 2013. The efficiency ratio measures how much of the Company's revenue is used to pay operating expenses. The Company computes its efficiency ratio by dividing non-interest expenses by the sum of its net interest income and non-interest income, but excluding gains on the sale of investment securities, derivatives gains or losses, credit-related other-than-temporary impairment losses, FDIC shared-loss expense, losses on the early extinguishment of debt, other gains and losses, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permits consistent comparability. Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to losses of \$16.5 million, compared to \$18.6 million for the same period in 2013. Revenue for purposes of the efficiency ratio amounted to \$120.8 million, compared to \$121.0 million for the same period in 2013.

Comparison of nine-month periods ended September 30, 2014 and 2013

Non-interest expense decreased 8.9% to \$180.8 million, compared to \$198.5 for the same period in 2013. The decrease is due mainly to the non-recurring merger and restructuring charges of \$13.1 million incurred during the nine-month period ended September 30, 2013 for the BBVAPR Acquisition and the implementation of expense reduction measures.

Compensation and employee benefits decreased 12.6% to \$61.1 million from \$69.9 million for the same period in 2013. The decrease is due mainly to the impact in 2013 of the assessment of employee bonuses required pursuant to the BBVAPR Acquisition of \$4.5 million, a decrease in average total employees during the nine-month period ended September 30, 2014, compared to the same period in 2013, and a decrease in commissions paid by the securities broker-dealer of \$1.4 million.

Professional and service fees decreased 29.1% to \$11.5 million, as compared to \$16.3 million for the same period in 2013. Legal expenses amounted to \$3.7 million, compared to \$3.4 million for the same period in 2013. Consulting and outsourcing expenses amounted to \$2.6 million, compared to \$4.1 million for the same period in 2013. Decrease in professional and service fees is mainly related to loan servicing fees amounting to \$3.0 million for a third party loan servicer whose contract was terminated during the quarter ended June 30, 2013.

Information technology expenses decreased 40.5% to \$4.6 million, as compared to \$7.7 million, mostly due to decrease in data processing expenses.

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

Electronic banking charges increased 22.9% to \$14.1 million, as compared to \$11.5 million, mostly due to the increase in expenses related to merchant business and card interchange transactions resulting from the continued growth of our banking business.

Foreclosure, repossession and other real estate expenses increased 64.9% to \$20.8 million, as compared to \$12.6 million for the same period in 2013, principally due to an increase in foreclosures and a decrease in the fair value of real estate as a result of current local economic conditions.

The decrease in non-interest expenses resulted in an improved efficiency ratio of 49.1% from 54.0%. Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to losses of \$48.7 million, compared to \$48.9 million for the same period in 2013. Revenue for purposes of the efficiency ratio amounted to \$368.3 million, compared to \$367.9 million for the same period in 2013.

Provision for Loan and Lease Losses

Comparison of quarters ended September 30, 2014 and 2013

Provision for non-covered loan and lease losses increased 63.1% to \$16.1 million from \$9.9 million when compared with the same period in 2013. Provision for covered loan and lease losses decreased 63.7% to \$1.1 million from \$3.1 million when compared to the same period in 2013. Based on an analysis of the credit quality and the composition of the Company's loan portfolio, management determined that the provision for the quarter ended September 30, 2014 was adequate in order to maintain the allowance for loan and lease losses at an adequate level to provide for probable losses based upon an evaluation of known and inherent risks.

Provision for non-covered loans, excluding acquired loans, increased 23.7% to \$8.6 million from \$6.9 million when compared with the same period in 2013. This was the result of an increase in the provision for auto and leasing of 130.2% to \$7.2 million, partially offset by a decrease in the provision for mortgage loans of 10.1% to \$1.2 million, an increase in the recapture for commercial loans of 225.2% to \$2.3 million, a decrease in the provision for consumer loans of 19.7% to \$2.3 million, and a decrease in the unallocated provision of 78.6% to \$43 thousand. At September 30, 2014, the auto portfolio has been increasing as new originations are ramping up balances outstanding. After almost two years from the BBVAPR Acquisition, this portfolio is beginning to reflect normal delinquency and charge-off levels as a seasoned portfolio.

Total charge-offs on non-covered loans, excluding acquired loans, increased 101.7% to \$11.6 million, as compared to \$5.8 million for the same period in 2013. This was the result of a 466.5% increase in auto and leasing charge-offs to \$7.4 million and a 240.9% increase in consumer charge-offs to \$1.4 million, partially offset by a 11.1% decrease in mortgage charge-offs to \$1.6 million and a 51.6% decrease in commercial charge-offs to \$1.1 million.

Total recoveries increased from \$704 thousand to \$2.7 million. As a result, the recoveries to charge-offs ratio increased from 12.22% to 23.18%. Net credit losses, excluding acquired loans, increased \$3.9 million to \$8.9 million, representing 1.34% of average non-covered loans outstanding versus 1.02% for the same period in 2013, annualized.

The non-covered acquired loans accounted for under ASC 310-20 required a provision for loan and lease losses of \$3.7 million, as compared to \$3.0 million for the same period in 2013. Non-covered acquired loans accounted for under ASC 310-30 required a provision for loan and lease losses of \$3.8 million. This portfolio did not require a provision for loan and lease losses for the same period in 2013. The provision for the quarter ended September 30, 2014, reflects the Company's revision of the expected cash flows in the non-covered acquired loan portfolio considering actual experiences and changes in the Company's expectations for the remaining term of the loan pools. Provision for covered loan and lease losses was \$1.1 million, compared to \$3.1 million for the same period in 2013, reflecting the Company's revision of the expected cash flows in the covered loan portfolio considering actual experiences and changes in the Company's expectations for the remaining terms of the loan pools.

Comparison of nine-month periods ended September 30, 2014 and 2013

Provision for non-covered loan and lease losses decreased \$15.9 million to \$39.4 million when compared to \$55.3 million, which included the impact of a \$21.0 million additional provision due to the reclassification to held-for-sale of non-performing residential mortgage loans. Provision for covered loan and lease losses decreased \$618 thousand, when compared to the same period in 2013. Based on an analysis of the credit quality and the composition of the Company's loan portfolio, management determined that the provision for the nine-month period ended September 30, 2014, was adequate in order to maintain the allowance for loan and lease losses at an adequate level to provide for probable losses based upon an evaluation of known and inherent risks.

Provision for non-covered loans, excluding acquired loans, decreased 55.8% to \$21.6 million from \$48.6 million when compared with the same period in 2013. This was the result of decrease in the provision for mortgage loans of 93.0% to \$2.3 million, an increase in the recapture for commercial loans of 232.4% to \$4.0 million, and an increase in the unallocated recapture of 134.9% to \$193 thousand, partially offset by an increase in the provision for auto and leasing of 155.1% to \$17.4 million and an increase in the provision for consumer loans of 24.7% to \$6.1 million. At September 30, 2014, the auto and consumer portfolios have been increasing as new originations are ramping up balances outstanding. After almost two years from the BBVAPR Acquisition, these portfolios are beginning to reflect

normal delinquency and charge-off levels as seasoned portfolios.

Total charge-offs on non-covered loans, excluding acquired loans, decreased 34.7% to \$27.6 million, as compared to \$42.3 million for the same period in 2013. This was the result of an 88.9% decrease in mortgage charge-offs to \$3.8 million and a 64.0% decrease in commercial charge-offs to \$2.0 million, partially offset by a 754.8% increase in auto and leasing charge-offs to \$18.0 million and a 269.4% increase in consumer charge-offs to \$3.8 million.

Total recoveries increased from \$1.3 million to \$7.2 million. As a result, the recoveries to charge-offs ratio increased from 3.05% to 26.05%. Net credit losses, excluding acquired loans, decreased \$20.6 million to \$20.4 million, representing 1.05% of average non-covered loans outstanding versus 3.96% in the same period in 2013, annualized. The credit losses for the nine-month period ended September 30, 2013 included a \$27 million charge-off from nonperforming mortgage loans transferred into the loan held-for-sale category. Isolating this credit charge-off, the net credit losses for the nine-month period ended September 30, 2013 would have been \$14.0 million, representing 1.35% of average non-covered loans outstanding, annualized.

The non-covered acquired loans accounted for under ASC 310-20 required a provision for loan and lease losses of \$10.5 million, as compared to \$6.7 million for the same period in 2013. Non-covered acquired loans accounted for under ASC 310-30 required a provision for loan and lease losses of \$7.3 million for the nine-month period ended September 30, 2014. This portfolio did not require provision for loan and leases losses for the same period in 2013. The provision for the nine-month period ended September 30, 2014 reflects the Company's revision of the expected cash flows in the non-covered acquired loan portfolio considering actual experiences and changes in the Company's expectations for the remaining term of the loan pools. Provision for covered loan and lease losses was \$4.3 million, compared to \$5.0 million for the same period in 2013, reflecting the Company's revision of the expected cash flows in

the covered loan portfolio considering actual experiences and changes in the Company's expectations for the remaining terms of the loan pools.

Please refer to the "Allowance for Loan and Lease Losses and Non-Performing Assets" section in this MD&A and Table 8 through Table 12 below for more detailed information concerning the allowances for the loan and lease losses, net credit losses and credit quality statistics.

Income Taxes

Comparison of quarters ended September 30, 2014 and 2013

Income tax expense increased \$1.4 million to \$8.0 million, compared to an income tax expense of \$6.6 million for the same period in 2013. The increase is caused by the change in enacted tax rates for capital gains during the quarter ended September 30, 2014 from 15% to 20%.

