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POPULAR INC
Form 10-Q
November 10, 2008

## Table of Contents

# UNITED STATES <br> SECURITIES AND EXCHANGE COMMISSION <br> Washington, D.C. 20549 <br> Form 10-Q 

p Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2008
Commission File Number: 000-13818
POPULAR, INC.
(Exact name of registrant as specified in its charter)

## Puerto Rico

66-0667416
(State or other jurisdiction of
(IRS Employer Identification Number) incorporation or organization)

## Popular Center Building

209 Muñoz Rivera Avenue, Hato Rey San Juan, Puerto Rico

00918
(Address of principal executive offices)
(787) 765-9800
(Registrant s telephone number, including area code)
NOT APPLICABLE
(Former name, former address and former fiscal year, if changed since last report)
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. p Yes o 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer p Accelerated filer o Non-accelerated filer o Smaller reporting company o (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). o Yes b No Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: Common Stock $\$ 6$ par value 282,035,628 shares outstanding as of November 4, 2008.

## POPULAR, INC. INDEX

Page
Part I Financial Information
Item 1. Financial Statements
Unaudited Consolidated Statements of Condition as of September 30, 2008, December 31, 2007 and September 30, 2007 ..... 4
Unaudited Consolidated Statements of Operations for the quarters and nine months ended September 30, 2008 and 2007 ..... 5
Unaudited Consolidated Statements of Changes in Stockholders Equity for the nine months ended September 30, 2008 and 2007 ..... 6
Unaudited Consolidated Statements of Comprehensive Income for the quarters and nine months ended September 30, 2008 and 2007 ..... 7
Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2008 and $\underline{2007}$ ..... 8
Notes to Unaudited Consolidated Financial Statements ..... 9
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations ..... 77
Item 3. Quantitative and Qualitative Disclosures about Market Risk ..... 118
Item 4. Controls and Procedures ..... 123
Part II Other Information
Item 1. Legal Proceedings ..... 123
Item 1A. Risk Factors ..... 124
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds ..... 129
Item 5. Other Information ..... 129
Item 6. Exhibits ..... 129
Signatures ..... 130
EX-10.1
EX-10.2
EX-12.1
EX-31.1
EX-31.2
EX-32.1

Edgar Filing: POPULAR INC - Form 10-Q

## Table of Contents

## Forward-Looking Information

The information included in this 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 Corporation s financial condition, results of operations, plans, objectives, future performance and business, including, but not limited to, statements with respect to the adequacy of the allowance for loan losses, 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 Corporation sfinancial 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, 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 are beyond the Corporation 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, 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; the relative strength or weakness of the consumer and commercial credit sectors and of the real estate markets; the performance of the stock and bond markets; competition in the financial services industry; possible legislative, tax or regulatory changes; and difficulties in combining the operations of acquired entities.
Moreover, the outcome of legal proceedings, as discussed in Part II, Item I. Legal Proceedings, is inherently uncertain and depends on judicial interpretations of law and the findings of regulators, judges and juries.
All forward-looking statements included in this document are based upon information available to the Corporation as of the date of this document, and we assume 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.

## Table of Contents

## ITEM 1. FINANCIAL STATEMENTS <br> POPULAR, INC. <br> CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

(In thousands, except share information)
ASSETS
Cash and due from bank

Money market investments:
Federal funds sold
Securities purchased under agreements to resell
Time deposits with other banks

Investment securities available-for-sale, at fair value:
Pledged securities with creditors right to repledge
Other investment securities available-for-sale Investment securities held-to-maturity, at amortized cost (market value as of September 30, 2008-\$716,430;
December 31, 2007-\$486,139; September 30, 2007 \$280,072)
Other investment securities, at lower of cost or realizable value (realizable value as of September 30, 2008 -
\$273,836; December 31, 2007 - $\$ 216,819$; September 30, 2007-\$179,598)
Trading account securities, at fair value:
Pledged securities with creditors right to repledge
Other trading securities
Loans held-for-sale measured at lower of cost or market value

Loans held-in-portfolio:
Loans held-in-portfolio pledged with creditors right to repledge
Other loans
Less Unearned income
Allowance for loan losses
Premises and equipment, net
Other real estate
Accrued income receivable
Servicing assets (at fair value on September 30, 2008 -
$\$ 127,827$; December 31, 2007 - $\$ 191,624$; September 30

Premises and equipment, net
Other real estate
Accrued income receivable
Servicing assets (at fair value on September 30, 2008 -
\$127,827; December 31, 2007-\$191,624; September 30,

September 30, 2008
\$ 1,183,997
\$ 1,183,997

December 31, 2007

September 30, 2007

173,330
121,613
14,554
309,497

3,256,348
4,249,295
4,742,127
4,312,394

719,832

229,158
390,181
54,217
245,134
$1,889,546$
423,303

2007-\$193,255)
Other assets (See Note 9)
Goodwill
Other intangible assets
Assets from discontinued operations (See Note 3)

1,456,994
630,761
69,503
67,662
968,669
\$ 40,390,142
\$ 44,411,437
\$ 47,280,131

## LIABILITIES AND STOCKHOLDERS EQUITY

Liabilities:
Deposits:
Non-interest bearing
Interest bearing

Federal funds purchased and assets sold under agreements to repurchase
Other short-term borrowings
Notes payable
Other liabilities
Liabilities from discontinued operations (See Note 3)

$$
\begin{array}{r}
\$ \quad 4,065,720 \\
23,845,677 \\
\\
27,911,397
\end{array}
$$

$28,334,478$
26,601,515

| $3,730,039$ | $5,437,265$ | $6,287,303$ |
| ---: | ---: | ---: |
| 507,011 | $1,501,979$ | $1,414,897$ |
| $4,242,487$ | $4,621,352$ | $8,314,791$ |
| 811,253 | 934,372 | 857,795 |
| 180,373 |  |  |

$$
37,382,560
$$

$$
40,829,446
$$

$$
43,476,301
$$

Commitments and contingencies (See Note 17)
Minority interest in consolidated subsidiaries
109
109
109

Stockholders equity:
Preferred stock, $\$ 25$ liquidation value; 30,000,000 shares authorized; 7,475,000 Class A shares issued and outstanding in all periods presented; $16,000,000$ Class B shares issued and outstanding at September 30, 2008
Common stock, $\$ 6$ par value; $470,000,000$ shares authorized in all periods presented; 295,335,063 shares issued (December 31, 2007 293,651,398; September 30, 2007 292,993,474) and 281,708,260 outstanding (December 31, 2007 280,029,215; September 30, 2007 279,597,529)
Surplus
Retained earnings
Accumulated other comprehensive loss, net of tax of
(\$22,374) (December 31, 2007 ( $\$ 15,438)$; September 30, 2007 (\$56,551))
Treasury stock at cost, 13,626,803 shares (December 31, 2007 13,622,183; September 30, 2007 13,395,945)

586,875
186,875
186,875

|  |  |  |
| ---: | ---: | ---: |
|  |  |  |
|  |  |  |
| $1,772,010$ | $1,761,908$ | $1,757,961$ |
| 564,021 | 568,184 | 536,129 |
| 384,062 | $1,319,467$ | $1,689,384$ |
|  |  |  |
| $(91,983)$ | $(46,812)$ | $(161,061)$ |
|  | $(207,740)$ | $(205,567)$ |
| $3,007,473$ | $3,581,882$ | $3,803,721$ |
| $\$ 40,390,142$ | $\$ 44,411,437$ | $\$ 47,280,131$ |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

## Table of Contents

## POPULAR, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

|  | Quarter ended |  |
| :---: | :---: | :---: |
| (In thousands, except per share information) | September 30, |  |
|  | 2008 | 2007 |

## INTEREST INCOME:

Loans
Money market investments
Investment securities
Trading account securities
INTEREST EXPENSE:
Deposits
Short-term borrowings

Long-term debt

| 165,611 | 196,825 | 528,596 | 552,657 |
| ---: | ---: | ---: | ---: |
| 37,233 | 108,971 | 137,824 | 340,162 |
| 28,355 | 12,341 | 75,823 | 39,667 |
|  |  |  |  |
| 231,199 | 318,137 | 742,243 | 932,486 |
|  |  |  |  |
| 324,282 | 331,646 | 990,338 | 968,342 |
| 252,160 | 86,340 | 602,561 | 219,477 |
|  |  |  |  |
| 72,122 | 245,306 | 387,777 | 748,865 |
| 52,433 | 49,704 | 155,319 | 146,567 |
| 95,302 | 89,863 | 306,649 | 265,712 |
|  |  |  |  |
| $(9,132)$ | $(776)$ | 69,430 | 112,842 |
| 6,669 | 9,239 | 38,547 | 29,765 |
|  |  |  |  |
| 6,522 | 6,975 | 25,696 | 40,224 |
| 36,134 | 21,920 | 92,836 | 87,968 |
|  |  |  |  |
| 260,050 | 422,231 | $1,076,254$ | $1,431,943$ |

OPERATING EXPENSES:
Personnel costs:

| Salaries | 118,948 | 116,169 | 360,963 | 357,706 |
| :--- | ---: | ---: | ---: | ---: |
| Pension, profit sharing and other benefits | 29,282 | 29,104 | 98,552 | 100,068 |
|  |  |  |  | 457,774 |
| Net occupancy expenses | 148,230 | 145,273 | 459,515 | 46,185 |
| Equipment expenses | 26,510 | 27,083 | 81,218 | 87,259 |
| Other taxes | 26,305 | 28,324 | 84,312 | 35,644 |
| Professional fees | 13,301 | 12,766 | 39,905 | 87,689 |
| Communications | 31,780 | 29,498 | 88,964 | 44,669 |

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| Business promotion | 16,216 | 27,479 | 51,064 |  | 83,410 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Printing and supplies | 3,269 | 3,760 | 10,763 |  | 11,536 |
| Other operating expenses | 40,764 | 27,429 | 113,722 |  | 81,176 |
| Amortization of intangibles | 3,966 | 2,234 | 8,948 |  | 8,030 |
|  | 322,915 | 318,961 | 976,548 |  | 973,372 |
| (Loss) income from continuing operations before income tax | $(62,865)$ | 103,270 | 99,706 |  | 458,571 |
| Income tax expense | 148,308 | 23,056 | 152,467 |  | 105,598 |
| (Loss) income from continuing operations | $(211,173)$ | 80,214 | $(52,761)$ |  | 352,973 |
| Loss from discontinued operations, net of tax (See Note 3) | $(457,370)$ | $(44,211)$ | $(488,242)$ |  | $(123,373)$ |
| NET (LOSS) INCOME | \$ $(668,543)$ | \$ 36,003 | \$ $(541,003)$ | \$ | 229,600 |
| NET (LOSS) INCOME APPLICABLE TO COMMON STOCK | \$ 679,772$)$ | \$ 33,024 | \$ (561,213) | \$ | 220,665 |
| (LOSSES) EARNINGS PER COMMON SHARE BASIC AND DILUTED: |  |  |  |  |  |
| (Losses) income from continuing operations | \$ (0.79) | \$ 0.28 | \$ (0.26) | \$ | 1.23 |
| Losses from discontinued operations | (1.63) | (0.16) | (1.74) |  | (0.44) |
| Net (loss) income | \$ (2.42) | \$ 0.12 | \$ (2.00) | \$ | 0.79 |
| DIVIDENDS DECLARED PER COMMON SHARE | 0.08 | 0.16 | 0.40 | \$ | 0.48 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

## Table of Contents

## POPULAR, INC. <br> CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

| (In thousands) | Nine months ended September 30, |  |
| :---: | :---: | :---: |
|  | 2008 | 2007 |
| Preferred stock: |  |  |
| Balance at beginning of year | \$ 186,875 | \$ 186,875 |
| Issuance of preferred stock | 400,000 |  |
| Balance at end of period | 586,875 | 186,875 |
| Common stock: |  |  |
| Balance at beginning of year | 1,761,908 | 1,753,146 |
| Common stock issued under the Dividend Reinvestment Plan | 10,102 | 4,755 |
| Stock options exercised |  | 60 |
| Balance at end of period | 1,772,010 | 1,757,961 |
| Surplus: |  |  |
| Balance at beginning of year | 568,184 | 526,856 |
| Common stock issued under the Dividend Reinvestment Plan | 5,072 | 7,835 |
| Issuance cost of preferred stock | $(10,065)$ |  |
| Stock options expense on unexercised options, net of forfeitures | 830 | 1,289 |
| Stock options exercised |  | 149 |
| Balance at end of period | 564,021 | 536,129 |
| Retained earnings: |  |  |
| Balance at beginning of year | 1,319,467 | 1,594,144 |
| Net (loss) income | $(541,003)$ | 229,600 |
| Cumulative effect of accounting change-adoption of SFAS No. 159 in 2008 |  |  |
| (2007-SFAS No. 156 and EITF 06-5) | $(261,831)$ | 8,667 |
| Cash dividends declared on common stock | $(112,361)$ | $(134,092)$ |
| Cash dividends declared on preferred stock | $(20,210)$ | $(8,935)$ |
| Balance at end of period | 384,062 | 1,689,384 |
| Accumulated other comprehensive loss: |  |  |
| Balance at beginning of year | $(46,812)$ | $(233,728)$ |
| Other comprehensive (loss) income, net of tax | $(45,171)$ | 72,667 |
| Balance at end of period | $(91,983)$ | $(161,061)$ |
| Treasury stock at cost: |  |  |
| Balance at beginning of year | $(207,740)$ | $(206,987)$ |
| Purchase of common stock | (358) | (352) |
| Reissuance of common stock | 586 | 1,772 |

Balance at end of period
$(207,512)$
$(205,567)$
Total stockholders equity \$3,007,473 \$3,803,721

## Disclosure of changes in number of shares:

|  | September 30, <br> 2008 | December 31, <br> 2007 | September 30, <br> 2007 |
| :--- | :---: | :---: | :---: |
| Preferred Stock: |  |  |  |
| Balance at beginning of year | $7,475,000$ | $7,475,000$ | $7,475,000$ |
| New shares issued | $16,000,000$ |  |  |
| Balance at end of period | $23,475,000$ | $7,475,000$ | $7,475,000$ |
| Common Stock Issued: |  |  |  |
| Balance at beginning of year | $293,651,398$ | $292,190,924$ | $292,190,924$ |
| Issued under the Dividend Reinvestment Plan | $1,683,665$ | $1,450,410$ | 792,486 |
| Stock options exercised |  | 10,064 | 10,064 |
|  | $295,335,063$ | $293,651,398$ | $292,993,474$ |
| Balance at end of period | $(13,626,803)$ | $(13,622,183)$ | $(13,395,945)$ |
| Treasury stock | $281,708,260$ | $280,029,215$ | $279,597,529$ |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

## Table of Contents

## POPULAR, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (UNAUDITED)

| (In thousands) | Quarter ended September 30, |  | Nine months ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2008 | 2007 | 2008 | 2007 |
| Net (loss) income | \$ $(668,543)$ | \$ 36,003 | \$ $(541,003)$ | \$229,600 |
| Other comprehensive (loss) income before tax: |  |  |  |  |
| Foreign currency translation adjustment | $(1,690)$ | (966) | $(2,882)$ | 2,014 |
| Adjustment of pension and postretirement benefit plans | (36) |  | (110) | (519) |
| Unrealized (losses) gains on securities available-for-sale arising during the period | $(13,611)$ | 156,462 | $(36,048)$ | 100,493 |
| Reclassification adjustment for losses (gains) included in net income | 11,704 | 3 | $(14,669)$ | (80) |
| Unrealized net gains (losses) on cash flow hedges | 947 | $(2,065)$ | $(1,160)$ | $(1,117)$ |
| Reclassification adjustment for losses (gains) included in net income | 1,169 | (164) | 2,762 | (289) |
| Cumulative effect of accounting change |  |  |  | (243) |
|  | $(1,517)$ | 153,270 | $(52,107)$ | 100,259 |
| Income tax (expense) benefit | (18) | $(39,514)$ | 6,936 | $(27,592)$ |
| Total other comprehensive (loss) income, net of tax | $(1,535)$ | 113,756 | $(45,171)$ | 72,667 |
| Comprehensive (loss) income | \$ $(670,078)$ | \$ 149,759 | \$ $(586,174)$ | \$302,267 |

Tax Effects Allocated to Each Component of Other Comprehensive (Loss) Income:

| (In thousands) | Quarter ended <br> September 30, |  | Nine months ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2008 | 2007 | 2008 | 2007 |
| Underfunding of pension and postretirement benefit plans |  |  |  | \$ 180 |
| Unrealized losses (gains) on securities available-for-sale arising during the period | \$1,694 | \$(40,302) | \$ 5,374 | $(28,280)$ |
| Reclassification adjustment for losses (gains) included in net income | (959) | (1) | 2,165 | 13 |
| Unrealized net gains (losses) on cash flows hedges | (297) | 723 | 478 | 371 |
| Reclassification adjustment for losses (gains) included in net income | (456) | 66 | $(1,081)$ | 124 |

Income tax (expense) benefit
\$ (18)
\$ 39,514$)$
\$ 6,936
\$(27,592)

Disclosure of accumulated other comprehensive loss:

|  | September | December |  |
| :--- | :---: | :---: | :---: |
| 30, | 31, | September 30, |  |
| (In thousands) | 2008 | 2007 | 2007 |
| Foreign currency translation adjustment | $\$(37,470)$ | $\$(34,588)$ | $\$(34,687)$ |
| Underfunding of pension and postretirement benefit plans | $(51,249)$ | $(51,139)$ | $(69,779)$ |
| Tax effect | 20,108 | 20,108 | 27,214 |
| Net of tax amount | $(31,141)$ | $(31,031)$ | $(42,565)$ |
| Unrealized (losses) gains on securities available-for-sale | $(23,625)$ | 27,092 | $(111,830)$ |
| Tax effect | 1,589 | $(5,950)$ | 28,879 |
| Net of tax amount | $(22,036)$ | 21,142 | $(82,951)$ |
| Unrealized losses on cash flows hedges | $(2,013)$ | $(3,615)$ | $(1,316)$ |
| Tax effect | 677 | 1,280 | 458 |
| Net of tax amount | $(1,336)$ | $(2,335)$ | $(858)$ |
|  |  |  | $\$(161,061)$ |
| Accumulated other comprehensive loss, net of tax | $\$(91,983)$ | $\$(46,812)$ |  |
| The accompanying notes are an integral part of these unaudited consolidated financial statements. |  |  |  |

## Table of Contents

## POPULAR, INC. <br> CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| (In thousands) | Nine months $2008$ | $\begin{aligned} & \text { September } 30, \\ & 2007 \end{aligned}$ |
| :---: | :---: | :---: |
| Cash flows from operating activities: |  |  |
| Net (loss) income | \$ $(541,003)$ | \$ 229,600 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |
| Depreciation and amortization of premises and equipment | 55,233 | 59,558 |
| Provision for loan losses | 621,552 | 359,606 |
| Amortization of intangibles | 8,948 | 8,030 |
| Amortization and fair value adjustments of servicing assets | 53,679 | 34,941 |
| Net gain on sale and valuation adjustments of investment securities | $(64,010)$ | $(79,857)$ |
| Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159 | 179,482 |  |
| Net gain on disposition of premises and equipment | $(23,643)$ | $(5,293)$ |
| Net loss (gain) on sale of loans and valuation adjustments on loans |  |  |
| held-for-sale | 54,527 | $(37,719)$ |
| Net amortization of premiums and accretion of discounts on investments | 16,034 | 15,801 |
| Net amortization of premiums and deferred loan origination fees and costs | 40,650 | 70,645 |
| Fair value adjustment of other assets held-for-sale | 103,702 |  |
| Earnings from investments under the equity method | $(6,899)$ | $(19,514)$ |
| Stock options expense | 830 | 1,339 |
| Deferred income taxes, net of valuation | 72,261 | $(94,581)$ |
| Net disbursements on loans held-for-sale | $(2,000,449)$ | $(4,007,301)$ |
| Acquisitions of loans held-for-sale | $(268,718)$ | $(474,269)$ |
| Proceeds from sale of loans held-for-sale | 1,289,738 | 3,475,817 |
| Net decrease in trading securities | 1,604,345 | 1,003,078 |
| Net decrease (increase) in accrued income receivable | 8,194 | $(42,675)$ |
| Net (increase) decrease in other assets | $(245,990)$ | 30,507 |
| Net (decrease) increase in interest payable | $(49,180)$ | 4,586 |
| Net increase in postretirement benefit obligation | 1,810 | 2,407 |
| Net (decrease) increase in other liabilities | $(35,120)$ | 18,645 |
| Total adjustments | 1,416,976 | 323,751 |
| Net cash provided by operating activities | 875,973 | 553,351 |
| Cash flows from investing activities: |  |  |
| Net decrease (increase) in money market investments | 697,215 | $(266,954)$ |
| Purchases of investment securities: |  |  |
| Available-for-sale | $(3,875,390)$ | $(67,920)$ |
| Held-to-maturity | $(4,958,286)$ | $(17,026,831)$ |
| Other | $(166,641)$ | $(47,786)$ |

Proceeds from calls, paydowns, maturities and redemptions of investment securities:

| Available-for-sale | $2,377,740$ | $1,066,304$ |
| :--- | ---: | ---: |
| Held-to-maturity | $4,724,818$ | $16,844,551$ |
| Other | 154,067 | 17,071 |
| Proceeds from sale of investment securities available-for-sale | $2,444,509$ | 37,352 |
| Proceeds from sale of other investment securities | 49,341 | 246,352 |
| Net disbursements on loans | $(976,109)$ | $(1,137,982)$ |
| Proceeds from sale of loans | $1,984,860$ | 16,367 |
| Acquisition of loan portfolios | $(4,505)$ | $(22,312)$ |
| Assets acquired, net of cash | $(2,378)$ |  |
| Mortgage servicing rights purchased | $(112,196)$ | $(25,596)$ |
| Acquisition of premises and equipment | 49,366 | $(69,607)$ |
| Proceeds from sale of premises and equipment | 87,280 | 29,501 |
| Proceeds from sale of foreclosed assets |  | 113,776 |
|  | $2,472,441$ | $(296,092)$ |
| Net cash provided by (used in) investing activities |  |  |
|  |  |  |
| Cash flows from financing activities: | $(400,901)$ | $2,150,668$ |
| Net (decrease) increase in deposits | $(1,707,225)$ | 524,858 |
| Net (decrease) increase in federal funds purchased and assets sold under | $(994,969)$ | $(2,619,228)$ |
| agreements to repurchase | $(1,312,938)$ | $(1,245,332)$ |
| Net decrease in other short-term borrowings | $1,182,917$ | 821,087 |
| Payments of notes payable | $(154,877)$ | $(142,898)$ |
| Proceeds from issuance of notes payable | 15,174 | 12,836 |
| Dividends paid | 389,935 | $(358)$ |
| Proceeds from issuance of common stock | $(2,983,242)$ | $(352)$ |
| Proceeds from issuance of preferred stock |  | $(498,361)$ |
| Treasury stock acquired | 365,172 | $(241,102)$ |
| Net cash used in financing activities | 818,825 | 950,158 |
|  |  | 709,056 |
| Net increase (decrease) in cash and due from banks | $\$ 1,183,997$ | $\$$ |
| Cash and due from banks at beginning of period |  | 7 |
| Cash and due from banks at end of period |  |  |

The accompanying notes are an integral part of these unaudited consolidated financial statements.
Note: The
Consolidated
Statements of
Cash Flows for
the nine months
ended
September 30,
2008 and 2007
include the cash
flows from
operating, investing and
financing
activities
associated with
discontinued
operations.

## Table of Contents

## Notes to Unaudited Consolidated Financial Statements

## Note 1 Nature of Operations and Basis of Presentation

Popular, Inc. (the Corporation or Popular ) is a diversified, publicly owned financial holding company subject to the supervision and regulation of the Board of Governors of the Federal Reserve System. The Corporation is a financial services provider with operations in Puerto Rico, the United States, the Caribbean and Latin America. As the leading financial institution in Puerto Rico, the Corporation offers retail and commercial banking services through its principal banking subsidiary, Banco Popular de Puerto Rico ( BPPR ), as well as auto and equipment leasing and financing, mortgage loans, consumer lending, investment banking, broker-dealer and insurance services through specialized subsidiaries. In the United States, the Corporation operates Banco Popular North America ( BPNA ), including its wholly-owned subsidiary E-LOAN, and Popular Financial Holdings ( PFH ). BPNA is a community bank providing a broad range of financial services and products. BPNA operates branches in New York, California, Illinois, New Jersey and Florida. E-LOAN markets deposit accounts under its name for the benefit of BPNA and offers loan customers the option of being referred to a trusted consumer lending partner for loan products. PFH operations were discontinued in the third quarter of 2008. Disclosures on the discontinued operations as well as recent restructuring plans in the BPNA and E-LOAN subsidiaries are included in Notes 3 and 27 of these consolidated financial statements. The Corporation, through its transaction processing company, EVERTEC, continues to use its expertise in technology as a competitive advantage in its expansion throughout the United States, the Caribbean and Latin America, as well as internally servicing many of its subsidiaries system infrastructures and transactional processing businesses. Note 25 to the consolidated financial statements presents further information about the Corporation s business segments. The unaudited consolidated financial statements include the accounts of Popular, Inc. and its majority-owned subsidiaries. All significant intercompany accounts 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 reclassifications have been made to the prior period consolidated financial statements to conform to the 2008 presentation, including retrospectively adjusting certain information of the consolidated statement of operations to present in a separate line item the results of discontinued operations from prior periods presented.
The statement of condition data as of December 31, 2007 was derived from audited financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted from the statements presented as of September 30, 2008, December 31, 2007 and September 30, 2007 pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, these financial statements should be read in conjunction with the audited consolidated financial statements of the Corporation for the year ended December 31, 2007, included in the Corporation s 2007 Annual Report. The Corporation s Form 10-K filed on February 29, 2008 incorporates by reference the 2007 Annual Report.

## Note 2 Recent Accounting Developments

SFAS No. 157 Fair Value Measurements
SFAS No. 157, issued in September 2006, defines fair value, establishes a framework of measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets carried at fair value will be classified and disclosed in one of the three categories in accordance with the hierarchy. The three levels of the fair value hierarchy are (1) quoted market prices for identical assets or liabilities in active markets, (2) observable market-based inputs or unobservable inputs that are corroborated by market data, and (3) unobservable inputs that are not corroborated by market data. SFAS No. 157 was effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the Financial Accounting Standards Board ( FASB ) issued financial staff position FSP FAS No. 157-2 which defers for one year the effective date for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value on a nonrecurring basis. The staff position also amends SFAS No. 157 to exclude SFAS No. 13 Accounting for Leases and its related

## Table of Contents

interpretive accounting pronouncements that address leasing transactions. The Corporation adopted the provisions of SFAS No. 157 that were not deferred by FSP FAS No. 157-2, commencing in the first quarter of 2008. The provisions of SFAS No. 157 are to be applied prospectively. Refer to Note 13 to these consolidated financial statements for the disclosures required for the quarter and nine months ended September 30, 2008. The adoption of SFAS No. 157 in January 1,2008 did not have an impact in beginning retained earnings.
FSP No. 157-3 Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ( FSP 157-3 ). FSP 157-3 clarifies the application of FAS 157 in a market that is not active. The FSP is intended to address the following application issues: (a) how the reporting entity s own assumptions (that is, expected cash flows and appropriately risk-adjusted discount rates) should be considered when measuring fair value when relevant observable inputs do not exist; (b) how available observable inputs in a market that is not active should be considered when measuring fair value; and (c) how the use of market quotes (for example, broker quotes or pricing services for the same or similar financial assets) should be considered when assessing the relevance of observable and unobservable inputs available to measure fair value. FSP 157-3 is effective on issuance, including prior periods for which financial statements have not been issued. The Corporation adopted FSP 157-3 for the quarter ended September 30, 2008 and the effect of adoption on the consolidated financial statements was not material.
SFAS No. 159 The Fair Value Option for Financial Assets and Liabilities Including an Amendment of FASB Statement No. 115
In February 2007, the FASB issued SFAS No. 159, which provided companies with an option to report selected financial assets and liabilities at fair value. The election to measure a financial asset or liability at fair value can be made on an instrument-by-instrument basis and is irrevocable. The difference between the carrying amount and the fair value at the election date is recorded as a transition adjustment to beginning retained earnings. Subsequent changes in fair value are recognized in earnings. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The Corporation adopted the provisions of SFAS No. 159 in January 2008.
The Corporation elected the fair value option for approximately $\$ 1.2$ billion of whole loans held-in-portfolio by PFH at adoption date. Additionally, management adopted the fair value option for approximately $\$ 287$ million of loans and $\$ 287$ million of bond certificates associated with PFH s on-balance sheet securitizations that were outstanding as of December 31, 2007. These loans serve as collateral for the bond certificates.
Refer to Note 12 to these consolidated financial statements for the impact of the initial adoption of SFAS No. 159 to beginning retained earnings as of January 1, 2008 and additional disclosures as of September 30, 2008.
FSP FIN No. 39-1 Amendment of FASB Interpretation No. 39
In April 2007, the FASB issued Staff Position FSP FIN No. 39-1, which defines right of setoff and specifies what conditions must be met for a derivative contract to qualify for this right of setoff. It also addresses the applicability of a right of setoff to derivative instruments and clarifies the circumstances in which it is appropriate to offset amounts recognized for those instruments in the statement of condition. In addition, this FSP permits the offsetting of fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments. The adoption of FSP FIN No. 39-1 in January 2008 did not have a material impact on the Corporation s consolidated financial statements and disclosures. The Corporation s policy is not to offset the fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement nor to offset the fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments.

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## Table of Contents

SFAS No. 141-R Statement of Financial Accounting Standards No. 141(R), Business Combinations (a revision of SFAS No. 141)
SFAS No. 141(R), issued in December 2007, will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Corporation will account for business combinations under this statement include the following: the acquisition date will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date at fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS No. 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. The Corporation will be required to prospectively apply SFAS No. 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS No. 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes in those amounts to be recorded in earnings. Management will be evaluating the effects that SFAS No. 141(R) will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented on the consolidated financial statements.
SFAS No. 160 Statement of Financial Accounting Standards No. 160, Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51
In December 2007, the FASB issued SFAS No. 160, which amends ARB No. 51, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 will require entities to classify noncontrolling interests as a component of stockholders equity on the consolidated financial statements and will require subsequent changes in ownership interests in a subsidiary to be accounted for as an equity transaction. Additionally, SFAS No. 160 will require entities to recognize a gain or loss upon the loss of control of a subsidiary and to remeasure any ownership interest retained at fair value on that date. This statement also requires expanded disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective on a prospective basis for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, except for the presentation and disclosure requirements, which are required to be applied retrospectively. Early adoption is not permitted. Management will be evaluating the effects, if any, that the adoption of this statement will have on its consolidated financial statements.
SFAS No. 161 Disclosures about Derivative Instruments and Hedging Activities
In March 2008, the FASB issued SFAS No. 161, an amendment of SFAS No. 133. The standard requires enhanced disclosures about derivative instruments and hedged items that are accounted for under SFAS No. 133 and related interpretations. The standard will be effective for all of the Corporation s interim and annual financial statements for periods beginning after November 15, 2008, with early adoption permitted. The standard expands the disclosure requirements for derivatives and hedged items and has no impact on how the Corporation accounts for these instruments. Management will be evaluating the enhanced disclosure requirements.
SFAS No. 162 The Hierarchy of Generally Accepted Accounting Principles
SFAS No. 162, issued by the FASB in May 2008, identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This statement is effective 60 days following the SEC s
approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. Management does not expect SFAS No. 162 to have a material impact on the Corporation s consolidated financial statements. The Board does not expect that this statement will result in a change in current accounting practice. However, transition

## Table of Contents

provisions have been provided in the unusual circumstance that the application of the provisions of this statement results in a change in accounting practice.

## Staff Accounting Bulletin No. 109 (SAB 109 ) Written Loan Commitments Recorded at Fair Value through Earnings

On November 5, 2007, the SEC issued Staff SAB 109, which requires that the fair value of a written loan commitment that is marked-to-market through earnings should include the future cash flows related to the loan s servicing rights. However, the fair value measurement of a written loan commitment still must exclude the expected net cash flows related to internally developed intangible assets (such as customer relationship intangible assets). SAB 109 applies to two types of loan commitments: (1) written mortgage loan commitments for loans that will be held-for-sale when funded that are marked-to-market as derivatives under SFAS No. 133 (derivative loan commitments); and (2) other written loan commitments that are accounted for at fair value through earnings under SFAS No. 159 s fair-value election.
SAB 109 supersedes SAB 105, which applied only to derivative loan commitments and allowed the expected future cash flows related to the associated servicing of the loan to be recognized only after the servicing asset had been contractually separated from the underlying loan by sale or securitization of the loan with servicing retained. SAB 109 will be applied prospectively to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The implementation of SAB 109 did not have a material impact to the Corporation s consolidated financial statements, including disclosures.
FASB Staff Position (FSP) FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions
The objective of FSP FAS 140-3, issued by the FASB in February 2008, is to provide implementation guidance on whether the security transfer and contemporaneous repurchase financing involving the transferred financial asset must be evaluated as one linked transaction or two separate de-linked transactions.
Current practice records the transfer as a sale and the repurchase agreement as a financing. The FSP FAS 140-3 requires the recognition of the transfer and the repurchase agreement as one linked transaction, unless all of the following criteria are met: (1) the initial transfer and the repurchase financing are not contractually contingent on one another; (2) the initial transferor has full recourse upon default, and the repurchase agreement sprice is fixed and not at fair value; (3) the financial asset is readily obtainable in the marketplace and the transfer and repurchase financing are executed at market rates; and (4) the maturity of the repurchase financing is before the maturity of the financial asset. The scope of this FSP is limited to transfers and subsequent repurchase financings that are entered into contemporaneously or in contemplation of one another.
FSP FAS 140-3 will be effective for the Corporation on January 1, 2009. Early adoption is prohibited. The Corporation will be evaluating the potential impact of adopting this FSP.
FASB Staff Position (FSP) FAS 142-3, Determination of the Useful Life of Intangible Assets
FSP FAS 142-3, issued by the FASB in April 2008, amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142 Goodwill and Other Intangible Assets . In developing these assumptions, an entity should consider its own historical experience in renewing or extending similar arrangements adjusted for entity s specific factors or, in the absence of that experience, the assumptions that market participants would use about renewals or extensions adjusted for the entity specific factors.
FSP FAS 142-3 shall be applied prospectively to intangible assets acquired after the effective date. This FSP will be effective for the Corporation on January 1, 2009. Early adoption is prohibited. The Corporation will be evaluating the potential impact of adopting this FSP.

## Table of Contents

FSP No. FAS 133-1 and FIN 45-4 Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161
FSP FAS 133-1 and FIN 45-4 requires disclosures by sellers of credit derivatives and additional disclosures about the current status of the payment/performance risk of financial guarantees. FSP FAS 133-1 and FIN 45-4 are effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Accordingly, the Corporation will adopt the provisions of FSP FAS 133-1 and FIN 45-4 in the first quarter 2009. The Corporation does not expect the adoption of the provisions of FSP FAS 133-1 and FIN 45-4 to have any material impact on the Corporation s financial condition and results of operations.

## Note 3 Discontinued Operations

On August 29, 2008, the Corporation announced that it had entered into an agreement to sell loans, residual interests and servicing related assets of PFH and Popular, FS to Goldman Sachs Mortgage Company, Goldman, Sachs \& Co. and Litton Loan Servicing, LP. The transaction closed on November 3, 2008. This sale resulted in a reduction in assets, mostly accounted at fair value, of over $\$ 900$ million, and provided over $\$ 700$ million in additional liquidity. In addition, on September 18, 2008, the Corporation announced the consummation of the sale of manufactured housing loans of PFH to $21^{\text {st }}$ Mortgage Corp. and Vanderbilt Mortgage and Finance, Inc. The transaction provided approximately $\$ 198$ million in cash and resulted in a reduction in unpaid principal balance of loans held at PFH of approximately $\$ 309$ million.
The above actions and past sales and restructuring plans executed at PFH in the past two years have resulted in the discontinuance of the Corporation s PFH operations, which were defined as a reportable segment for managerial reporting. This includes exiting all business activities, consisting of loan origination channels and loan servicing functions previously conducted at PFH. As of September 30, 2008, the Corporation reclassified $\$ 789$ million of net assets of the PFH business to discontinued operations, substantially all of which were classified as held-for-sale as of September 30, 2008.
The proceeds from the PFH asset sales will be used for repayment of the Corporation s medium-term notes due in 2009 as well as other debt maturities. The Corporation reported a net loss for the discontinued operations of $\$ 457.3$ million for the third quarter of 2008. The loss included write-downs of assets held-for-sale to fair value, losses on the sale of loans, restructuring charges and the recording of a valuation allowance on deferred tax assets of $\$ 171.2$ million. Assets and liabilities of discontinued operations, substantially all of which are classified as held-for-sale, were estimated as follows as of September 30, 2008:

## Loans

Servicing rights 37
Servicing advances 280
Residual interests 4
Other 22

Total assets $\quad \$ 869$

Secured borrowings 166
Other liabilities 14

Total liabilities $\quad \$ 180$

Net assets \$ 789

## Table of Contents

The following table provides financial information for the discontinued operations for the quarter and nine months ended September 30, 2008 and 2007.

