

OFG BANCORP
Form 10-Q
May 10, 2013

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 March 31, 2013

or

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

For the transition period from _____ to _____

Commission File Number 001-12647

OFG Bancorp

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

Principal Executive Offices:

254 Muñoz Rivera Avenue

San Juan, Puerto Rico 00918

Telephone Number: (787) 771-6800

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

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

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

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

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

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

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

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FORWARD-LOOKING STATEMENTS

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

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

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

- possible legislative, tax or regulatory changes; and
- difficulties in integrating the acquired Puerto Rico operations of Banco Bilbao Vizcaya Argentaria, S. A. (“BBVAPR”) into the Company’s operations.

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

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

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF MARCH 31, 2013 AND DECEMBER 31, 2012

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

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

See notes to unaudited consolidated financial statements.

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

Quarter Ended March 31,
2013 2012
(In thousands, except per share data)

Interest income:

Loans not covered under shared-loss agreements with the FDIC	\$	80,263	\$	18,123
Loans covered under shared-loss agreements with the FDIC		20,229		21,541
Total interest income from loans		100,492		39,664
Mortgage-backed securities		10,818		28,063
Investment securities and other		2,318		2,192
Total interest income		113,628		69,919

Interest expense:

Deposits		10,478		9,123
Securities sold under agreements to repurchase		7,248		17,570
Advances from FHLB and other borrowings		1,660		3,004
FDIC-guaranteed term notes		-		909
Subordinated capital notes		1,660		328
Total interest expense		21,046		30,934

Net interest income

		92,582		38,985
Provision for non-covered loan and lease losses		7,916		3,000
Provision for covered loan and lease losses, net		672		7,157

Total provision for loan and lease

losses		8,588		10,157
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Net interest income after provision for loan and lease losses

		83,994		28,828
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Non-interest income:

Financial service revenue		7,660		5,889
Banking service revenue		12,382		3,080
Mortgage banking activities		3,153		2,502
Total banking and financial service revenue		23,195		11,471

Net amortization of FDIC shared-loss indemnification asset		(12,871)		(4,827)
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Net gain (loss) on:

Sale of securities		-		7,360
Derivatives		(298)		-
Foreclosed real estate		(1,793)		(398)
Early extinguishment of subordinated capital notes		1,061		-

Other		(38)		(842)
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Total non-interest income, net		9,256		12,764
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Non-interest expense:

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

See notes to unaudited consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

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

See notes to unaudited consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

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

See notes to unaudited consolidated financial statements.

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

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

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

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS – (Continued)

FOR THE QUARTERS ENDED MARCH 31, 2013 AND 2012

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

See notes to unaudited consolidated financial statements

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION, CONSOLIDATION AND BASIS OF PRESENTATION

Nature of Operations

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

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

Basis of Presentation and Use of Estimates

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

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

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

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

Significant Accounting Policies

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Presentation of Comprehensive Income

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

Comprehensive Income is included in these unaudited consolidated financial statements.

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

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

Future Application of Accounting Standards

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 2 – BUSINESS COMBINATIONS***BBVAPR Acquisition***

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

Merger and Restructuring Charges

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

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

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

Restructuring Reserve

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

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

Quarter ended March 31,
2013
(In thousands)

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

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

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

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

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

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

OFG BANCORP**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)****NOTE 3 - INVESTMENTS***Money Market Investments*

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

Securities Purchased Under Agreements to Resell

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

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

Investment Securities

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

The Company, as part of its asset/liability management, may purchase U.S. Treasury securities and U.S. government sponsored agency discount notes close to their maturities as alternative to cash deposits at correspondent banks or as a short term vehicle to reinvest the proceeds of sale transactions until investment securities with attractive yields can be purchased.

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

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

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

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 4 - LOANS RECEIVABLE

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

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

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Non-covered Loans*Originated Loans and Leases

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

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

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

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

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2012

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

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

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

Credit cards, retail and commercial lines of credits, floor plans and performing auto loans with FICO scores over 660 acquired at a premium as part of the BBVAPR Acquisition are to be accounted for under the guidance of ASC 310-20, which requires that any contractually required loan payment receivable in excess of the Company's initial investment in the loans be accreted into interest income on a level-yield basis over the life of the loan. Loans accounted for under ASC 310-20 are placed on non-accrual status when past due in accordance with the Company's non-accrual policy, and any accretion of discount or amortization of premium is discontinued.

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

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

December 31, 2012

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

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

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

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

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

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

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Covered Loans

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

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

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

	2013	Quarter Ended March 31,	2012
	(In thousands)		
Accretable yield activity			
Balance at beginning of period	\$	188,008	\$ 188,822
Accretion		(20,229)	(21,541)
Transfer from non-accretable discount		6,328	7,597
Balance at end of period	\$	174,107	\$ 174,878
	2013	Quarter Ended March 31,	2012
	(In thousands)		
Non-accretable discount activity			
Balance at beginning of period	\$	237,555	\$ 412,170
Principal losses		(16,991)	(24,793)
Transfer to accretable yield		(6,328)	(7,597)
Balance at end of period	\$	214,236	\$ 379,780

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Non-accrual Loans

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

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

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

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

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

OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 5 - ALLOWANCE FOR LOAN AND LEASE LOSSES

Non-Covered Loans

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

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

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

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

Balance at end of period	\$ 22,889	\$ 16,314	\$ 1,313	\$ 1,741	\$ 77	\$ 42,334
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March 31, 2013

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

**Total ending
loan balance**

Impaired Loans

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

The following table presents the interest recognized in commercial and mortgage loans that were individually evaluated for impairment, excluding loans accounted for under ASC 310-30, for the quarters ended March 31, 2013

and 2012:

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

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OFG BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Modifications

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

	Quarter Ended March 31, 2013						
	Pre-Modification Number of contracts	Pre-Modification Outstanding Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months) (Dollars in thousands)	Post-Modification Outstanding Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
Mortgage loans	57	\$7,518	6.28%	331	\$8,040	4.35%	409
	Quarter Ended March 31, 2012						
	Pre-Modification Number of contracts	Pre-Modification Outstanding Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months) (Dollars in thousands)	Post-Modification Outstanding Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
Mortgage loans	58	\$9,445	6.49%	328	\$10,039	4.96%	403
Commercial loans	4	811	6.67%	71	1,173	7.18%	48

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

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

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Consumer	1	\$	18	-	\$	-
Commercial	-	\$	-	1	\$	357
		31				

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Credit Quality Indicators

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

The Company uses the following definitions for risk ratings:

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

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

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

December 31, 2012
Risk Ratings

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Balance	December 31, 2012 Delinquency					Individually Measured for Impairment
		0-29 days	30-59 days	60-89 days	90-119 days	120-364 days	
Outstanding							
Originated loans							

(In thousands)