Comparison of nine-month periods ended September 30, 2014 and 2013

Income tax expense increased to \$30.4 million, compared to an income tax benefit of \$18.2 million for the same period in 2013. The income tax benefit for the nine-month period ended September 30, 2013 included a \$38.6 million benefit from the effect in deferred taxes due to the increase in tax rates from 30.0% to 39.0% due to enacted law in 2013. Effective July 1, 2014 the capital gains tax rate was increased from 15% to 20%, which results in a net increase of the income tax expense for 2014.

Business Segments

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

Comparison of quarters ended September 30, 2014 and 2013

Banking

Net interest income of the Company's Banking segment slightly increased \$2.3 million for the third quarter of 2014, or 2.4%, reflecting a decrease of 28.2% in interest expense, partially offset by a slight decrease of 0.7% in interest income from loans. The decrease of \$3.1 million in interest expenses mainly reflects the lower cost of deposits before fair value amortization and core deposit intangible amortization (0.68% vs. 0.93%) due to the continuing progress in the repricing of the Company's core retail deposits.

Provision for non-covered loans losses increased \$6.2 million when compared to \$9.9 million for the third quarter of 2013, while provision for covered loans losses decreased \$2.0 million when compared to the third quarter of 2013.

Banking service revenues decreased \$2.4 million to \$9.8 million. The decrease is mostly due to the reclassification of loan late charges into interest income during the last quarter of 2013. For the quarter ended September 30, 2013, these revenues were included as part of banking activities, since the reclassification was not reflected until late 2013.

For the quarter ended September 30, 2013, the Company recognized a realized loss of \$1.5 million from the sale of performing and non-performing residential mortgage loans, which was not the case in the current quarter.

Non-interest expense of \$53.7 million increased 2.0% when compared to the same period in 2013. The increase in non-interest expense is mainly due to an increase in foreclosure, repossession and other real estate expenses of \$2.1 million to \$7.8 million, principally caused by an increase in foreclosures and a decrease in the fair value of real estate as a result of current local economic

conditions. Also, there was an increase in electronic banking charges of \$943 thousand to \$4.6 million, mostly due to the increase in expenses related to merchant business and card interchange transactions resulting from the continued growth of our banking business. This increase was partially offset by the \$2.3 million in merger and restructuring charges during the quarter ended September 30, 2013, compared to none in the current quarter.

Wealth Management

Wealth management revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, decreased 12.7% to \$6.2 million, compared to \$7.1 million for the same period in 2013. This decrease is mainly due to local market conditions, which has resulted in lower investment activity.

Non-interest expenses decreased 27.3% to \$4.5 million, mainly as commissions paid by the securities broker-dealer decreased when compared to the same quarter in 2013.

Treasury

Average investments decreased 13.8% resulting from redemptions and maturities during 2014. Nevertheless, interest income from investments remained level at \$11.7 million as the yield increased to 2.35% from 2.03%. Interest expenses remained constant at \$11 million when compared to the same period in 2013, reflecting lower borrowings at higher costs.

Non-interest expenses, mainly composed of indirect expenses allocated from support departments, decreased 68.0% to \$1.4 million as part of the Company's cost reduction strategy.

Comparison of nine-month periods ended September 30, 2014 and 2013

Banking

Net interest income increased \$10.0 million for the third quarter of 2014, or 3.4%, reflecting an increase of 1.4% in interest income from loans and a decrease of 16.7% in interest expense. The decrease of \$5.3 million in interest expenses when compared to the same period in 2013 mainly reflects the lower cost of deposits fair value amortization and core deposit intangible amortization (0.75% vs. 0.99%) due to the continuing progress in the repricing of the Company's core retail deposits and other reductions in its cost of funds.

Provision for non-covered loan losses decreased \$15.9 million when compared to \$55.3 million, which included the impact of a \$21.0 million additional provision due to the reclassification to held-for-sale of non-performing residential

mortgage loans. Provision for covered loan losses decreased \$618 thousand when compared to the same period in 2013.

Banking service revenues decreased 17.0% to \$30.3 million from \$36.5 million for the same period in 2013. The decrease in banking service revenues is mostly due to the reclassification of auto loan late charges into interest income during the last quarter of 2013 amounting to \$2.7 million. For the nine-month period ended September 30, 2013, these revenues were included as part of banking activities, since the reclassification was not reflected until late 2013. In addition, a non-recurring prepayment penalty was received during the first quarter of 2013 of approximately \$1 million. Lower overdrawn and non-sufficient fund fees by approximately \$1.1 million and lower retail checking fees by approximately \$987 thousand also contributed to the decrease.

Net FDIC shared- loss expense increased \$5.0 million to \$53.8 million from \$48.8 million for the same period in 2013.

For the nine-month period ended September 30, 2013, the Company recognized a realized loss of \$1.5 million from the sale of performing and non-performing residential mortgage loans, which did not have an impact in 2014.

Non-interest expense of \$156.9 million decreased 6.7% when compared to the same period in 2013. The decrease is due mainly to the non-recurring merger and restructuring charges of \$13.1 million incurred during the nine-month period ended September 30, 2013 for the BBVAPR Acquisition.

Wealth Management

Wealth management revenue decreased 11.7% to \$20.2 million, compared to \$22.9 million for the same period in 2013. This decrease is mainly due to local market conditions, which has resulted on lower investment activity.

Non-interest expenses decreased 17.5% to \$15.6 million from \$18.9 million for the same period in 2013. Commissions paid by the securities broker-dealer decreased \$1.4 million when compared to the same period in 2013.

Treasury

Average investments decreased 18.0% resulting from redemptions and maturities and the sale of available for sale securities during the current period amounting to \$184.9 million. Nevertheless, interest income from investments increased 8.7% to \$39.0 million as yield increased to 2.56% from 1.93%. Interest expenses slightly increased to \$31.7 million from \$31.1 million for the same period in 2013, reflecting lower borrowings at higher costs.

Non-interest expenses, mainly composed of indirect expenses allocated from support departments, decreased 27.4% to \$8.3 million as part of the Company's cost reduction strategy.

ANALYSIS OF FINANCIAL CONDITION

Assets Owned

At September 30, 2014, the Company's total assets amounted to \$7.673 billion representing a decrease of 5.9% when compared to \$8.158 billion at December 31, 2013. This reduction is mainly due to a decrease in investment securities available-for-sale of 19.8% from \$1.588 billion to \$1.274 billion, partially offset by a \$144.3 million increase in investment securities held-to-maturity.

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

The Company's loan portfolio is comprised of residential mortgage loans, commercial loans collateralized by mortgages on real estate located in Puerto Rico, other commercial and industrial loans, consumer loans, and auto loans. At September 30, 2014, the Company's loan portfolio decreased by 3.2% to \$4.857 billion compared to \$5.019 billion at December 31, 2013. At September 30, 2014, the covered loan portfolio decreased \$45.3 million, or 12.7% from December 31, 2013 as the loans continue to pay down. At September 30, 2014, the non-covered loan portfolio decreased \$117.2 million or 2.5%, primarily due to maturities and early pay downs of some commercial loans.

The FDIC indemnification asset amounted to \$120.6 million at September 30, 2014 and \$189.2 million as of December 31, 2013, representing a 36.3% reduction. The decrease in the FDIC indemnification asset is mainly related to the amortization of the FDIC indemnification asset by \$51.2 million during the nine-month period ended September 30, 2014.

Investments principally consist of U.S. government and agency bonds, mortgage-backed securities, and Puerto Rico government and agency bonds. At September 30, 2014, the investment portfolio decreased 10.8% to \$1.441 billion from \$1.615 billion at December 31, 2013. This decrease is mostly due to net effect of a reduction of \$98.7 million in Puerto Rico government obligations and a reduction of \$20.5 million in other debt securities due to redemptions and maturities. In addition, during the nine-month period ended September 30, 2014, the Company sold \$110.8 million of mortgage-backed available for sale securities taking advantage of market opportunities to realize gains and reduce some interest rate sensitivity. Recent purchases of investment securities were categorized as held-to-maturity. The Company's management will determine the category of following investment securities purchases based on the Company's approach at that time.