(1) Loss on disposition during the period is associated to the sale of manufactured housing loans in September 2008, which included lower of cost or market adjustments at reclassification from loans held-in-portfolio to loans held-for-sale.

As part of these actions at PFH, the Corporation entered into a restructuring plan (the PFH Discontinuance Restructuring Plan ) to eliminate employment positions, terminate contracts and incur other costs associated with the sale. Further information on the restructuring plan is provided in Note 20 to the consolidated financial statements.

## Note 4 Restrictions on Cash and Due from Banks and Highly-Liquid Securities

The Corporation s subsidiary banks are required by federal and state regulatory agencies to maintain average reserve balances with the Federal Reserve Bank or other banks. Those required average reserve balances were $\$ 630$ million as of September 30, 2008 (December 31, $2007 \$ 678$ million; September 30, $2007 \$ 588$ million). Cash and due from banks as well as other short-term, highly-liquid securities are used to cover the required average reserve balances. In compliance with rules and regulations of the Securities and Exchange Commission, at September 30, 2008, the Corporation had securities with a market value of $\$ 275$ thousand (December 31, 2007 - securities with a market value of $\$ 273$ thousand; September 30, 2007 securities with a market value of $\$ 397$ thousand); segregated in a special reserve bank account for the benefit of brokerage customers of its broker-dealer subsidiary. These securities were classified in the consolidated statement of condition within the other trading securities category.
As required by the Puerto Rico International Banking Center Regulatory Act, as of September 30, 2008, December 31, 2007, and September 30, 2007, the Corporation maintained separately for its two international banking entities ( IBEs ), \$600 thousand in time deposits, equally divided for the two IBEs, which were considered restricted assets.
As part of a line of credit facility with a financial institution, as of September 30, 2008, the Corporation maintained restricted cash of $\$ 1.9$ million as collateral (December 31, $2007 \quad \$ 1.9$ million; September 30, $2007 \quad \$ 1.9$ million). The cash is being held in certificates of deposits which mature in less than 90 days. The line of credit is used to support letters of credit.
As of September 30, 2008, the Corporation had restricted cash of $\$ 3.2$ million (December 31, 2007-\$3.5 million) to support a letter of credit related to a service settlement agreement.

## Table of Contents

Note 5 Pledged Assets
Certain securities and loans were pledged to secure public and trust deposits, assets sold under agreements to repurchase, other borrowings and credit facilities available. The classification and carrying amount of the Corporation s pledged assets, in which the secured parties are not permitted to sell or repledge the collateral, were as follows:

|  | September 30, <br> 2008 | December 31, <br> 2007 | September 30, <br> (In thousands) |
| :--- | :---: | ---: | ---: |
| Investment securities available-for-sale, at fair value |  |  |  |
| Investment securities held-to-maturity, at amortized <br> cost | $\$ 2,647,930$ | $\$ 2,944,643$ | $\$ 3,222,644$ |
| Loans held-for-sale measured at lower of cost or |  | 339 | 340 |
| market value | 36,218 | 42,428 | 41,266 |
| Loans held-in-portfolio | $7,686,937$ | $8,489,814$ | $11,482,585$ |
| Total pledged assets from continuing operations | $\$ 10,371,085$ | $\$ 11,477,224$ | $\$ 14,746,835$ |
| Pledged assets from discontinued operations (loans) (1) | $\$ 160,115$ |  |  |

(1) Included as part
of Assets from
discontinued
operations in the
consolidated
statement of
condition as of
September 30,
2008.

Pledged securities and loans in which the creditor has the right by custom or contract to repledge are presented separately in the consolidated statements of condition.
Note 6 Investment Securities Available-For-Sale
The amortized cost, gross unrealized gains and losses and approximate market value (or fair value for certain investment securities where no market quotations are available) of investment securities available-for-sale as of September 30, 2008, December 31, 2007 and September 30, 2007 were as follows:

| (In thousands) | AS OF SEPTEMBER 30, 2008 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Gross <br> Unrealized <br> Gains | Gross Unrealized Losses | Market <br> Value |
| U.S. Treasury securities | \$ 458,990 | \$ 5,219 |  | \$ 464,209 |
| Obligations of U.S. Government sponsored entities | 4,566,004 | 28,505 | \$ 9,670 | 4,584,839 |
| Obligations of Puerto Rico, States and political subdivisions | 104,227 | 165 | 2,691 | 101,701 |
| Collateralized mortgage obligations | 1,588,249 | 2,281 | 37,687 | 1,552,843 |

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| Mortgage-backed securities | 855,377 | 5,225 | 10,084 | 850,518 |
| :--- | ---: | ---: | ---: | ---: |
| Equity securities | 19,520 | 102 | 4,990 | 14,632 |
|  |  |  |  | $\$ 7,568,742$ |

## Table of Contents

| (In thousands) | AS OF DECEMBER 31,2007 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Market <br> Value |
| U.S. Treasury securities | \$ 476,104 | \$ 3 | \$ 5,011 | \$ 471,096 |
| Obligations of U.S. Government sponsored entities | 5,450,028 | 52,971 | 5,885 | 5,497,114 |
| Obligations of Puerto Rico, States and political subdivisions | 103,206 | 470 | 2,184 | 101,492 |
| Collateralized mortgage obligations | 1,403,292 | 3,754 | 10,506 | 1,396,540 |
| Mortgage-backed securities | 1,017,302 | 4,690 | 11,864 | 1,010,128 |
| Equity securities | 33,299 | 690 | 36 | 33,953 |
| Others | 4,812 |  |  | 4,812 |
|  | \$8,488,043 | \$62,578 | \$35,486 | \$8,515,135 |
|  | AS OF SEPTEMBER 30, 2007 |  |  |  |
| (In thousands) | Amortized Cost | Gross <br> Unrealized Gains | Gross Unrealized Losses | Market Value |
| U.S. Treasury securities | \$ 497,893 | \$ 41 | \$ 22,114 | \$ 475,820 |
| Obligations of U.S. Government sponsored entities | 5,871,339 | 2,628 | 55,613 | 5,818,354 |
| Obligations of Puerto Rico, States and political subdivisions | 109,289 | 420 | 2,871 | 106,838 |
| Collateralized mortgage obligations | 1,479,951 | 3,216 | 13,798 | 1,469,369 |
| Mortgage-backed securities | 969,023 | 3,190 | 22,738 | 949,475 |
| Equity securities | 46,100 | 1,780 | 6,598 | 41,282 |
| Others | 16,730 | 627 |  | 17,357 |
|  | \$8,990,325 | \$11,902 | \$ 123,732 | \$8,878,495 |

## Table of Contents

The table below shows the Corporation s amortized cost, gross unrealized losses and market 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 as of September 30, 2008, December 31, 2007 and September 30, 2007.

AS OF SEPTEMBER 30, 2008
Less than 12 months

|  | $\begin{array}{c}\text { Amortized } \\ \text { Cost }\end{array}$ |  |  |
| :--- | ---: | ---: | ---: | \(\left.\begin{array}{c}Gross <br>

Unrealized <br>

Losses\end{array}\right) ~\)| Market |
| :---: |
| Value |

12 months or more

| Amortized <br> Cost | Gross <br> Unrealized <br> Losses | Market <br> Value |
| :---: | :---: | ---: |
| $\$ 44,011$ | $\$ 2,238$ | $\$ 41,773$ |
| 414,813 | 23,668 | 391,145 |
| 270,609 | 7,696 | 262,913 |
| 29 | 10 | 19 |
|  |  | $\$ 695,850$ |

Total

| Amortized <br> Cost | Gross <br> Unrealized <br> Losses | Market <br> Value |
| ---: | :---: | ---: |
| $\$ 1,853,632$ | $\$ 9,670$ | $\$ 1,843,962$ |
| 94,215 | 2,691 | 91,524 |
| $1,311,406$ | 37,687 | $1,273,719$ |
| 528,481 | 10,084 | 518,397 |
| 13,909 | 4,990 | 8,919 |
| $\$ 3,801,643$ | $\$ 65,122$ | $\$ 3,736,521$ |

## Table of Contents

(In thousands)
Obligations of U.S. Government sponsored entities
Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations
Mortgage-backed securities
Equity securities
(In thousands)
U.S. Treasury securities
Obligations of U.S. Government sponsored entities

Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations
Mortgage-backed securities
Equity securities
(In thousands)
U.S. Treasury securities
Obligations of U.S. Government sponsored entities

Obligations of Puerto Rico, States and political
subdivisions
Collateralized mortgage obligations
subdivisions
Collateralized mortgage obligations
Mortgage-backed securities
Equity securities
正
68,242
779,118
756,207
328
$\$ 3,944,570$

AS OF DECEMBER 31, 2007
Less than 12 months
Gross

| Amortized <br> Cost | Unrealized <br> Losses | Market <br> Value |
| ---: | :---: | ---: |
| $\$ 67,107$ | $\$ 185$ | $\$ 66,922$ |
| 2,600 | 2 | 2,598 |
| 349,084 | 2,453 | 346,631 |
| 99,328 | 667 | 98,661 |
| 28 | 10 | 18 |
|  |  |  |
| $\$ 518,147$ | $\$ 3,317$ | $\$ 514,830$ |

12 months or more
Gross

| Amortized | Unrealized | Market |
| :---: | :---: | :---: |
| Cost | Losses | Value |


| $\$ 466,111$ | $\$ 5,011$ | $\$ 461,100$ |
| ---: | ---: | ---: |
| $1,807,457$ | 5,700 | $1,801,757$ |
|  |  |  |
| 65,642 | 2,182 | 63,460 |
| 430,034 | 8,053 | 421,981 |
| 656,879 | 11,197 | 645,682 |
| 300 | 26 | 274 |
|  |  |  |
| $\$ 3,426,423$ | $\$ 32,169$ | $\$ 3,394,254$ |


|  | Total <br> Gross |  |
| ---: | :---: | ---: |
| Amortized | Unrealized <br> Lost | Market <br> Value |
| $\$ 466,111$ | $\$ 5,011$ | $\$ 461,100$ |
| $1,874,564$ | 5,885 | $1,868,679$ |
|  |  |  |
| 68,242 | 2,184 | 66,058 |
| 779,118 | 10,506 | 768,612 |
| 756,207 | 11,864 | 744,343 |
| 328 | 36 | 292 |
|  |  |  |
| $\$ 3,944,570$ | $\$ 35,486$ | $\$ 3,909,084$ |

## Table of Contents

|  | AS OF SEPTEMBER 30, 2007 <br> Less than 12 months Gross |  |  |
| :---: | :---: | :---: | :---: |
| (In thousands) | Amortized Cost | Unrealized Losses | Market <br> Value |
| Obligations of U.S. Government sponsored entities | \$106,914 | \$ 3,960 | \$ 102,954 |
| Obligations of Puerto Rico, States and political subdivisions | 22,680 | 411 | 22,269 |
| Collateralized mortgage obligations | 283,814 | 1,869 | 281,945 |
| Mortgage-backed securities | 22,328 | 399 | 21,929 |
| Equity securities | 22,638 | 6,572 | 16,066 |
|  | \$458,374 | \$13,211 | \$445,163 |


|  | 12 months or more <br> Gross |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
| (In thousands) | Amortized <br> Cost | Unrealized <br> Losses | Market <br> Value |  |
| U.S. Treasury securities | $\$ 478,436$ | $\$ 22,114$ | $\$ 456,322$ |  |
| Obligations of U.S. Government sponsored entities | $5,212,523$ | 51,653 | $5,160,870$ |  |
| Obligations of Puerto Rico, States and political |  |  |  |  |
| subdivisions | 50,235 | 2,460 | 47,775 |  |
| Collateralized mortgage obligations | 576,852 | 11,929 | 564,923 |  |
| Mortgage-backed securities | 818,782 | 22,339 | 796,443 |  |
| Equity securities | 300 | 26 | 274 |  |
|  |  |  | $\$ 110,521$ | $\$ 7,026,607$ |


|  | Total <br> Gross |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
| (In thousands) | Amortized <br> Unrealized <br> Lost | Market <br> Value |  |  |
| U.S. Treasury securities | $\$ 478,436$ | $\$ 22,114$ | $\$ 456,322$ |  |
| Obligations of U.S. Government sponsored entities | $5,319,437$ | 55,613 | $5,263,824$ |  |
| Obligations of Puerto Rico, States and political |  |  | 2,871 | 70,044 |
| subdivisions | 72,915 | 13,798 | 846,868 |  |
| Collateralized mortgage obligations | 860,666 | 22,738 | 818,372 |  |
| Mortgage-backed securities | 841,110 | 6,598 | 16,340 |  |
| Equity securities | 22,938 |  |  |  |
|  | $\$ 7,595,502$ | $\$ 123,732$ | $\$ 7,471,770$ |  |

As of September 30, 2008, Obligations of Puerto Rico, States and political subdivisions include approximately $\$ 48$ million in Commonwealth of Puerto Rico Appropriation Bonds (Appropriation Bonds ) in the Corporation s
investment securities portfolios. The rating on these bonds by Moody s Investors Service ( Moody s ) is Ba1, one notch below investment grade, while Standard \& Poor s ( S\&P ) rates them as investment grade. As of September 30, 2008, these Appropriation Bonds represented approximately $\$ 2.2$ million in net unrealized losses in the Corporation s investment securities portfolios. The Corporation is closely monitoring the political and economic situation of the Island as part of its evaluation of its available-for-sale portfolio for any declines in value that management may consider being other-than-temporary. Management has the intent and ability to hold these investments for a reasonable period of time for a forecasted recovery of fair value up to (or beyond) the cost of these investments.
The unrealized loss positions of available-for-sale securities as of September 30, 2008, except for the obligations of the Puerto Rico government described above and certain equity securities which have recently declined in value

## Table of Contents

during 2008, are primarily associated with collateralized mortgage obligations and government sponsored-issued mortgage-backed securities. The vast majority of these securities are rated the equivalent of AAA by the major rating agencies. The investment portfolio is structured primarily with highly-liquid securities, which possess a large and efficient secondary market. Management believes that the unrealized losses in these available-for-sale securities as of September 30, 2008 are temporary and are substantially related to market interest rate fluctuations and not to the deterioration in the creditworthiness of the issuers. Also, management has the intent and ability to hold these investments for a reasonable period of time for a forecasted recovery of fair value up to (or beyond) the cost of these investments.
During the nine months ended September 30, 2008 and September 30, 2007, the Corporation recognized through earnings approximately $\$ 9.1$ million and $\$ 7.6$ million, respectively, in losses in equity securities classified as available-for-sale that management considered to be other-than-temporarily impaired.
The following table states the names of issuers and the aggregate amortized cost and market value of the securities of such issuer (includes available-for-sale and held-to-maturity securities), in which the aggregate amortized cost of such securities exceeds $10 \%$ of stockholders equity. This information excludes securities of the U.S. Government agencies and corporations. Investments in obligations issued by a state of the U.S. and its political subdivisions and agencies, which are payable and secured by the same source of revenue or taxing authority, other than the U.S. Government, are considered securities of a single issuer.

September 30, 2008 December 31, 2007
Amortized

| (In thousands) | Cost | Market Value |
| :--- | ---: | ---: |
|  |  |  |
| FNMA | $\$ 1,129,613$ | $\$ 1,120,659$ |
| FHLB | $4,936,497$ | $4,953,787$ |
| Freddie Mac | 828,800 | 815,104 |

Amortized

| Cost | Market Value |
| ---: | ---: |
|  |  |
| $\$ 1,132,834$ | $\$ 1,128,544$ |
| $5,649,729$ | $5,693,170$ |
| 918,976 | 913,609 |

September 30, 2007
Amortized
Cost Market Value
\$1,184,225 \$1,169,857
5,841,614 $\quad 5,788,544$

Note 7 Investment Securities Held-to-Maturity
The amortized cost, gross unrealized gains and losses and approximate market value (or fair value for certain investment securities where no market quotations are available) of investment securities held-to-maturity as of September 30, 2008, December 31, 2007 and September 30, 2007 were as follows:

## (In thousands)

AS OF SEPTEMBER 30, 2008
Gross Gross

|  | Amortized <br> Cost | Gross <br> Unrealized <br> Gains | Gross <br> Unrealized <br> Losses | Market <br> Value |
| :--- | ---: | :---: | :---: | :---: |
| (In thousands) | $\$ 526,486$ | $\$ 11$ |  |  |
| Obligations of U.S. Government sponsored <br> entities | 184,671 | 171 | $\$ 3,618$ | 181,224 |
| Obligations of Puerto Rico, States and political <br> subdivisions | 251 |  | 14 | 237 |
| Collateralized mortgage obligations 8,424 50 <br> Others   | $\$ 719,832$ | $\$ 232$ | $\$ 3,634$ | $\$ 716,430$ |

## Table of Contents

|  | AS OF DECEMBER 31, 2007 |  |  |  |
| :--- | :---: | :---: | :---: | :---: |
| Gross |  |  |  |  | \(\left.\left.$$
\begin{array}{c}\text { Gross }\end{array}
$$\right] \begin{array}{c}Mmortized <br>

Unrealized <br>
Unrealized <br>

Losses\end{array}\right) ~\)| Value |
| :---: |

(In thousands)
Obligations of U.S. Government sponsored entities
Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations
Others
(In thousands)
Obligations of Puerto Rico, States and political subdivisions

|  |  |  |  |
| :---: | :---: | :---: | :---: |
|  |  | Gross |  |
|  | months or more |  |  |
|  |  |  |  |
| (In thousands) | Amortized | Unrealized | Market |
|  | Cost | Losses | Value |

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| Collateralized mortgage obligations | $\$ 251$ | $\$ 14$ | $\$ 237$ |
| :--- | ---: | ---: | ---: |
| Others | 1,000 | 2 | 998 |
|  | $\$ 1,251$ | $\$ 16$ | $\$ 1,235$ |

## Table of Contents

|  | Total <br> Gross |  |  |
| :--- | :---: | :---: | ---: |
| (In thousands) | Amortized | Unrealized <br> Losses | Market <br> Value |
| Obligations of Puerto Rico, States and political subdivisions | $\$ 48,644$ | $\$ 3,618$ | $\$ 45,026$ |
| Collateralized mortgage obligations | 251 | 14 | 237 |
| Others | 1,000 | 2 | 998 |
|  | $\$ 49,895$ | $\$ 3,634$ | $\$ 46,261$ |

AS OF DECEMBER 31, 2007
Less than 12 months
Gross

| Amortized <br> Cost | Unrealized <br> Losses | Market <br> Value |
| :---: | :---: | ---: |
| $\$ 196,129$ | $\$ 1,497$ | $\$ 194,632$ |
| 1,883 | 26 | 1,857 |
| 1,250 | 1 | 1,249 |

\$199,262 \$1,524 \$197,738
(In thousands)
Collateralized mortgage obligations
Others

| $\$ 310$ | $\$ 17$ | $\$ 293$ |
| ---: | ---: | ---: |
| 1,250 | 3 | 1,247 |
| $\$ 1,560$ | $\$ 20$ | $\$ 1,540$ |


|  | Total Gross |  |
| :---: | :---: | :---: |
| Amortized | Unrealized <br> Losses | Market Value |
| \$ 196,129 | \$ 1,497 | \$ 194,632 |
| 1,883 | 26 | 1,857 |
| 310 | 17 | 293 |
| 2,500 | 4 | 2,496 |
| \$200,822 | \$1,544 | \$199,278 |


\left.|  | AS OF SEPTEMBER 30, 2007 |  |  |
| :--- | :---: | :---: | :---: |
| Less than 12 months |  |  |  |
| Gross |  |  |  |$\right)$

## Table of Contents



Management believes that the unrealized losses in the held-to-maturity portfolio as of September 30, 2008 are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuers. Management has the intent and ability to hold these investments until maturity.

## Note 8 Mortgage Servicing Rights

The Corporation recognizes as assets the rights to service loans for others, whether these rights are purchased or result from asset transfers (sales and securitizations).
Effective January 1, 2007, under SFAS No. 156, the Corporation identified servicing rights related to residential mortgage loans as a class of servicing rights and elected to apply fair value accounting to these mortgage servicing rights ( MSRs ). These MSRs are segregated between loans serviced by PFH and by the Corporation s banking subsidiaries. Fair value determination is performed on a subsidiary basis, with assumptions varying in accordance with the types of assets or markets served.
Classes of mortgage servicing rights were determined based on the different markets or types of assets being serviced. Under the fair value accounting method of SFAS No. 156, purchased MSRs and MSRs resulting from asset transfers are capitalized and carried at fair value.
Effective January 1, 2007, upon the remeasurement of the MSRs at fair value in accordance with SFAS No. 156, the Corporation recorded a cumulative effect adjustment to increase the 2007 beginning balance of MSRs by $\$ 15.3$ million, which resulted in a $\$ 9.6$ million, net of tax, increase in the retained earnings account of stockholders equity in 2007.

The Corporation uses a discounted cash flow model to estimate the fair value of MSRs. The discounted cash flow model incorporates assumptions that market participants would use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, prepayment and late fees, among other considerations. Prepayment speeds are adjusted for the Corporation s loan characteristics and portfolio behavior.

The MSRs of PFH are included as part of Assets from discontinued operations in the consolidated statement of condition as of September 30, 2008. The MSRs related to PFH operations were valued as of September 30, 2008 by allocating a portion of the estimated fair value of the servicing related assets to be sold to Goldman Sachs, which

## Table of Contents

was based on the purchase price terms under the agreement.
The changes in MSRs measured using the fair value method for the nine months ended September 30, 2008 and September 30, 2007 were:

|  | Residential MSRs <br> Banking <br> subsidiaries |  | PFH (2) |
| :--- | :---: | :---: | ---: |$\quad$ Total

(1) Represents
changes due to
collection /
realization of
expected cash
flows over time.
Residential mortgage loans serviced for others were $\$ 20.0$ billion as of September 30, 2008 (December 31, 2007 $\$ 20.5$ billion; September 30, 2007 \$18.1 billion).
Net mortgage servicing fees, a component of other service fees in the consolidated statements of operations, include the changes from period to period in the fair value of the MSRs, 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, representing changes due to collection / realization of expected cash flows.
The section below includes information on assumptions used in the valuation model of the MSRs, originated and purchased.

## Banking subsidiaries

The Corporation s banking subsidiaries retain servicing responsibilities on the sale of wholesale mortgage loans and under pooling / selling arrangements of mortgage loans into mortgage-backed securities, primarily GNMA and FNMA securities. Substantially all mortgage loans securitized by the banking subsidiaries have fixed rates. Under these servicing agreements, the banking subsidiaries do not earn significant prepayment penalty fees on the underlying loans serviced.

## Table of Contents

Key economic assumptions used in measuring the servicing rights retained at the date of the residential mortgage loan securitizations and whole loan sales by the banking subsidiaries during the quarter ended September 30, 2008 and year ended December 31, 2007 were:

|  | September 30, | December 31, |
| :--- | :---: | :---: |
|  | 2008 | 2007 |

Key economic assumptions used to estimate the fair value of MSRs derived from sales and securitizations of mortgage loans performed by the banking subsidiaries and the sensitivity to immediate changes in those assumptions were as follows:

| (In thousands) | Originated MSRs |  |
| :---: | :---: | :---: |
|  | September 30, 2008 | December 31, 2007 |
| Fair value of retained interests | \$ 110,026 | \$ 86,453 |
| Weighted average life | 11.3 years | 12.5 years |
| Weighted average prepayment speed (annual rate) | 8.8\% | 8.0\% |
| Impact on fair value of $10 \%$ adverse change | \$ $(3,972)$ | \$ $(1,983)$ |
| Impact on fair value of $20 \%$ adverse change | \$ $(7,143)$ | \$ $(3,902)$ |
| Weighted average discount rate (annual rate) | 11.48\% | 10.83\% |
| Impact on fair value of $10 \%$ adverse change | \$ $(3,453)$ | \$ $(2,980)$ |
| Impact on fair value of $20 \%$ adverse change | \$ $(6,072)$ | \$ $(5,795)$ |

The banking subsidiaries also own servicing rights purchased from other financial institutions. The fair value of purchased MSRs, their related valuation assumptions and the sensitivity to immediate changes in those assumptions as of period end were as follows:

| (In thousands) | Purchased MSRs |  |
| :---: | :---: | :---: |
|  | September 30, 2008 | $\begin{gathered} \text { December 31, } \\ 2007 \end{gathered}$ |
| Fair value of retained interests | \$ 17,801 | \$ 24,159 |
| Weighted average life of collateral | 6.5 years | 12.4 years |
| Weighted average prepayment speed (annual rate) | 15.5\% | 8.0\% |
| Impact on fair value of $10 \%$ adverse change | \$ (922) | \$ (719) |
| Impact on fair value of $20 \%$ adverse change | \$ (1,638) | \$ $(1,407)$ |
| Weighted average discount rate (annual rate) | 12.3\% | 10.8\% |
| Impact on fair value of $10 \%$ adverse change | \$ (713) | \$ (956) |
| Impact on fair value of $20 \%$ adverse change | \$ $(1,240)$ | \$ $(1,846)$ |

The sensitivity analyses presented in the tables above for servicing rights are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 and 20 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in the sensitivity tables included herein, the effect of a variation in a particular assumption on the fair
value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

## Table of Contents

## Popular Financial Holdings

As indicated previously, as of September 30, 2008, all of PFH s MSRs were part of the discontinued operations. Given that their sale became effective on November 3, 2008, these financial statements do not include sensitivity analyses for PFH s MSRs as of the end of the third quarter of 2008 since they were not considered relevant.
Key economic assumptions used to estimate the fair value of MSRs derived from securitization transactions and the sensitivity to immediate changes in those assumptions as of December 31, 2007 are presented below.

|  | December 31, 2007 <br> Originated MSRs |  |  |
| :--- | :---: | :---: | :---: |
| (In thousands) | Fixed-rate <br> loans | ARM <br> loans |  |
| Carrying amount of retained interests (fair value) | $\$ 47,243$ | $\$$ | 11,335 |
| Weighted average life of collateral | 4.3 years | 2.6 years |  |
| Weighted average prepayment speed (annual rate) | $20.7 \%$ | $30.0 \%$ |  |
| Impact on fair value of 10\% adverse change | $\$$ | $(192)$ | $\$$ |
| Impact on fair value of 20\% adverse change | $\$$ | $(886)$ | $\$$ |
| Weighted average discount rate (annual rate) | $\$ 17.0 \%$ | 688 |  |
| Impact on fair value of $10 \%$ adverse change | $\$(1,466)$ | $\$$ | $(225)$ |
| Impact on fair value of $20 \%$ adverse change | $\$$ | $(2,846)$ | $\$$ |

PFH, as servicer, collects prepayment penalties on a substantial portion of the underlying serviced loans. As such, an adverse change in the prepayment assumptions with respect to the MSRs could be partially offset by the benefit derived from the prepayment penalties estimated to be collected.
PFH also owns servicing rights purchased from other institutions. The fair value of purchased MSRs, their related valuation assumptions and the sensitivity to immediate changes in those assumptions as of December 31, 2007 are presented below.
(In thousands)
Carrying amount of retained interests (fair value)
Weighted average life of collateral
Weighted average prepayment speed (annual rate)
Impact on fair value of $10 \%$ adverse change
Impact on fair value of $20 \%$ adverse change Weighted average discount rate (annual rate) Impact on fair value of $10 \%$ adverse change
Impact on fair value of $20 \%$ adverse change

December 31, 2007
Purchased MSRs

| Fixed-rate loans | ARM loans |
| :---: | :---: |
| \$ 7,808 | \$ 14,626 |
| 4.7 years | 3.4 years |
| 18.3\% | 25.2\% |
| \$ (329) | \$ (719) |
| \$ (631) | \$ $(1,377)$ |
| 17.0\% | 17.0\% |
| \$ (330) | \$ (509) |
| \$ (633) | \$ (981) |

## Table of Contents

## Note 9 Other Assets

The caption of other assets in the consolidated statements of condition consists of the following major categories:

|  | September 30, <br> (In thousands) | December 31, <br> 2007 | September 30, <br> 2007 |
| :--- | :---: | :---: | ---: |
| Net deferred tax assets (net of valuation allowance) | $\$ 663,260$ | $\$ 525,369$ | $\$ 420,288$ |
| Securitization advances and related assets (1) |  | 168,599 | 82,980 |
| Bank-owned life insurance program | 222,298 | 215,171 | 212,698 |
| Prepaid expenses | 153,698 | 188,237 | 187,725 |
| Investments under the equity method | 117,766 | 89,870 | 85,806 |
| Derivative assets | 50,335 | 76,958 | 64,981 |
| Trade receivables from brokers and counterparties | 17,100 | 1,160 | 8,714 |
| Others | 187,762 | 191,630 | 181,497 |
|  |  |  |  |
| Total | $\$ 1,412,219$ | $\$ 1,456,994$ | $\$ 1,244,689$ |

(1) Securitization advances and related assets are included as part of Assets from discontinued operations as of September 30, 2008. Refer to

Note 3 to the consolidated financial
statements.

## Note 10 Derivative Instruments and Hedging

Refer to Note 30 to the consolidated financial statements included in the 2007 Annual Report for a complete description of the Corporation s derivative activities. The following represents the major changes that occurred in the Corporation s derivative activities during the third quarter of 2008.

## Cash Flow Hedges

Derivative financial instruments designated as cash flow hedges outstanding as of September 30, 2008 and
December 31, 2007 were as follows:

|  | As of September 30, 2008 |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Notional <br> amount | Derivative <br> assets | Derivative <br> liabilities | Equity OCI Ineffectiveness |
| Asset Hedges | $\$ 139,500$ | $\$ 1,137$ | $\$ 439$ | $\$ 426$ |

## Liability Hedges

Interest rate swaps \$200,000 \$ 2,711 \$(1,762)

|  | Notional |
| :--- | :---: | :---: | :---: | :---: | :---: |
| amount |  |$\quad$| Derivative of December 31, 2007 |
| :---: |
| assets |$\quad$| Derivative |
| :---: |
| liabilities |$\quad$ Equity OCI Ineffectiveness

The Corporation utilizes forward contracts to hedge the sale of mortgage-backed securities with duration terms over one month. Interest rate forward contracts are contracts for the delayed delivery of securities which the seller agrees to deliver on a specified future date at a specified price or yield. These forward contracts are used to hedge a forecasted transaction and thus qualify for cash flow hedge accounting in accordance with SFAS No. 133, as amended. Changes in the fair value of the derivatives are recorded in other comprehensive income. The amount included in accumulated other comprehensive income corresponding to these forward contracts is expected to be reclassified to earnings in the next twelve months. The contracts outstanding as of September 30, 2008 have a maximum remaining maturity of 79 days.

## Table of Contents

The Corporation also has designated as cash flow hedges, interest rate swap contracts that convert floating rate debt into fixed rate debt by minimizing the exposure to changes in cash flows due to higher interest rates. These interest rate swap contracts have a maximum remaining maturity of 6.3 months.

## Table of Contents

## Non-Hedging Activities

Financial instruments designated as non-hedging derivatives outstanding as of September 30, 2008 and December 31, 2007 were as follows:

As of September 30, 2008

| (In thousands) | Notional amount | Fair Values |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  | Derivative assets |  | erivative abilities |
| Forward contracts | \$ 292,531 | \$ 1,106 | \$ | 888 |
| Interest rate swaps associated with: |  |  |  |  |
| - bond certificates offered in an on-balance sheet securitization | 63,369 |  |  | 2,532 |
| - swaps with corporate clients | 1,003,508 | 29,280 |  |  |
| - swaps offsetting position of corporate client swaps | 933,893 |  |  | 27,938 |
| Foreign currency and exchange rate commitments w/ clients | 106 | 3 |  |  |
| Foreign currency and exchange rate commitments w/ counterparty | 106 |  |  | 3 |
| Interest rate caps | 128,300 | 612 |  |  |
| Interest rate caps for benefit of corporate clients | 128,300 |  |  | 612 |
| Indexed options on deposits | 208,557 | 19,151 |  |  |
| Bifurcated embedded options | 182,507 |  |  | 18,402 |
| Mortgage rate lock commitments | 101,434 | 6 |  | 558 |
| Total | \$3,042,611 | \$50,158 | \$ | 50,933 |
| As of December 31, 2007 |  |  |  |  |
|  |  | Fair Values |  |  |
| (In thousands) | Notional amount | Derivative assets |  | erivative abilities |
| Forward contracts | \$ 693,096 | \$ 74 | \$ | 3,232 |
| Interest rate swaps associated with: |  |  |  |  |
| - short-term borrowings | 200,000 |  |  | 1,129 |
| - bond certificates offered in an on-balance sheet securitization | 185,315 |  |  | 2,918 |
| - swaps with corporate clients | 802,008 |  |  | 24,593 |
| - swaps offsetting position of corporate client swaps | 802,008 | 24,593 |  |  |
| Credit default swap | 33,463 |  |  |  |
| Foreign currency and exchange rate commitments w/ clients | 146 |  |  | 1 |
| Foreign currency and exchange rate commitments w/ counterparty | 146 | 2 |  |  |
| Interest rate caps | 150,000 | 27 |  |  |
| Interest rate caps for benefit of corporate clients | 50,000 |  |  | 18 |
| Indexed options on deposits | 211,267 | 45,954 |  |  |
| Indexed options on S\&P Notes | 31,152 | 5,962 |  |  |


| Bifurcated embedded options | 218,327 |  | 50,227 |
| :--- | ---: | ---: | ---: |
| Mortgage rate lock commitments | 148,501 | 258 | 386 |
| Total | $\$ 3,525,429$ | $\$ 76,870$ | $\$ 82,504$ |

## Interest Rates Swaps

The Corporation has an interest rate swap outstanding with a notional amount of $\$ 63$ million to economically hedge the payments of certificates issued as part of a securitization. This swap is marked-to-market quarterly and recognized as part of interest expense. The Corporation recognized gains of $\$ 25$ thousand for the third quarter and $\$ 0.4$ million for the nine months ended September 30, 2008 due to changes in the fair value of this swap. The Corporation recognized losses of $\$ 3.8$ million for the third quarter and $\$ 1.8$ million for the nine months ended September 30, 2007 due to changes in its fair value.
In addition, the Corporation also enters into interest rate swaps in its capacity as an intermediary on behalf of its customers. The Corporation minimizes its market risk and credit risk by taking offsetting positions under the same terms and conditions with credit limit approvals and monitoring procedures.

## Table of Contents

## Interest Rate Caps

The Corporation enters into interest rate caps as an intermediary on behalf of its customers and simultaneously takes offsetting positions with creditworthy counterparts under the same terms and conditions thus minimizing its market and credit risks.

## Forward Contracts

The Corporation has loan sales commitments to economically hedge the changes in fair value of mortgage loans held-for-sale associated with interest rate lock commitments through both mandatory and best efforts forward sales agreements. These contracts are entered into in order to optimize the gain on sales of loans. These contracts are recognized at fair market value with changes directly reported in income as part of gain on sale of loans. For the quarter and nine months ended September 30, 2008, losses of $\$ 1.1$ million and gains of $\$ 1.1$ million, respectively, were recognized due to changes in fair value of these forward sales commitments. For the quarter and nine months ended September 30, 2007, losses of $\$ 3.7$ million and $\$ 2.1$ million, respectively, were recognized due to changes in fair value of these forward sales commitments. Additionally, the Corporation has forward commitments to hedge the changes in fair value of certain MBS securities classified as trading securities. For the quarter and nine months ended September 30, 2008, the Corporation recognized gains of $\$ 0.9$ million and $\$ 2.3$ million, respectively, due to changes in the fair value of these forward commitments, which were recognized as part of trading gains and losses. For the quarter and nine months ended September 30, 2007, losses of $\$ 0.5$ million and $\$ 0.7$ million, respectively, were recognized due to changes in fair value of these forward commitments.