Financial Assets Managed

The Company's financial assets managed include those managed by the Company's trust division, retirement plan administration subsidiary, and assets gathered by its broker-dealer subsidiary. The Company's trust division offers various types of IRAs and manages 401(k) and Keogh retirement plans and custodian and corporate trust accounts, while the retirement plan administration subsidiary, CPC, manages private retirement plans. At September 30, 2014, total assets managed by the Company's trust division and CPC amounted to \$2.852 billion, compared to \$2.797 billion at December 31, 2013. Oriental Financial Services offers a wide array of investment alternatives to its client base, such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money

management wrap-fee programs. At September 30, 2014, total assets gathered by Oriental Financial Services from its customer investment accounts decreased to \$2.484 billion, compared to \$2.493 billion at December 31, 2013. Changes in trust and broker-dealer related assets primarily reflect an increase in portfolio and differences in market values.

| TABLE 4 - ASSETS SUMMARY AND COMPOSITION | | | | | | |
|--|-------------------------------|------------------|---------------------|------------------|--|-----------------|
| | | | | | | |
| | September 30, | | December 31, | | | |
| | 2014 | | 2013 | | | Variance |
| | (Dollars in thousands) | | | | | |
| Investments: | | | | | | |
| FNMA and FHLMC certificates | \$ | 1,200,940 | \$ | 1,217,330 | | -1.3% |
| Obligations of US government-sponsored agencies | | 7,761 | | 10,649 | | -27.1% |
| CMOs issued by US government-sponsored agencies | | 184,958 | | 214,394 | | -13.7% |
| GNMA certificates | | 5,568 | | 7,816 | | -28.8% |
| Puerto Rico government and political subdivisions | | 15,446 | | 114,190 | | -86.5% |
| FHLB stock | | 21,189 | | 24,450 | | -13.3% |
| Other debt securities | | 3,511 | | 24,047 | | -85.4% |
| Other investments | | 1,752 | | 1,933 | | -9.4% |
| Total investments | | 1,441,125 | | 1,614,809 | | -10.8% |
| Loans: | | | | | | |
| Non-covered loans | | 4,593,311 | | 4,670,227 | | -1.6% |
| Allowance for loan and lease losses on non-covered loans | | (64,859) | | (54,298) | | -19.5% |
| Non-covered loans receivable, net | | 4,528,452 | | 4,615,929 | | -1.9% |
| Mortgage loans held for sale | | 16,757 | | 46,529 | | -64.0% |
| Total non-covered loans, net | | 4,545,209 | | 4,662,458 | | -2.5% |
| Covered loans | | 373,920 | | 409,690 | | -8.7% |
| Allowance for loan and lease losses on covered loans | | (62,227) | | (52,729) | | -18.0% |
| Total covered loans, net | | 311,693 | | 356,961 | | -12.7% |
| Total loans, net | | 4,856,902 | | 5,019,419 | | -3.2% |
| Securities purchased under agreements to resell | | - | | 60,000 | | -100.0% |
| Total securities and loans | | 6,298,027 | | 6,694,228 | | -5.9% |
| Other assets: | | | | | | |
| Cash and due from banks | | 696,369 | | 696,501 | | 0.0% |
| Money market investments | | 7,777 | | 6,967 | | 11.6% |
| FDIC indemnification asset | | 120,619 | | 189,240 | | -36.3% |
| Foreclosed real estate | | 100,564 | | 90,024 | | 11.7% |
| Accrued interest receivable | | 19,665 | | 18,734 | | 5.0% |
| Deferred tax asset, net | | 121,217 | | 137,564 | | -11.9% |

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|--|-----------|------------------|--|-----------|------------------|--|--------------|--|
| Premises and equipment, net | | 82,099 | | | 82,903 | | -1.0% | |
| Servicing assets | | 13,986 | | | 13,801 | | 1.3% | |
| Derivative assets | | 8,445 | | | 20,502 | | -58.8% | |
| Goodwill | | 86,069 | | | 86,069 | | 0.0% | |
| Other assets | | 118,502 | | | 121,482 | | -2.5% | |
| Total other assets | | 1,375,312 | | | 1,463,787 | | -6.0% | |
| Total assets | \$ | 7,673,339 | | \$ | 8,158,015 | | -5.9% | |
| Investments portfolio composition: | | | | | | | | |
| FNMA and FHLMC certificates | | 83.4% | | | 75.4% | | | |
| Obligations of US government-sponsored agencies | | 0.5% | | | 0.7% | | | |
| CMOs issued by US government-sponsored agencies | | 12.8% | | | 13.3% | | | |
| GNMA certificates | | 0.4% | | | 0.5% | | | |
| Puerto Rico government and political subdivisions | | 1.1% | | | 7.1% | | | |
| FHLB stock | | 1.5% | | | 1.5% | | | |
| Other debt securities and other investments | | 0.3% | | | 1.5% | | | |
| | | 100.0% | | | 100.0% | | | |

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| TABLE 5 — LOANS RECEIVABLE COMPOSITION | | | | | | |
|---|----------------------|------------------|---------------------|------------------|-----------------|---------------|
| | September 30, | | December 31, | | Variance | |
| | 2014 | | 2013 | | % | |
| (Dollars in thousands) | | | | | | |
| Non-covered loans: | | | | | | |
| Originated and other loans and leases held for investment: | | | | | | |
| Mortgage | \$ | 791,106 | \$ | 766,265 | | 3.2% |
| Commercial | | 1,217,235 | | 1,127,657 | | 7.9% |
| Consumer | | 175,882 | | 127,744 | | 37.7% |
| Auto and leasing | | 542,892 | | 379,874 | | 42.9% |
| Total originated and other loans and leases held for investment | | 2,727,115 | | 2,401,540 | | 13.6% |
| Acquired loans: | | | | | | |
| Accounted for under ASC 310-20 | | | | | | |
| Commercial | | 26,984 | | 77,681 | | -65.3% |
| Consumer | | 47,284 | | 56,174 | | -15.8% |
| Auto | | 210,808 | | 301,584 | | -30.1% |
| | | 285,076 | | 435,439 | | -34.5% |
| Accounted for under ASC 310-30 | | | | | | |
| Mortgage | | 670,188 | | 717,904 | | -6.6% |
| Commercial | | 485,444 | | 545,117 | | -10.9% |
| Construction | | 108,694 | | 126,427 | | -14.0% |
| Consumer | | 36,470 | | 63,620 | | -42.7% |
| Auto | | 276,749 | | 379,145 | | -27.0% |
| | | 1,577,545 | | 1,832,213 | | -13.9% |
| | | 1,862,621 | | 2,267,652 | | -17.9% |
| | | 4,589,736 | | 4,669,192 | | -1.7% |
| Deferred loans fees, net | | 3,575 | | 1,035 | | 245.4% |
| Loans receivable | | 4,593,311 | | 4,670,227 | | -1.6% |
| Allowance for loan and lease losses on non-covered loans | | (64,859) | | (54,298) | | -19.5% |
| Loans receivable, net | | 4,528,452 | | 4,615,929 | | -1.9% |
| Mortgage loans held-for-sale | | 16,757 | | 46,529 | | -64.0% |
| Total non-covered loans, net | | 4,545,209 | | 4,662,458 | | -2.5% |
| Covered loans: | | | | | | |
| Loans secured by 1-4 family residential properties | | 121,658 | | 121,748 | | -0.1% |
| Construction and development secured by 1-4 family residential properties | | 18,947 | | 17,304 | | 9.5% |

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| | | | | | | | |
|---|-----------|------------------|--|-----------|------------------|--|---------------|
| Commercial and other construction | | 228,410 | | | 264,249 | | -13.6% |
| Consumer | | 4,905 | | | 6,119 | | -19.8% |
| Leasing | | - | | | 270 | | -100.0% |
| Total covered loans | | 373,920 | | | 409,690 | | -8.7% |
| Allowance for loan and lease losses on covered loans | | (62,227) | | | (52,729) | | -18.0% |
| Total covered loans, net | | 311,693 | | | 356,961 | | -12.7% |
| Total loans receivable, net | \$ | 4,856,902 | | \$ | 5,019,419 | | -3.2% |

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As shown in Table 5 above, total loans, net, amounted to \$4.857 billion at September 30, 2014 and \$5.019 billion at December 31, 2013.

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

- Mortgage loan portfolio amounted to \$791.1 million (29.0% of the gross originated loan portfolio) compared to \$766.3 million (31.9% of the gross originated loan portfolio) at December 31, 2013. Mortgage loan production totaled \$55.3 million and \$158.1 million for the quarter and nine-month period ended September 30, 2014, respectively, which represents a decrease of 8.9% and 48.4 % from \$60.7 million and \$306.6 million for the same periods in 2013. Mortgage loans included delinquent loans in the GNMA buy-back option program amounting to \$40.1 million and \$34.9 million for the periods ended September 30, 2014, and December 31, 2013, respectively. Servicers of loans underlying GNMA mortgage-backed securities must report as their own assets the defaulted loans that they have the option (but not the obligation) to repurchase, even when they elect not to exercise that option.
- Commercial loan portfolio amounted to \$1.217 billion (44.6% of the gross originated loan portfolio) compared to \$1.128 billion (47.0% of the gross originated loan portfolio) at December 31, 2013. Commercial loan production decreased 75.3% to \$90.1 million for the third quarter of 2014, and 75.0% to \$175.3 million for the nine-month period ended September 30, 2014, from \$365.3 million and \$700.8 million for the same periods in 2013, respectively.
- Consumer loan portfolio amounted to \$175.9 million (6.4% of the gross originated loan portfolio) compared to \$127.7 million (5.3% of the gross originated loan portfolio) at December 31, 2013. Consumer loan production increased 0.3% to \$28.7 million for the quarter ended September 30, 2014, and decreased 10.2% to \$91.0 million for the nine-month period ended September 30, 2014 from \$28.6 million and \$101.4 million for the same periods in 2013, respectively.
- Auto loans and leasing portfolio amounted to \$542.9 million (20.0% of the gross originated loan portfolio) compared to \$379.9 million (15.8% of the gross originated loan portfolio) at December 31, 2013. Auto production was \$68.5 million for the quarter ended September 30, 2014 and \$251.9 million for the nine-month period ended September 30, 2014, compared to \$95.0 million and \$375.3 million for the same periods in 2013, respectively.

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

| Portfolio Type | September 30, 2014 | | | December 31, 2013 | | |
|----------------|--------------------|--|--|-------------------|--|--|
| | Carrying Amounts | % of Gross Non-Covered Acquired Loan Portfolio | | Carrying Amounts | % of Gross Non-Covered Acquired Loan Portfolio | |
| | | | | | | |
| | | | | | | |

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| (Dollars in thousands) | | | | | | | | | |
|-------------------------------|----|------------------|--|----------------|--|----|------------------|--|----------------|
| Mortgage | \$ | 670,188 | | 36.0% | | \$ | 717,904 | | 31.7% |
| Commercial | | 621,122 | | 33.3% | | | 749,225 | | 33.0% |
| Consumer | | 83,754 | | 4.5% | | | 119,794 | | 5.3% |
| Auto | | 487,557 | | 26.2% | | | 680,729 | | 30.0% |
| | \$ | 1,862,621 | | 100.00% | | \$ | 2,267,652 | | 100.00% |

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| TABLE 6 — HIGHER RISK RESIDENTIAL MORTGAGE LOANS | | | | | | | | | | |
|---|------------------|-----------------|----------------------------|------------------|-----------------|--------------|-------------------------|-----------------|---|--|
| September 30, 2014 | | | | | | | | | | |
| Higher-Risk Residential Mortgage Loans* | | | | | | | | | | |
| | | | | | | | | | High Loan-to-Value Ratio Mortgages | |
| Junior Lien Mortgages | | | Interest Only Loans | | | | LTV 90% and over | | | |
| Carrying | | | Carrying | | | | Carrying | | | |
| Value | Allowance | Coverage | Value | Allowance | Coverage | Value | Allowance | Coverage | | |
| (In thousands) | | | | | | | | | | |
| Delinquency: | | | | | | | | | | |
| 0 - 89 days | \$ 14,074 | \$ 233 | 1.66% | \$ 22,722 | \$ 984 | 4.33% | \$ 91,438 | \$ 1,975 | 2.16% | |
| 90 - 119 days | 99 | 4 | 4.04% | 113 | 5 | 4.42% | 1,002 | 38 | 3.79% | |
| 120 - 179 days | 14 | 0 | 0.00% | - | - | 0.00% | 491 | 16 | 3.26% | |
| 180 - 364 days | 80 | 1 | 1.25% | 510 | 69 | 13.53% | 495 | 21 | 4.24% | |
| 365+ days | 509 | 48 | 9.43% | 563 | 272 | 48.31% | 2,273 | 231 | 10.16% | |
| Total | \$ 14,776 | \$ 286 | 1.94% | \$ 23,908 | \$ 1,330 | 5.56% | \$ 95,699 | \$ 2,281 | 2.38% | |
| Percentage of total loans excluding acquired loans accounted for under ASC 310-30 | 0.49% | | | 0.79% | | | 3.16% | | | |
| Refinanced or Modified Loans: | | | | | | | | | | |
| Amount | \$ 2,235 | \$ 179 | 8.01% | \$ - | \$ - | 0.00% | \$ 14,234 | \$ 1,089 | 7.65% | |
| Percentage of Higher-Risk Loan | | | | | | | | | | |
| Category | 15.13% | | | 0.00% | | | 14.87% | | | |
| Loan-to-Value Ratio: | | | | | | | | | | |
| Under 70% | \$ 9,043 | \$ 191 | 2.11% | \$ 2,457 | \$ 226 | 9.20% | \$ - | \$ - | - | |
| 70% - 79% | 2,776 | 49 | 1.77% | 3,238 | 206 | 6.36% | - | - | - | |
| 80% - 89% | 766 | 20 | 2.61% | 7,116 | 355 | 4.99% | - | - | - | |
| 90% and over | 2,191 | 26 | 1.19% | 11,097 | 543 | 4.89% | 95,699 | 2,281 | 2.38% | |
| | \$ 14,776 | \$ 286 | 1.94% | \$ 23,908 | \$ 1,330 | 5.56% | \$ 95,699 | \$ 2,281 | 2.38% | |

| | | | | | | | | | | | | |
|--|-----------|-----------------------|-----------|-------------------------|-----------|---------------------|-----------|--------------------------|--|--|--|--|
| The following table includes the Company's lending and investment exposure to the Puerto Rico government, including its agencies, instrumentalities, municipalities and public corporations: | | | | | | | | | | | | |
| TABLE 7 - PUERTO RICO GOVERNMENT RELATED LOANS AND SECURITIES | | | | | | | | | | | | |
| September 30, 2014 | | | | | | | | | | | | |
| Maturity | | | | | | | | | | | | |
| Loans and Securities: | | Carrying Value | | Less than 1 Year | | 1 to 3 Years | | More than 3 Years | | Comments | | |
| (In thousands) | | | | | | | | | | | | |
| Central government | \$ | 32,662 | \$ | 7,733 | \$ | - | \$ | 24,929 | | Repayment sources include all available revenues of the Commonwealth | | |
| Public corporations | | 382,069 | | 299,982 | | 1,296 | | 80,791 | | \$80.8 million which mature in more than 3 years, with pledged securities (rating > A) | | |
| Municipalities | | 212,100 | | - | | 1,174 | | 210,926 | | Repayment from property taxes | | |
| Investment securities | | 20,915 | | - | | 439 | | 20,476 | | | | |
| Total | \$ | 647,746 | \$ | 307,715 | \$ | 2,909 | \$ | 337,122 | | | | |

Some highlights follow on the data included above:

- Loans to municipalities are backed by their unlimited taxing power or real and personal property taxes.
- 48% of loans and securities balances mature in 12-months or less.
- Deposits from municipalities, central government and other government entities totaled \$359.2 million at September 30, 2014. However, this amount may decline as a result of recently enacted legislation to improve the liquidity of the Government Development Bank for Puerto Rico ("GDB") by requiring the Commonwealth's agencies,

instrumentalities and public corporations to maintain certain deposits at GDB.

- The Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the “Recovery Act”) enacted in the second quarter of 2014 establishes procedures for the adjustment of debts of certain public corporations. Significantly all of the Company’s public corporation debtors are authorized to seek relief under the Recovery Act.
- Oriental Bank is part of a four bank syndicate providing a \$550 million dollar revolving line of credit to finance the purchase of fuel for the day to day power generation activities of the Puerto Rico Electric Power Authority (“PREPA”), a public corporation authorized to seek relief under the Recovery Act. The Bank’s participation in the line of credit has an unpaid principal balance of \$200.0 million as of September 30, 2014. As part of the bank syndicate, the Company agreed during the quarter to extend its credit facility with PREPA to March 31, 2015. In connection with such extension, PREPA appointed a Chief Restructuring Officer to work alongside the Executive Director to develop, organize and manage a financial and operational restructuring of PREPA subject to the approval of PREPA’s Board. PREPA also committed to delivering a comprehensive business plan by December 15, 2014 and a full debt restructuring plan by March 2, 2015. After the extension, the Company classified the credit as substandard and a troubled-debt restructuring. The Company conducted an impairment analysis considering the probability of collection of principal and interest and concluded that the loan should be maintained in accrual status requiring no impairment.

Credit Risk Management

Allowance for Loan and Lease Losses

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

At September 30, 2014, the Company's allowance for non-covered loan and lease losses amounted to \$64.9 million, an increase from \$54.3 million at December 31, 2013. At September 30, 2014, \$50.3 million of the allowance corresponded to originated and other loans held for investment, or 1.84% of total non-covered originated and other loans held for investment, compared to \$49.1 million or 2.04% of total non-covered originated and other loans held for investment at December 31, 2013. The allowance increased as a result of a \$21.6 million provision for loan and lease losses and \$7.2 million of recoveries, which were partially offset by charge-offs of \$27.6 million during the nine-month period ended September 30, 2014. The allowance for residential mortgage loans and commercial loans decreased by 5.3% (or \$1.1 million), and 38.8% (or \$5.8 million), respectively, when compared with the balances recorded at December 31, 2013. The allowance for consumer loans and auto and leases increased by 45.0% (or \$2.7 million) and 70.4% (or \$5.5 million), respectively, when compared with the balances recorded at December 31, 2013. The unallocated allowance at September 30, 2014 decreased by 51.4%, or \$193 thousand, when compared with the balance recorded at December 31, 2013. Changes are related to the evolution and the current trends of the portfolio. In the mortgage and commercial portfolios, losses have decreased, therefore less reserve was required. In the consumer and auto portfolios, losses had increased, therefore higher reserve was required.

Allowance for loan and lease losses recorded for acquired non-covered loans accounted for under the provisions of ASC 310-20 at September 30, 2014 was \$4.5 million compared to \$2.4 million at December 31, 2013, a 89.5% increase. The allowance increased as a result of a \$10.5 million provision for loan and lease losses and \$1.9 million of recoveries, which were partially offset by \$10.4 million in charge-offs during the nine-month period ended September

30, 2014. The allowance for commercial loans decreased by 70.8% (or \$656 thousand), when compared with the balance recorded at December 31, 2013. The allowance for consumer and auto loans increased by 100% (or \$1.0 million) and 121.2% (or \$1.7 million), respectively, when compared with the balances recorded at December 31, 2013, due to the normal amortization of credit discount of these acquired loans.

Allowance for loan and lease losses recorded for acquired non-covered loans accounted for under ASC-310-30 at September 30, 2014 was \$10.1 million as compared to \$2.9 million at December 31, 2013. The allowance increased as a result of a \$7.3 million provision for loan and lease losses during the nine-month period ended September 30, 2014. The allowance for commercial loans increased by 490.5% (or \$8.4 million), when compared with the balance recorded at December 31, 2013. The allowance for consumer and auto loans decreased by 98.8% (or \$413 thousand) and 100% (or \$732 thousand), respectively, when compared with the balances recorded at December 31, 2013.