## Mortgage Rate Lock Commitments

The Corporation has mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed for a specified period of time. The mortgage rate lock commitments are accounted as derivatives pursuant to SFAS No. 133. These contracts are recognized at fair value with changes directly reported in income as part of gain on sale of loans. For the quarter and nine months ended September 30, 2008, gains of $\$ 0.1$ million and losses of $\$ 0.4$ million, respectively, were recognized due to changes in fair value of these commitments. For the quarter and nine months ended September 30, 2007, the Corporation recognized gains of $\$ 1.9$ million and $\$ 0.4$ million, respectively, related to these commitments.

## Note 11 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2008 and 2007, allocated by reportable segments, were as follows (refer to Note 25 for the definition of the Corporation s reportable segments):

| 2008 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Balance at January 1, 2008 | Goodwill acquired | Purchase accounting adjustments | Other | Balance at September 30 2008 |
| Banco Popular de Puerto Rico: |  |  |  |  |  |
| Commercial Banking | \$ 35,371 |  | \$ $(3,631)$ |  | \$ 31,740 |
| Consumer and Retail Banking | 136,407 |  | $(17,796)$ |  | 118,611 |
| Other Financial Services | 8,621 | \$ 153 | 3 | \$ 12 | 8,789 |
| Banco Popular North America: |  |  |  |  |  |
| Banco Popular North America | 404,237 |  |  |  | 404,237 |
| E-LOAN |  |  |  |  |  |
| EVERTEC | 46,125 | 1,000 | 85 | $(2,415)$ | 44,795 |
| Total Popular, Inc. | \$ 630,761 | \$ 1,153 | \$ $(21,339)$ | \$ 2,403 ) | \$ 608,172 |

## Table of Contents

|  | 2007 <br> Balance at <br> anuary 1, <br> 2007 | acquired | Other | Goodwill <br> Beptember 30, <br> 2007 |
| :--- | :---: | :---: | :---: | :---: |
| (In thousands) | $\$ 14,674$ |  |  | $\$ 14,674$ |
| Banco Popular de Puerto Rico: | 34,999 |  | 34,999 |  |
| Commercial Banking | 4,391 |  | 4,391 |  |
| Consumer and Retail Banking | 568,647 |  | 568,647 |  |
| Other Financial Services <br> Banco Popular North America: | 45,142 | $\$ 1,137$ | $\$(183)$ | 46,096 |
| Banco Popular North America | $\$ 667,853$ | $\$ 1,137$ | $\$(183)$ | $\$ 668,807$ |

Purchase accounting adjustments consist of adjustments to the value of the assets acquired and liabilities assumed resulting from the completion of appraisals or other valuations, adjustments to initial estimates recorded for transaction costs, if any, and contingent consideration paid during a contractual contingency period. The purchase accounting adjustments during the nine months ended September 30, 2008 at the BPPR reportable segment were mostly related to the acquisition of Citibank s retail branches in Puerto Rico (acquisition completed in December 2007). The reduction in goodwill in the EVERTEC reportable segment during the nine months ended September 30, 2008 was the result of the sale of substantially all assets of EVERTEC s health processing division during the third quarter of 2008.
During the third quarter of 2008, management completed the annual goodwill impairment tests for the Corporation's significant reporting units (BPPR and BPNA). Based on the results of the impairment tests, management concluded that goodwill at those reporting units is not impaired. The first step of the goodwill impairment test required by SFAS No. 142, which is used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. The carrying amount of BPNA exceeded its fair value, thus the second step of the goodwill impairment test was performed for that reporting unit. The second step, which is used to measure the amount of impairment loss, if any, compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. The implied fair value of goodwill shall be determined in the same manner as the amount of goodwill recognized in a business combination is determined. That is, an entity shall allocate the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. The fair value of the assets and liabilities reflects market conditions, thus volatility in prices could have a material impact on the determination of the implied fair value of the reporting unit goodwill at the impairment test date. Based on the results of the second step, management concluded that there was no goodwill impairment to be recognized by BPNA. Management monitors events or circumstances that could trigger a test for impairment between annual tests.
As of September 30, 2008, other than goodwill, the Corporation had $\$ 17$ million of identifiable intangibles with indefinite useful lives (December 31, $2007 \quad \$ 17$ million; September 30, $2007 \quad \$ 65$ million).
The following table reflects the components of other intangible assets subject to amortization:

September 30, 2008
Gross Accumulated Amount Amortization

December 31, 2007
Gross Accumulated
Amount Amortization

September 30, 2007
Gross Accumulated
Amount Amortization

| Core deposits | $\$ 71,238$ | $\$ 28,446$ | $\$ 66,381$ | $\$ 23,171$ | $\$ 46,302$ | $\$ 22,836$ |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Other customer <br> relationships | 12,898 | 7,105 | 13,421 | 5,753 | 15,021 | 5,192 |
| Other intangibles | 7,534 | 5,663 | 5,118 | 3,763 | 6,074 | 3,509 |
| Total | $\$ 91,670$ | $\$ 41,214$ | $\$ 84,920$ | $\$ 32,687$ | $\$ 67,397$ | $\$ 31,537$ |

During the quarter and nine months ended September 30, 2008, the Corporation recognized $\$ 4$ million and $\$ 9$ million, respectively, in amortization expense related to other intangible assets with definite lives (September 30, 2007 $\$ 2$ million and $\$ 8$ million in the quarter and nine months ended September 30, 2007, respectively).

## Table of Contents

The following table presents the estimated aggregate annual amortization expense of the intangible assets with definite lives for each of the following fiscal years:

|  | (In <br> thousands) |
| :---: | :---: |
| 2008 | $\$ 11,695$ |
| 2009 | 10,228 |
| 2010 | 8,294 |
| 2011 | 6,939 |
| 2012 | 5,919 |

## Note 12 Fair Value Option

As indicated in Note 2 to the consolidated financial statements, the Corporation elected to measure at fair value certain loans and borrowings outstanding at January 1, 2008 pursuant to the fair value option provided by SFAS No. 159. These financial instruments, all of which pertained to the discontinued operations of Popular Financial Holdings, were as follows:

Approximately $\$ 1.2$ billion of whole loans held-in-portfolio by PFH that were outstanding as of December 31, 2007. These whole loans consist principally of first lien residential mortgage loans and closed-end second lien loans that were originated through the exited origination channels of PFH (e.g. asset acquisition, broker and retail channels), and home equity lines of credit that had been originated by E-LOAN, but sold to PFH as part of the Corporation s 2007 U.S. reorganization whereby E-LOAN became a subsidiary of BPNA. Also, to a lesser extent, the loan portfolio included mixed-use / multi-family loans (small commercial category) and manufactured housing loans.

Management believed upon adoption of the accounting standard that accounting for these loans at fair value provided a more relevant and transparent measurement of the realizable value of the assets and differentiated the PFH portfolio from the loan portfolios that the Corporation continues to originate through channels other than PFH.

Approximately $\$ 287$ million of owned-in-trust loans and $\$ 287$ million of bond certificates associated with PFH securitization activities that were outstanding as of December 31, 2007. The owned-in-trust loans are pledged as collateral for the bond certificates as a financing vehicle through on-balance sheet securitization transactions. These loan securitizations conducted by the Corporation did not meet the sale criteria under SFAS No. 140; accordingly, the transactions are treated as on-balance sheet securitizations for accounting purposes. Due to the terms of the transactions, particularly the existence of an interest rate swap agreement and to a lesser extent clean up calls, the Corporation was unable to recharacterize these loan securitizations as sales for accounting purposes in 2007. The owned-in-trust loans include first lien residential mortgage loans, closed-end second lien loans, mixed-use / multi-family loans (small commercial category) and manufactured housing loans. The majority of the portfolio is comprised of first lien residential mortgage loans.

These owned-in-trust loans do not pose the same magnitude of risk to the Corporation as those loans owned outright because certain of the potential losses related to owned-in-trust loans are born by the bondholders and not the Corporation. Upon the adoption of SFAS No. 159, the loans and related bonds are both measured at fair value, thus their net position better portrays the credit risk born by the Corporation.
Excluding the PFH loans elected for the fair value option as described above, PFH s reportable segment held approximately $\$ 1.8$ billion of additional loans at the time of fair value option election on January 1, 2008. Of these remaining loans, at adoption date, $\$ 1.4$ billion were classified as loans held-for-sale and were not subject to the fair value option as the loans were intended to be sold to an institutional buyer during the first quarter of 2008. These loans were sold in March 2008. The remaining $\$ 0.4$ billion in other loans held-in-portfolio at PFH as of that same date consisted principally of a small portfolio of auto loans that was acquired from E-LOAN, warehousing revolving

## Table of Contents

lines of credit with monthly advances and pay-downs, and construction credit agreements in which the permanent financing will be provided by a lender other than PFH.
There were no other assets or liabilities elected for the fair value option after January 1, 2008.
Upon adoption of SFAS No. 159 the Corporation recognized a $\$ 262$ million negative after-tax adjustment ( $\$ 409$ million before tax) to beginning retained earnings due to the transitional adjustment for electing the fair value option, as detailed in the following table.

|  | Cumulative <br> effect |  |  |
| :--- | :---: | :---: | :---: |
| (In thousands) | January 1, 2008 <br> (Carrying value | adjustment to <br> January 1, 2008 <br> retained <br> earnings <br> Gain (Loss) | January 1, <br> 2008 <br> fair value <br> (Carrying <br> value <br> after adoption) |
| Loans | adoption) |  |  |

After-tax cumulative effect of adopting fair value option accounting
\$ $(261,831)$
As of January 1, 2008, the Corporation eliminated $\$ 37$ million in allowance for loan losses associated to the loan portfolio elected for fair value option accounting and recognized it as part of the cumulative effect adjustment. The following table presents the differences as of September 30, 2008 between the aggregate fair value, including accrued interest, and aggregate unpaid principal balance ( UPB ) of those loans / notes payable for which the fair value option has been elected. Also, the table presents information of non-accruing loans accounted under the fair value option.

|  | Aggregate fair <br> value <br> as of <br> September 30, <br> 2008 | Aggregate UPB <br> as of <br> September 30, <br> 2008 | Unrealized |
| :--- | :---: | :---: | :---: |
| (In thousands) | $\$ 583,812$ | $\$ 1,145,717$ | $\$(561,905)$ |
| Loans | $\$ 64,802$ | $\$ 185,433$ | $\$(120,631)$ |
| Loans past due 90 days or more | $\$ 64,802$ | $\$ 185,433$ | $\$(120,631)$ |

(1) It is the

Corporation s
policy to
recognize
interest income
separately from
other changes in
fair value.
Interest income
on these loans
was included as
part of Loss
from
discontinued operations, net of tax in the consolidated statement of operations and is based on the note s contractual rate. Interest income is reversed, if necessary, in accordance with the Corporation s non-accruing policy for each particular loan
type.
During the quarter and nine-months ended September 30, 2008, the Corporation recognized $\$ 137.2$ million and $\$ 169.8$ million, respectively, in losses attributable to changes in the fair value of loans, including net losses attributable to changes in instrument-specific credit spreads. During the quarter and nine months ended September 30, 2008, the Corporation recognized $\$ 3.4$ million and $\$ 9.6$ million, respectively, in losses attributable to changes in the fair value of notes payable (bond certificates). These losses were included in the caption Loss from discontinued operations, net of tax in the consolidated statement of operations.
These financial instruments are included as part of Assets / Liabilities from discontinued operations in the consolidated statement of condition as of September 30, 2008. PFH, which held the SFAS No. 159 loan portfolio, was financed primarily by advances from its holding company, Popular North America ( PNA ). In turn, PNA depended totally on the capital markets to raise financing to meet its financial obligations. Given the mounting pressure to address PNA s liquidity needs and the continuing problems with accessing the U.S. capital markets given

## Table of Contents

the current unprecedented market conditions, management decided that the only viable option available to permanently raise the liquidity required by PNA was to sell PFH assets. This decision was taken in the third quarter of 2008.

## Note 13 Fair Value Measurement

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2008, the Corporation adopted SFAS No. 157, which provides a framework for measuring fair value under accounting principles generally accepted. Under SFAS No. 157, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels in order to increase consistency and comparability in fair value measurements and disclosures. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for the fair value measurement are observable or unobservable. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect the Corporation s estimates about assumptions that market participants would use in pricing the asset or liability based on the best information available. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1-Unadjusted quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date. Valuation on these instruments does not necessitate a significant degree of judgment since valuations are based on quoted prices that are readily available in an active market.

Level 2- Quoted prices other than those included in Level 1 that are observable either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or that can be corroborated by observable market data for substantially the full term of the financial instrument.

Level 3- Inputs are unobservable and significant to the fair value measurement. Unobservable inputs reflect the Corporation s own assumptions about assumptions that market participants would use in pricing the asset or liability.
The Corporation maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available. Fair value is based upon quoted market prices when available. If listed price or quotes are not available, the Corporation employs internally-developed models that primarily use market-based inputs including yield curves, interest rates, volatilities, and credit curves, among others. Valuation adjustments are limited to those necessary to ensure that the financial instrument s fair value is adequately representative of the price that would be received or paid in the marketplace. These adjustments include amounts that reflect counterparty credit quality, the Corporation s credit standing, constraints on liquidity and unobservable parameters that are applied consistently.
The estimated fair value may be subjective in nature and may involve uncertainties and matters of significant judgment for certain financial instruments. Changes in the underlying assumptions used in calculating fair value could significantly affect the results. In addition, the fair value estimates are based on outstanding balances without attempting to estimate the value of anticipated future business. Therefore, the estimated fair value may materially differ from the value that could actually be realized on a sale.

## Table of Contents

## Fair Value on a Recurring Basis

The following fair value hierarchy table presents information about the Corporation s assets and liabilities measured at fair value on a recurring basis at September 30, 2008:

| (In millions) | At September 30, 2008 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Quoted prices in active markets for identical assets or liabilities Level 1 | Significant other <br> observable inputs Level 2 |  | Significant <br> unobservable inputs Level 3 | Balance as <br> of September 30, 2008 |
| Assets |  |  |  |  |  |
| Continuing Operations |  |  |  |  |  |
| Investment securities available-for-sale | \$ 10 | \$7,522 | \$ | \$ 37 | \$7,569 |
| Trading account securities |  | 207 |  | 237 | 444 |
| Derivatives |  | 51 |  |  | 51 |
| Mortgage servicing rights |  |  |  | 128 | 128 |
| Discontinued Operations |  |  |  |  |  |
| Loans measured at fair value (SFAS |  |  |  |  |  |
| No. 159) |  |  |  | 584 | 584 |
| Residual interests trading |  |  |  | 4 | 4 |
| Mortgage servicing rights |  |  |  | 37 | 37 |
| Total | \$ 10 | \$7,780 |  | \$,027 | \$8,817 |
| Liabilities |  |  |  |  |  |
| Continuing Operations |  |  |  |  |  |
| Derivatives |  | \$ (52) |  |  | \$ (52) |
| Discontinued Operations |  |  |  |  |  |
| Notes payable measured at fair value (SFAS No. 159) |  |  |  | \$ (166) | (166) |
| Derivatives |  | (2) |  |  | (2) |
| Total |  | \$ (54) |  | \$ (166) | \$ (220) |

## Table of Contents

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the quarter and nine months ended September 30, 2008:

Quarter ended September 30, 2008
$\left.\begin{array}{llllll} & & & \begin{array}{c}\text { Changes } \\ \text { in }\end{array} \\ \text { unrealized } \\ \text { gains }\end{array}\right)$

## Assets

## Continuing

Operations
Investment securities
available-for-sale
Trading account securities
Mortgage servicing rights
Discontinued
Operations
Loans measured at fair value (SFAS No. 159)
Residual interests trading 35 56 2
\$ 39

130

$$
845
$$

Mortgage servicing rights
Residual interests -available-for-sale
\$ (1)
\$ (1) \$ 37
(a)
(74) 237 (1)
(b)
$8 \quad 128$
(7)
(d)

310 \$ 1
(10)
(137)
(29)
(19)
\$ 1,417
Total

$$
\begin{equation*}
2, i \tag{R}
\end{equation*}
$$

(2)
(123) 584
(c)
(2)

4
37
7
(12)
(c)
(32)
(c)

$$
2
$$

## Liabilities

## Discontinued

## Operations

Notes payable measured at fair value (SFAS
No. 159) \$ (174) \$ (3)

Total
\$ (174) \$ (3)
\$ 11 \$ (166) \$ (3)
(a) Gains
(losses) are included in Net (loss) gain on sale and valuation adjustments of investment securities in the statement of operations.
(b) Gains
(losses) are included in Trading account profit (loss) in the statement of operations.
(c) Gains
(losses) are included in Loss
from
discontinued operations, net of tax in the statement of operations.
(d) Gains
(losses) are included in Other service fees in the statement of operations.

## Table of Contents



## Liabilities

## Discontinued

Operations
Notes payable
measured at fair
value (SFAS
No. 159)
Total
\$ (201) \$ (9)
\$ (201) \$ (9)
\$ 44 \$ (166) \$ (9)
(c)
$\$ 44 \quad \$(166) \quad \$(9)$
(a) Gains
(losses) are
included in Net
(loss) gain on
sale and
valuation
adjustments of investment
securities in the
statement of
operations.
(b) Gains
(losses) are
included in
Trading account
profit (loss) in
the statement of operations.
(c) Gains
(losses) are
included in Loss
from
discontinued
operations, net
of tax in the
statement of
operations.
(d) Gains
(losses) are included in Other service fees in the statement of operations.

There were no transfers in and / or out of Level 3 for financial instruments measured at fair value on a recurring basis during the quarter and nine months ended September 30, 2008.

## Table of Contents

Gains and losses (realized and unrealized) included in earnings for the quarter and nine months ended September 30, 2008 for Level 3 assets and liabilities included in the previous tables are reported in the consolidated statement of operations as follows:
(In millions)

## Continuing Operations

Interest income
Other service fees
Trading account loss
Discontinued Operations (1)
Interest income
Other service fees
Net loss on sale and valuation adjustments of investment securities
Trading account loss
Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159
\$ (10)
\$ (7)
Total gains
(losses)
included in earnings
Quarter ended September 30, 2008
Change in
unrealized gains
or losses relating to assets /
liabilities still held at reporting date3
(19)

Total
\$ (199)
(1) All income statement amounts for the discontinued operations disclosed in this table are aggregated and included in the line item Loss from discontinued operations, net of tax in the consolidated statement of operations.
(In millions)

## Continuing Operations

Interest income
Other service fees
Trading account loss
Discontinued Operations (1)
Interest income
Other service fees
Net loss on sale and valuation adjustments of investment securities
Trading account loss
Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159

Total
\$ (264) (179)
(4)
(43)
(losses) liabilities still held at included in earnings
\$ (9)
\$
(1)

2
reporting date

(1) All income
statement
amounts for the
discontinued
operations
disclosed in this
table are
aggregated and
included in the
line item Loss
from
discontinued
operations, net
of tax in the
consolidated
statement of
operations.

## Table of Contents

Additionally, the Corporation may be required to measure certain assets at fair value on a nonrecurring basis in accordance with generally accepted accounting principles. The adjustments to fair value usually result from the application of lower of cost or market accounting, identification of impaired loans requiring specific reserves under SFAS No. 114, or write-downs of individual assets. The following table presents those financial assets that were subject to a fair value measurement on a non-recurring basis during the nine months ended September 30, 2008 and which are still included in the consolidated statement of condition as of September 30, 2008. The amounts disclosed represent the aggregate of the fair value measurements of those assets as of the end of the reporting period.

| (In millions) | Quoted prices in active markets for identical assets Level 1 | Significant other observable inputs Level 2 | Significant unobservable inputs Level 3 | Total |
| :---: | :---: | :---: | :---: | :---: |
| Assets |  |  |  |  |
| Continuing Operations |  |  |  |  |
| Loans (1) |  |  | \$ 474 | \$474 |
| Discontinued Operations |  |  |  |  |
| Loans held-for-sale (2) |  |  | 42 | 42 |
| Securitization advances |  |  | 280 | 280 |

(1) Relates primarily
to certain
impaired
collateral
dependent loans.
The impairment
was 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
SFAS No. 114
(as amended by
SFAS No. 118).
(2) Relates
principally to
loans transferred
from loans
held-in-portfolio
to loans
held-for-sale.
Their lower of
cost or market
adjustments were
principally
determined
based on negotiated price terms for the loans.

Following is a description of the Corporation s valuation methodologies used for assets and liabilities measured at fair value. The disclosure requirements exclude certain financial instruments and all non-financial instruments.
Accordingly, the aggregate fair value amounts of the financial instruments presented in Note 13 do not represent management $s$ estimate of the underlying value of the Corporation.

## Trading Account Securities and Investment Securities Available-for-Sale

U.S. Treasury securities: The fair value of U.S. Treasury securities is based on yields that are interpolated from the constant maturity treasury curve. These securities are classified as Level 2.

Obligations of U.S. Government sponsored entities: The Obligations of U.S. Government sponsored entities include U.S agency securities. The fair value of U.S. agency securities, except for structured notes, is based on an active exchange market and is based on quoted market prices for similar securities. The U.S. agency securities are classified as Level 2. U.S. agency structured notes are priced based on a bond stheoretical value from similar bonds defined by credit quality and market sector and for which the fair value incorporates an option adjusted spread in deriving their fair value. These securities are classified as Level 2.

Obligations of Puerto Rico, States and political subdivisions: Obligations of Puerto Rico, States and political subdivisions include municipal bonds. The bonds are segregated and the like characteristics divided into specific sectors. Market inputs used in the evaluation process include all or some of the following: trades, bid price or spread, two sided markets, quotes, benchmark curves including but not limited to Treasury benchmarks, LIBOR and swap curves, market data feeds such as MSRB, discount and capital rates, and trustee reports. The municipal bonds are classified as Level 2.

Mortgage-backed securities: Certain agency mortgage-backed securities ( MBS ) are priced based on a bond s theoretical value from similar bonds defined by credit quality and market sector. Their fair value incorporates an option adjusted spread. The agency MBS are classified as Level 2. Other agency MBS such as GNMA Puerto Rico Serials are priced using an internally-prepared pricing matrix with quoted prices from local brokers dealers. These particular MBS are classified as Level 3.

Collateralized mortgage obligations: Agency and private collateralized mortgage obligations ( CMOs ) are priced based on a bond $s$ theoretical value from similar bonds defined by credit quality and market sector and for which fair value incorporates an option adjusted spread. The option adjusted spread model

## Table of Contents

includes prepayment and volatility assumptions, ratings (whole loans collateral) and spread adjustments. These investment securities are classified as Level 2.

Equity securities: Equity securities with quoted market prices obtained from an active exchange market are classified as Level 1.

Corporate securities and mutual funds: Quoted prices for these security types are obtained from broker dealers. Given that the quoted prices are for similar instruments or do not trade in highly liquid markets, the corporate securities and mutual funds are classified as Level 2. The important variables in determining the prices of Puerto Rico tax-exempt mutual fund shares are net asset value, dividend yield and type of assets in the fund. All funds trade based on a relevant dividend yield taking into consideration the aforementioned variables. In addition, demand and supply also affect the price. Corporate securities that trade less frequently are classified as Level 3.

## Derivatives

Interest rate swaps, interest rate caps and index options are traded in over-the-counter active markets. These derivatives are indexed to an observable interest rate benchmark, such as LIBOR or equity indexes, and are priced using present value and option pricing models using observable inputs. The derivatives are substantially classified as Level 2. Other derivatives that are exchange-traded, such as futures and options, or that are liquid and have quoted prices, such as forward contracts or TBA s, are also classified as Level 2.

## Mortgage servicing rights

Mortgage servicing rights ( MSRs ) do not trade in an active market with readily observable prices. MSRs are priced internally using a discounted cash flow model. The valuation model considers servicing fees, portfolio characteristics, prepayments 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 MSRs are classified as Level 3.

## Loans held-in-portfolio considered impaired under SFAS No. 114 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 SFAS No. 114 (as amended by SFAS No. 118). Currently, the associated loans considered impaired as of June 30, 2008 are classified as Level 3.

## Assets / Liabilities from discontinued operations

The fair value measurements of assets and liabilities associated to the discontinued operations are mostly derived from the price indicators negotiated in a market transaction with Goldman Sachs, the prospective buyer of substantially all of the assets of the discontinued business as indicated in Note 3 to the consolidated financial statements.

## Table of Contents

## Note 14 Borrowings

The composition of federal funds purchased and assets sold under agreements to repurchase was as follows:

|  | September 30, <br> (In thousands) | December 31, <br> 2008 | September 30, <br> 2007 |
| :--- | :---: | ---: | ---: |
| Federal funds purchased | $\$ 139,951$ | $\$ 303,492$ | $\$ 690,332$ |
| Assets sold under agreements to repurchase | $3,590,088$ | $5,133,773$ | $5,596,971$ |
|  | $\$ 3,730,039$ | $\$ 5,437,265$ | $\$ 6,287,303$ |

Other short-term borrowings consisted of:
$\left.\begin{array}{lcccc} & \begin{array}{c}\text { September } \\ 30,\end{array} & \begin{array}{c}\text { December 31, } \\ 2007\end{array} & \begin{array}{c}\text { September 30, } \\ 2007\end{array} \\ \text { (In thousands) } & 2008\end{array}\right)$

Note: Refer to the
Corporation s
Form 10-K for
the year ended
December 31,
2007, for rates
and maturity
information
corresponding

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to the
borrowings
outstanding as of such date.

## Table of Contents

Notes payable consisted of:
(In thousands)

Advances with the FHLB:
-with maturities ranging from 2009 through 2018 paying interest at fixed rates ranging from $2.67 \%$ to $6.98 \%$
(September 30, $20072.51 \%$ to $6.98 \%$ )
-maturing in 2008 paying interest monthly at a floating rate of $0.0075 \%$ over the 1 -month LIBOR rate

Advances under revolving lines of credit maturing in 2008 paying interest monthly at a floating rate of $0.75 \%$ over the 1-month LIBOR rate

| September 30, | December 31, | September 30, |
| :---: | :---: | :---: |
| 2008 | 2007 | 2007 |

\$1,241,717
\$ 813,958
\$ 738,099

250,000
250,000

317,926

Advances under revolving lines of credit with maturities ranging from 2008 to 2009 paying interest quarterly at floating rates ranging from $0.20 \%$ to $0.27 \%$
(September 30, $20070.20 \%$ to $0.35 \%$ ) over the 3-month LIBOR rate

Term notes maturing in 2030 paying interest monthly at fixed rates ranging from $3.00 \%$ to $6.00 \%$

Term notes with maturities ranging from 2008 to 2013 paying interest semiannually at fixed rates ranging from $3.88 \%$ to $7.00 \%$ (September 30, $20073.60 \%$ to $5.65 \%$ )

Term notes with maturities ranging from 2008 to 2013 paying interest monthly at a floating rate of $3.00 \%$ over the 10 -year U.S. Treasury note rate

Term notes maturing in 2009 paying interest quarterly at a floating rate of $0.40 \%$ to $3.25 \%$ (September 30, 2007 $0.35 \%$ to $0.40 \%$ ) over the 3-month LIBOR rate

Secured borrowings paying interest monthly at fixed rates ranging from $4.00 \%$ to $7.12 \%$

Secured borrowings paying interest monthly at floating rates ranging from $0.06 \%$ to $3.51 \%$ over the 1 -month LIBOR rate

Notes linked to the S\&P 500 Index maturing in 2008

Junior subordinated deferrable interest debentures with maturities ranging from 2027 to 2034 with fixed interest rates ranging from $6.13 \%$ to $8.33 \%$ (Refer to Note 15)

85,000

3,100
$1,579,509$

4,642
6,805
7,502

449,880
199,706
349,610

2,381,081
59,241

227,743
$1,189,286$

36,498
37,876

849,672
849,672
849,672

Other
Total notes payable from continuing operations
Notes payable from discontinued operations
\$ 166,436

Note: Refer to the
Corporation s
Form 10-K for
the year ended
December 31,
2007, for rates
and maturity
information
corresponding
to the
borrowings
outstanding as
of such date.
Key index rates
as of
September 30, 2008 and
September 30, 2007, respectively, were as follows:
1-month LIBOR
rate $=3.93 \%$
and $5.12 \%$;
3-month LIBOR
rate $=4.05 \%$
and $5.23 \%$;
10-year U.S.
Treasury note = $3.83 \%$ and 4.59\%.

* These secured
borrowings are
part of
discontinued
operations and,
therefore, are
included in the
line item
Liabilities from
discontinued
operations in the
consolidated
statement of
condition as of
September 30,

2008. 

## Table of Contents

## Note 15 Trust Preferred Securities

As of September 30, 2008 and 2007, the Corporation had established four trusts for the purpose of issuing trust preferred securities (the capital securities ) to the public. The proceeds from such issuances, together with the proceeds of the related issuances of common securities of the trusts (the common securities ), were used by the trusts to purchase junior subordinated deferrable interest debentures (the junior subordinated debentures ) issued by the Corporation. The sole assets of the trusts consisted of the junior subordinated debentures of the Corporation and the related accrued interest receivable. These trusts are not consolidated by the Corporation under the provisions of FIN No. 46(R).
The junior subordinated debentures are included by the Corporation as notes payable in the consolidated statements of condition, while the common securities issued by the issuer trusts are included as other investment securities. The common securities of each trust are wholly-owned, or indirectly wholly-owned, by the Corporation. Financial data pertaining to the trusts follows:
(In thousands, including reference notes)
$\left.\begin{array}{lccccrr} \\ & & & & & \text { Popular North } \\ \text { America } \\ \text { Capital }\end{array}\right)$
(a) Statutory
business trust
that is
wholly-owned
by Popular
North America
( PNA ) and indirectly
wholly-owned
by the
Corporation.
(b) Statutory
business trust
that is
wholly-owned
by the
Corporation.
(c) The obligations of PNA under the junior subordinated debentures and its guarantees of the capital securities under the trust are fully and unconditionally guaranteed on a subordinated basis by the Corporation to the extent set forth in the applicable guarantee agreement.
(d) These capital securities are fully and unconditionally guaranteed on a subordinated basis by the Corporation to the extent set forth in the applicable guarantee agreement.
(e) The original issuance was for $\$ 150,000$. In 2003, the Corporation reacquired $\$ 6,000$ of the 8.327\% capital securities.
(f) The Corporation has the right, subject to any required prior approval from
the Federal
Reserve, to
redeem after
certain dates or
upon the
occurrence of certain events
mentioned
below, the
junior
subordinated debentures at a
redemption
price equal to
$100 \%$ of the
principal
amount, plus
accrued and
unpaid interest
to the date of redemption. The maturity of the junior subordinated debentures may be shortened at the option of the Corporation prior to their stated maturity dates (i) on or after the stated optional redemption dates stipulated in the agreements, in whole at any time or in part from time to time, or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of a tax event, an investment
company event
or a capital
treatment event
as set forth in
the indentures
relating to the
capital
securities, in
each case
subject to
regulatory
approval. A
capital treatment
event would
include a
change in the
regulatory
capital treatment
of the capital
securities as a
result of the
recent
accounting
changes
affecting the
criteria for
consolidation of
variable interest
entities such as
the trust under
FIN 46(R).
(g) Same as
(f) above,
except that the
investment
company event
does not apply
for early
redemption.
The capital securities of Popular Capital Trust I and Popular Capital Trust II are traded on the NASDAQ under the symbols BPOPN and BPOPM, respectively.

## Table of Contents

## Note 16 Stockholders Equity

The Corporation s authorized preferred stock may be issued in one or more series, and the shares of each series shall have such rights and preferences as shall be fixed by the Board of Directors when authorizing the issuance of that particular series.
On May 28, 2008, the Corporation issued $16,000,000$ shares of Series B Preferred Stock at a purchase price of $\$ 25.00$ per share.
The Corporation s preferred stock outstanding at September 30, 2008 consists of:
$6.375 \%$ non-cumulative monthly income preferred stock, 2003 Series A. These shares of preferred stock are perpetual, nonconvertible and are redeemable solely at the option of the Corporation with the consent of the Board of Governors of the Federal Reserve System beginning on March 31, 2008. The redemption price per share is $\$ 25.50$ from March 31, 2008 through March 30, 2009, $\$ 25.25$ from March 31, 2009 through March 30, 2010 and $\$ 25.00$ from March 31, 2010 and thereafter.
$8.25 \%$ non-cumulative monthly income preferred stock, 2008 Series B. These shares of preferred stock are perpetual, nonconvertible and are redeemable, in whole or in part, solely at the option of the Corporation with the consent of the Board of Governors of the Federal Reserve System beginning on May 28, 2013. The redemption price per share is $\$ 25.50$ from May 28, 2013 through May 28, 2014, $\$ 25.25$ from May 28, 2014 through May 28, 2015 and $\$ 25.00$ from May 28, 2015 and thereafter.
The Banking Act of the Commonwealth of Puerto Rico requires that a minimum of $10 \%$ of BPPR s net income for the year be transferred to a statutory reserve account until such statutory reserve equals the total of paid-in capital on common and preferred stock. Any losses incurred by a bank must first be charged to retained earnings and then to the reserve fund. Amounts credited to the reserve fund may not be used to pay dividends without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The failure to maintain sufficient statutory reserves would preclude BPPR from paying dividends. BPPR s statutory reserve fund totaled $\$ 374$ million as of September 30, 2008 (December 31, $2007 \$ 374$ million; September 30, $2007 \$ 346$ million). There were no transfers between the statutory reserve account and the retained earnings account during the quarter and nine months ended September 30, 2008 and 2007.

## Note 17 Commitments and Contingencies

Commercial letters of credit and stand-by letters of credit amounted to $\$ 28$ million and $\$ 175$ million, respectively, as of September 30, 2008 (December 31, 2007 \$26 million and $\$ 174$ million; September 30, $2007 \$ 18$ million and $\$ 196$ million). There were also other commitments outstanding and contingent liabilities, such as commitments to extend credit.
As of September 30, 2008, the Corporation recorded a liability of \$563 thousand (December 31, 2007-\$636 thousand; September 30, $2007 \$ 721$ thousand), which represents the fair value of the obligations undertaken in issuing the guarantees under stand-by letters of credit. The fair value approximates the fee received from the customer for issuing such commitments. These fees are deferred and are recognized over the commitment period. The liability was included as part of other liabilities in the consolidated statements of condition. The contract amounts in stand-by letters of credit outstanding represent the maximum potential amount of future payments the Corporation could be required to make under the guarantees in the event of nonperformance by the customers. These stand-by letters of credit are used by the customer as a credit enhancement and typically expire without being drawn upon. The Corporation s stand-by letters of credit are generally secured, and in the event of nonperformance by the customers, the Corporation has rights to the underlying collateral provided, which normally includes cash and marketable securities, real estate, receivables and others. Management does not anticipate any material losses related to these instruments. Popular, Inc. at the holding company level ( PIHC ) fully and unconditionally guarantees certain borrowing obligations issued by certain of its wholly-owned consolidated subsidiaries, which aggregated to $\$ 2.3$ billion as of September 30, 2008 (December 31, $2007 \$ 2.9$ billion and September 30, $2007 \$ 3.3$ billion). In addition, as of

## Table of Contents

September 30, 2008, PIHC fully and unconditionally guaranteed $\$ 824$ million of capital securities (December 31, 2007 and September 30, $2007 \$ 824$ million) issued by four wholly-owned issuing trust entities that have been deconsolidated pursuant to FIN No. 46R.
The Corporation is a defendant in a number of legal proceedings arising in the normal course of business. Based on the opinion of legal counsel, management believes that the final disposition of these matters will not have a material adverse effect on the Corporation s financial position or results of operations.