Allowance for loan and lease losses recorded for covered loans at September 30, 2014 was \$62.2 million as compared to \$52.7 million at December 31, 2013. The allowance increased as a result of a \$4.3 million provision for loan and lease losses and \$5.2 million of FDIC shared-loss portion of provision for covered loan and lease losses during the nine-month period ended September 30, 2014. The allowance for loan and lease losses on covered loans is accounted under the provisions of ASC 310-30. Under this accounting guidance, the allowance for loan and lease losses on covered loans is evaluated at each financial reporting period, based on forecasted cash flows. Credit related decreases in expected cash flows, compared to those previously forecasted, are recognized by recording a provision for credit losses on covered loans when it is probable that all cash flows expected at acquisition will not be collected. The portion of the loss on covered loans reimbursable from the FDIC is recorded as an offset to the provision for credit losses and increases the FDIC indemnification asset.

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

Non-performing Assets

The Company’s non-performing assets include non-performing loans and foreclosed real estate (see Tables 11 and 12). At September 30, 2014 and December 31, 2013, the Company had \$103.7 million and \$86.2 million, respectively, of non-accrual loans, including acquired loans accounted under ASC 310-20 (loans with revolving feature and/or acquired at a premium). At September 30, 2014 and December 31 2013, loans whose terms have been extended and which are classified as troubled-debt restructuring that are not included in non-performing assets amounted to \$273.6 million and \$66.5 million, respectively.

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

At September 30, 2014, the Company’s non-performing assets increased by 13.4% to \$176.1 million (3.07% of total assets, excluding covered assets and acquired loans with deteriorated credit quality) from \$155.3 million (2.61% of total assets, excluding covered assets and acquired loans with deteriorated credit quality) at December 31, 2013. The Company does not expect non-performing loans to result in significantly higher losses as most are well-collateralized with adequate loan-to-value ratios. At September 30, 2014, the allowance for non-covered originated loan and lease losses to non-performing loans coverage ratio was 50.50% (61.52% at December 31, 2013).

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

The following items comprise non-performing assets:

- Originated and other loans held for investment:

Mortgage loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan, except for FHA and VA insured mortgage loans which are placed in non-accrual when they become 18 months or more past due. At September 30, 2014, the Company's originated non-performing mortgage loans totaled \$67.0 million (64.6% of the Company's non-performing loans), a 31.3% increase from \$51.1 million (59.4% of the Company's non-performing loans) at December 31, 2013. Non-performing loans in this category are primarily residential mortgage loans.

Commercial loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the underlying collateral, if any. At September 30, 2014, the Company's originated non-performing commercial loans amounted to \$22.3 million (21.5% of the Company's non-performing loans), a 2.4% decrease from \$22.8 million at December 31, 2013 (26.5% of the Company's non-performing loans). Most of this portfolio is collateralized by commercial real estate properties.

Consumer loans — are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 120 days in personal loans and 180 days in credit cards and personal lines of credit. At September 30, 2014, the Company's originated non-performing consumer loans amounted to \$1.2 million (1.2% of the Company's total non-performing loans), a 54.2% increase from \$805 thousand at December 31, 2013 (0.9% of the Company's total non-performing loans).

Auto loans and leases — are placed on non-accrual status when they become 90 days past due, partially written-off to collateral value when payments are delinquent 120 days, and fully written-off when payments are delinquent 180 days. At September 30, 2014, the Company's originated non-performing auto loans and leases amounted to \$9.0 million (8.7% of the Company's total non-performing loans), an increase of 77.0% from \$5.1 million at December 31, 2013 (5.9% of the Company's total non-performing loans).

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

Commercial revolving lines of credit and credit cards — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the underlying collateral, if any. At September 30, 2014, the Company's acquired non-performing commercial lines of credit accounted for under ASC 310-20 amounted to \$1.0 million (1.0% of the Company's non-performing loans), a 59.9% decrease from \$2.5 million at December 31, 2013 (3.0% of the Company's non-performing loans).

Consumer revolving lines of credit and credit cards — are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 180 days. At September 30, 2014, the Company's acquired non-performing consumer lines of credit and credit cards accounted for under ASC 310-20 totaled \$1.4 million (1.4% of the Company's non-performing loans), a 36.8% decrease from \$2.2 million at December 31, 2013 (2.6% of the Company's non-performing loans).

Auto loans acquired at premium - are placed on non-accrual status when they become 90 days past due, partially written-off to collateral value when payments are delinquent 120 days, and fully written-off when payments are delinquent 180 days. At September 30, 2014, the Company's acquired non-performing auto loans accounted for under ASC 310-20 totaled \$1.7 million (1.7% of the Company's non-performing loans), an 8.6% increase from \$1.6 million at December 31, 2013 (1.9% of the Company's non-performing loans).

- Foreclosed real estate is initially recorded at the lower of the related loan balance or fair value less the estimated cost to sell as of the date of foreclosure. Any excess of the loan balance over the fair value of the property is charged against the allowance for loan and lease losses. Subsequently, any excess of the carrying value over the estimated fair value less disposition cost is charged to operations. Net losses on foreclosed real estate and other repossessed assets for the quarter and nine month period ended September 30, 2014, amounted to \$5.3 million and \$13.7 million, respectively, compared to \$3.6 million and \$7.1 million for the same periods in 2013.

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

The Loss Mitigation Program helps mortgage borrowers who are or will become financially unable to meet the current or scheduled mortgage payments. Loans that qualify under this program are those guaranteed by FHA, VA, RHS, "Banco de la Vivienda de Puerto Rico," conventional loans guaranteed by Mortgage Guaranty Insurance Corporation (MGIC), conventional loans sold to FNMA and FHLMC, and conventional loans retained by the Company. The program offers diversified alternatives such as regular or reduced payment plans, payment moratorium, mortgage loan modification, partial claims (only FHA), short sale, and payment in lieu of foreclosure.

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

There may not be a foreclosure sale scheduled within 60 days prior to a loan modification under any such programs. This requirement does not apply to loans where the foreclosure process has been stopped by the Company. In order to apply for any of the loan modification programs, the borrower may not be in active bankruptcy or have been discharged from Chapter 7 bankruptcy since the

loan was originated. Loans in these programs are to be evaluated by management for troubled-debt restructuring classification if the Company grants a concession for legal or economic reasons due to the debtor's financial difficulties.

| TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES SUMMARY | | | | | | | | | | |
|--|--|--|-------------|--|-----------------|--|--|-------------|----------|-----------------|
| | | | | | | | | | | |
| | | | | | | | | | | |
| | Quarter Ended September 30, | | | | Variance | Nine-Month Period Ended September 30, | | | | Variance |
| | 2014 | | 2013 | | % | 2014 | | 2013 | % | |
| | (Dollars in thousands) | | | | | | | | | |
| <u>Non-covered loans</u> | | | | | | | | | | |
| <u>Originated and other loans:</u> | | | | | | | | | | |
| Balance at beginning of period | \$ 50,638 | | \$ 45,701 | | 10.8% | \$ 49,081 | | \$ 39,921 | 22.9% | |
| Provision for non-covered loan and lease losses | 8,569 | | 6,930 | | 23.7% | 21,625 | | 48,645 | -55.5% | |
| Charge-offs | (11,622) | | (5,762) | | 101.7% | (27,621) | | (42,282) | -34.7% | |
| Recoveries | 2,694 | | 704 | | 282.7% | 7,194 | | 1,289 | 458.1% | |
| | 50,279 | | 47,573 | | 5.7% | 50,279 | | 47,573 | 5.7% | |
| <u>Acquired loans accounted for under ASC 310-20:</u> | | | | | | | | | | |
| Balance at beginning of period | \$ 3,444 | | \$ 924 | | 100.0% | \$ 2,354 | | \$ - | 100.0% | |
| Provision for non-covered loan and lease losses | 3,731 | | 2,970 | | 25.6% | 10,542 | | 6,698 | 57.4% | |
| Charge-offs | (3,408) | | (2,831) | | 20.4% | (10,368) | | (8,595) | 20.6% | |
| Recoveries | 693 | | 978 | | -29.1% | 1,932 | | 3,938 | -50.9% | |
| | 4,460 | | 2,041 | | 118.5% | 4,460 | | 2,041 | 118.5% | |
| <u>Acquired loans accounted for under ASC</u> | | | | | | | | | | |

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|--|----|---------------|----|---------------|--------------|----|---------------|----|---------------|--------------|--|--|--|
| 310-30: | | | | | | | | | | | | | |
| Balance at beginning of period | \$ | 6,278 | \$ | - | 100.0% | \$ | 2,863 | \$ | - | 100.0% | | | |
| Provision for non-covered loan and lease losses | | 3,842 | | - | 100.0% | | 7,257 | | - | 100.0% | | | |
| | | 10,120 | | - | 100.0% | | 10,120 | | - | 100.0% | | | |
| Total non-covered loans balance at end of period | \$ | 64,859 | \$ | 49,614 | 30.7% | \$ | 64,859 | \$ | 49,614 | 30.7% | | | |
| Allowance for loans and lease losses on originated and other loans to: | | | | | | | | | | | | | |
| Total originated loans | | 1.84% | | 2.03% | -9.2% | | 1.84% | | 2.03% | -9.2% | | | |
| Non-performing originated loans | | 50.50% | | 59.78% | -15.5% | | 50.50% | | 59.78% | -15.5% | | | |
| Allowance for loans and lease losses on acquired loans accounted for under ASC 310-20 to: | | | | | | | | | | | | | |
| Total acquired loans accounted for under ASC 310-20 | | 1.56% | | 0.39% | 100.0% | | 1.56% | | 0.39% | 100.0% | | | |
| Non-performing acquired loans accounted for under ASC 310-20 | | 107.03% | | 70.33% | 52.2% | | 107.03% | | 70.33% | 52.2% | | | |
| Covered loans | | | | | | | | | | | | | |