## Note 18 Other Service Fees

The caption of other service fees in the consolidated statements of operations consists of the following major categories:

|  | Quarter ended <br> September 30, |  | Nine months ended <br> September 30, |  |
| :--- | :---: | ---: | ---: | ---: | ---: |
| (In thousands) | 2008 | 2007 | 2008 | 2007 |
|  |  |  |  |  |
| Credit card fees and discounts | $\$ 27,138$ | $\$ 25,975$ | $\$ 81,664$ | $\$ 74,498$ |
| Debit card fees | 28,170 | 16,228 | 79,880 | 49,184 |
| Processing fees | 13,044 | 11,674 | 38,587 | 35,463 |
| Insurance fees | 12,378 | 14,410 | 38,254 | 40,624 |
| Sale and administration of investment products | 6,890 | 8,043 | 25,966 | 22,614 |
| Mortgage servicing fees, net of amortization and |  |  |  |  |
| fair value adjustments | $(1,407)$ | 4,706 | 13,809 | 16,257 |
| Other fees | 9,089 | 8,827 | 28,489 | 27,072 |
|  |  |  |  |  |
| Total | $\$ 95,302$ | $\$ 89,863$ | $\$ 306,649$ | $\$ 265,712$ |

## Note 19 Pension and Postretirement Benefits

The Corporation has noncontributory defined benefit pension plans and supplementary benefit pension plans for regular employees of certain of its subsidiaries.
The components of net periodic pension cost for the quarters and nine months ended September 30, 2008 and 2007 were as follows:

| (In thousands) | Pension Plans |  |  |  | Benefit Restoration Plans |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Quarters ended <br> September 30, |  | Nine months ended September 30, |  | Quarters ended September 30, |  | Nine months ended September 30, |  |
|  | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Service cost | \$ 2,315 | \$ 2,639 | \$ 6,945 | \$ 8,384 | \$ 182 | \$ 221 | \$ 546 | \$ 678 |
| Interest cost | 8,611 | 7,958 | 25,833 | 23,890 | 461 | 419 | 1,383 | 1,258 |
| Expected return on plan assets | $(10,169)$ | $(10,532)$ | $(30,507)$ | $(31,589)$ | (420) | (369) | $(1,260)$ | $(1,105)$ |
| Amortization of prior service cost | 67 | 52 | 201 | 156 | (13) | (13) | (39) | (39) |
| Amortization of net loss |  |  |  |  | 172 | 248 | 515 | 743 |
| Net periodic cost | \$ 824 | 117 | \$ 2,472 | \$ 841 | \$ 382 | \$ 506 | \$ 1,145 | \$ 1,535 |
| One-time settlement gain |  |  |  |  | (24) |  | (24) |  |
| Curtailment gain |  |  |  | (246) |  |  |  | (258) |

$\begin{array}{llllllllllllll}\text { Total cost } & \$ & 824 & \$ & 117 & \$ & 2,472 & \$ & 595 & \$ 358 & \$ 506 & \$ 1,121 & \$ 1,277\end{array}$
For the nine months ended September 30, 2008, contributions made to the pension and restoration plans amounted to approximately $\$ 1.3$ million. The total contributions expected to be paid during the year 2008 for the pension and restoration plans amount to approximately $\$ 1.8$ million.

## Table of Contents

The Corporation also provides certain health care benefits for retired employees of certain subsidiaries. The components of net periodic postretirement benefit cost for the quarters and nine months ended September 30, 2008 and 2007 were as follows:

|  | Quarters ended <br> September 30, |  | Nine months ended <br> September 30, |  |
| :--- | :---: | :---: | ---: | ---: |
| (In thousands) | 2008 | 2007 | 2008 | 2007 |
| Service cost | $\$ 485$ | $\$ 578$ | $\$ 1,455$ | $\$ 1,734$ |
| Interest cost | 1,967 | 1,889 | 5,901 | 5,667 |
| Amortization of prior service cost | $(262)$ | $(261)$ | $(786)$ | $(784)$ |
| Total net periodic cost | $\$ 2,190$ | $\$ 2,206$ | $\$ 6,570$ | $\$ 6,617$ |

For the nine months ended September 30, 2008, contributions made to the postretirement benefit plan amounted to approximately $\$ 4.4$ million. The total contributions expected to be paid during the year 2008 for the postretirement benefit plan amount to approximately $\$ 6.4$ million.
Note 20 Restructuring Plans

## PFH Discontinuance Restructuring Plan

As disclosed in Note 3 to the consolidated financial statements, on August 29, 2008, the Corporation announced an agreement to sell loans and servicing assets of PFH and Popular, FS to various Goldman Sachs affiliates. As disclosed in Note 27 to the consolidated financial statements, the transaction closed on November 3, 2008. This sale resulted in a reduction in assets, mostly accounted at fair value, of over $\$ 900$ million, and provided over $\$ 700$ million in additional liquidity. In addition, on September 18, 2008, the Corporation announced the consummation of the sale of manufactured housing loans of PFH to $21^{\text {st }}$ Mortgage Corp. and Vanderbilt Mortgage and Finance, Inc. The transaction provided approximately $\$ 198$ million in cash and resulted in a reduction in unpaid principal balance of loans held at PFH of approximately $\$ 309$ million.
As part of the sale of the loans and servicing assets, the Corporation entered into a restructuring plan (the PFH Discontinuance Restructuring Plan ) to eliminate employment positions, terminate contracts and incur other costs associated with the discontinuance of PFH s operations. It is anticipated that this Plan will result in estimated combined charges for the Corporation of approximately $\$ 14$ million, of which $\$ 5.1$ million was recognized during the third quarter of 2008. The remainder costs consisting of severance bonuses and other employee benefits, lease and other contract termination expenses will be recognized during the fourth quarter of 2008 and early 2009.
Full-time equivalent employees at the PFH reportable segment were 299 as of September 30, 2008, compared with 934 as of September 30, 2007.
During the quarter ended September 30, 2008, the PFH Discontinuance Restructuring Plan resulted in charges, on a pre-tax basis, broken down as follows:

| (In thousands) | Impairments on long-lived assets | Restructuring costs | Total |
| :---: | :---: | :---: | :---: |
| Quarter ended: |  |  |  |
| September 30, 2008 | \$ 3,916(a) | \$ 1,164(b) | \$5,080 |
| Total | \$ 3,916 | \$ 1,164 | \$5,080 |

(a) Fixed assets and prepaid

## expenses

(b) Severance, retention bonuses and other employee benefits

The PFH Discontinuance Restructuring Plan charges incurred in the third quarter of 2008 are included in the line item Loss from discontinued operations, net of tax in the consolidated statement of operations.

## Table of Contents

## PFH Branch Network Restructuring Plan

The Corporation closed Equity One s consumer service branches during the first quarter of 2008 as part of the initiatives to exit the subprime loan origination operations at PFH (the PFH Branch Network Restructuring Plan ). The PFH Branch Network Restructuring Plan followed the sale on March 1, 2008 of approximately $\$ 1.4$ billion of PFH consumer and mortgage loans that were originated through Equity One s consumer branch network to American General Financial (American General ). American General hired certain of Equity One s consumer services employees and retained certain branch locations. During the quarter ended March 31, 2008, Equity One closed substantially all branches not assumed by American General.
During the quarter and nine months ended September 30, 2008 and as part of this particular restructuring plan, the Corporation incurred certain costs, on a pre-tax basis, as detailed in the table below.

| (In thousands) | Quar Sept | r ended mber 30, 08 | Nine months ended <br> September 30, 2008 |  |
| :---: | :---: | :---: | :---: | :---: |
| Personnel costs |  | 63 | \$ | 8,468(a) |
| Net occupancy expenses |  |  |  | 5,905(b) |
| Equipment expenses |  |  |  | 675 |
| Communications |  |  |  | 590 |
| Other operating expenses |  |  |  | 1,021(c) |
| Total restructuring charges |  | 63 |  | 16,659 |

(a) Severance, retention bonuses and other benefits
(b) Lease
terminations
(c) Contract
cancellations
and branch
closing costs
Also, during the fourth quarter of 2007, and as disclosed in the 2007 Annual Report, the Corporation recognized impairment charges on long-lived assets of $\$ 1.9$ million, mainly associated with leasehold improvements, furniture and equipment.
As of September 30, 2008, the PFH Branch Network Restructuring Plan has resulted in combined charges for 2007 and 2008, broken down as follows:

|  | Impairments <br> on <br> long-lived | Restructuring |  |
| :---: | :---: | :---: | :---: |
| (In thousands) | assets | costs | Total |

Quarter ended:

| December 31, 2007 | $\$ 1,892$ |  | $\$ 1,892$ |
| :--- | :---: | :---: | :---: |
| March 31, 2008 |  | $\$ 17,029$ | 17,029 |
| June 30, 2008 |  | $(433)$ | $(433)$ |
| September 30, 2008 |  | 63 | 63 |
| Total | $\$ 1,892$ | $\$ 16,659$ | $\$ 18,551$ |

The PFH Branch Network Restructuring Plan costs are included in the line item Loss from discontinued operations, net of tax in the consolidated statements of operations for 2008 and 2007.

## Table of Contents

The following table presents the changes during 2008 in the reserve for restructuring costs associated with the PFH Branch Network Restructuring Plan.
(In thousands)
Balance at January 1, 2008
Charges in quarter ended March 31
Cash payments
Balance at March 31, 2008
Charges in quarter ended June 30
Cash payments
Reversals
Balance at June 30, 2008
Charges in quarter ended September 30,
Cash payments
Balance as of September 30, 2008
E-LOAN Restructuring Plan
As indicated in the 2007 Annual Report, in November 2007, the Corporation began a restructuring plan for its Internet
financial services subsidiary E-LOAN (the E-LOAN Restructuring Plan ). This plan included a substantial reduction of
marketing and personnel costs at E-LOAN and changes in E-LOAN s business model. The changes included
concentrating marketing investment toward the Internet and the origination of first mortgage loans that qualified for
sale to government sponsored entities ( GSEs ). Also, as a result of escalating credit costs in the current economic
environment and lower liquidity in the secondary markets for mortgage related products, in the fourth quarter of 2007,
the Corporation determined to hold back the origination by E-LOAN of home equity lines of credit, closed-end second
lien mortgage loans and auto loans. Refer to Note 27 to these consolidated financial statements for disclosures on an
additional restructuring plan at E-LOAN that was approved by the Corporation s Board of Directors subsequent to the
quarter ended September 30, 2008. The new restructuring plan further reduced the operations conducted at E-LOAN
by eliminating loan origination activities.
The E-LOAN Restructuring Plan resulted in charges recorded in the fourth quarter of 2007 amounting to
\$231.9 million, which included \$211.8 million in non-cash impairment losses related to its goodwill and trademark
intangible assets.
The cost-control plan initiative and changes in loan origination strategies incorporated as part of the E-LOAN
Restructuring Plan resulted in the elimination of over 400 positions between the fourth quarter of 2007 and second
quarter of 2008.
The following table presents the changes in restructuring costs reserves for 2008 associated with the E-LOAN
Restructuring Plan.
Balance at March 31, 2008 ..... 3,879
Payments ..... (936)
Balance at June 30, 2008 ..... 2,943
Payments ..... (460)
Reversals ..... $(1,036)$
Balance as of September 30, 2008 ..... \$ 1,447The E-LOAN Restructuring Plan charges are part of the results of the BPNA reportable segment.

## Table of Contents

## Note 21 Income Taxes

The reconciliation of unrecognized tax benefits, including accrued interest, was as follows:
(In millions)
Balance as of January 1, 2008 \$22.2
Additions for tax positions January March 2008 1.4
Balance as of March 31, $2008 \quad 23.6$
Additions for tax positions April June 2008 4.4
Balance as of June 30, $2008 \quad 28.0$
Additions for tax positions July September $2008 \quad 1.1$
Balance as of September 30, 2008
As of September 30, 2008, the related accrued interest approximated $\$ 4.1$ million (September 30, $2007 \$ 3.2$ million). Management determined that as of September 30, 2008 and 2007 there was no need to accrue for the payment of penalties.
After consideration of the effect on U.S. federal tax of unrecognized U.S. state tax benefits, the total amount of unrecognized tax benefits, including U.S. and Puerto Rico, that if recognized, would affect the Corporation s effective tax rate, was approximately $\$ 27.8$ million as of September 30, 2008 (September 30, $2007 \quad \$ 26.0$ million). The amount of unrecognized tax benefits may increase or decrease in the future for various reasons including adding amounts for current tax year positions, expiration of open income tax returns due to the statutes of limitation, changes in management s judgment about the level of uncertainty, status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions.
The Corporation and its subsidiaries file income tax returns in Puerto Rico, the U.S. federal jurisdiction, various U.S. states and political subdivisions, and foreign jurisdictions. As of September 30, 2008, the following years remain subject to examination in the U.S. Federal jurisdiction: 2006 and thereafter; and in the Puerto Rico jurisdiction, 2003 and thereafter. The U.S. Internal Revenue Service ( IRS ) commenced an examination of the Corporation s U.S. operations tax return for 2006. As of September 30, 2008, the IRS has not proposed any adjustment as a result of the audit. Although the outcomes of the tax audits are uncertain, the Corporation believes that adequate amounts of tax and interest have been provided for any adjustments that are expected to result from open years. The Corporation does not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

## Table of Contents

The following table presents the components of the Corporation s deferred tax assets and liabilities.

| (In thousands) | $\begin{gathered} \text { September } 30, \\ 2008 \end{gathered}$ | $\begin{gathered} \text { December } 31 \\ 2007 \end{gathered}$ |
| :---: | :---: | :---: |
| Deferred tax assets: |  |  |
| Tax credits available for carryforward and other credits available | \$ 76,669 | \$ 20,132 |
| Net operating losses carryforward available | 361,082 | 175,349 |
| Deferred compensation | 2,960 | 4,993 |
| Postretirement and pension benefits | 66,325 | 62,548 |
| Difference in basis related to securitizations treated as sales for tax and borrowings for books | 55,741 | 66,105 |
| Deferred loan origination fees | 8,467 | 8,333 |
| Allowance for loan losses | 297,467 | 214,544 |
| Deferred gains | 15,910 | 16,355 |
| Unearned income | 2,768 | 1,488 |
| Unrealized losses on derivatives | 320 | 932 |
| Intercompany deferred gains | 11,573 | 17,017 |
| SFAS. No 159 - Fair value option | 172,975 |  |
| Differences between assigned values and the tax basis of the assets and |  |  |
| liabilities recognized in purchase business combinations |  | 113 |
| Other temporary differences | 19,326 | 14,204 |
| Total gross deferred tax assets | \$ 1,091,583 | \$602,113 |
| Deferred tax liabilities: |  |  |
| Differences between assigned values and the tax basis of the assets and |  |  |
| liabilities recognized in purchase business combinations | \$ 2,060 |  |
| Deferred loan origination costs | 11,307 | \$ 18,861 |
| Accelerated depreciation | 9,421 | 10,346 |
| Amortization of intangibles | 22,432 | 17,263 |
| Unrealized net gain on trading and available-for-sale securities | 6,867 | 19,367 |
| Other temporary differences | 15,837 | 16,266 |
| Total gross deferred tax liabilities | \$ 67,924 | \$ 82,103 |
| Gross deferred tax assets less liabilities | \$ 1,023,659 | \$520,010 |
| Less: Valuation allowance | $(360,429)$ | (39) |
| Net deferred tax assets | \$ 663,230 | \$519,971 |

SFAS No. 109 Accounting for Income Taxes ( SFAS No. 109 ) states that a deferred tax asset should be reduced by a valuation allowance if based on the weight of all available evidence, it is more likely than not (a likelihood of more than $50 \%$ ) that some portion or all of the deferred tax asset will not be realized. The valuation allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. The determination of whether a deferred tax asset is realizable is based on weighting all available evidence, including both positive and negative evidence. SFAS No. 109 provides that the realization of deferred tax assets, including carryforwards and deductible temporary differences, depends upon the existence of sufficient taxable income of the same character
during the carryback or carryforward period. SFAS No. 109 requires the consideration of all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, taxable income in carryback years and tax-planning strategies.
The Corporation s U.S. mainland operations are in a cumulative loss position for the three-year period ended September 30, 2008. For purposes of assessing the realizability of the deferred tax assets in the U.S. mainland, this cumulative taxable loss position is considered significant negative evidence and has caused us to conclude that the Corporation will not be able to fully realize the deferred tax assets in the future. However, management has also concluded that $\$ 322$ million of the U.S. deferred tax assets will be realized. In making this analysis, management evaluated the factors that contributed to these losses in order to assess whether these factors were temporary or indicative of a permanent decline in the earnings of the U.S. mainland operations. Based on the analysis performed, management determined that the cumulative loss position was caused primarily by a significant increase in credit losses in two of its main businesses due to the unprecedented current credit market conditions, losses related to the PFH

## Table of Contents

discontinued business, and restructuring charges. In assessing the realizability of the deferred tax assets, management has considered all four sources of taxable income mentioned above, including its forecast of future taxable income, which includes assumptions about the unprecedented deterioration in the economy and in credit quality. The forecast includes cost reductions initiated in connection with the reorganization of the U.S. mainland operations and two tax-planning strategies. The two strategies considered in management's analysis include reducing the level of interest expense in the U.S. operations by transferring debt to the Puerto Rico operations and the transfer of a profitable line of business to the U.S. mainland operations. Based on the analysis as of September 30, 2008, and the weight of the evidence available, management determined that the Corporation s U.S. operations will not generate sufficient taxable income in the foreseeable future to fully realize the deferred tax assets. Accordingly, management concluded that it is more likely than not that the Corporation will not be able to fully realize the benefit of these deferred tax assets and thus, a valuation allowance for $\$ 360.4$ million was recorded during the third quarter of 2008. Management will reassess the realizability of the deferred tax assets during the fourth quarter of the year. If future events differ from management s September 30, 2008 assessment, an additional or full valuation allowance may need to be established which would likely have a material adverse effect on the Corporation's results of operations, financial condition and capital position.

## Note 22 Stock-Based Compensation

The Corporation maintained a Stock Option Plan (the Stock Option Plan ), which permitted the granting of incentive awards in the form of qualified stock options, incentive stock options, or non-statutory stock options of the Corporation. In April 2004, the Corporation s shareholders adopted the Popular, Inc. 2004 Omnibus Incentive Plan (the
Incentive Plan ), which replaced and superseded the Stock Option Plan. Nevertheless, all outstanding award grants under the Stock Option Plan continue to remain in effect as of September 30, 2008 under the original terms of the Stock Option Plan.
Stock Option Plan
Employees and directors of the Corporation or any of its subsidiaries were eligible to participate in the Stock Option Plan. The Board of Directors or the Compensation Committee of the Board had the absolute discretion to determine the individuals that were eligible to participate in the Stock Option Plan. This plan provides for the issuance of Popular, Inc. s common stock at a price equal to its fair market value at the grant date, subject to certain plan provisions. The shares are to be made available from authorized but unissued shares of common stock or treasury stock. The Corporation s policy has been to use authorized but unissued shares of common stock to cover each grant. The maximum option term is ten years from the date of grant. Unless an option agreement provides otherwise, all options granted are $20 \%$ exercisable after the first year and an additional $20 \%$ is exercisable after each subsequent year, subject to an acceleration clause at termination of employment due to retirement.

## Table of Contents

The following table presents information on stock options outstanding as of September 30, 2008:
(Not in thousands)
Exercise Price

Range per Share \begin{tabular}{cccccc}

\& \begin{tabular}{c}
Options <br>
Outstanding

 \& 

Weighted-Average <br>
Exercise Price of <br>
Options Outstanding

 \& 

Weighted-Average <br>
Remaining Life of <br>
Options Outstanding <br>
In Years

 \& 

Options <br>
Exercisable <br>
(fully vested)

 \& 

Weighted-Average <br>
Exercise Price of <br>
Options Exercisable
\end{tabular} <br>

$\$ 14.39$ \& $\$ 18.50$ \& $1,485,205$ \& $\$ 15.82$ \& 3.99 \& $1,485,205$ <br>
$\$ 19.25$ \& $\$ 27.20$ \& $1,527,145$ \& $\$ 25.23$ \& 5.73 \& $1,209,578$ <br>
$\$ 14.39$ \& $\$ 27.20$ \& $3,012,350$ \& $\$ 20.59$ \& 4.87 \& $2,694,783$
\end{tabular}

The aggregate intrinsic value of options outstanding as of September 30, 2008 was $\$ 2.6$ million (September 30, 2007 $\$ 8.7$ million). There was no intrinsic value of options exercisable as of September 30, 2008 and 2007.
The following table summarizes the stock option activity and related information:

| (Not in thousands) | Options <br> Outstanding | Weighted-Average <br> Exercise Price |
| :--- | ---: | :---: |
| Outstanding at January 1, 2007 | $3,144,799$ | $\$ 20.65$ |
| Granted | $(10,064)$ | 15.83 |
| Exercised | $(19,063)$ | 25.50 |
| Forfeited | $(23,480)$ | 20.08 |
| Expired | $3,092,192$ | $\$ 20.64$ |
| Outstanding as of December 31, 2007 |  |  |
| Granted | $(30,620)$ | 26.13 |
| Exercised | $(49,222)$ | 20.67 |
| Forfeited | $3,012,350$ | $\$ 20.59$ |
| Expired |  | $\$ 20.2$ |

The stock options exercisable as of September 30, 2008 totaled 2,694,783 (September 30, $2007-2,395,158$ ). There were no stock options exercised during the quarters ended September 30, 2008 and 2007. Thus, there was no intrinsic value of options exercised during the quarters ended September 30, 2008 and 2007. There were no stock options exercised during the nine-month period ended September 30, 2008 (September 30, 2007 10,064). Thus, there was no intrinsic value of options exercised during the nine-month period ended September 30, 2008 (September 30, $2007 \quad \$ 28$ thousand).
There were no new stock option grants issued by the Corporation under the Stock Option Plan during 2007 and 2008. The Corporation recognized $\$ 0.3$ million of stock option expense, with a tax benefit of $\$ 0.1$ million, for the quarter ended September 30, 2008 (September 30, $2007 \$ 0.4$ million, with a tax benefit of $\$ 0.2$ million). For the nine months ended September 30, 2008, the Corporation recognized $\$ 0.8$ million of stock option expense, with a tax benefit of $\$ 0.3$ million (September 30, $2007 \$ 1.3$ million, with a tax benefit of $\$ 0.5$ million). The total unrecognized compensation cost as of September 30, 2008 related to non-vested stock option awards was $\$ 0.8$ million and is expected to be recognized over a weighted-average period of 1 year.
Incentive Plan

The Incentive Plan permits the granting of incentive awards in the form of Annual Incentive Awards, Long-term Performance Unit Awards, Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Units or Performance Shares. Participants in the Incentive Plan are designated by the Compensation Committee of the Board of Directors (or its delegate as determined by the Board). Employees and directors of the Corporation and / or any of its subsidiaries are eligible to participate in the Incentive Plan. The shares may be made available from common

## Table of Contents

stock purchased by the Corporation for such purpose, authorized but unissued shares of common stock or treasury stock. The Corporation s policy with respect to the shares of restricted stock has been to purchase such shares in the open market to cover each grant.
Under the Incentive Plan, the Corporation has issued restricted shares, which become vested based on the employees continued service with Popular. Unless otherwise stated in an agreement, the compensation cost associated with the shares of restricted stock is determined based on a two-prong vesting schedule. The first part is vested ratably over five years commencing at the date of grant and the second part is vested at termination of employment after attainment of 55 years of age and 10 years of service. The five-year vesting part is accelerated at termination of employment after attaining 55 years of age and 10 years of service.
The following table summarizes the restricted stock activity under the Incentive Plan and related information to members of management:

| (Not in thousands) | Restricted Stock | Weighted-Average Grant Date Fair Value |  |
| :---: | :---: | :---: | :---: |
| Non-vested at January 1, 2007 | 611,470 | \$ | 22.55 |
| Granted |  |  |  |
| Vested | $(304,003)$ |  | 22.76 |
| Forfeited | $(3,781)$ |  | 19.95 |
| Non-vested as of December 31, 2007 | 303,686 | \$ | 22.37 |
| Granted |  |  |  |
| Vested | $(50,649)$ |  | 20.33 |
| Forfeited | $(4,134)$ |  | 19.95 |
| Non-vested as of September 30, 2008 | 248,903 |  | 22.82 |

During the quarters and nine-month periods ended September 30, 2008 and 2007, no shares of restricted stock were awarded to management under the Incentive Plan.
Beginning in 2007, the Corporation authorized the issuance of performance shares, in addition to restricted shares, under the Incentive Plan. The performance shares award consists of the opportunity to receive shares of Popular, Inc. s common stock provided the Corporation achieves certain performance goals during a 3-year performance cycle. The compensation cost associated with the performance shares will be recorded ratably over a three-year performance period. The performance shares will be granted at the end of the three-year period and will be vested at grant date, except when the participant s employment is terminated by the Corporation without cause. In such case, the participant will receive a pro-rata amount of shares calculated as if the Corporation would have met the performance goal for the performance period. As of September 30, 2008, 6,528 shares have been granted under this plan.
During the quarter ended September 30, 2008, the Corporation recognized $\$ 0.5$ million of restricted stock expense related to management incentive awards, with a tax benefit of $\$ 0.2$ million (September 30, 2007 \$33 thousand, with a tax benefit of $\$ 14$ thousand). For the nine-month period ended September 30, 2008, the Corporation recognized $\$ 1.7$ million of restricted stock expense related to management incentive awards, with a tax benefit of $\$ 0.6$ million (September 30, $2007 \$ 1.9$ million, with a tax benefit of $\$ 0.7$ million). The fair market value of the restricted stock vested was $\$ 1.6$ million at grant date and $\$ 0.8$ million at vesting date. This triggers a shortfall of $\$ 0.8$ million that was recorded as an additional income tax expense since the Corporation does not have any surplus due to windfalls. The fair market value of the restricted stock earned was $\$ 28$ thousand. During the quarter and nine-month period ended September 30, 2008, the Corporation recognized $\$ 12$ thousand and $\$ 0.9$ million, respectively, of performance shares expense, with a tax benefit of $\$ 5$ thousands and $\$ 0.3$ million, respectively. The total unrecognized compensation cost related to non-vested restricted stock awards and performance shares to members of management as of September 30,

2008 was $\$ 9$ million and is expected to be recognized over a weighted-average period of 2 years.

## Table of Contents

The following table summarizes the restricted stock under the Incentive Plan and related information to members of the Board of Directors:

|  | Restricted | Weighted-Aver <br> Grant Date Fai <br> Value |
| :--- | :---: | ---: |
| (Not in thousands) | Stock | 22.02 |
| Non-vested at January 1, 2007 | 76,614 | 15.89 |
| Granted | 38,427 | 19.97 |
| Vested | $(115,041)$ |  |
| Forfeited |  | 11.08 |
| Non-vested as of December 31, 2007 | 50,815 | 11.08 |
| Granted | $(50,815)$ |  |

Non-vested as of September 30, 2008

During the quarter ended September 30, 2008, the Corporation granted 5,467 (September 30, 2007-3,018) shares of restricted stock to members of the Board of Directors of Popular, Inc. and BPPR, which became vested at grant date. During the quarter ended September 30, 2008, the Corporation recognized $\$ 0.1$ million of restricted stock expense related to these restricted stock grants, with a tax benefit of $\$ 45$ thousand (September 30, $2007 \quad \$ 0.1$ million, with a tax benefit of $\$ 45$ thousand). For the nine-month period ended September 30, 2008, the Corporation granted 50,815 (September 30, 2007 32,381) shares of restricted stock to members of the Board of Directors of Popular Inc. and BPPR, which became vested at grant date. During the nine-month period ended September 30, 2008, the Corporation recognized $\$ 0.3$ million of restricted stock expense related to these restricted stock grants, with a tax benefit of $\$ 0.1$ million (September 30, $2007 \quad \$ 0.4$ million, with a tax benefit of $\$ 0.2$ million). The fair value at vesting date of the restricted stock vested during 2008 for directors was $\$ 0.6$ million.

## Note 23 (Loss) Earnings per Common Share

The computation of (loss) earnings per common share ( EPS ) follows:

|  | Quarter ended September 30, |  |  |  | Nine months ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands, except share information) |  | 2008 |  | 2007 |  | 2008 |  | 2007 |
| Net (loss) income from continuing operations | \$ | $(211,173)$ | \$ | 80,214 | \$ | $(52,761)$ | \$ | 352,973 |
| Net loss from discontinued operations |  | $(457,370)$ |  | $(44,211)$ |  | $(488,242)$ |  | $(123,373)$ |
| Less: Preferred stock dividends |  | 11,229 |  | 2,979 |  | 20,210 |  | 8,935 |
| Net (loss) income applicable to common stock | \$ | $(679,772)$ | \$ | 33,024 | \$ | $(561,213)$ | \$ | 220,665 |
| Average common shares outstanding |  | 281,489,469 |  | 279,625,715 |  | 280,841,638 |  | 279,355,496 |
| Average potential common shares |  |  |  |  |  |  |  | 78,016 |
|  |  | 281,489,469 |  | 279,625,715 |  | 280,841,638 |  | 279,433,512 |

Average common shares outstanding assuming dilution

| Basic and diluted EPS from continuing <br> operations | $\$$ | $(0.79)$ | $\$$ | 0.28 | $\$$ | $(0.26)$ | $\$$ | 1.23 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Basic and diluted EPS from discontinued <br> operations |  |  |  |  |  |  |  |  |
| Basic and diluted EPS | $\$$ | $(1.63)$ | $\$$ | $(0.16)$ | $\$$ | $(1.74)$ | $\$$ | $(0.44)$ |
|  | $\$$ | $(2.42)$ | $\$$ | 0.12 | $\$$ | $(2.00)$ | $\$$ | 0.79 |

Potential common shares consist of common stock issuable under the assumed exercise of stock options and under restricted stock awards using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from exercise, in addition to the amount of compensation cost attributed to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect in earnings per share. For the quarter and nine-month period ended

## Table of Contents

September 30, 2008, there were $3,012,350$ and $3,049,600$ weighted average antidilutive stock options outstanding, respectively (September 30, 2007 3,099,617 and 2,209,290).
Note 24 Supplemental Disclosure on the Consolidated Statements of Cash Flows
Additional disclosures on non-cash activities for the nine-month period are listed in the following table:

|  | September 30, <br> (In thousands) | September 30, <br>  <br>  <br> Non-cash activities: |
| :--- | ---: | ---: |
| Loans transferred to other real estate | $\$ 007$ |  |
| Loans transferred to other property | 78,521 | $\$ 134,325$ |
| Total loans transferred to foreclosed assets | 32,725 | 26,907 |
| Transfers from loans held-in-portfolio to loans held- for-sale | 111,246 | 161,232 |
| Transfers from loans held-for-sale to loans held-in- portfolio | 690,222 |  |
| Loans securitized into investment securities (a) | 60,032 | 244,117 |
| Recognition of mortgage servicing rights on securitizations or asset | $1,357,249$ | $1,064,299$ |
| transfers |  | 22,033 |
| Business acquisitions: |  | 25,722 |
| Fair value of assets acquired |  | 703 |
| Goodwill and other intangible assets acquired |  | 2,401 |
| Other liabilities assumed |  | $(726)$ |

(a) Includes loans
securitized into
investment
securities and
subsequently
sold before
quarter end.

## Note 25 Segment Reporting

The Corporation s corporate structure consists of three reportable segments Banco Popular de Puerto Rico, Banco Popular North America and EVERTEC. These reportable segments pertain only to the continuing operations of Popular, Inc. As previously indicated in Note 3 to the consolidated financial statements, the operations of Popular Financial Holdings that were considered a reportable segment were classified as discontinued operations in the third quarter of 2008. Also, a corporate group has been defined to support the reportable segments. The Corporation retrospectively adjusted information in the statements of operations to exclude results from discontinued operations from 2007 periods to conform to the 2008 presentation.
Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. The segments were determined based on the organizational structure, which focuses primarily on the markets the segments serve, as well as on the products and services offered by the segments. Banco Popular de Puerto Rico:
Given that Banco Popular de Puerto Rico constitutes a significant portion of the Corporation s results of operations and total assets as of September 30, 2008, additional disclosures are provided for the business areas included in this reportable segment, as described below:

Commercial banking represents the Corporation s banking operations conducted at BPPR, which are targeted mainly to corporate, small and middle size businesses. It includes aspects of the lending and depository businesses, as well as other finance and advisory services. BPPR allocates funds across segments based on
duration matched transfer pricing at market rates. This area also incorporates income related with the investment of excess funds, as well as a proportionate share of the investment function of BPPR.

Consumer and retail banking represents the branch banking operations of BPPR which focus on retail clients. It includes the consumer lending business operations of BPPR, as well as the lending operations of Popular Auto, Popular Finance, and Popular Mortgage. These three subsidiaries focus on auto and lease financing, small personal loans and mortgage loan originations, respectively. This area also incorporates income related with the investment of excess funds from the branch network, as well as a proportionate share of the investment function of BPPR.

## Table of Contents

Other financial services include the trust and asset management service units of BPPR, the brokerage and investment banking operations of Popular Securities, and the insurance agency and reinsurance businesses of Popular Insurance, Popular Insurance V.I., Popular Risk Services, and Popular Life Re. Most of the services that are provided by these subsidiaries generate profits based on fee income.

## Banco Popular North America:

Banco Popular North America s reportable segment consists of the banking operations of BPNA, E-LOAN, Popular Equipment Finance, Inc. and Popular Insurance Agency, U.S.A. BPNA operates through a branch network with presence in 5 states, while E-LOAN supports BPNA s deposit gathering through its online platform. All direct lending activities at E-LOAN are being terminated as described in Note 27 to the consolidated financial statements. Popular Insurance Agency, U.S.A. offers investment and insurance services across the BPNA branch network. Popular Equipment Finance, Inc. specializes in financing manufacturing, commercial and healthcare equipment in various markets. The U.S. operations also include the mortgage business unit of Banco Popular, National Association. Due to the significant losses in the E-LOAN operations during 2007, impacted in part by the restructuring charges and impairment losses that resulted from the restructuring plan effected in 2007, management has determined to provide as additional disclosure the results of E-LOAN apart from the other BPNA subsidiaries.

## EVERTEC:

This reportable segment includes the financial transaction processing and technology functions of the Corporation, including EVERTEC, with offices in Puerto Rico, Florida, the Dominican Republic and Venezuela; EVERTEC USA, Inc. incorporated in the United States; and ATH Costa Rica, S.A., EVERTEC LATINOAMERICA, SOCIEDAD ANONIMA and T.I.I. Smart Solutions Inc. located in Costa Rica. In addition, this reportable segment includes the equity investments in Consorcio de Tarjetas Dominicanas, S.A. ( CONTADO ) and Servicios Financieros, S.A. de C.V. ( Serfinsa ), which operate in the Dominican Republic and El Salvador, respectively. This segment provides processing and technology services to other units of the Corporation as well as to third parties, principally other financial institutions in Puerto Rico, the Caribbean and Central America.
The Corporate group consists primarily of the holding companies: Popular, Inc., Popular North America and Popular International Bank, excluding the equity investments in CONTADO and Serfinsa, which due to the nature of their operations are included as part of the EVERTEC segment. The holding companies obtain funding in the capital markets to finance the Corporation s growth, including acquisitions. The Corporate group also includes the expenses of the four administrative corporate areas that are identified as critical for the organization: Finance, Risk Management, Legal and People, and Communications. These corporate administrative areas have the responsibility of establishing policy, setting up controls and coordinating the activities of their corresponding groups in each of the reportable segments.
The Corporation may periodically reclassify reportable segment results based on modifications to its management reporting and profitability measurement methodologies and changes in organizational alignment.

## Table of Contents

The accounting policies of the individual operating segments are the same as those of the Corporation described in Note 1 . Transactions between reportable segments are primarily conducted at market rates, resulting in profits that are eliminated for reporting consolidated results of operations.

2008
For the quarter ended September 30, 2008

| (In thousands) |  | o Popula de <br> rto Rico | Banco Popular North America |  | EVERTEC |  | Intersegment <br> Eliminations |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income (expense) | \$ | 238,373 | \$ | 89,424 | \$ | (134) |  |
| Provision for loan losses |  | 128,917 |  | 123,243 |  |  |  |
| Non-interest income |  | 120,329 |  | 52,486 |  | 63,350 | \$ $(37,020)$ |
| Amortization of intangibles |  | 2,241 |  | 1,506 |  | 219 |  |
| Depreciation expense |  | 10,292 |  | 3,525 |  | 3,569 | (18) |
| Other operating expenses |  | 184,406 |  | 91,285 |  | 46,710 | $(36,616)$ |
| Income tax (benefit) expense |  | $(2,548)$ |  | 61,394 |  | 4,231 | (150) |
| Net income (loss) | \$ | 35,394 | \$ | $(139,043)$ | \$ | 8,487 | \$ (236) |
| Segment Assets |  | ,262,308 |  | ,747,724 |  | 60,439 | \$ $(241,376)$ |

For the quarter ended September 30, 2008

| (In thousands) |  | Total portable egments |  | orporate |  | inations |  | Total pular, Inc. |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income (expense) | \$ | 327,663 | \$ | $(3,670)$ | \$ | 289 | \$ | 324,282 |
| Provision for loan losses |  | 252,160 |  |  |  |  |  | 252,160 |
| Non-interest income (loss) |  | 199,145 |  | $(9,621)$ |  | $(1,596)$ |  | 187,928 |
| Amortization of intangibles |  | 3,966 |  |  |  |  |  | 3,966 |
| Depreciation expense |  | 17,368 |  | 584 |  |  |  | 17,952 |
| Other operating expenses |  | 285,785 |  | 17,160 |  | $(1,948)$ |  | 300,997 |
| Income tax expense |  | 62,927 |  | 106,929 |  | $(21,548)$ |  | 148,308 |
| Net loss | \$ | $(95,398)$ | \$ | $(137,964)$ | \$ | 22,189 | \$ | $(211,173)$ |
| Segment Assets |  | ,029,095 |  | 326,012 |  | , 933,634$)$ |  | ,421,473 |

For the nine months ended September 30, 2008

|  | Banco Popular <br> de | Banco <br> Popular <br> North |  | Intersegment |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Puerto Rico | America | EVERTEC | Eliminations |  |
| Net interest income (expense) | $\$ 726,256$ | $\$ 277,227$ | $\$$ | (603) |  |
| Provision for loan losses | 339,151 | 263,370 |  |  |  |

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| Non-interest income | 483,087 | 135,583 | 198,922 | $\$(112,601)$ |
| :--- | ---: | ---: | ---: | ---: |
| Amortization of intangibles | 3,749 | 4,527 | 672 | $(54)$ |
| Depreciation expense | 31,296 | 10,793 | 10,849 | $(111,428)$ |
| Other operating expenses | 568,923 | 276,105 | 138,975 | $(436)$ |
| Income tax expense | 39,517 | 33,350 | 14,083 |  |
|  |  |  |  |  |
| Net income (loss) | $\$ 226,707$ | $\$(175,335)$ | $\$ 33,740$ | $\$$ |

## Table of Contents

For the nine months ended September 30, 2008

|  | Total <br> Reportable <br> Segments | Corporate | Eliminations | Total <br> Popular, Inc. |  |
| :--- | ---: | :---: | :---: | :---: | ---: |
| (In thousands) | $\$ 1,002,880$ | $\$(13,482)$ | $\$$ | 940 | $\$ 990,338$ |
| Net interest income (expense) | 602,521 | 40 |  | $(9,263)$ | 602,561 |
| Provision for loan losses | 704,991 | $(7,251)$ |  |  | 8,477 |
| Non-interest income (loss) | 8,948 |  |  | 54,621 |  |
| Amortization of intangibles | 52,884 | 1,737 |  | $(7,545)$ | 912,979 |
| Depreciation expense | 872,575 | 47,949 | $(20,674)$ | 152,467 |  |
| Other operating expenses | 86,514 | 86,627 |  |  |  |
| Income tax expense | $\$ 84,429$ | $\$(157,086)$ | $\$ 19,896$ | $\$(52,761)$ |  |

2007
For the quarter ended September 30, 2007
(In thousands)
Net interest income (expense)
Provision for loan losses
Non-interest income
Amortization of intangibles
Depreciation expense
Other operating expenses
Income tax expense (benefit)
Net income (loss)
Segment Assets

|  |  |  | Banco |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Banco Popular de |  | Popular North |  | EVERTEC |  | Intersegment Eliminations |  |
| \$ | 241,725 | \$ | 93,995 | \$ | (74) |  |  |
|  | 66,077 |  | 20,263 |  |  |  |  |
|  | 116,522 |  | 35,976 |  | 59,585 |  | $(34,840)$ |
|  | 190 |  | 1,810 |  | 234 |  |  |
|  | 10,290 |  | 4,126 |  | 4,035 |  | (19) |
|  | 172,267 |  | 107,568 |  | 43,157 |  | $(34,696)$ |
|  | 29,247 |  | $(2,696)$ |  | 3,987 |  | (48) |
| \$ | 80,176 | \$ | $(1,100)$ | \$ | 8,098 | \$ | (77) |
| \$26,137,863 |  |  | ,818,525 |  | 24,834 |  | $(507,488)$ |

For the quarter ended September 30, 2007

| (In thousands) | Total Reportable Segments |  | Corporate |  | Eliminations |  | Total <br> Popular, Inc. |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income (expense) | \$ | 335,646 | \$ | $(5,244)$ | \$ | 1,244 | \$ | 331,646 |
| Provision for loan losses |  | 86,340 |  |  |  |  |  | 86,340 |
| Non-interest income |  | 177,243 |  | 1,663 |  | $(1,981)$ |  | 176,925 |
| Amortization of intangibles |  | 2,234 |  |  |  |  |  | 2,234 |
| Depreciation expense |  | 18,432 |  | 601 |  |  |  | 19,033 |
| Other operating expenses |  | 288,296 |  | 11,778 |  | $(2,380)$ |  | 297,694 |
| Income tax expense (benefit) |  | 30,490 |  | $(8,097)$ |  | 663 |  | 23,056 |

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| Net income (loss) | $\$ 87,097$ | $\$(7,863)$ | $\$$ | 980 | $\$ 0,214$ |
| :--- | :--- | ---: | :--- | :--- | ---: | :--- | ---: |
| Segment Assets | $\$ 39,673,734$ | $\$ 14,120,052(a)$ | $\$(6,513,655)$ | $\$ 47,280,131$ |  |

(a) Includes
$\$ 7,569$ million in assets from PFH.

## Table of Contents

For the nine months ended September 30, 2007

| (In thousands) |  | Banco |  | Intersegment Eliminations |
| :---: | :---: | :---: | :---: | :---: |
|  | Banco Popular de Puerto Rico | Popular North America | EVERTEC |  |
| Net interest income (expense) | \$ 711,103 | \$275,733 | \$ (547) |  |
| Provision for loan losses | 176,557 | 42,913 |  |  |
| Non-interest income | 358,364 | 138,585 | 179,060 | \$(103,974) |
| Amortization of intangibles | 1,508 | 5,821 | 701 |  |
| Depreciation expense | 31,455 | 12,208 | 12,355 | (55) |
| Other operating expenses | 525,259 | 320,325 | 131,782 | $(103,892)$ |
| Income tax expense | 87,629 | 10,206 | 11,736 | (10) |
| Net income | \$ 247,059 | \$ 22,845 | \$ 21,939 | \$ (17) |

For the nine months ended September 30, 2007

|  | Total <br> Reportable <br> Segments | Corporate | Eliminations | Total <br> Popular, <br> Inc. |
| :--- | ---: | :---: | ---: | ---: | ---: |
| (In thousands) | $\$ 986,289$ | $\$(21,314)$ | $\$ 3,367$ | $\$ 968,342$ |
| Net interest income (expense) | 219,470 | 7 | $(18,668)$ | 683,078 |
| Provision for loan losses | 572,035 | 129,711 |  | 8,030 |
| Non-interest income | 8,030 |  |  | 57,746 |
| Amortization of intangibles | 55,963 | 1,783 |  | 907,596 |
| Depreciation expense | 873,474 | 40,567 | $(6,445)$ | 105,598 |
| Other operating expenses | 109,561 | $(336)$ | $(3,627)$ |  |
| Income tax expense (benefit) |  |  |  |  |
|  | $\$ 291,826$ | $\$ 66,376$ | $\$(5,229)$ | $\$ 352,973$ |

The Corporate group s financial results for the nine months ended September 30, 2008 include an unfavorable impact to income taxes due to the allocation of $\$ 116.3$ million of the $\$ 360.4$ million valuation allowance on the deferred tax assets of the U.S. mainland operations to Popular North America ( PNA ), holding company of the U.S. operations. PNA files a consolidated tax return.
During the nine months ended September 30, 2008, the Corporate group realized net losses on sale and valuation adjustments of investment securities, mainly marketable equity securities, of approximately $\$ 9.1$ million before tax (2007 $\$ 107.3$ million in net gains before tax). These amounts are included in non-interest income within the Corporate group.
Additional disclosures with respect to the Banco Popular de Puerto Rico reportable segment are as follows:
2008
For the quarter ended September 30, 2008

|  | Total Banco |
| :---: | :---: |
| Commercial | Popular de |

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| (In thousands) | Banking |  | Retail Banking |  | Other <br> Financial <br> Services |  | Eliminations |  | Puerto Rico |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 83,878 | \$ | 151,284 | \$ | 3,062 | \$ | 149 | \$ | 238,373 |
| Provision for loan losses |  | 99,564 |  | 29,353 |  |  |  |  |  | 128,917 |
| Non-interest income |  | 26,655 |  | 73,157 |  | 20,988 |  | (471) |  | 120,329 |
| Amortization of intangibles |  | 76 |  | 2,011 |  | 154 |  |  |  | 2,241 |
| Depreciation expense |  | 5,062 |  | 4,901 |  | 329 |  |  |  | 10,292 |
| Other operating expenses |  | 45,892 |  | 123,290 |  | 15,297 |  | (73) |  | 184,406 |
| Income tax (benefit) expense |  | $(20,683)$ |  | 15,662 |  | 2,558 |  | (85) |  | $(2,548)$ |
| Net (loss) income | \$ | $(19,378)$ | \$ | 49,224 | \$ | 5,712 | \$ | (164) | \$ | 35,394 |
| Segment Assets |  | ,596,931 |  | ,925,656 |  | 34,585 |  | 4,864) |  | 262,308 |

## Table of Contents

For the nine months ended September 30, 2008


Total Banco
Other
(In thousands)
Net interest income
Provision for loan losses
Non-interest income
Amortization of intangibles
Depreciation expense
Other operating expenses
Income tax expense

| Net income | $\$ 35,682$ | $\$ 38,218$ | $\$ 6,203$ | $\$$ | 73 | $\$ 80,176$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Segment Assets | $\$ 11,729,908$ | $\$ 18,651,108$ | $\$ 508,838$ | $\$(4,751,991)$ | $\$ 26,137,863$ |  |

For the nine months ended September 30, 2007

|  |  | Total Banco |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Commercial | Consumer <br> and <br> Retail | Other <br> Financial | Popular de |
| Banking | Services | Eliminations | Puerto Rico |  |

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| Net interest income | $\$ 279,789$ | $\$ 422,844$ | $\$ 8,022$ | $\$ 448$ | $\$ 711,103$ |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Provision for loan losses | 57,070 | 119,487 |  |  | 176,557 |
| Non-interest income | 67,307 | 225,382 | 66,440 | $(765)$ | 358,364 |
| Amortization of intangibles | 470 | 705 | 333 |  | 1,508 |
| Depreciation expense | 10,941 | 19,609 | 905 |  | 31,455 |
| Other operating expenses | 130,909 | 345,292 | 49,315 | $(257)$ | 525,259 |
| Income tax expense | 42,128 | 37,783 | 7,731 | $(13)$ | 87,629 |
|  |  |  |  |  |  |
| Net income | $\$ 105,578$ | $\$ 125,350$ | $\$ 16,178$ | $\$(47)$ | $\$ 247,059$ |

## Table of Contents

Additional disclosures with respect to the Banco Popular North America reportable segment are as follows:
2008
For the quarter ended September 30, 2008

|  | Banco Popular <br> North America | E-LOAN | Eliminations |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | | Total |
| :---: |
| (In thousands) |
|  |
| Bet interest income |
| North America |

For the nine months ended September 30, 2008

|  | Banco <br> Popular <br> North |  |  | Total |
| :--- | ---: | ---: | ---: | ---: | ---: |
| (In thousands) | America | E-LOAN | Eliminations | Banco Popular |
| North |  |  |  |  |
| America |  |  |  |  |


|  | Banco Popular <br> North America | E-LOAN | Eliminations |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | | Total Banco |
| :---: |
| Popular North |
| America |

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| Provision for loan losses |  | 16,822 |  | 3,441 |  |  |  | 20,263 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Non-interest income |  | 25,423 |  | 10,993 |  | (440) |  | 35,976 |
| Amortization of intangibles |  | 1,112 |  | 698 |  |  |  | 1,810 |
| Depreciation expense |  | 3,246 |  | 880 |  |  |  | 4,126 |
| Other operating expenses |  | 72,901 |  | 34,655 |  | 12 |  | 107,568 |
| Income tax expense (benefit) |  | 6,500 |  | $(9,129)$ |  | (67) |  | $(2,696)$ |
| Net income (loss) | \$ | 12,158 | \$ | $(13,136)$ | \$ | (122) | \$ | $(1,100)$ |
| Segment Assets |  | 825,285 |  | 329,950 |  | 6,710) |  | 818,525 |

## Table of Contents

For the nine months ended September 30, 2007

| (In thousands) | Banco <br> Popular <br> North <br> America | E-LOAN | Eliminations | Total Banco Popular North America |
| :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$261,229 | \$ 13,857 | \$ 647 | \$275,733 |
| Provision for loan losses | 36,457 | 6,456 |  | 42,913 |
| Non-interest income | 73,809 | 65,837 | $(1,061)$ | 138,585 |
| Amortization of intangibles | 3,728 | 2,093 |  | 5,821 |
| Depreciation expense | 9,737 | 2,471 |  | 12,208 |
| Other operating expenses | 211,508 | 108,782 | 35 | 320,325 |
| Income tax expense (benefit) | 26,812 | $(16,448)$ | (158) | 10,206 |
| Net income (loss) | \$ 46,796 | \$ $(23,660)$ | \$ (291) | \$ 22,845 |

A breakdown of intersegment eliminations, particularly revenues, by segment in which the revenues are recorded follows:
INTERSEGMENT REVENUES*

|  | Quarter ended |  | Nine months ended |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
|  | September | September |  |  |  |
|  | 30, | 30, | September 30, | September 30, |  |
| (In thousands) | 2008 | 2007 | 2008 | 2007 |  |
|  |  |  |  |  |  |
| Banco Popular de Puerto Rico: | $\$ 158$ | $\$$ | 459 | $\$$ | 848 |
| Commercial Banking | 303 | 997 | 1,904 | $\$ 01$ |  |
| Consumer and Retail Banking | $(50)$ | $(83)$ | $(180)$ | $(314)$ |  |
| Other Financial Services |  |  |  | $(2,737)$ | $(1,309)$ |
| Banco Popular North America: | $(456)$ | $(1,481)$ | $(627)$ | $(103,571)$ |  |
| Banco Popular North America |  |  |  | $(111,809)$ | $(36,975)$ |
| E-LOAN | $(34,732)$ |  |  |  |  |
| EVERTEC | $\$(37,020)$ | $\$(34,840)$ | $\$(112,601)$ | $\$(103,974)$ |  |

* For purposes of the intersegment revenues disclosure, revenues include interest income (expense) related to internal funding and other
income derived
from
intercompany
transactions,
mainly related to
processing /
information
technology
services.


## Table of Contents

A breakdown of revenues and selected balance sheet information by geographical area follows:

## Geographic Information

| (In thousands) | Quarter ended |  | Nine months ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { September } \\ 30, \\ 2008 \end{gathered}$ | $\begin{gathered} \text { September } \\ 30, \\ 2007 \end{gathered}$ | September 30, 2008 | $\begin{gathered} \text { September 30, } \\ 2007 \end{gathered}$ |
| Revenues (1) |  |  |  |  |
| Puerto Rico | \$352,893 | \$362,805 | \$1,201,999 | \$1,203,601 |
| United States | 134,177 | 123,792 | 393,005 | 382,174 |
| Other | 25,140 | 21,974 | 83,811 | 65,645 |
| Total consolidated revenues | \$512,210 | \$508,571 | \$1,678,815 | \$1,651,420 |
| (1) Total revenues include net interest income, service charges on deposit accounts, other service fees, net gain (loss) on sale and valuation adjustments of investment securities, trading account profit (loss), gain on sale of loans and valuation adjustments on loans held-for-sale, and other operating income. |  |  |  |  |

(In thousands)

Selected Balance Sheet Information: (1)
Puerto Rico
Total assets
Loans

| September 30, | December 31, | September 30, |
| :---: | :---: | :---: |
| 2008 | 2007 | 2007 |

Deposits
Mainland United States
Total assets
Loans
Deposits
Other
Total assets
Loans
Deposits (2)
(1) Does not
include balance
sheet
information of the discontinued operations for the period ended September 30, 2008.
(2) Represents deposits from
BPPR
operations
located in the
U.S. and British

Virgin Islands.
Note 26 Condensed Consolidating Financial Information of Guarantor and Issuers of Registered Guaranteed

## Securities

The following condensed consolidating financial information presents the financial position of Popular, Inc. Holding Company ( PIHC ) (parent only), Popular International Bank, Inc. ( PIBI ), Popular North America, Inc. ( PNA ), and all other subsidiaries of the Corporation as of September 30, 2008, December 31, 2007 and September 30, 2007, and the results of their operations and cash flows for the periods ended September 30, 2008 and 2007.
PIBI is an operating subsidiary of PIHC and is the holding company of its wholly-owned subsidiaries: ATH Costa Rica S.A., EVERTEC LATINOAMERICA, SOCIEDAD ANONIMA, T.I.I. Smart Solutions Inc., Popular Insurance V.I., Inc. and PNA.

PNA is an operating subsidiary of PIBI and is the holding company of its wholly-owned subsidiaries:
PFH, including its wholly-owned subsidiaries Equity One, Inc., Popular Financial Management, LLC, Popular Housing Services, Inc., and Popular Mortgage Servicing, Inc.;

Banco Popular North America ( BPNA ), including its wholly-owned subsidiaries Popular Equipment Finance, Inc., Popular Insurance Agency, U.S.A., Popular FS, LLC and E-LOAN, Inc.;

Banco Popular, National Association ( BP, N.A. ), including its wholly-owned subsidiary Popular

## Table of Contents

Insurance, Inc.; and
EVERTEC USA, Inc.
PIHC, PIBI and PNA are authorized issuers of debt securities and preferred stock under a shelf registration filed with the Securities and Exchange Commission.
PIHC fully and unconditionally guarantees all registered debt securities and preferred stock issued by PNA. The principal source of income for the PIHC consists of dividends from BPPR. As members subject to the regulations of the Federal Reserve System, BPPR and BPNA must obtain the approval of the Federal Reserve Board for any dividend if the total of all dividends declared by each entity during the calendar year would exceed the total of its net income for that year, as defined by the Federal Reserve Board, combined with its retained net income for the preceding two years, less any required transfers to surplus or to a fund for the retirement of any preferred stock. The payment of dividends by BPPR may also be affected by other regulatory requirements and policies, such as the maintenance of certain minimum capital levels. As of September 30, 2008, BPPR could have declared a dividend of approximately $\$ 92$ million (December 31, $2007 \quad \$ 45$ million; September 30, $2007 \quad \$ 219$ million) without the approval of the Federal Reserve Board. As of September 30, 2008, BPNA was required to obtain the approval of the Federal Reserve Board to declare a dividend. The Corporation has never received dividend payments from its U.S. subsidiaries. Refer to Popular, Inc. s Form 10-K for the year ended December 31, 2007 for further information on dividend restrictions imposed by regulatory requirements and policies on the payment of dividends by BPPR, BPNA and BP, N.A.

## Table of Contents

## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF CONDITION SEPTEMBER 30, 2008
(UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other <br> Subsidiaries <br> and | Elimination | Popular, Inc. |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | eliminations | entries | Consolidated |

ASSETS
Cash and due from banks
Money market investments \$ 1,582 \$


64
\$
7,676
\$ 1,176,453
\$
(1,778)
\$ 1,183,997

Investment securities available-for-sale, at fair value
Investment securities held-to-maturity, at amortized cost Other investment securities, at lower of cost or realizable value Trading account securities, at fair value Investment in subsidiaries 2,428,180

201,659
$1,548,408$
Loans held-for-sale measured at lower of cost or market value

245,134

Loans held-in-port
Less Unearned income
Allowance for loan losses

812,694
901,000
26,539,342
183,770
726,420

901,000 25,629,152
$(4,178,247)$
7,568,742

456,486
692,096
$(430,000)$
719,832

14,425
202340

444,398


245,134

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Assets from discontinued operations

$$
\begin{array}{rrrrrr} 
& & & & 968,669 & 968,669 \\
\$ 3,832,584 & \$ & 318,386 & \$ 2,557,786 & \$ 40,199,881 & \$(6,518,495)
\end{array} \begin{aligned}
& \$ 40,390,142
\end{aligned}
$$

## LIABILITIES AND STOCKHOLDERS EQUITY

## Liabilities:

Deposits:
Non-interest bearing
Interest bearing

| $\$ 4,067,440$ | $\$$ | $(1,720)$ | $\$ 4,065,720$ |
| ---: | ---: | ---: | ---: |
| $23,885,241$ |  | $(39,564)$ | $23,845,677$ |
| $27,952,681$ |  | $(41,284)$ | $27,911,397$ |

Federal funds purchased and assets sold under agreements to repurchase
Other short-term borrowings
Notes payable Subordinated notes Other liabilities
Liabilities of discontinued operations
825,111 $71 \quad 2,382,999 \quad 36,514,582 \quad(2,340,203) \quad 37,382,560$

Minority interest in consolidated subsidiaries $109 \quad 109$

Stockholders equity:
Preferred stock
Common stock

| 586,875 |  |  |  | 586,875 |  |
| ---: | ---: | ---: | ---: | ---: | ---: |
| $1,772,010$ | 3,961 | 2 | 51,819 | $(55,782)$ | $1,772,010$ |
| 555,227 | $1,451,193$ | $1,334,964$ | $3,560,903$ | $(6,338,266)$ | 564,021 |
| 392,856 | $(1,085,414)$ | $(1,151,358)$ | 122,898 | $2,105,080$ | 384,062 |

Retained earnings
Accumulated other
comprehensive loss, net of tax
Treasury stock, at cost

| $(91,983)$ | $(51,425)$ | $(8,821)$ | $(50,053)$ | 110,299 | $(91,983)$ |
| ---: | ---: | ---: | ---: | ---: | ---: |
| $(207,512)$ |  |  | $(377)$ | 377 | $(207,512)$ |
| $3,007,473$ | 318,315 | 174,787 | $3,685,190$ | $(4,178,292)$ | $3,007,473$ |
|  |  |  |  |  |  |
| $3,832,584$ | $\$ 318,386$ | $\$ 2,557,786$ | $\$ 40,199,881$ | $\$(6,518,495)$ | $\$ 40,390,142$ |

## Table of Contents

## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF CONDITION
DECEMBER 31, 2007
(UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other <br> Subsidiaries <br> and | Elimination | Popular, Inc. |
| :--- | :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Co. | Holding Co. | eliminations | entries | Consolidated |

## ASSETS

Cash and due from

| banks | $\$$ | 1,391 | $\$$ | 376 | $\$$ | 400 | $\$$ | 818,455 | $\$$ | $(1,797)$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Money market |  |  |  |  |  |  |  |  |  |  |

Other investment securities, at lower of cost or realizable value 14,425

12,392
189,766
216,584
Investment in subsidiaries
$2,817,934 \quad 648,720 \quad 1,717,823$
$(5,184,477)$
Loans held-for-sale measured at lower of

| cost or market value |  |  |  | $1,889,546$ |  | $1,889,546$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Loans held-in-portfolio | 725,426 | 25,150 | $2,978,528$ | $28,282,440$ | $(3,807,978)$ | $28,203,566$ |
| Less Unearned income <br> Allowance for loan <br> losses |  |  |  | 182,110 |  | 182,110 |
|  | 60 |  |  | 548,772 |  | 548,832 |
|  | 725,366 | 25,150 | $2,978,528$ | $27,551,558$ | $(3,807,978)$ | $27,472,624$ |

Premises and

| equipment, net | 23,772 |  | 131 | 564,260 |  |
| :--- | :---: | ---: | ---: | ---: | ---: |
| Other real estate |  |  |  | 81,410 |  |
| Accrued income |  |  |  |  | 588,163 |
| receivable | 1,675 | 62 | 14,271 | 215,719 | $(15,613)$ |
| Servicing assets |  |  |  | 196,645 | 216,114 |
| Other assets | 40,740 | 60,814 | 47,210 | $1,336,674$ | $(28,444)$ |
| Goodwill |  |  |  | 630,761 | $1,456,994$ |
| Other intangible assets | 554 |  |  | 68,949 |  |
|  |  |  |  | 630,761 |  |
|  |  |  |  |  | 69,503 |

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$\$ 4,298,386 \quad \$ 768,378 \quad \$ 4,770,906 \quad \$ 44,165,746 \quad \$(9,591,979) \quad \$ 44,411,437$

## LIABILITIES AND

STOCKHOLDERS EQUITY
Liabilities:
Deposits:
Non-interest bearing
Interest bearing

Federal funds purchased and assets sold under agreements

| to repurchase |  |  |  |  | $\$ 168,892$ | $5,391,273$ | $(122,900)$ | $5,437,265$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Other short-term |  |  |  |  | $1,055,773$ | $1,707,184$ | $(1,525,978)$ | $1,501,979$ |
| borrowings | $\$$ | 165,000 |  |  | 1,159 |  |  |  |
| Notes payable | 480,117 |  |  | $2,754,339$ | $3,669,216$ | $(2,282,320)$ | $4,621,352$ |  |
| Subordinated notes |  |  |  |  |  | 430,000 | $(430,000)$ |  |
| Other liabilities | 71,387 | $\$$ | 116 | 62,059 | 843,892 | $(43,082)$ | 934,372 |  |
|  | 716,504 |  | 116 | $4,141,063$ | $40,378,232$ | $(4,406,469)$ | $40,829,446$ |  |

Minority interest in consolidated subsidiaries

Stockholders equity:
Preferred stock
Common stock
Surplus
Retained earnings
Treasury stock, at cost

| 186,875 |  |  |  |  | 186,875 |
| ---: | ---: | ---: | ---: | ---: | ---: |
| $1,761,908$ | 3,961 | 2 | 51,619 | $(55,582)$ | $1,761,908$ |
| 563,183 | 851,193 | 734,964 | $2,709,595$ | $(4,290,751)$ | 568,184 |
| $1,324,468$ | $(46,897)$ | $(99,806)$ | $1,037,153$ | $(895,451)$ | $1,319,467$ |
| $(207,740)$ |  |  | $(664)$ | 664 | $(207,740)$ |
|  |  |  |  |  |  |
| $(46,812)$ | $(39,995)$ | $(5,317)$ | $(10,298)$ | 55,610 | $(46,812)$ |
|  |  |  |  |  |  |
| $3,581,882$ | 768,262 | 629,843 | $3,787,405$ | $(5,185,510)$ | $3,581,882$ |
|  |  |  |  |  |  |
| $\$ 4,298,386$ | $\$ 768,378$ | $\$ 4,770,906$ | $\$ 44,165,746$ | $\$(9,591,979)$ | $\$ 44,411,437$ |

## Table of Contents

## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF CONDITION SEPTEMBER 30, 2007
(UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other <br> Subsidiaries <br> and | Elimination | Popular, Inc. |
| :--- | :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | eliminations | entries | Consolidated |

## ASSETS

Cash and due from banks
Money market investments \$ 89
\$
1,079
\$
15,56
\$

692,595
\$
(1
$(1,075)$
\$ 709,056

71,000 300
195
753,797
$(190,195)$
635,097
Investment securities available-for-sale, at fair value

38,578
8,839,917
8,878,495
Investment securities held-to-maturity, at amortized cost 626,189 1,250 81,828
Other investment securities, at lower of cost or realizable value $\begin{array}{lll}14,425 & 1 & 12,392\end{array}$ 152,558 179,376
Trading account securities, at fair value

662,477
662,158
Investment in subsidiaries

3,218,956 1,009,325
1,959,999
$(6,188,280)$
Loans held-for-sale measured at lower of cost or market value

423,303
423,303
Loans held-in-portfolio
378,107
21,550 3,084,479
33,213,737
$(3,469,649)$
33,228,224
Less Unearned income
330,723
Allowance for loan losses

60
600,213
330,723

| 60 |  |  | 600,213 |
| ---: | ---: | ---: | ---: |
| 378,047 | 21,550 | $3,084,479$ | $32,282,801$ |

Premises and equipment, net

24,359 132

556,277
580,768
Other real estate
Accrued income

| receivable | 742 | 54 | 14,274 | 290,500 | $(14,654)$ | 290,916 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Servicing assets |  |  |  | 196,992 |  | 196,992 |
| Other assets | 42,374 | 60,592 | 59,188 | $1,154,630$ | $(72,095)$ | $1,244,689$ |
| Goodwill |  |  |  | 668,807 |  | 668,807 |
| Other intangible assets | 554 |  |  | 99,917 |  | 100,471 |

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## LIABILITIES AND STOCKHOLDERS EQUITY

## Liabilities:

Deposits:
Non-interest bearing
Interest bearing

Federal funds
purchased and assets

| to repurchase |  |  |  |  | \$ 265,332 | 6,211,672 | $(189,701)$ | 6,287,303 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Other short-term |  |  |  |  |  |  |  |  |
| borrowings | \$ | 25,000 |  |  | 849,716 | 1,827,830 | $(1,287,649)$ | 1,414,897 |
| Notes payable |  | 486,494 |  |  | 2,920,305 | 7,090,311 | $(2,182,319)$ | 8,314,791 |
| Subordinated notes |  |  |  |  |  | 430,000 | $(430,000)$ |  |
| Other liabilities |  | 62,321 | \$ | 80 | 119,174 | 762,094 | $(85,874)$ | 857,795 |
|  |  | 573,815 |  | 80 | 4,154,527 | 42,924,933 | $(4,177,054)$ | 43,476,301 |

Minority interest in consolidated subsidiaries

Stockholders equity:
Preferred stock
Common stock
Surplus
Retained earnings

| 186,875 |  |  |  | 186,875 |  |
| ---: | ---: | ---: | ---: | ---: | ---: |
| $1,757,961$ | 3,961 | 2 | 51,619 | $(55,582)$ | $1,757,961$ |
| 531,128 | 851,193 | 734,964 | $2,571,595$ | $(4,152,751)$ | 536,129 |
| $1,694,385$ | 330,750 | 269,284 | $1,566,766$ | $(2,171,801)$ | $1,689,384$ |

Accumulated other
comprehensive loss, net of tax
Treasury stock, at cost

| $(161,061)$ | $(53,255)$ | $(12,551)$ | $(124,451)$ <br> $(205,567)$ |  |  |
| ---: | ---: | ---: | ---: | ---: | ---: |

## Table of Contents

POPULAR, INC.
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE QUARTER ENDED SEPTEMBER 30, 2008 (UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other <br> Subsidiaries <br> and | Elimination | Popular, Inc. |
| :--- | :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | eliminations | entries | Consolidated |

INTEREST AND
DIVIDEND
INCOME:
Dividend income

| from subsidiaries | \$ | 45,000 |  |  |  |  |  | \$ | $(45,000)$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans |  | 6,566 |  |  | \$ | 23,955 | \$ 457,784 |  | $(30,400)$ | \$ 457,905 |
| Money market |  |  |  |  |  |  |  |  |  |  |
| investments |  | 1,016 | \$ | 322 |  | 105 | 3,462 |  | $(1,458)$ | 3,447 |
| Investment securities |  | 7,376 |  | 94 |  | 223 | 84,112 |  | $(7,015)$ | 84,790 |
| Trading account securities |  |  |  |  |  |  | 9,339 |  |  | 9,339 |
|  |  | 59,958 |  | 416 |  | 24,283 | 554,697 |  | $(83,873)$ | 555,481 |

INTEREST
EXPENSE:

| Deposits |  |  |  | 166,021 | (410) | 165,611 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Short-term |  |  |  |  |  |  |
| borrowings | 191 |  | 4,101 | 42,196 | $(9,255)$ | 37,233 |
| Long-term debt | 9,265 |  | 30,223 | 18,364 | $(29,497)$ | 28,355 |
|  | 9,456 |  | 34,324 | 226,581 | $(39,162)$ | 231,199 |
| Net interest income |  |  |  |  |  |  |
| Provision for loan |  |  |  |  |  |  |
| losses |  |  |  | 252,160 |  | 252,160 |
| Net interest income (loss) after provision |  |  |  |  |  |  |
| for loan losses | 50,502 | 416 | $(10,041)$ | 75,956 | $(44,711)$ | 72,122 |
| Service charges on deposit accounts |  |  |  | 52,433 |  | 52,433 |
| Other service fees |  |  |  | 95,172 | 130 | 95,302 |
| Net (loss) gain on sale and valuation |  |  |  |  |  |  |
| investment securities |  | $(9,147)$ |  | 15 |  | $(9,132)$ |
| Trading account profit |  |  |  | 6,669 |  | 6,669 |

Gain on sale of loans and valuation adjustments on loans held-for-sale
Other operating income (loss)

## OPERATING

EXPENSES:
Personnel costs:
Salaries
Pension, profit
sharing and other benefits

Net occupancy

| expenses | 641 | 7 | 1 | 25,861 |  | 26,510 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Equipment expenses | 1,020 |  |  | 25,285 |  | 26,305 |
| Other taxes | 850 |  |  | 12,451 |  | 13,301 |
| Professional fees | 6,941 | 3 | $(204)$ | 26,636 | $(1,596)$ | 31,780 |
| Communications | 63 | 5 | 9 | 12,497 |  | 12,574 |
| Business promotion | 373 |  |  |  | 15,843 |  |
| Printing and supplies | 19 |  |  | 3,250 |  | 3,269 |
| Other operating <br> expenses | $(15,905)$ | $(100)$ | $(316)$ | 57,436 | $(351)$ | 40,764 |
| Amortization of <br> intangibles |  |  |  | 3,966 |  | 3,966 |
|  |  |  |  |  |  |  |
|  | 319 | 23 | $(510)$ | 325,031 | $(1,948)$ | 322,915 |

Income (loss) before income tax and equity in losses of subsidiaries
Income tax expense

$$
50,277
$$

$(5,280)$
(12,482)
1,964
7,299
$(51,020)$
$(44,360)$
$(62,865)$

Income (loss) before
equity in losses of subsidiaries 48,313
$(5,280)$
$(19,781)$
$(189,816)$
$(44,609)$
$(211,173)$
Equity in
undistributed losses of subsidiaries $(259,486) \quad(243,789) \quad(225,347)$

728,622
Net loss from
continuing operations $\$(211,173) \quad \$(249,069) \quad \$(245,128) \quad \$(189,816) \quad \$ 684,013 \quad \$(211,173)$
Net loss from
discontinued
operations, net of tax
$(457,370)$
$(457,370)$
Table of Contents

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Equity in undistributed losses of discontinued

| operations | $(457,370)$ | $(457,370)$ | $(457,370)$ |  | $1,372,110$ |  |
| :--- | ---: | ---: | ---: | ---: | ---: | :--- |
| NET LOSS | $\$(668,543)$ | $\$(706,439)$ | $\$(702,498)$ | $\$(647,186)$ | $\$ 2,056,123$ | $\$(668,543)$ |

## Table of Contents

POPULAR, INC.
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE QUARTER ENDED SEPTEMBER 30, 2007
(UNAUDITED)

|  |  |  |  | All other |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Popular, Inc. | PIBI | PNA | Subsidiaries and | Elimination | Popular, Inc. |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | eliminations | entries | Consolidated |

## INTEREST AND

DIVIDEND
INCOME:
Dividend income from subsidiaries

## Loans

Money market investments
Investment securities

| $\$ 69,800$ |  |  |
| ---: | ---: | ---: |
| 4,800 | $\$$ | 31 |
|  |  |  |
| 176 |  | 244 |
| 10,093 |  | 307 |

Trading account securities
$84,869 \quad 582$
10,163
\$ $(69,800)$
\$ 40,827
\$ 523,436
$(45,300)$
\$523,794
$(1,255) \quad 6,807$
223 105,742
$(7,346)$
109,019

INTEREST
EXPENSE:

| Deposits |  |  |  | 197,065 | (240) | 196,825 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Short-term borrowings | 383 |  | 14,635 | 114,131 | $(20,178)$ | 108,971 |
| Long-term debt | 8,368 |  | 38,071 | (313) | $(33,785)$ | 12,341 |
|  | 8,751 |  | 52,706 | 310,883 | $(54,203)$ | 318,137 |
| Net interest income (loss) | 76,118 | 582 | $(11,654)$ | 336,098 | $(69,498)$ | 331,646 |
| Provision for loan |  |  |  |  |  |  |
| losses |  |  |  | 86,340 |  | 86,340 |

Net interest income (loss) after provision for loan losses
Service charges on deposit accounts $76,118 \quad 582 \quad(11,654) \quad 249,758$
$(69,498) \quad 245,306$

Other service fees
Net (loss) gain on sale and valuation adjustments of investment securities $(1,025) \quad 258$ 49,704 49,704

Trading account profit
90,582
(719) 89,863

Gain on sale of loans and valuation adjustment on loans held-for-sale
Other operating income (loss)

OPERATING
EXPENSES:
Personnel costs:

|  |  | 6,975 | 6,975 |  |  |
| ---: | ---: | ---: | ---: | ---: | ---: |
| 68 | 2,296 | $(94)$ | 20,090 | $(440)$ | 21,920 |
| 75,161 | 3,136 | $(11,748)$ | 426,339 | $(70,657)$ | 422,231 |