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|--|----|---------------|----|---------------|--------------|----|---------------|----|---------------|--------------|
| Balance at beginning of period | \$ | 59,515 | \$ | 53,992 | 10.2% | \$ | 52,729 | \$ | 54,124 | -2.6% |
| Provision for covered loan and lease losses, net | | 1,115 | | 3,074 | -63.7% | | 4,339 | | 4,956 | -12.4% |
| FDIC shared-loss portion on (provision for) recapture of loan and lease losses | | 1,597 | | (511) | -412.5% | | 5,159 | | (2,525) | -304.3% |
| Balance at end of period | \$ | 62,227 | \$ | 56,555 | 10.0% | \$ | 62,227 | \$ | 56,555 | 10.0% |

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| TABLE 9 — ALLOWANCE FOR NON-COVERED LOAN AND LEASE LOSSES BREAKDOWN | | | | | | |
|--|-----------|-------------------------------|--|--------------------------|----------------|-----------------------|
| | | September 30, 2014 | | December 31, 2013 | | Variance % |
| (Dollars in thousands) | | | | | | |
| Originated and other loans held for investment | | | | | | |
| Allowance balance: | | | | | | |
| Mortgage | \$ | 18,872 | | \$ | 19,937 | -5.3% |
| Commercial | | 9,112 | | | 14,897 | -38.8% |
| Consumer | | 8,709 | | | 6,006 | 45.0% |
| Auto and leasing | | 13,404 | | | 7,866 | 70.4% |
| Unallocated allowance | | 182 | | | 375 | -51.5% |
| Total allowance balance | \$ | 50,279 | | \$ | 49,081 | 2.4% |
| Allowance composition: | | | | | | |
| Mortgage | | 37.53% | | | 40.62% | -7.6% |
| Commercial | | 18.12% | | | 30.35% | -40.3% |
| Consumer | | 17.32% | | | 12.24% | 41.5% |
| Auto and leasing | | 26.66% | | | 16.03% | 66.3% |
| Unallocated allowance | | 0.37% | | | 0.76% | -51.3% |
| | | 100.00% | | | 100.00% | |
| Allowance coverage ratio at end of period applicable to: | | | | | | |
| Mortgage | | 2.39% | | | 2.60% | -8.3% |
| Commercial | | 0.75% | | | 1.32% | -43.3% |
| Consumer | | 4.95% | | | 4.70% | 5.3% |
| Auto and leasing | | 2.47% | | | 2.07% | 19.2% |
| Unallocated allowance to total originated loans | | 0.01% | | | 0.02% | -57.3% |
| Total allowance to total originated loans | | 1.84% | | | 2.04% | -9.8% |
| Allowance coverage ratio to non-performing loans: | | | | | | |
| Mortgage | | 28.16% | | | 39.05% | -27.9% |
| Commercial | | 40.88% | | | 65.25% | -37.4% |
| Consumer | | 701.77% | | | 746.09% | -5.9% |
| Auto and leasing | | 148.80% | | | 154.57% | -3.7% |
| Total | | 50.50% | | | 61.52% | -17.9% |
| Acquired loans accounted for under ASC 310-20 | | | | | | |
| Allowance balance: | | | | | | |
| Commercial | \$ | 270 | | \$ | 926 | -70.8% |
| Consumer | | 1,031 | | | - | 100.0% |

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|---|-----------|----------------|--|-----------|----------------|--|---------------|
| Auto | | 3,159 | | | 1,428 | | 121.2% |
| Total allowance balance | \$ | 4,460 | | \$ | 2,354 | | 89.5% |
| Allowance composition: | | | | | | | |
| Commercial | | 6.05% | | | 39.34% | | -84.6% |
| Consumer | | 23.12% | | | 0.00% | | 100.0% |
| Auto | | 70.83% | | | 60.66% | | 16.8% |
| | | 100.00% | | | 100.00% | | |
| Allowance coverage ratio at end of period applicable to: | | | | | | | |
| Commercial | | 1.00% | | | 1.19% | | -16.1% |
| Consumer | | 2.18% | | | 0.00% | | 100.0% |
| Auto | | 1.50% | | | 0.47% | | 216.5% |
| Total allowance to total acquired loans | | 1.56% | | | 0.54% | | 189.4% |
| Allowance coverage ratio to non-performing loans: | | | | | | | |
| Commercial | | 26.50% | | | 36.41% | | -27.2% |
| Consumer | | 73.54% | | | 0.00% | | 100.0% |
| Auto | | 180.93% | | | 88.81% | | 103.7% |
| Total | | 107.03% | | | 36.95% | | 189.6% |

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| TABLE 9 — ALLOWANCE FOR NON-COVERED LOAN AND LEASE LOSSES BREAKDOWN (CONTINUED) | | | | | | | |
|--|-------------------------------|-------------------------------|-----------|--------------------------|--|-----------------------|--|
| | | September 30, 2014 | | December 31, 2013 | | Variance % | |
| | (Dollars in thousands) | | | | | | |
| Acquired loans accounted for under ASC 310-30 | | | | | | | |
| Allowance balance: | | | | | | | |
| Commercial | \$ | 10,115 | \$ | 1,713 | | 490.5% | |
| Consumer | | 5 | | 418 | | 100.0% | |
| Auto | | - | | 732 | | -100.0% | |
| Total allowance balance | \$ | 10,120 | \$ | 2,863 | | 253.5% | |
| Allowance composition: | | | | | | | |
| Commercial | | 99.95% | | 59.83% | | 67.1% | |
| Consumer | | 0.05% | | 14.60% | | 100.0% | |
| Auto | | 0.00% | | 25.57% | | -100.0% | |
| | | 100.00% | | 100.00% | | | |

| TABLE 10 — NET CREDIT LOSSES STATISTICS ON LOAN AND LEASES, EXCLUDING LOANS ACCOUNTED FOR UNDER ASC 310-30 | | | | | | | | | |
|---|------------------------------------|-------------------|---------------|--------------------|--|---------------|--|-----------------|--|
| | Quarter Ended September 30, | | | Variance | Nine-Month Period Ended September 30, | | | Variance | |
| | 2014 | 2013 | % | 2014 | 2013 | % | | | |
| (Dollar in thousands) | | | | | | | | | |
| Originated and other loans and leases: | | | | | | | | | |
| Mortgage | | | | | | | | | |
| Charge-offs | \$ (1,563) | \$ (1,758) | -11.1% | \$ (3,764) | \$ (33,466) | -88.8% | | | |
| Recoveries | 138 | - | 100.0% | 374 | - | 100.0% | | | |
| Total | (1,425) | (1,758) | -18.9% | (3,390) | (33,466) | -89.9% | | | |
| Commercial | | | | | | | | | |
| Charge-offs | (1,081) | (2,234) | -51.6% | (2,043) | (5,678) | -64.0% | | | |
| Recoveries | 56 | 28 | 100.0% | 269 | 290 | -7.2% | | | |
| Total | (1,025) | (2,206) | -53.5% | (1,774) | (5,388) | -67.1% | | | |
| Consumer | | | | | | | | | |
| Charge-offs | (1,585) | (465) | 240.9% | (3,820) | (1,034) | 269.4% | | | |
| Recoveries | 66 | 37 | 78.4% | 457 | 145 | 215.2% | | | |
| Total | (1,519) | (428) | 254.9% | (3,363) | (889) | 278.3% | | | |
| Auto | | | | | | | | | |
| Charge-offs | (7,393) | (1,305) | 466.5% | (17,994) | (2,105) | 754.8% | | | |
| Recoveries | 2,434 | 639 | 280.9% | 6,094 | 855 | 612.7% | | | |
| Total | (4,959) | (666) | 644.6% | (11,900) | (1,250) | 852.0% | | | |
| Net credit losses | | | | | | | | | |
| Total charge-offs | (11,622) | (5,762) | 101.7% | (27,621) | (42,283) | -34.7% | | | |
| Total recoveries | 2,694 | 704 | 282.7% | 7,194 | 1,290 | 457.7% | | | |
| Total | \$ (8,928) | \$ (5,058) | 76.5% | \$ (20,427) | \$ (40,993) | -50.2% | | | |
| Net credit losses to average loans outstanding: | | | | | | | | | |
| Mortgage | 0.72% | 0.92% | -21.7% | 0.57% | 5.70% | -90.0% | | | |
| Commercial | 0.34% | 1.04% | -67.3% | 0.20% | 1.88% | -89.4% | | | |
| Consumer | 3.77% | 1.75% | 115.4% | 3.08% | 1.73% | 78.0% | | | |
| Auto | 3.73% | 0.98% | 280.6% | 3.32% | 1.15% | 188.7% | | | |
| Total | 1.34% | 1.02% | 31.4% | 1.05% | 3.96% | -73.5% | | | |
| Recoveries to charge-offs | 23.18% | 12.22% | 89.7% | 26.05% | 3.05% | 753.7% | | | |