Salaries
Pension, profit sharing
and other benefits

Net occupancy

| expenses | 542 |
| :--- | :--- |
| Equipment expenses | 388 |

Equipment expenses 388
Other taxes 438
Professional fees $\quad 2,718$
Communications 115
Business promotion 989
Printing and supplies
Other operating expenses
Amortization of intangibles

112,598
(410)

116,169

28,227
(116)

29,104
140,825
(526)

145,273

7
26,534
27,083
1 27,935
28,324
12,328 12,766
(2)
(14) 27,426
(630)

29,498
15,115
15,000
27,479
13,745
3,760

Income (loss) before income tax and equity in earnings (losses) of subsidiaries
Income tax expense (benefit)

Income (loss) before equity in earnings (losses) of subsidiaries Equity in undistributed earnings (losses) of subsidiaries

Net income (loss) from continuing operations Net loss from discontinued operations, net of tax

19
83
$(11,547)$
$\begin{array}{llllll}76,644 & 3,117 & (11,831) & 104,444 & (69,104) & 103,270\end{array}$
1,755
$(4,141)$
25,166
276
103,270
23,056
2,234
$(1,553) \quad 318,961$
27,429
2,234
321,895


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Equity in undistributed losses of discontinued operations

NET INCOME
(LOSS) $\quad \$ 36,003 \quad \$(49,797) \quad \$(53,880) \quad \$ 35,067 \quad \$ 68,610 \quad \$ 36,003$

## Table of Contents

POPULAR, INC.
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 (UNAUDITED)

| (In thousands) | Popular, Inc. Holding Co. |  | BI Co |  | PNA lding Co. | All other Subsidiaries and eliminations | Elimination entries | Popular, Inc. <br> Consolidated |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| INTEREST AND DIVIDEND |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| INCOME: |  |  |  |  |  |  |  |  |
| Dividend income |  |  |  |  |  |  |  |  |
| Loans | 19,339 | \$ | 219 | \$ | 82,547 | \$ 1,421,969 | $(102,137)$ | \$ 1,421,937 |
| Money market |  |  |  |  |  |  |  |  |
| Investment securities | 23,452 |  | 726 |  | 670 | 257,847 | $(21,046)$ | 261,649 |
| Trading account securities |  |  |  |  |  | 35,344 |  | 35,344 |
|  | 179,264 |  | ,672 |  | 83,517 | 1,729,884 | $(261,756)$ | 1,732,581 |

INTEREST
EXPENSE:


| Net interest income (loss) after provision for loan losses | 150,592 | 1,672 | $(32,215)$ | 401,740 | (134,012) | 387,777 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Service charges on deposit accounts |  |  |  | 155,319 |  | 155,319 |
| Other service fees |  |  |  | 313,641 | $(6,992)$ | 306,649 |
| Net (loss) gain on sale and valuation adjustments of |  |  |  |  |  |  |
| investment securities |  | $(9,147)$ |  | 78,577 |  | 69,430 |
|  |  |  |  | 38,547 |  | 38,547 |

Trading account profit
Gain on sale of loans and valuation adjustments on loans held-for-sale Other operating (loss) income
$(17)$
150,575

|  | 25,696 |  |  |  |
| ---: | ---: | ---: | ---: | ---: |
| 10,628 | $(4,992)$ | 90,838 | $(3,621)$ | 92,836 |
| 3,153 | $(37,207)$ | $1,104,358$ | $(144,625)$ | $1,076,254$ |

OPERATING
EXPENSES:
Personnel costs:

| Salaries | 17,142 | 289 |  | 345,541 | $(2,009)$ | 360,963 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Pension, profit sharing and other benefits | 4,091 | 58 |  | 94,476 | (73) | 98,552 |
|  | 21,233 | 347 |  | 440,017 | $(2,082)$ | 459,515 |
| Net occupancy |  |  |  |  |  |  |
| Equipment expenses | 2,761 |  |  | 81,551 |  | 84,312 |
| Other taxes | 1,750 |  |  | 38,155 |  | 39,905 |
| Professional fees | 14,386 | 8 | (24) | 78,873 | $(4,279)$ | 88,964 |
| Communications | 258 | 14 | 27 | 37,838 |  | 38,137 |
| Business promotion | 1,144 |  |  | 49,920 |  | 51,064 |
| Printing and supplies | 61 |  |  | 10,702 |  | 10,763 |
| Other operating expenses | $(42,645)$ | (301) | (195) | 158,046 | $(1,183)$ | 113,722 |
| Amortization of intangibles |  |  |  | 8,948 |  | 8,948 |
|  | 832 | 90 | (189) | 983,359 | $(7,544)$ | 976,548 |

Income (loss) before income tax and equity in losses of

| subsidiaries | 149,743 | 3,063 | $(37,018)$ | 120,999 | $(137,081)$ | 99,706 |
| :--- | ---: | :---: | ---: | :---: | ---: | ---: |
| Income tax expense | 2,629 |  | $(1,073)$ | 150,282 | 629 | 152,467 |
| (benefit) |  |  |  |  |  |  |

Income (loss) before equity in losses of subsidiaries 147,114

3,063
$(35,945)$
$(29,283) \quad(137,710)$
$(52,761)$
Equity in undistributed losses of subsidiaries
$(199,875) \quad(291,506) \quad(265,535)$
756,916
Net loss from continuing operations $\$(52,761) \quad \$(288,443) \quad \$(301,480) \quad \$(29,283) \quad \$ 619,206 \quad \$(52,761)$

Net loss from discontinued

| operations, net of tax <br> Equity in <br> undistributed losses <br> of discontinued |  |  |  | $(488,242)$ |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| operations | $(488,242)$ | $(488,242)$ | $(488,242)$ |  | $1,464,726)$ |  |
| NET LOSS | $\$(541,003)$ | $\$(776,685)$ | $\$(789,722)$ | $\$(517,525)$ | $\$ 2,083,932$ | $\$(541,003)$ |

## Table of Contents

## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 (UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other <br> Subsidiaries <br> and | Elimination | Popular, Inc. |
| :--- | :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | eliminations | entries | Consolidated |

INTEREST AND
DIVIDEND
INCOME:
Dividend income

|  |  |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| from subsidiaries | $\$ 159,200$ |  |  |  |  | $\$(159,200)$ |  |
| Loans | 14,339 | $\$$ | 31 | $\$ 117,001$ | $\$ 1,520,272$ | $(130,219)$ | $\$ 1,521,424$ |
| Money market |  |  | 359 |  | 13 | 20,064 | $(4,384)$ |

INTEREST
EXPENSE:

| Deposits |  |  | 553,804 | $(1,147)$ | 552,657 |
| :--- | ---: | :---: | :---: | :---: | ---: |
| Short-term |  |  | 355,528 | $(61,235)$ | 340,162 |
| borrowings | 2,348 | 43,521 | 355,956 | $(2,499)$ | $(94,890)$ |
| Long-term debt | 25,100 |  |  | 39,667 |  |
|  | 27,448 | 155,477 | 906,833 | $(157,272)$ | 932,486 |

Net interest income

| (loss) | 174,663 | 1,893 | $(37,793)$ | 987,874 | $(158,295)$ | 968,342 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for loan |  |  |  |  |  |  |
| losses | 7 |  |  | 219,470 |  | 219,477 |
| Net interest income (loss) after provision |  |  |  |  |  |  |
| for loan losses | 174,656 | 1,893 | $(37,793)$ | 768,404 | $(158,295)$ | 748,865 |
| Service charges on deposit accounts |  |  |  | 146,567 |  | 146,567 |
| Other service fees |  |  |  | 268,703 | $(2,991)$ | 265,712 |
| Net gain (loss) on sale and valuation adjustments of |  |  |  |  |  |  |
| investment securities | 115,567 | $(8,249)$ |  | 5,524 |  | 112,842 |
|  |  |  |  | 29,765 |  | 29,765 |

Trading account profit
Gain on sale of loans and valuation adjustment on loans held-for-sale Other operating income (loss)

|  |  | 40,224 | 40,224 |  |  |
| ---: | ---: | ---: | ---: | ---: | ---: |
| 9,830 | 13,506 | $(723)$ | 67,044 | $(1,689)$ | 87,968 |
| 300,053 | 7,150 | $(38,516)$ | $1,326,231$ | $(162,975)$ | $1,431,943$ |

OPERATING
EXPENSES:
Personnel costs:
Salaries
Pension, profit sharing and other benefits

Net occupancy
expenses

Equipment expense
Other taxes
Professional fees
Communications
15,500
293
343,137
$(1,224)$
357,706

Business promotion
Printing and supplies
Other operating expenses intangibles

441
979,531
$(4,992)$
973,372
Income (loss) before income tax and equity in earnings (losses) of subsidiaries
Income tax expense (benefit)

Income (loss) before equity in earnings (losses) of subsidiaries 270,744

7,066
$(25,322)$
258,963
$(158,478)$
352,973
Equity in undistributed earnings (losses) of subsidiaries

Net income
(loss) from continuing operations
$\$ 352,973 \quad \$(5,393) \quad \$(14,749) \quad \$ 258,963 \quad \$(238,821) \quad \$ 352,973$ Net loss from
discontinued
operations, net of tax
Equity in
undistributed losses of discontinued operations $(123,373) \quad(123,373) \quad(123,373)$ 370,119

NET INCOME
(LOSS) $\quad \$ 229,600 \quad \$(128,766) \quad \$(138,122) \quad \$ 135,590 \quad \$ 131,298 \quad \$ \quad 229,600$

## Table of Contents

POPULAR, INC.
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 (UNAUDITED)
(In thousands)
Cash flows from operating
activities:

Net loss

Adjustments to reconcile net loss to net cash provided by (used in) operating activities: Equity in undistributed losses of subsidiaries
Depreciation and amortization of premises and equipment
Provision for loan losses
Amortization of intangibles Amortization and fair value adjustment of servicing assets

688,117 779,748 753,777
$(2,221,642)$

| 1,735 | 2 | 53,496 |
| ---: | ---: | ---: |
| 40 | 621,512 | 62,233 |
|  | 8,948 | 8,948 |

Net loss (gain) on sale and valuation adjustment of investment securities Popular,

| Inc. <br> Holding <br> Co. | Holding | PNA | Subsidiaries <br> and | Elimination | Popular, Inc. |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Co. | Holding Co. | eliminations | entries | Consolidated |  | $\$(541,003) \quad \$(776,685) \quad \$(789,722) \quad \$(517,525) \quad \$ 2,083,932 \quad \$(541,003)$

Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159 179,482

179,482
Net loss (gain) on disposition of premises and equipment Net gain on sale of loans and valuation adjustments on loans held-for-sale
Net amortization of premiums and accretion of discounts on investments
Net amortization of premiums and deferred loan origination fees and costs $57 \quad(23,700)$

$$
9,147
$$

53,679
8,948
method
Stock options expense
Deferred income taxes, net of valuation
Net disbursements on loans held-for-sale
Acquisitions of loans
held-for-sale
Proceeds from sale of loans held-for-sale
Net decrease in trading securities
Net decrease (increase) in accrued income receivable Net decrease (increase) in other assets
Net (decrease) increase in interest payable
Net increase in postretirement benefit obligation
Net increase
(decrease) increase in other liabilities

Total adjustments
Net cash provided by (used in) operating activities

## Cash flows from investing

 activities:Net (increase) decrease in money market investments Purchases of investment securities:
Available-for-sale
Held-to-maturity
Other
Proceeds from calls, paydowns, maturities and redemptions of investment securities:
Available-for-sale

| 748,500 | $2,377,740$ | $2,377,740$ |
| ---: | ---: | ---: |
| $3,976,318$ | $4,724,818$ |  |
| 154,067 | 154,067 |  |
|  |  |  |
|  | 8,296 | $2,436,213$ |

Table of Contents

Net
(disbursements) repayments on loans
Proceeds from sale of loans
Acquisition of loan portfolios
Capital contribution to subsidiary
$(1,512)$
$(4,505)$
$(4,505)$

Mortgage servicing rights purchased
Acquisition of premises and equipment
(578)

Proceeds from sale of premises and equipment Proceeds from sale of foreclosed assets

Net cash (used in) provided by investing activities $(540,186)$ $(5,850)$ 1,225,734 2,429,533 $(636,790) \quad 2,472,441$

## Cash flows from financing activities:

Net decrease in deposits Net decrease in federal funds purchased and assets sold under agreements to repurchase
Net decrease in other short-term borrowings
Payments of notes payable Proceeds from issuance of notes payable

335,297
Dividends paid to parent company

| $(687,353)$ | 25,150 | 1,341,322 | $\begin{gathered} (916,687) \\ 1,984,860 \end{gathered}$ | $(738,541)$ | $\begin{gathered} (976,109) \\ 1,984,860 \end{gathered}$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | $(4,505)$ |  | $(4,505)$ |
| $(1,512)$ |  |  |  | 1,512 |  |
|  |  |  | $(3,628)$ |  | $(3,628)$ |
| (578) |  |  | $(111,618)$ |  | $(112,196)$ |
|  |  |  | 49,366 |  | 49,366 |
|  |  |  | 87,280 |  | 87,280 |
| $(540,186)$ | $(5,850)$ | 1,225,734 | 2,429,533 | $(636,790)$ | 2,472,441 |
|  |  |  | $(261,806)$ | $(139,095)$ | $(400,901)$ |
|  |  | $(128,941)$ | $(1,617,158)$ | 38,874 | $(1,707,225)$ |
| $(165,000)$ |  | $(478,311)$ | $(392,200)$ | 40,542 | $(994,969)$ |
| $(31,152)$ |  | $(574,480)$ | $(1,407,625)$ | 700,319 | $(1,312,938)$ |
| 335,297 |  | 7,902 | 841,718 | $(2,000)$ | 1,182,917 |
|  |  |  | $(134,900)$ | 134,900 |  |

## Table of Contents

| (In thousands) | Popular, Inc. <br> Holding Co. | PIBI <br> Holding <br> Co. | PNA <br> Holding Co. | All other Subsidiaries and eliminations | Elimination | Popular, Inc. <br> Consolidated |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Dividends paid | $(154,877)$ |  |  |  |  | $(154,877)$ |
| Proceeds from issuance of common stock | 15,174 |  |  |  |  | 15,174 |
| Proceeds from issuance of preferred stock | 386,142 |  |  |  | 3,793 | 389,935 |
| Treasury stock acquired | (59) |  |  | (299) |  | (358) |
| Capital contribution from parent |  |  |  | 1,509 | $(1,509)$ |  |
| Net cash provided by (used in) financing activities | 385,525 |  | $(1,173,830)$ | $(2,970,761)$ | 775,824 | $(2,983,242)$ |
| Net increase (decrease) in cash and due from banks | 191 | (312) | 7,276 | 357,998 | 19 | 365,172 |
| Cash and due from banks at beginning of period | 1,391 | 376 | 400 | 818,455 | $(1,797)$ | 818,825 |
| Cash and due from banks at end of period | \$ 1,582 | \$ 64 | \$ 7,676 | \$ 1,176,453 | \$ $(1,778)$ | \$ 1,183,997 |

## Table of Contents

POPULAR, INC.
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 (UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other <br> Subsidiaries <br> and | Elimination | Popular, Inc. |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | eliminations | entries | Consolidated |

Cash flows from operating activities: Net income (loss) $\quad \$ \quad 229,600 \quad(\$ 128,766) \quad(\$ 138,122) \quad \$ \quad 135,590 \quad \$ 131,298 \quad \$ \quad 229,600$

Adjustments to reconcile net income to net cash provided by (used in) operating activities:
Equity in
undistributed losses of subsidiaries $41,144 \quad 135,832 \quad 112,800$
$(289,776)$
Depreciation and amortization of premises and equipment $\quad 1,78$ Provision for loan losses
Amortization of intangibles
Amortization and fair value adjustments of servicing assets

34,941
59,558

Net (gain) loss on sale and valuation
adjustment of investment securities $(115,567)$

8,249
27,461
$(79,857)$
Net gain on disposition of premises and equipment 1
Net gain on sale of loans and valuation adjustments on loans held-for-sale $(37,719)$
$(37,719)$
Net amortization of premiums and accretion of discounts on investments $(5,525)$

7
21,312
15,801

Net amortization of premiums and deferred loan origination fees and costs
(Earnings) losses from investments under the equity method
Stock options expense

$$
(4,580)
$$

$(13,506)$
70,645
70,645

Deferred income taxes 1,451
$(13,635)$
$(114,112)$
31,715
$(94,581)$
Net disbursements on loans held-for-sale Acquisitions of loans held-for-sale $(474,269)$
Proceeds from sale of loans held-for-sale

3,475,817
3,475,817
Net decrease in trading securities
Net decrease (increase) in accrued income receivable
Net decrease (increase) in other assets
Net increase in
interest payable
Net increase in postretirement benefit obligation
Net increase in other liabilities
Total adjustments 316
(43)
$(2,693) \quad(42,857) \quad 2,602$
$(4,007,301)$
$(474,269)$
$\begin{array}{lll}1,002,759 & 319 & 1,003,078\end{array}$

Net cash provided by (used in) operating activities 175,965

4,492
$(6,101)$
537,871
$(158,876)$
553,351
Cash flows from investing activities:
Net
(increase) decrease in money market investments
Purchases of investment securities:
$\left.\begin{array}{lrlrrr}\text { Available-for-sale } & (6,808) & (2) & & (793,475) & 732,365\end{array}\right)(67,920)$

Proceeds from calls, paydowns, maturities and redemptions of investment securities: Available-for-sale Held-to-maturity 2,559,000 900
Other
Proceeds from sale of investment securities available-for- sale Proceeds from sale of other investment securities 245,484
Net repayments (disbursements) on loans from sale
Proceeds from sale of loans
Acquisition of loan portfolios
Capital contribution to subsidiary 5,783

16,605
14,964
37,352

Assets acquired, net of cash
Mortgage servicing rights purchased 89,556
$(21,550)$
$(125,919)$
$(753,204) \quad(326,865)$
$(1,137,982)$

Acquisition of premises and equipment (513)
(300)

500
(200)
$(2,378)$
$(2,378)$

Proceeds from sale of premises and equipment 29,50
Proceeds from sale of foreclosed assets

Net cash provided by (used in) investing activities

80,537
$(3,570)$
$(123,625)$
$(46,254) \quad(203,180)$
$(296,092)$
Cash flows from
financing activities:
Net increase in deposits
Net increase in federal funds purchased and assets sold under agreements to repurchase Net decrease in other short-term borrowings

105,503

| $(45,242)$ | $(2,575,473)$ | 127,274 | $(2,619,228)$ |
| ---: | ---: | ---: | ---: |
| $(4,583)$ | $(1,443,198)$ | 202,449 | $(1,245,332)$ |

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Payments of notes
payable
Proceeds from
issuance of notes

| payable | 298 | 89,293 | 731,496 |  |
| :--- | :---: | :---: | :---: | :---: |
| Dividends paid to <br> parent company |  | $(159,200)$ | 159,200 | 821,087 |

## Table of Contents

| (In thousands) | Popular, Inc. <br> Holding Co. | PIBI Holding Co. | PNA <br> Holding Co. | All other Subsidiaries and eliminations | Elimination entries | Popular, Inc. <br> Consolidated |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Dividends paid | $(142,898)$ |  |  |  |  | $(142,898)$ |
| Proceeds from issuance of common stock | 12,836 |  |  |  |  | 12,836 |
| Treasury stock acquired | (63) |  |  | (289) |  | (352) |
| Capital contribution from parent |  |  |  | (200) | 200 |  |
| Net cash (used in) provided by financing activities | $(255,614)$ |  | 144,971 | $(748,890)$ | 361,172 | $(498,361)$ |
| Net increase (decrease) in cash and due from banks | 888 | 922 | 15,245 | $(257,273)$ | (884) | $(241,102)$ |
| Cash and due from banks at beginning of period | 2 | 157 | 322 | 949,868 | (191) | 950,158 |
| Cash and due from banks at end of period | \$ 890 | \$1,079 | \$ 15,567 | \$ 692,595 | \$ $(1,075)$ | \$ 709,056 |

## Table of Contents

## Note 27 Subsequent Events

## Transaction with Goldman Sachs

On November 3, 2008, the Corporation completed the sale of the loan and servicing assets of PFH to various Goldman Sachs affiliates. This transaction is described in Note 3 to the consolidated financial statements.

## Restructuring Plans

On October 17, 2008, the Board of Directors of Popular, Inc. approved two restructuring plans. The restructuring plan for Banco Popular North America (the BPNA Restructuring Plan ) contemplates the following measures: closing, consolidation or sale of underperforming branches in all existing markets; the shutting down, sale or downsizing of lending businesses that do not generate deposits or fee income; and the reduction of general expenses associated with functions supporting the aforementioned branch and balance sheet initiatives.
It is anticipated that the BPNA Restructuring Plan will result in estimated combined charges for the Corporation of $\$ 36.6$ million, to be recognized during the fourth quarter of 2008 and in 2009, broken down as follows:
(\$ in millions)

Severance, bonuses and other benefits
$\begin{array}{ll}\text { Lease contract terminations and write-off of leasehold improvements } & 17.9\end{array}$
$\begin{array}{ll}\text { Other costs, mostly write-downs of core deposit intangibles } & 4.3\end{array}$

Total $\$ 36.6$

As a result of the BPNA Restructuring Plan, the exiting and downsizing of certain business lines and reductions in support functions, the Corporation expects an overall headcount reduction of $30 \%$ or about 640 full-time equivalent positions.
The restructuring plan of E-LOAN (the E-LOAN 2008 Restructuring Plan ) contemplates E-LOAN ceasing to operate as a direct lender in the fourth quarter of 2008. E-LOAN will continue to market deposit accounts under its name for the benefit of BPNA and offer loan customers the option of being referred to a trusted consumer lending partner.
It is anticipated that the E-LOAN Restructuring Plan will result in estimated combined charges for the Corporation of $\$ 13.6$ million, to be recognized during the fourth quarter of 2008 and in 2009 , broken down as follows:
(\$ in millions)
$\begin{array}{ll}\text { Severance, bonuses and other benefits } & \$ 6.1\end{array}$
Lease contract terminations and write-off of leasehold improvements
2.5

Other costs, principally write-downs of equipment and other intangibles
Total

These estimates are preliminary as management is still in the process of evaluating the cost of implementing the restructuring plans. Accordingly, no assurance can be given that the final charges may not differ by a significant amount from these estimates.
BPNA and E-LOAN are part of the BPNA reportable segment.

## Table of Contents

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

This report includes management s discussion and analysis ( MD\&A ) of the consolidated financial position and financial performance of Popular, Inc. and its subsidiaries (the Corporation or Popular ). All accompanying tables, financial statements and notes included elsewhere in this report should be considered an integral part of this analysis.

## OVERVIEW

Popular, Inc. (the Corporation or Popular ) is a diversified, publicly owned financial holding company subject to the supervision and regulation of the Board of Governors of the Federal Reserve System. The Corporation is a financial services provider with operations in Puerto Rico, the United States, the Caribbean and Latin America. As the leading financial institution in Puerto Rico, the Corporation offers retail and commercial banking services through its principal banking subsidiary, Banco Popular de Puerto Rico ( BPPR ), as well as auto and equipment leasing and financing, mortgage loans, consumer lending, investment banking, broker-dealer and insurance services through specialized subsidiaries. In the United States, the Corporation operates Banco Popular North America ( BPNA ), including its wholly-owned subsidiary E-LOAN, and Popular Financial Holdings ( PFH ). BPNA is a community bank providing a broad range of financial services and products. BPNA operates branches in New York, California, Illinois, New Jersey, Florida and Texas. E-LOAN markets deposit accounts under its name for the benefit of BPNA and offers loan customers the option of being referred to a trusted consumer lending partner for loan products. PFH operations were discontinued in the third quarter of 2008. Disclosures on the discontinued operations as well as recent restructuring plans in the BPNA and E-LOAN subsidiaries are included in this MD\&A. The Corporation, through its transaction processing company, EVERTEC, continues to use its expertise in technology as a competitive advantage in its expansion throughout the United States, the Caribbean and Latin America, as well as internally servicing many of its subsidiaries system infrastructures and transactional processing businesses. Note 25 to the consolidated financial statements presents information about the Corporation s business segments.
The Corporation reported a net loss of $\$ 668.5$ million for the quarter ended September 30, 2008, compared with a net income of $\$ 36.0$ million in the same quarter of 2007. Table A provides selected financial data and performance indicators for the quarter and nine-month periods ended September 30, 2008 and 2007.
The following items principally impacted financial results for the quarter ended September 30, 2008:
Losses of $\$ 457.3$ million, net of tax, related to the discontinued operations of the U.S.-based reporting segment Popular Financial Holdings. The losses included write-downs of assets held-for-sale to fair value, losses on the sale of loans, restructuring charges and an unfavorable impact to income tax due to the recording of a valuation allowance on deferred tax assets of $\$ 171.2$ million.

Losses from continuing operations of $\$ 211.2$ million, net of tax, primarily resulting from a valuation allowance of $\$ 189.2$ million against the Corporation s deferred tax assets related to U.S. operations which negatively impacted income tax expense and higher provision for loan losses of $\$ 165.8$ million as a result of higher credit losses, particularly in real estate related loans.
Financial results for the quarter and nine months ended September 30, 2008 and 2007 are summarized in Table A. The Corporation retrospectively adjusted certain information, principally that impacting the statement of operations, to present in a separate line item the results from discontinued operations from prior periods presented in this Form 10-Q for comparability purposes. The discussions in this MD\&A pertain to Popular, Inc. s continuing operations, unless otherwise indicated.

## Net Loss from Continuing Operations:

Financial results for the quarter ended September 30, 2008 for Popular s continuing operations were principally impacted by the following items (on a pre-tax basis compared to the third quarter of 2007):

Higher income tax expense by $\$ 125.3$ million, which includes a $\$ 189.2$ million adjustment to recognize a valuation allowance on a part of the deferred tax assets related to the Corporation s continuing U.S. operations. Given that the Corporation files a consolidated U.S. tax return for its

## Table of Contents

U.S. operations, the Corporation can continue to benefit from the net operating losses carryforward derived from the PFH reportable segment losses. Based on the internal assessment of the realization of the U.S. deferred tax asset, during the third quarter of 2008, management determined that it was appropriate to establish a valuation allowance of $\$ 360.4$ million, of which $\$ 189.2$ million of the impact in income tax expense is accounted as part of the Corporation s continuing operations. Refer to the Income Taxes section of this MD\&A for further information on deferred tax assets.

Higher provision for loan losses for the third quarter of 2008 by $\$ 165.8$ million, including $\$ 61.9$ million in specific reserves for loans classified as impaired under SFAS No. 114. The increase in provision for loan losses was driven principally by higher net charge-offs and deteriorating credit quality trends. Details on credit quality indicators are included in the Credit Risk Management and Loan Quality Section in this MD\&A. The current state of the economy and uncertainty in the private and public sectors has had an adverse effect on the credit quality of the Corporation s loan portfolios.

Lower net interest income by $\$ 7.4$ million, and
Higher operating expenses by $\$ 4.0$ million.
The above were partially offset by higher non-interest income by $\$ 11.0$ million.
Banco Popular de Puerto Rico reportable segment s net income amounted to $\$ 35.4$ million for the quarter ended September 30, 2008, compared to net income of $\$ 80.2$ million for the same quarter in 2007. The Corporation s banking business in Puerto Rico continues to feel the pressure of weak economic conditions. The reduction in net income, when comparing the results for the 2008 and 2007 third quarters, was principally attributed to an increase in its provision for loan losses of $\$ 62.8$ million. Revenues derived from deposit accounts and other service fees increased $7 \%$. Management in the Puerto Rico operations continues focusing on addressing credit-related challenges and on implementing additional income opportunities and cost reduction initiatives to mitigate the additional provision expense. The expense reduction efforts include (i) reducing headcount by attrition (leveraging human resources through internal mobility), (ii) focusing on projects that will result in immediate contributions to profitability, and (iii) rationalizing product lines that consistently fail to deliver adequate returns on equity. Banco Popular de Puerto Rico will consolidate its consumer-finance operations, Popular Finance, into its retail banking operations. Popular Finance stopped originating loans on November 1, 2008. Some of Popular Finance s 44 branches will continue to operate as customer-service operations. The remaining branches of Popular Finance will be closed or sold. Employees at Popular Finance will be relocated to support other business lines at the Puerto Rico operations.
EVERTEC, the Corporation s processing business, continues to perform well, reporting net income of $\$ 8.5$ million in the third quarter of 2008, compared to $\$ 8.1$ million in the same quarter of the previous year, for an increase of approximately $5 \%$.
Banco Popular North America ( BPNA ) reportable segment, which includes E-LOAN, reported a net loss for the quarter ended September 30, 2008 of $\$ 139.0$ million, compared to a net loss of $\$ 1.1$ million in the same quarter of 2007. Of the results for the quarter ended September 30, 2008, $\$ 51.7$ million of those losses pertain to BPNA, while $\$ 87.4$ million pertains to E-LOAN. These operations were impacted by an increase of $\$ 103.0$ million in the provision for loan losses compared to the same quarter of 2007 and by $\$ 94.5$ million valuation allowance established for part of the deferred tax assets in the third quarter of 2008. The Corporation has concluded that an accelerated downturn of the U.S. economy requires a leaner, more efficient U.S. business model. As such, the Corporation is reducing the size of its banking operations in the U.S. mainland to a level suited to present economic conditions. The objective of the restructuring plan for this reportable segment is to improve profitability in the short term, increase liquidity and lower credit costs, and over time achieve a greater integration with corporate functions in Puerto Rico. Refer to the Subsequent Events section of this MD\&A for information on the BPNA restructuring plan approved by the Corporation s Board of Directors in October 2008.

## Table of Contents

## TABLE A

## Financial Highlights

| Financial Condition Highlights (In thousands) | At September 30, |  |  | Average for the nine months** |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2008 | 2007 | Variance | 2008 | 2007 | Variance |
| Money market investments | \$ 309,497 | 635,097 | $(325,600)$ | 651,043 | 449,722 | \$ 201,321 |
| Investment and trading securities | 8,962,130 | 9,999,296 | $(1,037,166)$ | 8,949,770 | 10,574,675 | $(1,624,905)$ |
| Loans | 26,581,169* | 33,320,804 | $(6,739,635)$ | 26,513,808 | 25,110,127 | 1,403,681 |
| Total earning assets | 35,852,796* | 43,955,197 | $(8,102,401)$ | 36,114,621 | 36,134,524 | $(19,903)$ |
| Total assets | 40,390,142 | 47,280,131 | $(6,889,989)$ | 41,391,639 | 47,168,015 | $(5,776,376)$ |
| Deposits | 27,911,397 | 26,601,515 | 1,309,882 | 27,268,864 | 24,972,662 | 2,296,202 |
| Borrowings | 8,479,537* | 16,016,991 | $(7,537,454)$ | 7,519,439 | 9,750,011 | $(2,230,572)$ |
| Stockholders equity | 3,007,473 | 3,803,721 | $(796,248)$ | 3,440,296 | 3,870,770 | $(430,474)$ |

## Operating Highlights

(In thousands, except per share information)
Net interest income
Provision for loan losses
Non-interest income
Operating expenses
(Loss) income from continuing operations before income tax
Income tax expense
(Loss) income from continuing operations, net of income tax
Loss from discontinued operations, net of income tax
Net (loss) income
Net (loss) income applicable to common stock
Earnings per common share:
Basic and diluted (losses) earnings from continuing operations
Basic and diluted (losses) earnings
from discontinued operations
Basic and diluted (losses) earnings Total

| Third Quarter |  |  | Nine months ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 2008 | 2007 | Variance | 2008 | 2007 | Variance |
| \$ 324,282 | \$331,646 | \$ (7,364) | \$ 990,338 | \$ 968,342 | \$ 21,996 |
| 252,160 | 86,340 | 165,820 | 602,561 | 219,477 | 383,084 |
| 187,928 | 176,925 | 11,003 | 688,477 | 683,078 | 5,399 |
| 322,915 | 318,961 | 3,954 | 976,548 | 973,372 | 3,176 |
| $(62,865)$ | 103,270 | $(166,135)$ | 99,706 | 458,571 | $(358,865)$ |
| 148,308 | 23,056 | 125,252 | 152,467 | 105,598 | 46,869 |
| $(211,173)$ | 80,214 | $(291,387)$ | $(52,761)$ | 352,973 | $(405,734)$ |
| $(457,370)$ | $(44,211)$ | $(413,159)$ | $(488,242)$ | $(123,373)$ | $(364,869)$ |
| \$(668,543) | \$ 36,003 | \$ $(704,546)$ | \$ $(541,003)$ | \$ 229,600 | \$(770,603) |
| \$(679,772) | \$ 33,024 | \$(712,796) | \$ $(561,213)$ | \$ 220,665 | \$ 781,878 ) |
| \$ (0.79) | \$ 0.28 | \$ (1.07) | \$ (0.26) | \$ 1.23 | \$ (1.49) |
| \$ (1.63) | \$ (0.16) | \$ (1.47) | \$ (1.74) | \$ (0.44) | \$ (1.30) |
| \$ (2.42) | \$ 0.12 | \$ (2.54) | \$ (2.00) | \$ 0.79 | \$ (2.79) |

## Selected Statistical Information

|  |  |  | Third Quarter |  | Nine months ended <br> September 30, |  |
| :--- | :---: | ---: | ---: | ---: | ---: | :---: |
|  |  | 2008 | 2007 | 2008 | 2007 |  |
|  |  |  |  |  |  |  |
| Common Stock Data |  |  |  |  |  |  |
|  | Market price | $\$ 11.17$ | $\$ 16.18$ | $\$ 14.07$ | $\$ 18.94$ |  |
| High |  | 5.12 | 11.38 | 5.12 | 11.38 |  |
| Low |  |  |  |  |  |  |

## End

Book value per share at period end
Dividends declared per share
Dividend payout ratio

| Profitability Ratios $\quad$ Return on assets | $(6.55 \%)$ | $0.30 \%$ | $(1.75 \%)$ | $0.65 \%$ |
| :--- | :---: | :---: | :---: | :---: |
| Return on common equity | $(93.32)$ | 3.52 | $(24.57)$ | 8.01 |
| Net interest spread (taxable equivalent) | 3.42 | 3.27 | 3.44 | 3.22 |
| Net interest margin (taxable equivalent) | 3.89 | 3.88 | 3.92 | 3.83 |
|  |  |  |  |  |
|  |  | $8.54 \%$ | $8.29 \%$ | $8.31 \%$ |
| Capitalization Ratios $\quad$ Equity to assets | 6.97 | 6.77 | 6.75 | $8.21 \%$ |
| Tangible equity to assets | $80.56)$ | $(1.20)$ | $(26.24)$ | 6.68 |
| Internal capital generation | 9.09 | 10.73 | 9.09 | 10.73 |
| Tier I capital to risk adjusted assets | 10.35 | 11.98 | 10.35 | 11.98 |
| Total capital to risk adjusted assets | 7.17 | 8.31 | 7.17 | 8.31 |

* Excludes assets
/ liabilities from
discontinued operations as of September 30, 2008 as follows: $\$ 626$ million in loans, $\$ 630$ million in earning assets, and $\$ 166$ million in borrowings.
These are included as part of Assets / Liabilities from discontinued operations in the consolidated statement of condition as of such date.
** Excludes averages of assets / liabilities from discontinued operations.
Averages for
September 30,

2007 were
retrospectively
adjusted to
conform to the
September 30, 2008
presentation.

## Table of Contents

The Corporation, like other financial institutions, is subject to a number of risks, many of which are outside of management s control, though efforts are made to manage those risks while optimizing returns. Among the risks to which the Corporation is subject are: (1) market risk, which is the risk that changes in market rates and prices will adversely affect the Corporation s financial condition or results of operations, (2) liquidity risk, which is the risk that the Corporation will have insufficient cash or access to cash to meet operating needs and financial obligations, (3) credit risk, which is the risk that loan customers or other counterparties will be unable to perform their contractual obligations, and (4) operational risk, which is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. In addition, the Corporation is subject to legal, compliance and reputational risks, among others.
As a financial services company, the Corporation s earnings are significantly affected by general business and economic conditions. Lending and deposit activities and fee income generation are influenced by the level of business spending and investment, consumer income, spending and savings, capital market activities, competition, customer preferences, interest rate conditions and prevailing market rates on competing products. The Corporation continuously monitors general business and economic conditions, industry-related indicators and trends, competition, interest rate volatility, credit quality indicators, loan and deposit demand, operational and systems efficiencies, revenue enhancements and changes in the regulation of financial services companies. The Corporation operates in a highly regulated environment and may be adversely affected by changes in federal and local laws and regulations. Also, competition with other financial institutions could adversely affect its profitability.
The description of the Corporation s business contained in Item 1 of the Corporation s Form 10-K for the year ended December 31, 2007, while not all inclusive, discusses additional information about the business of the Corporation and risk factors, many beyond the Corporation s control that, in addition to the other information in this Form 10-Q, including Item 1A of Part III; readers should consider.
Further discussion of operating results, financial condition and credit, market and liquidity risks is presented in the narrative and tables included herein.
The shares of the Corporation s common (BPOP) and preferred stock (BPOPO and BPOPP) are traded on the National Association of Securities Dealers Automated Quotation (NASDAQ ) system.