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| Average originated loans: | | | | | | | | | | |
|----------------------------------|-----------|------------------|-----------|------------------|--------------|-----------|------------------|-----------|------------------|--------------|
| Mortgage | \$ | 789,204 | \$ | 763,929 | 3.3% | \$ | 786,434 | \$ | 783,172 | 0.4% |
| Commercial | | 1,190,607 | | 852,395 | 39.7% | | 1,174,220 | | 382,654 | 206.9% |
| Consumer | | 161,147 | | 97,738 | 64.9% | | 145,659 | | 68,480 | 112.7% |
| Auto | | 531,914 | | 271,727 | 95.8% | | 478,592 | | 144,995 | 230.1% |
| Total | \$ | 2,672,872 | \$ | 1,985,789 | 34.6% | \$ | 2,584,905 | \$ | 1,379,301 | 87.4% |

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| TABLE 10 — NET CREDIT LOSSES STATISTICS ON LOAN AND LEASES, EXCLUDING LOANS ACCOUNTED FOR UNDER ASC 310-30 (CONTINUED) | | | | | | | | | | | |
|---|------------------------------------|----------------|-------------|----------------|-----------------|--|----------------|-------------|----------------|-----------------|--|
| | Quarter Ended September 30, | | | | Variance | Nine-Month Period Ended September 30, | | | | Variance | |
| | 2014 | | 2013 | | | 2014 | | 2013 | | | |
| (Dollars in thousands) | | | | | | | | | | | |
| Acquired loans accounted for under ASC 310-20: | | | | | | | | | | | |
| Commercial | | | | | | | | | | | |
| Charge-offs | \$ | (228) | \$ | - | 100.0% | \$ | (512) | \$ | (25) | 1948.0% | |
| Recoveries | | 35 | | 6 | 483.3% | | 65 | | 6 | 983.3% | |
| Total | | (193) | | 6 | -3316.7% | | (447) | | (19) | 2252.6% | |
| Consumer | | | | | | | | | | | |
| Charge-offs | | (1,432) | | (1,233) | 16.1% | | (5,442) | | (3,847) | 41.5% | |
| Recoveries | | 139 | | 88 | 58.0% | | 363 | | 932 | -61.1% | |
| Total | | (1,293) | | (1,145) | 12.9% | | (5,079) | | (2,915) | 74.2% | |
| Auto | | | | | | | | | | | |
| Charge-offs | | (1,747) | | (1,598) | 9.3% | | (4,413) | | (4,723) | -6.6% | |
| Recoveries | | 519 | | 884 | -41.3% | | 1,504 | | 3,000 | -49.9% | |
| Total | | (1,228) | | (714) | 72.0% | | (2,909) | | (1,723) | 68.8% | |
| Net credit losses | | | | | | | | | | | |
| Total charge-offs | | (3,407) | | (2,831) | 20.3% | | (10,367) | | (8,595) | 20.6% | |
| Total recoveries | | 693 | | 978 | -29.1% | | 1,932 | | 3,938 | -50.9% | |
| Total | \$ | (2,714) | \$ | (1,853) | 46.5% | \$ | (8,435) | \$ | (4,657) | 81.1% | |
| Net credit losses to average loans outstanding: | | | | | | | | | | | |
| Commercial | | 7.26% | | -0.01% | -62125.6% | | 1.66% | | 0.01% | 28946.2% | |
| Consumer | | 7.88% | | 6.30% | 25.1% | | 10.05% | | 4.93% | 103.7% | |
| Auto | | 2.21% | | 0.81% | 171.6% | | 1.54% | | 0.53% | 190.1% | |
| Total | | 3.64% | | 1.18% | 208.6% | | 3.17% | | 0.65% | 387.4% | |
| Recoveries to charge-offs | | 20.34% | | 34.55% | -41.1% | | 18.64% | | 45.82% | -59.3% | |
| Average loans accounted for under ASC 310-20: | | | | | | | | | | | |

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|--------------|-----------|----------------|-----------|----------------|--|---------------|-----------|----------------|-----------|----------------|--|---------------|
| Commercial | \$ | 10,634 | \$ | 205,051 | | -94.8% | \$ | 35,983 | \$ | 444,255 | | -91.9% |
| Consumer | | 65,639 | | 72,726 | | -9.7% | | 67,399 | | 78,803 | | -14.5% |
| Auto | | 221,989 | | 350,587 | | -36.7% | | 251,808 | | 432,673 | | -41.8% |
| Total | \$ | 298,262 | \$ | 628,364 | | -52.5% | \$ | 355,190 | \$ | 955,731 | | -62.8% |

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| TABLE 11 — NON-PERFORMING ASSETS | | | | | | |
|---|----------------------|----------------|---------------------|----------------|-----------------|--------------|
| | September 30, | | December 31, | | Variance | |
| | 2014 | | 2013 | | (%) | |
| (Dollars in thousands) | | | | | | |
| Non-performing assets: | | | | | | |
| Non-accruing loans | | | | | | |
| Troubled-Debt Restructuring loans | \$ | 26,558 | \$ | 26,847 | | -1.1% |
| Other loans | | 70,490 | | 56,430 | | 24.9% |
| Accruing loans | | | | | | |
| Troubled-Debt Restructuring loans | | 3,844 | | 1,898 | | 102.5% |
| Other loans | | 2,842 | | 977 | | 190.9% |
| Total non-performing loans | \$ | 103,734 | \$ | 86,152 | | 20.4% |
| Foreclosed real estate not covered under the shared-loss agreements with the FDIC | | 50,750 | | 56,815 | | -10.7% |
| Other repossessed assets | | 21,576 | | 12,314 | | 75.2% |
| | \$ | 176,060 | \$ | 155,281 | | 13.4% |
| Non-performing assets to total assets, excluding covered assets and acquired loans with deteriorated credit quality (including those by analogy) | | 3.07% | | 2.61% | | 17.6% |
| Non-performing assets to total capital | | 18.93% | | 17.55% | | 7.9% |

| | Quarter Ended September 30, | | | | Nine-Month Period Ended September 30, | | | |
|--|------------------------------------|-----|-------------|-----|--|-------|-------------|-------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| (In thousands) | | | | | | | | |
| Interest that would have been recorded in the period if the loans had not been classified as non-accruing loans | \$ | 833 | \$ | 560 | \$ | 1,389 | \$ | 1,371 |

| TABLE 12 — NON-PERFORMING LOANS | | | | | | | |
|--|----------------------|----------------|---------------------|---------------|-----------------|--------------|--|
| | September 30, | | December 31, | | Variance | | |
| | 2014 | | 2013 | | % | | |
| (Dollars in thousands) | | | | | | | |
| Non-performing loans: | | | | | | | |
| Originated and other loans held for investment | | | | | | | |
| Mortgage | \$ | 67,028 | \$ | 51,058 | | 31.3% | |
| Commercial | | 22,290 | | 22,830 | | -2.4% | |
| Consumer | | 1,241 | | 805 | | 54.2% | |
| Auto and leasing | | 9,008 | | 5,089 | | 77.0% | |
| | | 99,567 | | 79,782 | | 24.8% | |
| Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium) | | | | | | | |
| Commercial | | 1,019 | | 2,543 | | -59.9% | |
| Consumer | | 1,402 | | 2,219 | | -36.8% | |
| Auto | | 1,746 | | 1,608 | | 8.6% | |
| | | 4,167 | | 6,370 | | -34.6% | |
| Total | \$ | 103,734 | \$ | 86,152 | | 20.4% | |
| Non-performing loans composition percentages: | | | | | | | |
| Originated loans | | | | | | | |
| Mortgage | | 64.6% | | 59.4% | | | |
| Commercial | | 21.5% | | 26.5% | | | |
| Consumer | | 1.2% | | 0.9% | | | |
| Auto and leasing | | 8.7% | | 5.9% | | | |
| Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium) | | | | | | | |
| Commercial | | 1.0% | | 3.0% | | | |
| Consumer | | 1.4% | | 2.6% | | | |
| Auto | | 1.7% | | 1.9% | | | |
| Total | | 100.0% | | 100.0% | | | |
| Non-performing loans to: | | | | | | | |
| Total loans, excluding covered loans and loans accounted for | | 3.44% | | 3.04% | | 13.1% | |

| | | | | | | | | |
|---|--|---------------|--|--|---------------|--|--------------|--|
| under ASC 310-30 (including those by analogy) | | | | | | | | |
| Total assets, excluding covered assets and loans accounted for | | | | | | | | |
| under ASC 310-30 (including those by analogy) | | 1.81% | | | 1.45% | | 24.8% | |
| Total capital | | 11.15% | | | 9.74% | | 14.6% | |
| Non-performing loans with partial charge-offs to: | | | | | | | | |
| Total loans, excluding covered loans and loans accounted for | | | | | | | | |
| under ASC 310-30 (including those by analogy) | | 1.02% | | | 0.83% | | 22.9% | |
| Non-performing loans | | 29.51% | | | 27.35% | | 7.9% | |
| Other non-performing loans ratios: | | | | | | | | |
| Charge-off rate on non-performing loans to non-performing loans | | | | | | | | |
| on which charge-offs have been taken | | 54.35% | | | 56.05% | | -3.0% | |
| Allowance for loan and lease losses to non-performing | | | | | | | | |
| loans on which no charge-offs have been taken | | 74.86% | | | 82.18% | | -8.9% | |