## DISCONTINUED OPERATIONS

On August 29, 2008, the Corporation announced that it had entered into an agreement to sell loans, residual interests and servicing related assets of PFH and Popular, FS to Goldman Sachs Mortgage Company, Goldman, Sachs \& Co. and Litton Loan Servicing, LP. The transaction closed on November 3, 2008. This sale resulted in a reduction in assets, mostly accounted at fair value, of over $\$ 900$ million, and provided over $\$ 700$ million in additional liquidity. In addition, on September 18, 2008, the Corporation announced the consummation of the sale of manufactured housing loans of PFH to $21^{\text {st }}$ Mortgage Corp. and Vanderbilt Mortgage and Finance, Inc. The transaction provided approximately $\$ 198$ million in cash and resulted in a reduction in unpaid principal balance of loans held at PFH of approximately $\$ 309$ million.
The above actions and past sales and restructuring plans executed at PFH in the past two years have resulted in the discontinuance of the Corporation s PFH operations. This includes exiting all business activities, consisting of loan origination channels and loan servicing functions previously conducted at PFH. As of September 30, 2008, the Corporation reclassified $\$ 789$ million of net assets of the PFH business to discontinued operations, substantially all of which were classified as held-for-sale as of September 30, 2008.
The proceeds from the PFH asset sales will be used for repayment of the Corporation s medium-term notes due in

## Table of Contents

2009 as well as other debt maturities. The Corporation reported a net loss for the discontinued operations of $\$ 457.3$ million in the third quarter of 2008. The loss included write-downs of assets held-for-sale to fair value, losses on the sale of loans, restructuring charges and the recording of a valuation allowance on deferred tax assets of $\$ 171.2$ million.
Assets and liabilities of discontinued operations, substantially all of which are classified as held-for-sale, were estimated as follows as of September 30, 2008:

| (\$ in millions) | September 30 2008 |  |
| :---: | :---: | :---: |
| Loans | \$ | 626 |
| Servicing rights |  | 37 |
| Servicing advances |  | 280 |
| Residual interests |  | 4 |
| Other |  | 22 |
| Total assets | \$ | 969 |
| Secured borrowings | \$ | 166 |
| Other liabilities |  | 14 |
| Total liabilities | \$ | 180 |
| Net assets | \$ | 789 |

The following table provides financial information for the discontinued operations for the quarter and nine months ended September 30, 2008 and 2007.

| (\$ in millions) | Quarter ended |  |  | Nine months ended |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | September $30,2008$ |  | ember 30, $2007$ | September $\text { 30, } 2008$ |  | ember 30, $2007$ |
| Net interest income | \$ 1.6 | \$ | 28.5 | \$ 30.7 | \$ | 118.1 |
| Provision for loan losses | 10.5 |  | 61.8 | 19.0 |  | 140.1 |
| Non-interest (loss) income, including fair value adjustments on loans and MSRs | (256.4) |  | (9.9) | (255.4) |  | (60.5) |
| Operating expenses, including reductions in value of servicing advances and other real estate | 126.3 |  | 28.0 | 193.0 |  | 110.0 |
| Loss on disposition during the period(1) | (53.5) |  |  | (53.5) |  |  |
| Pre-tax loss from discontinued operations | \$(445.1) | \$ | (71.2) | \$(490.2) | \$ | (192.5) |
| Income tax expense (benefit) | 12.2 |  | (27.0) | (2.0) |  | (69.1) |
| Loss from discontinued operations, net of tax | \$(457.3) | \$ | (44.2) | \$(488.2) | \$ | (123.4) |

(1) Loss on disposition during the period is associated to the sale of manufactured housing loans in September 2008, which included lower of cost or market adjustments at reclassification from loans held-in-portfolio to loans held-for-sale.

As part of these actions at PFH , the Corporation entered into a restructuring plan (the PFH Discontinuance Restructuring Plan ) to eliminate employment positions, terminate contracts and incur other costs associated with the sale. Further information on the restructuring plan is provided in the Restructuring Plans section in this MD\&A. As of September 30, 2008, on a pro-forma basis after giving effect to the sale of PFH s loan and servicing assets described above, the Corporation s capital ratios are estimated as follows: Tier I capital ratio of approximately $9.43 \%$, total capital ratio of approximately $10.69 \%$, and leverage ratio of approximately $7.15 \%$. Refer to Table K for the Corporation s regulatory capital ratios and amounts of total risk-based capital, Tier I risk-based capital and Tier I leverage at September 30, 2008.

## Table of Contents

## SUBSEQUENT EVENTS

## Transaction with Goldman Sachs

On November 3, 2008, the Corporation completed the sale of the loans and servicing assets of PFH to various Goldman Sachs affiliates. Refer to the Discontinued Operations section of this MD\&A for further information.

## Restructuring Plans

The Corporation has concluded that an accelerated downturn of the U.S. economy requires a leaner, more efficient U.S. business model. As such, the Corporation is reducing the size of its banking operations in the U.S. mainland to a level suited to present economic conditions. On October 17, 2008, the Board of Directors of Popular, Inc. approved two restructuring plans for the BPNA reportable segment. The objective of the restructuring plans is to improve profitability in the short term, increase liquidity and lower credit costs, and over time achieve a greater integration with corporate functions in Puerto Rico.
The restructuring plan for Banco Popular North America (banking operations) (the BPNA Restructuring Plan ) contemplates the following measures: closing, consolidation or sale of underperforming branches in all existing markets; the shutting down, sale or downsizing of lending businesses that do not generate deposits or fee income; and the reduction of general expenses associated with functions supporting the aforementioned branch and balance sheet initiatives.
It is anticipated that the BPNA Restructuring Plan will result in estimated combined charges for the Corporation of $\$ 36.6$ million, to be recognized during the fourth quarter of 2008 and in 2009, broken down as follows:
(\$ in millions)
Severance, bonuses and other benefits \$14.4
Lease contract terminations and write-off of leasehold improvements 17.9
Other costs, mostly write-downs of core deposit intangibles 4.3
Total \$36.6
As a result of the BPNA Restructuring Plan, the exiting and downsizing of certain business lines and reductions in support functions, the Corporation expects an overall headcount reduction of $30 \%$ or about 640 full-time equivalent positions.
The BPNA Restructuring Plan is expected to achieve annual expense savings at BPNA of approximately $\$ 50$ million and is expected to be rolled out in the fourth quarter 2008 with an estimated completion date of June 2009.
The restructuring plan of E-LOAN (the E-LOAN 2008 Restructuring Plan ) contemplates E-LOAN ceasing to operate as a direct lender in the fourth quarter of 2008. E-LOAN will continue to market deposit accounts under its name for the benefit of BPNA and offer loan customers the option of being referred to a trusted consumer lending partner. All operational and support functions will be transferred to BPNA and EVERTEC by July 2009.
It is anticipated that the E-LOAN 2008 Restructuring Plan will result in estimated combined charges for the Corporation of $\$ 13.6$ million, to be recognized during the fourth quarter of 2008 and in 2009, broken down as follows:
(\$ in millions)
Severance, bonuses and other benefits
\$ 6.1
Lease contract terminations and write-off of leasehold improvements 2.5
Other costs, principally write-downs of equipment and other intangibles 5.0
Total
\$13.6

## Table of Contents

Annualized expected savings from the E-LOAN 2008 Restructuring Plan are estimated at approximately $\$ 37$ million. These estimates are preliminary as management is still in the process of evaluating the cost of implementing the restructuring plans. Accordingly, no assurance can be given that the final charges may not differ by a significant amount from these estimates.

## Legislation

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act of 2008 ( EESA ), which provides the U.S. Secretary of the United States Treasury Department ( Treasury ) with broad authority to deploy up to $\$ 750$ billion into the financial system to help restore stability and liquidity to U.S. markets. On October 24, 2008, Treasury announced plans to direct $\$ 250$ billion of this authority into preferred stock investments by Treasury in qualified financial institutions as part of the Troubled Asset Relief Program ( TARP ) Capital Purchase Program. The program is voluntary and requires an institution to comply with a number of restrictions and provisions, including limits on executive compensation, stock redemptions and declaration of dividends. Applications must be submitted by November 14, 2008 and are subject to approval by the Treasury. This program provides for a minimum investment of $1 \%$ of Risk-Weighted Assets, with a maximum investment equal to the lesser of $3 \%$ of Total Risk-Weighted Assets or $\$ 25$ billion. The perpetual preferred stock investment will have a dividend rate of $5 \%$ per year, until the fifth anniversary of the Treasury investment, and a dividend rate of $9 \%$, thereafter. This program also requires the Treasury to receive warrants for common stock equal to $15 \%$ of the capital invested by the Treasury. Participation in the program is not automatic and subject to approval by the Treasury.
Furthermore, the EESA included a provision for an increase in the amount of deposits insured by the Federal Deposit Insurance Corporation ( FDIC ) to $\$ 250,000$. On October 14, 2008, the FDIC announced a new program the Temporary Liquidity Guarantee Program that provides unlimited deposit insurance on funds in noninterest-bearing transaction deposit accounts not otherwise covered by the existing deposit insurance limit of $\$ 250,000$.

## RESTRUCTURING PLANS IN PLACE AS OF SEPTEMBER 30, 2008

## PFH Discontinuance Restructuring Plan

As previously indicated in the Discontinued Operations section of this MD\&A, in August 2008 the Corporation entered into a new restructuring plan for its PFH operations to eliminate employment positions, terminate contracts and incur other costs associated with the discontinuance of PFH s operations It is anticipated that the PFH Discontinuance Restructuring Plan will result in estimated combined charges for the Corporation of approximately $\$ 14$ million, from which $\$ 5.1$ million was recognized during the third quarter of 2008 and the remainder is expected to be recognized during the fourth quarter of 2008 and 2009. The costs consist of severance bonuses and other employee benefits, lease and contract termination expenses, and other costs, principally consisting of software, equipment and fixed asset impairments. Full-time equivalent employees at the PFH reportable segment were 299 as of September 30, 2008.

## Table of Contents

During the quarter ended September 30, 2008, the PFH Discontinuance Restructuring Plan resulted in charges, on a pre-tax basis, broken down as follows:

|  | Impairments on <br> long-lived <br> assets | Restructuring |
| :--- | :---: | :---: | :---: |

(a) Fixed assets and
prepaid
expenses
(b) Severance, retention bonuses and other employee benefits
The PFH Discontinuance Restructuring Plan charges incurred in the third quarter of 2008 are included in the line item
Loss from discontinued operations, net of tax in the consolidated statement of operations.

## PFH Branch Network Restructuring Plan

Given the disruption in the capital markets since the summer of 2007 and its impact on funding, management of the Corporation concluded during the fourth quarter of 2007 that it would be difficult to generate an adequate return on the capital invested at Equity One s consumer service branches.
The Corporation closed Equity One s consumer service branches during the first quarter of 2008 as part of the initiatives to exit the subprime loan origination operations at PFH (the PFH Branch Network Restructuring Plan ). The PFH Branch Network Restructuring Plan followed the sale on March 1, 2008 of approximately $\$ 1.4$ billion of PFH consumer and mortgage loans that were originated through Equity One s consumer branch network to American General Financial ( American General ). This company hired certain of Equity One s consumer services employees and retained certain branch locations. During the quarter ended March 31, 2008, Equity One closed substantially all branches not assumed by American General.
During the quarter and nine months ended September 30, 2008 and as part of this particular restructuring plan, the Corporation incurred certain costs, on a pre-tax basis, as detailed in the table below.

| (In thousands) | Qua | r ended mber 30, 08 | Nine months ended <br> September 30, 2008 |  |
| :---: | :---: | :---: | :---: | :---: |
| Personnel costs |  | 63 | \$ | 8,468(a) |
| Net occupancy expenses |  |  |  | 5,905(b) |
| Equipment expenses |  |  |  | 675 |
| Communications |  |  |  | 590 |
| Other operating expenses |  |  |  | 1,021(c) |
| Total restructuring charges |  | 63 |  | 16,659 |

(a) Severance, retention
bonuses and
other benefits
(b) Lease
terminations
(c) Contract
cancellations
and branch
closing costs
Also, during the fourth quarter of 2007 and as disclosed in the 2007 Annual Report, the Corporation recognized impairment charges on long-lived assets of $\$ 1.9$ million, mainly associated with leasehold improvements, furniture and equipment.

## Table of Contents

As of September 30, 2008, the PFH Branch Network Restructuring Plan has resulted in combined charges for 2007 and 2008, broken down as follows:

|  | Impairments on | Restructuring |  |
| :---: | :---: | :---: | :---: |
| (In thousands) | long-lived assets | costs | Total |
| Quarter ended: |  |  |  |
| December 31, 2007 | \$ 1,892 |  | \$ 1,892 |
| March 31, 2008 |  | \$ 17,029 | 17,029 |
| June 30, 2008 |  | (433) | (433) |
| September 30, 2008 |  | 63 | 63 |
| Total | \$ 1,892 | \$ 16,659 | \$ 18,551 |

The following table presents the changes during 2008 in the reserve for restructuring costs associated with the PFH Branch Network Restructuring Plan.

losses related to its goodwill and trademark intangible assets.
The cost-control plan initiative and changes in loan origination strategies incorporated as part of the plan resulted in the elimination of over 400 positions between the fourth quarter of 2007 and first quarter of 2008. Full-time equivalent employees at E-LOAN were 300 as of September 30, 2008, compared with 806 as of September 30, 2007.

## Table of Contents

The following table presents the changes in restructuring costs reserves for 2008 associated with the E-LOAN Restructuring Plan.

| (In thousands) | Restructuring costs |
| :---: | :---: |
| Balance at January 1, 2008 | \$ 8,808 |
| Payments | $(4,628)$ |
| Reversals | (301) |
| Balance at March 31, 2008 | 3,879 |
| Payments | (936) |
| Balance at June 30, 2008 | 2,943 |
| Payments | (460) |
| Reversals | $(1,036)$ |
| Balance as of September 30, 2008 | \$ 1,447 |
| The Corporation does not expect to incur additional significant restructuring costs related to this specific E-LOAN |  |
| Restructuring Plan during the remainder of year 2008. The associated liability outstanding as of September 30, 2008 is mostly related to lease terminations. |  |
| The E-LOAN Restructuring Plan charges are part of the results of the BPNA reportable segment. Refer to Note 25 to the consolidated financial statements for disclosures on the financial results of E-LOAN for the quarter and nine months ended September 30, 2008 and the comparable periods in 2007. |  |
| These costs related to E-LOAN do not consider the new restructuring plan approved in October 2008 which was disclosed in the Subsequent Events section of this MD\&A and which eliminated loan origination activities at E-LOAN. |  |

## SFAS No. 159 FAIR VALUE OPTION ELECTION

SFAS No. 159 provides entities the option to measure certain financial assets and financial liabilities at fair value with changes in fair value recognized in earnings each period. SFAS No. 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument.
As indicated in Note 2 to the consolidated financial statements, the Corporation elected to measure at fair value certain loans and borrowings outstanding at January 1, 2008 pursuant to the fair value option provided by SFAS No. 159. All of these financial instruments pertained to the operations of Popular Financial Holdings, and at the SFAS No. 159 adoption date included:

Approximately $\$ 1.2$ billion of whole loans held-in-portfolio by PFH outstanding as of December 31, 2007. These whole loans consisted principally of first lien residential mortgage loans and closed-end second lien loans that were originated through the exited origination channels of PFH (e.g. asset acquisition, broker and retail channels), and home equity lines of credit that had been originated by E-LOAN but sold to PFH as part of the Corporation s 2007 U.S. reorganization. Also, to a lesser extent, the loan portfolio included mixed-use / multi-family loans (small commercial category) and manufactured housing loans.

Approximately $\$ 287$ million of owned-in-trust loans and $\$ 287$ million of bond certificates associated with PFH securitization activities that were outstanding as of December 31, 2007. The owned-in-trust loans are pledged as collateral for the bond certificates as a financing vehicle through on-balance sheet securitization transactions. The owned-in-trust loans include first lien residential mortgage loans, closed-end second lien loans, mixed-use / multi-family loans (small commercial category) and manufactured housing loans. The

## Table of Contents

Upon adoption of SFAS No. 159, the Corporation recognized a negative after-tax adjustment to beginning retained earnings due to the transitional adjustment for electing the fair value option, as detailed in the following table.

|  |  | Cumulative effect |  |
| :---: | :---: | :---: | :---: |
| (In thousands) | January 1, 2008 (Carrying value prior to adoption) | adjustment to <br> January 1, 2008 <br> retained <br> earnings <br> Gain (Loss) | January 1, 2008 <br> fair value <br> (Carrying value <br> after adoption) |
| Loans | \$ 1,481,297 | \$ $(494,180)$ | \$ 987,117 |
| Notes payable (bond certificates) | \$ $(286,611)$ | \$ 85,625 | \$ $(200,986)$ |

Pre-tax cumulative effect of adopting fair value option accounting
\$ $(408,555)$
Net increase in deferred tax asset
146,724
After-tax cumulative effect of adopting fair value option accounting

The fair value adjustments in the loan portfolios recorded upon adoption of SFAS No. 159 on January 1, 2008 were mainly the result of factors such as:

In general, the loan portfolio is, in the most part, considered subprime and due to market conditions, considered distressed assets in a very illiquid market.

There was a significant deterioration in the delinquency profile of the second-lien closed-end mortgage loan portfolio

Property values obtained on subprime loans in foreclosure were declining dramatically. As property values do not justify initiating a foreclosure action, the loan in essence could behave as an unsecured loan.

A substantial share of PFH s closed-end second lien portfolio has combined loan-to-values greater than $90 \%$.
The consumer loans measured at fair value also include home equity lines of credit that although were considered prime based on FICO scores, the portfolio had deteriorated. Similar to second lien closed-end loans, the HELOCs were also behaving as an unsecured loan.

Certain of the loan portfolios were trading at distressed levels based on the small trading activity available for the products and the expected return by the investors rather than the actual performance and fundamentals of these loans.
Similar factors and continuing disruptions in the capital markets and credit deterioration contributed to the further decline in value of the loan portfolio during 2008.
The following table presents the differences as of September 30, 2008 between the aggregate fair value, including accrued interest, and aggregate unpaid principal balance ( UPB ) of those loans / notes payable for which the fair value
option was elected. The fair value of these assets as of September 30, 2008 was determined based on the pricing terms of the sales agreement with Goldman Sachs.

|  |  | $\begin{aligned} & \text { Aggregate UPB } \\ & \text { as } \end{aligned}$ |  |  |
| :---: | :---: | :---: | :---: | :---: |
| (In thousands) | value as of September 30, 2008 |  |  |  |
| Loans: |  |  |  |  |
| Mortgage | \$ 442,140 | \$ | 779,071 | \$ $(336,931)$ |
| Consumer | 78,802 |  | 246,090 | $(167,288)$ |
| Commercial | 62,870 |  | 120,556 | $(57,686)$ |
| Total loans | \$ 583,812 |  | 1,145,717 | \$(561,905) |
| Notes payable (bond certificates) | \$(166,436) |  | $(242,883)$ | \$ 76,447 |

During the quarter and nine-months ended September 30, 2008, the Corporation recognized $\$ 137.2$ million and $\$ 169.8$ million, respectively, in losses attributable to changes in the fair value of loans, including net losses attributable to changes in instrument-specific credit spreads. During the quarter and nine months ended September 30, 2008, the Corporation recognized $\$ 3.4$ million and $\$ 9.6$ million, respectively, in losses attributable to changes in

## Table of Contents

the fair value of notes payable (bond certificates). These losses were included in the caption Loss from discontinued operations, net of tax in the consolidated statement of operations.
These financial instruments are included as part of Assets / Liabilities from discontinued operations in the consolidated statement of condition as of September 30, 2008. PFH, which held the SFAS No. 159 loan portfolio, was financed primarily by advances from its holding company, Popular North America ( PNA ). In turn, PNA depended totally on the capital markets to raise financing to meet its financial obligations. Given the mounting pressure to address PNA s liquidity needs and the continuing problems with accessing the U.S. capital markets given the current unprecedented market conditions, management decided that the only viable option available to permanently raise the liquidity required by PNA was to sell PFH assets. This decision was taken in the third quarter of 2008.
The following table provides information on non-performing loans measured at fair value pursuant to SFAS No. 159. Non-Performing Loans Measured at Fair Value pursuant to SFAS No. 159
(Dollars in thousands)
Commercial
Mortgage
Consumer
Total non-performing loans measured at fair value
Loans past due 90 days or more

Unpaid principal

| Fair value as of <br> September 30, <br> 2008 | balance as of <br> September 30, <br> 2008 | Unrealized <br> losses |
| :---: | ---: | ---: |
| $\$$5,704 <br> 58,693 <br> 405 | $\$ 16,399$ | $\$(10,695)$ |
|  | 160,356 |  |
| $\$ 64,802$ | 8,678 | $(101,663)$ |
|  | $\$ 185,433$ | $\$(120,631)$ |
| $\$ 64,802$ | $\$ 185,433$ | $\$(120,631)$ |

## RECENT ACCOUNTING PRONOUNCEMENTS AND INTERPRETATIONS

## SFAS No. 157 Fair Value Measurements

SFAS No. 157, issued in September 2006, defines fair value, establishes a framework of measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets carried at fair value will be classified and disclosed in one of the three categories in accordance with the hierarchy. The three levels of the fair value hierarchy are (1) quoted market prices for identical assets or liabilities in active markets, (2) observable market-based inputs or unobservable inputs that are corroborated by market data, and (3) unobservable inputs that are not corroborated by market data. SFAS No. 157 was effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the Financial Accounting Standards Board ( FASB ) issued financial staff position FSP FAS No. 157-2 which defers for one year the effective date for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value on a nonrecurring basis. The staff position also amends SFAS No. 157 to exclude SFAS No. 13 Accounting for Leases and its related interpretive accounting pronouncements that address leasing transactions. The Corporation adopted the provisions of SFAS No. 157 that were not deferred by FSP FAS No. 157-2, commencing in the first quarter of 2008. The provisions of SFAS No. 157 are to be applied prospectively. Refer to Note 13 to these consolidated financial statements for the disclosures required for the nine-month period ended September 30, 2008. The adoption of SFAS No. 157 in January 1, 2008 did not have an impact in beginning retained earnings.
FSP No. 157-3 Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ( FSP 157-3 ). FSP 157-3 clarifies the application of FAS 157 in a market that is not active. The FSP is intended to address the following application issues: (a) how the reporting entity s own assumptions (that is, expected cash flows and appropriately risk-adjusted discount rates) should be considered
when measuring fair value when relevant observable inputs do not exist; (b) how available observable inputs in a market that is not active should be considered when measuring fair value; and (c) how the use of market quotes (for example, broker quotes or pricing services for the same or similar financial assets) should be considered when assessing the relevance of observable and unobservable inputs available to measure fair value. FSP 157-3 is

## Table of Contents

effective on issuance, including prior periods for which financial statements have not been issued. The Corporation adopted FSP 157-3 for the quarter ended September 30, 2008 and the effect of adoption on the consolidated financial statements was not material.
SFAS No. 159 The Fair Value Option for Financial Assets and Liabilities Including an Amendment of FASB Statement No. 115
In February 2007, the FASB issued SFAS No. 159, which provides companies with an option to report selected financial assets and liabilities at fair value. The election to measure a financial asset or liability at fair value can be made on an instrument-by-instrument basis and is irrevocable. The difference between the carrying amount and the fair value at the election date is recorded as a transition adjustment to beginning retained earnings. Subsequent changes in fair value are recognized in earnings. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet.
The Corporation adopted the provisions of SFAS No. 159 in January 2008 as previously described in the SFAS No. 159 Fair Value Option Election section in this MD\&A and in Note 12 to the consolidated financial statements. FSP FIN No. 39-1 Amendment of FASB Interpretation No. 39
In April 2007, the FASB issued Staff Position FSP FIN No. 39-1, which defines right of setoff and specifies what conditions must be met for a derivative contract to qualify for this right of setoff. It also addresses the applicability of a right of setoff to derivative instruments and clarifies the circumstances in which it is appropriate to offset amounts recognized for those instruments in the statement of condition. In addition, this FSP permits the offsetting of fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments. The adoption of FSP FIN No. 39-1 in January 2008 did not have a material impact on the Corporation s consolidated financial statements and disclosures. The Corporation s policy is not to offset the fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement nor to offset the fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments.
SFAS No. 141-R Statement of Financial Accounting Standards No. 141(R), Business Combinations (a revision of SFAS No. 141)
SFAS No. 141(R), issued in December 2007, will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Corporation will account for business combinations under this statement include the following: the acquisition date will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date at fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS No. 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. The Corporation will be required to prospectively apply SFAS No. 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS No. 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes
in those amounts to be recorded in earnings. Management will be evaluating the effects that SFAS No. 141(R) will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented on the consolidated financial statements.

## Table of Contents

SFAS No. 160 Statement of Financial Accounting Standards No. 160, Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51
In December 2007, the FASB issued SFAS No. 160, which amends ARB No. 51, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 will require entities to classify noncontrolling interests as a component of stockholders equity on the consolidated financial statements and will require subsequent changes in ownership interests in a subsidiary to be accounted for as an equity transaction. Additionally, SFAS No. 160 will require entities to recognize a gain or loss upon the loss of control of a subsidiary and to remeasure any ownership interest retained at fair value on that date. This statement also requires expanded disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective on a prospective basis for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, except for the presentation and disclosure requirements, which are required to be applied retrospectively. Early adoption is not permitted. Management will be evaluating the effects, if any, that the adoption of this statement will have on its consolidated financial statements.

## SFAS No. 161 Disclosures about Derivative Instruments and Hedging Activities

In March 2008, the FASB issued SFAS No. 161, an amendment of SFAS No. 133. The standard requires enhanced disclosures about derivative instruments and hedged items that are accounted for under SFAS No. 133 and related interpretations. The standard will be effective for all of the Corporation sinterim and annual financial statements for periods beginning after November 15, 2008, with early adoption permitted. The standard expands the disclosure requirements for derivatives and hedged items and has no impact on how the Corporation accounts for these instruments. Management will be evaluating the enhanced disclosure requirements.
SFAS No. 162 The Hierarchy of Generally Accepted Accounting Principles"
SFAS No. 162, issued by the FASB in May 2008, identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This statement is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. Management does not expect SFAS No. 162 to have a material impact on the Corporation s consolidated financial statements. The Board does not expect that this statement will result in a change in current accounting practice. However, transition provisions have been provided in the unusual circumstance that the application of the provisions of this statement results in a change in accounting practice.
Staff Accounting Bulletin No. 109 (SAB 109 ) Written Loan Commitments Recorded at Fair Value through Earnings
On November 5, 2007, the SEC issued Staff SAB 109, which requires that the fair value of a written loan commitment that is marked-to-market through earnings should include the future cash flows related to the loan s servicing rights. However, the fair value measurement of a written loan commitment still must exclude the expected net cash flows related to internally developed intangible assets (such as customer relationship intangible assets). SAB 109 applies to two types of loan commitments: (1) written mortgage loan commitments for loans that will be held-for-sale when funded that are marked-to-market as derivatives under SFAS No. 133 (derivative loan commitments); and (2) other written loan commitments that are accounted for at fair value through earnings under SFAS No. 159 s fair-value election.
SAB 109 supersedes SAB 105, which applied only to derivative loan commitments and allowed the expected future cash flows related to the associated servicing of the loan to be recognized only after the servicing asset had been contractually separated from the underlying loan by sale or securitization of the loan with servicing retained. SAB 109 will be applied prospectively to derivative loan commitments issued or modified in fiscal quarters beginning after December 15,2007 . The implementation of SAB 109 did not have a material impact to the Corporation s consolidated financial statements, including disclosures.

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## Table of Contents

FASB Staff Position (FSP) FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions
The objective of FSP FAS 140-3, issued by the FASB in February 2008, is to provide implementation guidance on whether the security transfer and contemporaneous repurchase financing involving the transferred financial asset must be evaluated as one linked transaction or two separate de-linked transactions.
Current practice records the transfer as a sale and the repurchase agreement as a financing. The FSP FAS 140-3 requires the recognition of the transfer and the repurchase agreement as one linked transaction, unless all of the following criteria are met: (1) the initial transfer and the repurchase financing are not contractually contingent on one another; (2) the initial transferor has full recourse upon default, and the repurchase agreement sprice is fixed and not at fair value; (3) the financial asset is readily obtainable in the marketplace and the transfer and repurchase financing are executed at market rates; and (4) the maturity of the repurchase financing is before the maturity of the financial asset. The scope of this FSP is limited to transfers and subsequent repurchase financings that are entered into contemporaneously or in contemplation of one another.
FSP FAS 140-3 will be effective for the Corporation on January 1, 2009. Early adoption is prohibited. The Corporation will be evaluating the potential impact of adopting this FSP.
FASB Staff Position (FSP) FAS 142-3, Determination of the Useful Life of Intangible Assets
FSP FAS 142-3, issued by the FASB in April 2008, amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142 Goodwill and Other Intangible Assets . In developing these assumptions, an entity should consider its own historical experience in renewing or extending similar arrangements adjusted for entity specific factors or, in the absence of that experience, the assumptions that market participants would use about renewals or extensions adjusted for the entity specific factors.
FSP FAS 142-3 shall be applied prospectively to intangible assets acquired after the effective date. This FSP will be effective for the Corporation on January 1, 2009. Early adoption is prohibited. The Corporation will be evaluating the potential impact of adopting this FSP.
FSP No. FAS 133-1 and FIN 45-4 Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161
FSP FAS 133-1 and FIN 45-4 requires disclosures by sellers of credit derivatives and additional disclosures about the current status of the payment/performance risk of financial guarantees. FSP FAS 133-1 and FIN 45-4 are effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Accordingly, the Corporation will adopt the provisions of FSP FAS 133-1 and FIN 45-4 in the first quarter 2009. The Corporation does not expect the adoption of the provisions of FSP FAS 133-1 and FIN 45-4 to have any material impact on the Corporation s financial condition and results of operations.

## CRITICAL ACCOUNTING POLICIES / ESTIMATES

The accounting and reporting policies followed by the Corporation and its subsidiaries conform to generally accepted accounting principles in the United States of America and general practices within the financial services industry. Various elements of the Corporation s accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. These estimates are made under facts and circumstances at a point in time and changes in those facts and circumstances could produce actual results that differ from those estimates.
Management has discussed the development and selection of the critical accounting policies and estimates with the Corporation s Audit Committee. The Corporation has identified as critical accounting policies those related to securities classification and related values, loans and allowance for loan losses, retained interests on transfers of financial assets (valuations of residual interests and mortgage servicing rights), income taxes, goodwill and other intangible assets, and pension and postretirement benefit obligations. For a summary of the Corporation s previously identified critical accounting policies and estimates, refer to that particular section in the MD\&A included in Popular, Inc. s 2007 Financial Review and Supplementary Information to Stockholders, incorporated by reference in Popular, Inc. s Annual Report on Form 10-K for the year ended December 31, 2007 (the 2007 Annual Report ).

## Table of Contents

Also, refer to Note 1 to the consolidated financial statements included in the 2007 Annual Report for a summary of the Corporation s significant accounting policies.
Furthermore, commencing in the first quarter of 2008, management identified as critical accounting policies and estimates the Fair Value Measurement of Financial Instruments as a result of the adoption of SFAS No. 157 and SFAS No. 159.
As disclosed in the Corporation's 2007 Annual Report, management considers income taxes as a critical accounting estimate. Given the magnitude of the valuation allowance recorded on deferred tax assets as of September 30, 2008, this MD\&A includes a discussion of the Corporation's accounting policy with respect to this accounting aspect. Income taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ( SFAS No. 109 ). The Corporation records income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized based on the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, and attributable to operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which the temporary differences are expected to be recovered or paid. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period when the changes are enacted. SFAS No. 109 requires a reduction of the carrying amounts of deferred tax assets by a valuation allowance if, based on the available evidence, it is more likely than not (defined by SFAS No. 109 as a likelihood of more than 50 percent) that such assets will not be realized. Accordingly, the need to establish valuation allowances for deferred tax assets are assessed periodically by the Corporation based on the SFAS No. 109 more-likely-than-not realization threshold criterion. In the assessment for a valuation allowance, appropriate consideration is given to all positive and negative evidence related to the realization of the deferred tax assets. This assessment considers, among other matters, all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, the future taxable income exclusive of reversing temporary differences and carryforwards, taxable income in carryback years and tax-planning strategies. In making such assessments, significant weight is given to evidence that can be objectively verified.
The valuation of deferred tax assets requires judgment in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns and future profitability. Our accounting for deferred tax consequences represents our best estimate of those future events. Changes in our current estimates, due to unanticipated events or otherwise, could have a material impact on our financial condition and results of operations.

## Fair Value Measurement of Financial Instruments

Effective January 1, 2008, the Corporation is required to determine the fair market values of its financial instruments based on the fair value hierarchy established in SFAS No. 157, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.
The Corporation currently measures at fair value on a recurring basis its trading assets, available-for-sale securities, mortgage servicing rights and residual interests on a recurring basis. From time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as loans held-for-sale, loans held-for-investment and certain other assets. These nonrecurring fair value adjustments typically result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. Also, the Corporation carries certain loans and borrowings at fair value upon the adoption of SFAS No. 159. These loans and borrowings are part of the assets held-for-sale by PFH as of September 30, 2008 and are included in the categories of Assets / Liabilities from discontinued operations in the consolidated statement of condition.
The Corporation categorizes its assets and liabilities measured at fair value under the three-level hierarchy as required by SFAS No. 157. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for fair value measurement are observable or unobservable. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect the Corporation s estimates about assumptions that market participants would use in pricing the asset or liability based on the best information available. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

## Table of Contents

Level 1- Unadjusted quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date. Valuation on these instruments does not necessitate a significant degree of judgment since valuations are based on quoted prices that are readily available in an active market.

Level 2- Quoted prices other than those included in Level 1 that are observable either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or that can be corroborated by observable market data for substantially the full term of the financial instrument.

Level 3- Valuations include unobservable inputs that are supported by little or no market activity and that are significant to the fair value measurement of the financial asset or liability. The fair value is estimated using modeling techniques such as discounted cash flow analyses. These modeling techniques incorporate assessments regarding assumptions that market participants would use in pricing the asset or the liability, including assumptions about the risks inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset, and the risk of nonperformance. Assessments with respect to assumptions that market participants would make are inherently difficult to determine and use of different assumptions could result in material changes to these fair value measurements.
Refer to Note 13 to the consolidated financial statements for information on the Corporation s fair value measurement disclosures required by SFAS No. 157, including assets and liabilities categorized by the three levels of the hierarchy. As of September 30, 2008, approximately $\$ 7.8$ billion or $95 \%$ out of the $\$ 8.2$ billion of assets from continuing operations measured at fair value on a recurring basis used market-based or market-derived valuation inputs in their valuation methodology and, therefore, were classified as Level 1 or Level 2. Approximately $5 \%$ of the assets from continuing operations measured at fair value on a recurring basis were classified as Level 3 since their valuation methodology considered significant unobservable inputs. The assets from discontinued operations measured at fair value on a recurring basis amounting to $\$ 0.6$ billion were all classified as Level 3 in the hierarchy. Also, the bond certificates from discontinued operations measured at fair value were classified as Level 3 in the hierarchy. Additionally, the Corporation reported $\$ 796$ million of financial assets that were measured at fair value on a nonrecurring basis during the nine-month period ended September 30, 2008 that were still held as of such date and were all classified as Level 3 in the hierarchy.
The estimate of fair value reflects the Corporation s judgment regarding appropriate valuation methods and assumptions. The amount of judgment involved in estimating the fair value of a financial instrument is affected by a number of factors, such as type of instrument, the liquidity of the market for the instrument, and the contractual characteristics of the instrument.
In determining fair value, the Corporation maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available.
If listed prices or quotes are not available, the Corporation employs valuation models that primarily use market-based inputs including yield curves, interest rates, volatilities, and credit curves, among other considerations. When market observable data is not available, the valuation of financial instruments becomes more subjective and involves substantial judgment. The need to use unobservable inputs generally results from the lack of market liquidity for certain types of loans and securities, which results in diminished observability of both actual trades and assumptions that would otherwise be available to value these instruments. When fair values are estimated based on modeling techniques, such as discounted cash flow models, the Corporation considers assumptions such as interest rates, prepayment speeds, default rates, loss severity rates and discount rates. Valuation adjustments are limited to those necessary to ensure that the financial instrument $s$ fair value is adequately representative of the price that would be received or paid in the marketplace. These adjustments include, for example, amounts that reflect counterparty credit quality, the Corporation s creditworthiness, and constraints on liquidity.