| TABLE 13 - LIABILITIES SUMMARY AND COMPOSITION | | | | | | |
|--|----|--------------------------|--|-------------------------|----|-----------------------|
| | | September 30, | | December 31, | | |
| | | 2014 | | 2013 | | Variance % |
| (Dollars in thousands) | | | | | | |
| Deposits: | | | | | | |
| Non-interest bearing deposits | \$ | 734,449 | | \$ 744,328 | | -1.3% |
| NOW accounts | | 1,397,600 | | 1,393,645 | | 0.3% |
| Savings and money market accounts | | 1,263,114 | | 1,194,566 | | 5.7% |
| Certificates of deposit | | 1,672,708 | | 2,048,040 | | -18.3% |
| Total deposits | | 5,067,871 | | 5,380,579 | | -5.8% |
| Accrued interest payable | | 1,304 | | 2,686 | | -51.5% |
| Total deposits and accrued interest payable | | 5,069,175 | | 5,383,265 | | -5.8% |
| Borrowings: | | | | | | |
| Securities sold under agreements to repurchase | | 1,012,228 | | 1,267,618 | | -20.1% |
| Advances from FHLB | | 334,787 | | 336,143 | | -0.4% |
| Other term notes | | 3,872 | | 3,663 | | 5.7% |
| Subordinated capital notes | | 101,190 | | 100,010 | | 1.2% |
| Total borrowings | | 1,452,077 | | 1,707,434 | | -15.0% |
| Total deposits and borrowings | | 6,521,252 | | 7,090,699 | | -8.0% |
| Other Liabilities: | | | | | | |
| Securities purchased but not yet received | | 30,057 | | - | | 100.0% |
| Derivative liabilities | | 11,414 | | 14,937 | | -23.6% |
| Acceptances outstanding | | 21,077 | | 23,042 | | -8.5% |
| Other liabilities | | 159,541 | | 144,424 | | 10.5% |
| Total liabilities | \$ | 6,743,341 | | 7,273,102 | \$ | -7.3% |
| Deposits portfolio composition percentages: | | | | | | |
| Non-interest bearing deposits | | 14.5% | | 13.8% | | |
| NOW accounts | | 27.6% | | 25.9% | | |
| Savings and money market accounts | | 24.9% | | 22.2% | | |
| Certificates of deposit | | 33.0% | | 38.1% | | |
| | | 100.0% | | 100.0% | | |
| Borrowings portfolio composition percentages: | | | | | | |
| Securities sold under agreements to repurchase | | 69.7% | | 74.2% | | |

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|--|----|---------------|--|----|---------------|--|--|
| Advances from FHLB | | 23.1% | | | 19.7% | | |
| Other term notes | | 0.3% | | | 0.2% | | |
| Subordinated capital notes | | 6.9% | | | 5.9% | | |
| | | 100.0% | | | 100.0% | | |
| Securities sold under agreements to repurchase (excluding accrued interest) | | | | | | | |
| Amount outstanding at period-end | \$ | 1,010,000 | | \$ | 1,265,000 | | |
| Daily average outstanding balance | \$ | 1,058,378 | | \$ | 1,353,011 | | |
| Maximum outstanding balance at any month-end | \$ | 1,149,167 | | \$ | 1,552,269 | | |

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Liabilities and Funding Sources

As shown in Table 13 above, at September 30, 2014, the Company's total liabilities were \$6.743 billion, 7.3% less than the \$7.273 billion reported at December 31, 2013. Deposits and borrowings, the Company's funding sources, amounted to \$6.521 billion at September 30, 2014 versus \$7.091 billion at December 31, 2013, an 8.0% decrease.

At September 30, 2014, deposits represented 78% and borrowings represented 22% of interest-bearing liabilities, compared to 76% and 24%, respectively, at December 31, 2013. At September 30, 2014, deposits, the largest category of the Company's interest-bearing liabilities, were \$5.069 billion, down 5.8% from \$5.383 billion at December 31, 2013. Non-maturing deposit balances increased 1.09%, to \$3.395 billion, while higher-priced time deposits declined 18.3% as part of efforts to reduce the cost of deposits, which averaged 0.66% as of September 30, 2014 compared to 0.73% at December 31, 2013.

Borrowings consist mainly of repurchase agreements, FHLB-NY advances, subordinated capital notes, and short-term borrowings. At September 30, 2014, borrowings amounted to \$1.452 billion, 15.0% lower than the \$1.707 billion reported at December 31, 2013. Repurchase agreements as of September 30, 2014 decreased \$255.4 million to \$1.012 billion from \$1.268 billion at December 31, 2013, as the Company used available cash to pay off repurchase agreements at maturity.

As a member of the FHLB-NY, the Bank can obtain advances from the FHLB-NY secured by the FHLB-NY stock owned by the Bank as well as by certain of the Bank's mortgage loans and investment securities. Advances from the FHLB-NY amounted to \$334.8 million as of September 30, 2014 and \$336.1 million as of December 31, 2013. These advances mature from October 2014 through July 2020.

Stockholders' Equity

At September 30, 2014, the Company's total stockholders' equity was \$930.0 million, a 5.1% increase when compared to \$884.9 million at December 31, 2013. Increase in stockholders' equity was mainly driven by the income for the nine-month period ended September 30, 2014, partially offset by an increase in treasury stock, as a result of the 707,500 repurchased shares of outstanding common stock during the first and third quarter of 2014.

From December 31, 2013 to September 30, 2014, tangible common equity to total assets increased to 8.70% from 7.61%, Tier 1 Leverage Capital Ratio increased to 10.51% from 9.11%, Tier 1 Risk-Based Capital Ratio increased to 15.96% from 14.35%, and Total Risk-Based Capital Ratio increased to 17.50% from 16.14%.

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

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

| TABLE 14 — CAPITAL, DIVIDENDS AND STOCK DATA | | | | | | |
|---|----|----------------------|--|---------------------|---------------|-----------------|
| | | September 30, | | December 31, | | Variance |
| | | 2014 | | 2013 | | % |
| (Dollars in thousands, except per share data) | | | | | | |
| Capital data: | | | | | | |
| Stockholders' equity | \$ | 929,998 | | \$ | 884,913 | 5.1% |
| Regulatory Capital Ratios data: | | | | | | |
| Leverage capital ratio | | 10.51% | | | 9.06% | 16.0% |
| Minimum leverage capital ratio required | | 4.00% | | | 4.00% | |
| Actual tier 1 capital | \$ | 782,797 | | \$ | 736,106 | 6.3% |
| Minimum tier 1 capital required | \$ | 297,984 | | \$ | 324,910 | -8.3% |
| Excess over regulatory requirement | \$ | 484,814 | | \$ | 411,197 | 17.9% |
| Tier 1 risk-based capital ratio | | 15.96% | | | 14.38% | 11.0% |
| Minimum tier 1 risk-based capital ratio required | | 4.00% | | | 4.00% | |
| Actual tier 1 risk-based capital | \$ | 782,797 | | \$ | 736,106 | 6.3% |
| Minimum tier 1 risk-based capital required | \$ | 196,233 | | \$ | 204,757 | -4.2% |
| Excess over regulatory requirement | \$ | 586,565 | | \$ | 531,350 | 10.4% |
| Risk-weighted assets | \$ | 4,905,814 | | \$ | 5,118,927 | -4.2% |
| Total risk-based capital ratio | | 17.50% | | | 16.16% | 8.3% |
| Minimum total risk-based capital ratio required | | 8.00% | | | 8.00% | |
| Actual total risk-based capital | \$ | 858,356 | | \$ | 827,459 | 3.7% |
| Minimum total risk-based capital required | \$ | 392,465 | | \$ | 409,514 | -4.2% |
| Excess over regulatory requirement | \$ | 465,891 | | \$ | 417,946 | 11.5% |
| Risk-weighted assets | \$ | 4,905,814 | | \$ | 5,118,927 | -4.2% |
| Tangible common equity to total assets | | 8.70% | | | 7.61% | 14.3% |
| Tangible common equity to risk-weighted assets | | 13.61% | | | 12.13% | 12.2% |
| Total equity to total assets | | 12.12% | | | 10.85% | 11.7% |
| Total equity to risk-weighted assets | | 18.96% | | | 17.29% | 9.7% |
| Tier 1 common equity to risk-weighted assets | | 11.86% | | | 10.46% | 13.4% |
| Tier 1 common equity capital | \$ | 581,927 | | \$ | 535,237 | 8.7% |
| Stock data: | | | | | | |

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| | | | | | | | |
|--|----|------------|--|----|------------|--|--------|
| Outstanding common shares | | 45,059,988 | | | 45,676,922 | | -1.4% |
| Book value per common share | \$ | 16.96 | | \$ | 15.74 | | 7.8% |
| Tangible book value per common share | \$ | 14.82 | | \$ | 13.60 | | 9.0% |
| Market price at end of period | \$ | 14.98 | | \$ | 17.34 | | -13.6% |
| Market capitalization at end of period | \$ | 674,999 | | \$ | 792,038 | | -14.8% |

| | Nine-Month Period Ended September 30, | | | | Variance |
|-----------------------------------|---------------------------------------|--------|------|--------|----------|
| | 2014 | | 2013 | | % |
| Common dividend data: | | | | | |
| Cash dividends declared | \$ | 10,822 | \$ | 8,219 | 31.7% |
| Cash dividends declared per share | \$ | 0.24 | \$ | 0.18 | 33.3% |
| Payout ratio | | 21.05% | | 12.95% | 62.6% |
| Dividend yield | | 2.14% | | 1.48% | 44.1% |

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

| | September 30, | | December 31, |
|----------------------------|----------------------|--|---------------------|
| | 2014 | | 2013 |
| | | (In thousands, except share or per share information) | |
| Total stockholders' equity | | | |