## Table of Contents

As of September 30, 2008, the Corporation s portfolio of trading and investment securities available-for-sale amounted to $\$ 8.0$ billion and represented $98 \%$ of the Corporation s assets from continuing operations measured at fair value on a recurring basis. As of September 30, 2008, net unrealized gains on the trading portfolio approximated $\$ 11.8$ million, while for securities available-for-sale the unrealized net losses approximated $\$ 23.6$ million. Fair values for most of the Corporation s trading and investment securities are classified under the Level 2 category. Refer to Note 13 to the consolidated financial statements for more detailed information on the significant security types, hierarchy levels and general description of the particular valuation methodologies for trading and investment securities. Also, Note 6 provides a detail of the Corporation sinvestment securities available-for-sale, which represent a significant share of the financial assets measured at fair value as of September 30, 2008.
The fair value of a loan is impacted by the nature of the asset and the market liquidity and activity. When available, the Corporation uses observable market data, including recent closed market transactions, to value loans. When this data is unobservable, the Corporation uses valuation methodologies using current market interest rate data adjusted for factors such as credit risk. When appropriate, loans are valued using collateral values as a practical expedient. As previously indicated, the Corporation measured at fair value $\$ 584$ million in loans as of September 30, 2008 pursuant to the SFAS No. 159 election which were classified as part of Assets from discontinued operations . The loans measured at fair value pursuant to SFAS No. 159 were valued internally utilizing the pricing terms of the sales agreement with Goldman Sachs as the best available fair value indicator.
Mortgage servicing rights ( MSRs ), which amounted to $\$ 165$ million as of September 30, 2008 including $\$ 37$ million of MSRs from discontinued operations, do not trade in an active market with readily observable prices. MSRs for the banking operations are priced using a discounted cash flow model. The valuation model considers servicing fees, portfolio characteristics, prepayments assumptions, delinquency rates, late charges, other ancillary revenues, cost to service and other economic factors. Refer to the Critical Accounting Policies / Estimates section of the 2007 Annual Report for information on the valuation methodologies followed by the Corporation with respect to MSRs. Disclosure of the key economic assumptions used to measure MSRs and a sensitivity analysis to adverse changes to these assumptions is included in Note 8 to the consolidated financial statements. The MSRs related to PFH operations were valued as of September 30, 2008 by allocating a portion of the estimated fair value of the servicing related assets to be sold to Goldman Sachs, which was based on the price terms under the agreement. PFH s MSRs are included as part of
Assets from discontinued operations in the consolidated statement of condition.

## NET INTEREST INCOME

Net interest income is the Corporation s primary source of earnings. Tables B and C present the different components of the Corporation s net interest income from continuing operations, on a taxable equivalent basis, for the quarter and nine months ended September 30, 2008, compared with the same periods in 2007, segregated by major categories of interest earning assets and interest bearing liabilities.
The interest earning assets include the investment securities and loans that are exempt from income tax, principally in Puerto Rico. The main sources of tax-exempt interest income are investments in obligations of the U.S. Government, some U.S. Government agencies and sponsored entities of the Puerto Rico Commonwealth and its agencies, and assets held by the Corporation s international banking entities, which are tax exempt under Puerto Rico laws. To facilitate the comparison of all interest related to these assets, the interest income has been converted to a taxable equivalent basis, using the applicable statutory income tax rates at each respective quarter and nine-month period. The taxable equivalent computation considers the interest expense disallowance required by the Puerto Rico tax law.
Average outstanding securities balances are based upon amortized cost excluding any unrealized gains or losses on securities available-for-sale. Non-accrual loans have been included in the respective average loans and leases categories. Loan fees collected and costs incurred in the origination of loans are deferred and amortized over the term of the loan as an adjustment to interest yield. Interest income for quarter and nine months ended September 30, 2008 included favorable impacts of $\$ 3.5$ million and $\$ 13.0$ million, respectively, consisting principally of amortization of loan origination costs and fees, amortization of net premiums on loans purchased, and prepayment penalties and late payment charges. The favorable impact for the quarter and nine month period ended September 30, 2007 was $\$ 6.8$ million and $\$ 19.0$ million, respectively. The negative variance in this category was mainly influenced by a lower amount of origination fees, prepayment penalties and late fees.

## Table of Contents

TABLE B
Analysis of Levels \& Yields on a Taxable Equivalent Basis for Continuing Operations Quarter ended September 30,


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Note: The changes that are not due solely to volume or rate are allocated to volume and rate based on the proportion of the change in each category.

[^0]Includes interest<br>bearing demand<br>deposits<br>corresponding<br>to certain<br>government<br>entities in<br>Puerto Rico.

As shown in Table B, the decrease in average earning assets was mainly due to the Corporation s strategy of not reinvesting maturities of low yielding investments. Increases in both commercial loans and consumer loans partially offset the reduction in the investments category. Construction loans accounted for $54 \%$ of the increase in the commercial loans category. The performance of these loans will continue to challenge the Corporation in the current economic environment; however the performance of these loans is being closely monitored. The increase in the consumer loans category was mainly due to a higher balance of home equity lines of credit ( HELOCs ) from the E-LOAN subsidiary. E-LOAN discontinued the origination of these loans earlier this year as part of its restructuring plan. The Corporation s funding mix was also modified with a portion of borrowings being replaced by brokered

## Table of Contents

certificates of deposits and the Corporation increasing its long-term borrowings position in both BPPR and BPNA. Refer to the Financial Condition section of this MD\&A for further discussion of variance explanations.
The decrease in net interest income was mainly the result of the following factors:
The Federal Reserve ( FED ) lowered the federal funds target rate by 275 basis points from September 30, 2007 to September 30, 2008. The reduction in market rates impacted the yield of several of the Corporations earning assets during that period. These assets include; commercial and construction loans of which $63 \%$ have floating or adjustable rates; floating rate collateralized mortgage obligations, and HELOCs, as well as the origination of loans in a low interest rate environment.

Liquidity concerns during the second half of 2007 prompted the Corporation to enter into certain financing agreements which limited the expected benefit of reduced market rates in the overall cost of funds. The increase of $\$ 1.3$ billion in the quarterly average balance of brokered certificates of deposit, which carry a higher rate than short-term borrowings, impacted negatively the results for the third quarter of 2008.

The previously mentioned reduction in the yield of floating rate HELOCs as well as reductions made during 2007 in the uncollectible interest reserve for credit cards, which generated a positive impact in income during the third quarter of 2007, contributed to the reduction in yield of the consumer loan portfolio.
Favorable items impacting net interest income include a lower cost for borrowings and interest bearing deposits. The decreases in market rates impacted the variance in addition to reductions in the rates paid for certain non-maturity deposits.
As shown in Table C, net interest income on a taxable equivalent basis for the nine month period ended September 30, 2008 increased mainly due to a change in the mix of average earning assets. Low yielding investments matured while the loan portfolio continued its growth. The dynamics of this movement left earning assets in line with the third quarter of 2007 while the loan portfolio yield is over 200 basis points higher than the investments.

## Table of Contents

TABLE C
Analysis of Levels \& Yields on a Taxable Equivalent Basis for Continuing Operations Nine-month period ended September 30,


[^1]

Note: The changes that are not due solely to volume or rate are allocated to volume and rate based on the proportion of the change in each category.

* Includes
commercial construction loans.
Includes interest
bearing demand
deposits
corresponding
to certain
government
entities in


## PROVISION FOR LOAN LOSSES

The provision for loan losses in the continuing operations totaled $\$ 252.2$ million, or $148 \%$ of net charge-offs, for the quarter ended September 30, 2008, compared with $\$ 86.3$ million or $136 \%$, respectively, for the same quarter in 2007. The provision for loan losses for the quarter ended September 30, 2008, when compared with the same quarter in 2007, reflects higher net charge-offs by $\$ 107.1$ million, mainly in construction loans by $\$ 53.9$ million, consumer loans by $\$ 27.3$ million, commercial loans by $\$ 18.0$ million, and mortgage loans by $\$ 7.8$ million. Provision and net charge-offs information for prior periods was retrospectively adjusted to exclude discontinued operations from continuing operations for comparative purposes.

## Table of Contents

The current state of the economy and uncertainty in the private and public sectors has had an adverse effect on the credit quality of the Corporation s loan portfolios. The economic slowdown could cause those adverse effects to continue, as delinquency rates may increase in the short-term, until more sustainable economic growth resumes and property values stabilize.
The higher level of provision for the quarter ended September 30, 2008 was mainly attributable to the continuing deterioration in the commercial and construction loan portfolios due to current economic conditions and the slowdown in the United States housing sector. The allowance for loan losses for commercial and construction credits has increased, particularly the specific reserves for loans considered impaired. During the quarter ended September 30, 2008, the Corporation recorded $\$ 61.9$ million in specific reserves for loans classified as impaired under SFAS No. 114.
Further information on net charge-offs and non-performing assets is provided in the Credit Risk Management and Loan Quality section of this MD\&A.

## NON-INTEREST INCOME

Non-interest income from continuing operations totaled $\$ 187.9$ million for the quarter ended September 30, 2008, an increase of $6 \%$, compared with the same quarter in 2007. For the nine-month period ended September 30, 2008, non-interest income from continuing operations totaled $\$ 688.5$ million, an increase of $1 \%$ when compared to the same period of the previous year.
Refer to Table D for a breakdown of non-interest income by major categories for the quarters and nine months ended September 30, 2008 and 2007.

## TABLE D

## Non-Interest Income

| (In thousands) | Quarter ended September 30, |  |  | Nine months ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2008 | 2007 | \$ Variance | 2008 | 2007 |  | Variance |
| Service charges on deposit accounts | \$ 52,433 | \$ 49,704 | \$ 2,729 | \$155,319 | \$146,567 |  | 8,752 |
| Other service fees: |  |  |  |  |  |  |  |
| Credit card fees and discounts | 27,138 | 25,975 | 1,163 | 81,664 | 74,498 |  | 7,166 |
| Debit card fees | 28,170 | 16,228 | 11,942 | 79,880 | 49,184 |  | 30,696 |
| Processing fees | 13,044 | 11,674 | 1,370 | 38,587 | 35,463 |  | 3,124 |
| Insurance fees | 12,378 | 14,410 | $(2,032)$ | 38,254 | 40,624 |  | $(2,370)$ |
| Sale and administration of investment products | 6,890 | 8,043 | $(1,153)$ | 25,966 | 22,614 |  | 3,352 |
| Mortgage servicing fees, net of fair value |  |  |  |  |  |  |  |
| adjustments | $(1,407)$ | 4,706 | $(6,113)$ | 13,809 | 16,257 |  | $(2,448)$ |
| Trust fees | 2,906 | 2,880 | 26 | 9,038 | 7,806 |  | 1,232 |
| Other fees | 6,183 | 5,947 | 236 | 19,451 | 19,266 |  | 185 |
| Total other service fees | 95,302 | 89,863 | 5,439 | 306,649 | 265,712 |  | 40,937 |
| Net (loss) gain on sale and valuation adjustments of | $(9,132)$ | (776) | $(8,356)$ | 69,430 | 112,842 |  | $(43,412)$ |

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investment securities

Trading account profit
Gain on sale of loans and valuation adjustments on loans held-for-sale
Other operating income

6,669 9,23
$(2,570)$
38,547
29,765
8,782

Total non-interest
income

Major variance explanations in non-interest income for the quarter ended September 30, 2008, when compared to the same quarter of the previous year, were as follows:

An increase in other operating income mostly related to $\$ 21.1$ million in gains on the sale of a New York real estate property by the U.S. banking subsidiary during this quarter, which was partially offset by lower referral and escrow closing services income from E-LOAN due to the downsizing of its operations in 2008 and from lower revenues derived from investments accounted for under the equity method;

Other service fees for the quarter ended September 30, 2008, increased by $6 \%$ when compared to the same

## Table of Contents

quarter of the previous year. A detail of other service fees by category is shown in the Table D. There were higher debit card fees as a result of higher revenues from merchants due in part to a change in the pricing structure for transactions processed from a fixed charge per transaction to a variable rate based on the amount of the transaction, as well as higher surcharging income from the use of Popular s automated teller machine network, which were partially offset by unfavorable changes in the fair value of the servicing assets during this quarter;
These variances were partially offset by:
Higher net loss on sale and valuation adjustments of investment securities, which consisted of the following:

|  | Quarter ended September 30, |  |  | Nine months ended September 30, |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
|  | 2008 | 2007 | $\$$ Variance | 2008 | 2007 | $\$$ Variance |  |
| (In thousands) |  |  |  |  |  |  |  |
| Net gain (loss) on sale <br> of investment securities | $\$$ | 15 | $\$(776)$ | $\$ 791$ | $\$ 78,577$ | $\$ 120,443$ | $\$(41,866)$ |
| Valuation adjustments <br> of investment securities | $(9,147)$ |  | $(9,147)$ | $(9,147)$ | $(7,601)$ | $(1,546)$ |  |
| Total | $\$(9,132)$ | $\$(776)$ | $\$(8,356)$ | $\$ 69,430$ | $\$ 112,842$ | $\$(43,412)$ |  |

During the quarter ended September 30, 2008, the Corporation recorded other-than-temporary impairments on investment securities held by the corporate group of $\$ 9.1$ million, principally associated to equity investments in a U.S. financial institution.

Major variance explanations in non-interest income for the nine months ended September 30, 2008, when compared to the same period in 2007, were as follows:

Other service fees for the nine months ended September 30, 2008, increased by $15 \%$ when compared to the same period of the previous year. Refer to Table D for a detail of other service fees by major categories. Debit card fees were the principal driver of the increase in other service fees due to similar factors described in the quarterly results. Also, credit card fees increased due to higher merchant fees and credit card interchange fees due to higher merchant sales volume;

Trading account profits increased for the nine-month period ended September 30, 2008, which was principally related to a gross gain of approximately $\$ 8.8$ million on the sale of approximately $\$ 232$ million in principal balance of residential mortgage loans originated in Puerto Rico from BPPR s portfolio, which were securitized into Fannie Mae mortgage-backed securities and sold in the secondary markets in the second quarter of 2008.

Service charges on deposit accounts also increased primarily in BPPR due to higher account analysis fees in commercial accounts which price structure varies according to transaction volume, compensating deposit balances and earnings credit given to the customer which also varies with interest rates;

Other operating income increased by $\$ 4.9$ million. During the nine months ended September 30, 2008, the Corporation realized the $\$ 21.1$ million gain on the sale of the New York real estate property and also a $\$ 12.8$ million gain on the sale of six retail bank branches of BPNA in Houston, Texas to Prosperity Bank in January 2008. The impact of these two items was offset in part by lower revenues derived from investments accounted for under the equity method and lower other referral and escrow closing services income from E-LOAN due to the downsizing of its operations, among the principal factors.
The variances in those categories for the nine-month period were partially offset by:
Lower net gain on sale and valuation adjustments of investment securities by $\$ 43.4$ million. The decrease in the net gain on sale of investment securities for the nine-month period ended September 30, 2008, compared with the same period in 2007, was mostly related to $\$ 118.7$ million in realized gains on the sale of the Corporation s
interest in Telecomunicaciones de Puerto Rico, Inc. ( TELPRI ) during the first quarter of 2007. This was partially offset by $\$ 49.3$ million in realized gains due to the redemption by Visa of shares of common stock held by the Corporation during the first quarter of 2008 and by $\$ 28.3$ million in capital gains from sales of $\$ 2.4$ billion in U.S. agency securities during the second quarter of 2008 . The proceeds from the sale of securities in the second quarter of 2008 were reinvested primarily in U.S. agency securities, and to a lesser extent in mortgage-backed securities with a longer average duration.

## Table of Contents

Lower gain on sales of loans and unfavorable valuation adjustments on loans held-for-sale, which are broken down as follows:

|  | Quarter ended September 30, |  |  | Nine months ended September 30, |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | ---: |
| (In thousands) | 2008 | 2007 | $\$$ Variance | 2008 | 2007 | $\$$ Variance |  |
| Gain on sales of loans | $\$ 6,877$ | $\$ 10,227$ | $\$(3,350)$ | $\$ 25,923$ | $\$ 46,161$ | $\$(20,238)$ |  |
| Lower of cost or market <br> valuation adjustment on <br> loans held-for-sale | $(355)$ | $(3,252)$ | 2,897 | $(227)$ | $(5,937)$ | 5,710 |  |
| Total | $\$ 6,522$ | $\$ 6,975$ | $\$(453)$ | $\$ 25,696$ | $\$ 40,224$ | $\$(14,528)$ |  |

The decrease in gains on sales of loans for the nine months ended September 30, 2008, when compared to the same period of the previous year, was primarily related to lower origination volumes and lower yields at E-LOAN due to the weakness in the U.S. mainland mortgage and housing market and to the downsizing of E-LOAN s operations, partially offset by higher gain on the sales of Small Business Administration ( SBA ) loans by the U.S. banking subsidiary and higher gain on the sales of leases by the U.S. leasing subsidiary.

## OPERATING EXPENSES

Refer to Table E for a breakdown of operating expenses of the continuing operations by major categories.
TABLE E
Operating Expenses

| (In thousands) | Quarter ended September 30, |  |  |  | Nine months ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2008 | 2007 |  | Variance | 2008 | 2007 |  | Variance |
| Personnel costs | \$148,230 | \$145,273 | \$ | 2,957 | \$459,515 | \$457,774 | \$ | 1,741 |
| Net occupancy expenses | 26,510 | 27,083 |  | (573) | 81,218 | 76,185 |  | 5,033 |
| Equipment expenses | 26,305 | 28,324 |  | $(2,019)$ | 84,312 | 87,259 |  | $(2,947)$ |
| Other taxes | 13,301 | 12,766 |  | 535 | 39,905 | 35,644 |  | 4,261 |
| Professional fees | 31,780 | 29,498 |  | 2,282 | 88,964 | 87,689 |  | 1,275 |
| Communications | 12,574 | 15,115 |  | $(2,541)$ | 38,137 | 44,669 |  | $(6,532)$ |
| Business promotion | 16,216 | 27,479 |  | $(11,263)$ | 51,064 | 83,410 |  | $(32,346)$ |
| Printing and supplies | 3,269 | 3,760 |  | (491) | 10,763 | 11,536 |  | (773) |
| Other operating expenses | 40,764 | 27,429 |  | 13,335 | 113,722 | 81,176 |  | 32,546 |
| Amortization of intangibles | 3,966 | 2,234 |  | 1,732 | 8,948 | 8,030 |  | 918 |
| Total | \$322,915 | \$318,961 | \$ | 3,954 | \$976,548 | \$973,372 |  | 3,176 |

Personnel expenses rose by $2 \%$, compared with the same quarter of the previous year. The increase in personnel costs is primarily a result of annual salary revisions and lower deferred salaries as a result of lower volume of loan originations. Excluding PFH, FTEs were 10,744 as of September 30, 2008, a decrease of 503 from the same date in 2007. This reduction was mainly due to a reduction in E-LOAN s headcount as a result of the E-LOAN Restructuring Plan by 506 full-time equivalent employees ( FTEs ), when compared to September 30, 2007.
Professional fees for the quarter ended September 30, 2008 increased when compared to the same quarter of 2007 as a result of consulting and advisory services associated to the U.S. sale transactions and valuation services. This was

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partially offset by lower loan origination costs, such as appraisals and title recording fees, at E-LOAN, and temporary workforce services. For the quarter ended September 30, 2008, other operating expenses increased when compared to the same quarter of the previous year mainly due to higher FDIC insurance assessments, credit card interchange and processing costs, repossessed property expenses, and losses on disposition of assets, among others. There was also a higher amortization of intangibles for the quarter ended September 30, 2008 mostly due to fair value revisions to core deposit intangibles on the acquisition of the Citibank retail branches in Puerto Rico based on final analyses completed this quarter.
Partially offsetting these increases in quarterly results were reductions in business promotion, communication expenses, and equipment expenses. The reduction in business promotion for the quarter resulted principally from the downsizing of E-LOAN s operations and from cost control measures on marketing expenditures. The decrease in communication expenses for the quarter ended September 2008, compared with the same quarter in 2007, was

## Table of Contents

mainly due to lower telephone expenses, including savings derived from changes in telephone communication technology. Equipment expenses also decreased primarily associated with E-LOAN.
For the nine-month period ended September 30, 2008, operating expenses for the continuing operations increased less than $1 \%$ compared with the same period of the previous year. Similar factors as described for the quarterly results principally impacted the variances. In addition, net occupancy expenses increased by $7 \%$ for the nine-month period ended September 30, 2008, when compared to the same period of the previous year mainly due to higher electricity and rental expenses. Increases in other taxes for the nine months ended September 30, 2008, when compared to the same period of 2007, resulted from higher personal property taxes resulting from tax settlement from previous years in certain Puerto Rico municipalities.

## INCOME TAXES

Income tax expense from continuing operations amounted to $\$ 148.3$ million for the quarter ended September 30, 2008, compared with income tax expense of $\$ 23.1$ million for the same quarter of 2007. As previously indicated in the Overview section of this MD\&A, during the quarter ended September 30, 2008, the Corporation recorded a valuation allowance on deferred tax assets of the U.S. mainland operations of $\$ 360.4$ million. The recording of this valuation increased income tax expense by $\$ 189.2$ million on the continuing operations and $\$ 171.2$ million on the discontinued operations for the quarter and year-to-date periods ended September 30, 2008. The deferred tax assets and full valuation allowance pertains to the continuing operations for statement of condition purposes.
The components of the income tax expense (benefit) for the continuing operations for the quarter ended September 30, 2008 is as follows:

|  | Puerto Rico and other jurisdictions |  | U.S. jurisdiction |  | Consolidated |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Amount | $\%$ of pre-tax income | Amount | $\begin{gathered} \% \text { of } \\ \text { pre-tax } \\ \text { loss } \end{gathered}$ | Amount | $\%$ of pre-tax loss |
| Computed income tax at statutory rates | \$ 13,356 | 39\% | \$ $(33,989)$ | 35\% | \$ $(20,633)$ | 33\% |
| Benefits of net tax exempt interest income | $(14,811)$ | (43) | (929) | 1 | $(15,740)$ | 25 |
| Effect of income subject to preferential tax rate | 66 |  |  |  | 66 |  |
| Difference in tax rates due to multiple jurisdictions | 1,456 | 4 |  |  | 1,456 | (2) |
| Deferred tax valuation allowance |  |  | 189,232 | (195) | 189,232 | (301) |
| State taxes and others | (929) | (3) | $(5,144)$ | 5 | $(6,073)$ | 10 |
| Income tax expense (benefit) | \$ (862) | (3\%) | \$ 149,170 | (154\%) | \$148,308 | (235\%) |

Income tax expense for the continuing operations amounted to $\$ 152.5$ million for the nine-month period ended September 30, 2008, compared with $\$ 105.6$ million for the same period in 2007. The increase in income tax expense was primarily due to the impact on the recording of the valuation allowance previously indicated, partially offset by lower pre-tax earnings, and higher exempt interest income net of disallowance of expenses attributed to such exempt income.

The Corporation s deferred tax assets as of September 30, 2008 amounted to $\$ 1.0$ billion ( $\$ 663$ million, net of the valuation allowance) compared to $\$ 520$ million as of December 31, 2007. Note 21 to the consolidated financial statements provides the composition of the net deferred tax assets as of such dates. Of the deferred tax assets as of September 30, 2008, $\$ 322$ million are related to the Corporation s U.S. mainland operations (net of the valuation allowance) and $\$ 341$ million pertain to the Puerto Rico operations. Of the amount related to the U.S. operations, without considering the valuation allowance, $\$ 358$ million is attributable to net operating losses of such operations, which had an expiration term of up to 20 years. The Corporation assessed the realization of the deferred tax assets by weighting all available negative and positive evidence, including future profitability, taxable income on carryback years and tax planning strategies. This evaluation was made in accordance with SFAS No. 109 Accounting for Income Taxes ( SFAS No. 109 ) which requires the recognition of a valuation allowance for the deferred tax assets if it is more likely than not (a

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## Table of Contents

likelihood of more than $50 \%$ ) that some portion or all of the deferred tax asset will not be realized. The realization of the deferred tax assets is dependent upon the generation of enough taxable income before the end of the expiration period.
The Corporation s U.S. mainland operations are in a cumulative loss position for the three-year period ended September 30, 2008. For purposes of assessing the realizability of the deferred tax assets in the U.S. mainland, this cumulative taxable loss position is considered significant negative evidence and has caused us to conclude that the Corporation will not be able to fully realize the deferred tax assets in the future. However, management has also concluded that $\$ 322$ million of the U.S. deferred tax assets will be realized. In making this analysis, management evaluated the factors that contributed to these losses in order to assess whether these factors were temporary or indicative of a permanent decline in the earnings of the U.S. mainland operations. Based on the analysis performed, management determined that the cumulative loss position was caused primarily by a significant increase in credit losses in two of its main businesses due to the unprecedented current credit market conditions, losses related to the PFH discontinued business, and restructuring charges. In assessing the realizability of the deferred tax assets, management has considered all four sources of taxable income mentioned in SFAS No. 109 and described in the Critical Accounting Policies / Estimates section of this MD\&A, including its forecast of future taxable income, which includes assumptions about the unprecedented deterioration in the economy and in credit quality. The forecast includes cost reductions initiated in connection with the reorganization of the U.S. mainland operations and two tax-planning strategies. The two strategies considered in management s analysis include reducing the level of interest expense in the U.S. operations by transferring such debt to the Puerto Rico operations and the transfer of a profitable line of business to the U.S. mainland operations. Based on the analysis as of September 30, 2008, and the weight of the evidence available, management determined that the Corporation s U.S. operations will not generate sufficient taxable income in the foreseeable future to fully realize the deferred tax assets. Accordingly, management concluded that it is more likely than not that the Corporation will not be able to fully realize the benefit of these deferred tax assets and thus, a valuation allowance for $\$ 360.4$ million was recorded during the third quarter of 2008. Management will reassess the realizability of the deferred tax assets during the fourth quarter of the year. If future events differ from management s September 30, 2008 assessment, an additional or full valuation allowance may need to be established which would likely have a material adverse effect on the Corporation's results of operations, financial condition and capital position.
Refer to Note 21 to the consolidated financial statements for further information on the Corporation s income taxes. Also, you can refer to Item 1A. Risk Factors of this Form 10-Q for additional information.

## REPORTABLE SEGMENT RESULTS

The Corporation s reportable segments for managerial reporting purposes consist of Banco Popular de Puerto Rico, EVERTEC and Banco Popular North America. These reportable segments pertain only to the continuing operations of Popular, Inc. As previously indicated, the operations of PFH that were considered a reportable segment were discontinued in the third quarter of 2008. Also, a Corporate group has been defined to support the reportable segments. For managerial reporting purposes, the costs incurred by the corporate group are not allocated to the reportable segments. For a description of the Corporation s reportable segments, including additional financial information and the underlying management accounting process, refer to Note 25 to the consolidated financial statements. Financial information for interim periods prior to 2008 was restated to conform to the 2008 presentation. The Corporate group had a net loss of $\$ 138.0$ million in the third quarter of 2008, compared with a net loss of $\$ 7.9$ million in the same quarter of 2007. The Corporate group had net loss of $\$ 157.1$ million for the nine months ended September 30, 2008, compared with net income of $\$ 66.4$ million for the same period in 2007. The Corporate group's financial results for the quarter and nine months ended September 30, 2008 included an unfavorable impact to income taxes due to an allocation (for segment reporting purposes) of $\$ 116.3$ million of the $\$ 360.4$ million valuation allowance on the deferred tax assets of the U.S. mainland operations to Popular North America ( PNA ), holding company of the U.S. operations. PNA files a consolidated tax return. During the nine months ended September 30, 2007, the Corporate group realized net gains on the sale and valuation adjustment of investment securities approximating $\$ 107.3$ million, mainly due to gains on the sale of the Corporation s interest in TELPRI during the first quarter of 2007.

## Table of Contents

Highlights on the earnings results for the reportable segments are discussed below.

## Banco Popular de Puerto Rico

The Banco Popular de Puerto Rico reportable segment reported net income of $\$ 35.4$ million for the quarter ended September 30, 2008, a decrease of $\$ 44.8$ million, or $56 \%$, when compared with the same quarter in the previous year, primarily associated to an increase in the provision for loan losses. The main factors that contributed to the variance in results for the quarter ended September 30, 2008, when compared to the third quarter of 2007, included:
lower net interest income by $\$ 3.4$ million, or $1 \%$, primarily due to a lower rate environment in the latter part of 2007 and 2008. The lower market rates had a negative impact in the average yield of commercial and construction loans, as well as on the yield of floating rate collateralized mortgage obligations. In addition, the Corporation s strategy of not renewing low yielding investments contributed to a lower average balance in the investments category. Furthermore, the acquisition of brokered certificates of deposit during the latter part of 2007 prevented the Corporation s cost of funds from fully benefiting from the decreases in market rates. These unfavorable variances were partially offset by a reduction in the cost of non-maturity deposits as well as a lower cost of short-term borrowings.
higher provision for loan losses by $\$ 62.8$ million, or $95 \%$, primarily associated with the current economic conditions, including a recessionary cycle in Puerto Rico and deteriorating credit quality trends in the commercial and construction loan portfolios. During the quarter ended September 30, 2008, the Corporation recorded $\$ 32.7$ million in specific reserves for loans classified as impaired under SFAS No. 114 in the Puerto Rico operations. The ratio of allowance for loan losses to loans held-in-portfolio for the Banco Popular de Puerto Rico reportable segment was $3.00 \%$ as of September 30, 2008, compared with $2.22 \%$ as of September 30, 2007. The provision for loan losses represented $124 \%$ of net charge-offs for the third quarter of 2008, compared with $136 \%$ of net charge-offs in the same period of 2007. The annualized net charge-offs to average loans held-in-portfolio for the Banco Popular de Puerto Rico operations was $2.60 \%$ for the quarter ended September 30, 2008, compared with $1.23 \%$ in the same quarter of the previous year.
higher non-interest income by $\$ 3.8$ million, or $3 \%$, mainly due to a favorable variance in the caption of other service fees during the third quarter of 2008, principally related to increase fee income from debit cards and credit cards; partially offset by unfavorable adjustments in the value of servicing rights primarily due to higher prepayment speed assumption. Also, there were higher service charges on deposit accounts by $\$ 2.8$ million; partially offset by lower trading profits by $\$ 2.6$ million, principally related to the mortgage banking operations.
higher operating expenses by $\$ 14.2$ million, or $8 \%$, primarily associated with higher credit card interchange and processing costs, personnel costs, professional fees and amortization of intangibles, among others.
lower income taxes by $\$ 31.8$ million, due to an income tax benefit of $\$ 2.5$ million in the third quarter of 2008 compared to an income tax expense of $\$ 29.2$ million in the same quarter of the previous year. The variance was due to lower income before taxes and higher exempt interest income net of disallowance of expenses related to the exempt income.
Net income for the nine months ended September 30, 2008 totaled $\$ 226.7$ million, a decrease of $\$ 20.4$ million, or $8 \%$, compared with the same period in the previous year. These results reflected:
higher net interest income by $\$ 15.2$ million, or $2 \%$;
higher provision for loan losses by $\$ 162.6$ million, or $92 \%$;
higher non-interest income by $\$ 124.7$ million, or 35\%;
higher operating expenses by $\$ 45.7$ million, or $8 \%$; and
lower income tax expense by $\$ 48.1$ million, or $55 \%$.
Factors similar to those described in the quarterly variances above were the contributors to the variances in the nine-month periods. Also included in non-interest income for the nine months ended September 30, 2008 was the gain on redemption of Visa stock amounting to approximately $\$ 40.9$ million recognized in the first quarter of 2008, $\$ 28.3$ million in gains on the sale of $\$ 2.4$ billion in U.S. agency securities during the second quarter of 2008, and higher trading profits by $\$ 8.8$ million, principally due to the sale of mortgage-backed securities.

## Table of Contents

## EVERTEC

EVERTEC s net income for the quarter ended September 30, 2008 totaled $\$ 8.5$ million, an increase of $5 \%$ compared with the results of the same quarter in the previous year.
The principal factors that contributed to the variance in results for the quarter ended September 30, 2008, when compared with the third quarter of 2007, included:
higher non-interest income by $\$ 3.8$ million, or $6 \%$, primarily due to higher transaction processing fees mainly related to the automated teller machine ( ATM ) network and point-of-sale ( POS ) terminals, higher cash processing fees, information technology ( IT ) consulting services and business process outsourcing, among others.
higher operating expenses by $\$ 3.1$ million, or $6 \%$, primarily due to higher personnel, professional fees and other operating expenses; and
higher income tax expense by $\$ 0.2$ million or $6 \%$.
Net income for the nine months ended September 30, 2008 totaled $\$ 33.7$ million, an increase of $\$ 11.8$ million, or $54 \%$, compared to $\$ 21.9$ million for the same period in the previous year. These results reflected:
higher non-interest income by $\$ 19.9$ million, or $11 \%$. The results for the nine months ended September 30, 2008 included $\$ 7.6$ million in gains on the redemption of Visa stock held by ATH Costa Rica during the first quarter of 2008. Also, there were higher fees related to the volume of transactions processed in the ATM network and POS terminals, higher cash processing, item processing, payment processing, IT consulting services, and business process outsourcing.
higher operating expenses by $\$ 5.7$ million, or $4 \%$; and
higher income tax expense by $\$ 2.3$ million, or $20 \%$.

## Banco Popular North America

Banco Popular North America reported a net loss of $\$ 139.0$ million for the quarter ended September 30, 2008, compared to a net loss of $\$ 1.1$ million for the third quarter of 2007. The main factors that contributed to the quarterly variance in this reportable segment included:
lower net interest income by $\$ 4.6$ million, or 5\%;
higher provision for loan losses by $\$ 103.0$ million, primarily due to higher net charge-offs in the construction, mortgage, consumer and commercial loan portfolios. During the quarter ended September 30, 2008, the Corporation recorded $\$ 29.2$ million in specific reserves for commercial, construction and mortgage loans classified as impaired under SFAS No. 114 in the Banco Popular North America reportable segment. Furthermore, the consumer loan portfolio has been impacted by higher losses in home equity lines of credit and second lien mortgage loans, which similar to first mortgage loans, have been unfavorably impacted by the deterioration in the U.S. residential housing market. The increase in the provision for loan losses considers inherent losses in the portfolios evidenced by an increase in non-performing loans in this reportable segment by $\$ 211$ million, when compared to September 30, 2007. The ratio of allowance for loan losses to loans held-in-portfolio for the Banco Popular North America reportable segment was $2.37 \%$ as of September 30, 2008, compared with $0.97 \%$ as of September 30, 2007. The provision for loan losses represented $185 \%$ of net charge-offs for the third quarter of 2008, compared with $137 \%$ of net charge-offs in the same period of 2007. The annualized net charge-offs to average loans held-in-portfolio for the Banco Popular North America operations was $2.60 \%$ for the quarter ended September 30, 2008, compared with $0.62 \%$ in the same quarter of the previous year.
higher non-interest income by $\$ 16.5$ million, or $46 \%$, mainly due to gains of $\$ 21.1$ million on the sale of a real estate property;
lower operating expenses by $\$ 17.2$ million, or $15 \%$. E-LOAN s expenses were reduced by $\$ 20.2$ million principally in business promotion, personnel costs, professional fees, equipment expenses and net occupancy expenses. The reduction at E-LOAN was partially offset by higher personnel costs by $\$ 1.3$ million and other operating expenses at the banking subsidiary, including higher FDIC assessments.

## Table of Contents

income tax expense of $\$ 61.4$ million in the third quarter of 2008, compared with income tax benefit of $\$ 2.7$ million in the third quarter of 2007. Although the BPNA reportable segment had higher operating losses in the third quarter of 2008, the tax benefits were offset by the recording of a $\$ 94.5$ valuation allowance on deferred tax assets.
Net loss for the nine months ended September 30, 2008 totaled $\$ 175.3$ million, compared to net income of $\$ 22.8$ million for the same period in the previous year. These results reflected:
higher net interest income by $\$ 1.5$ million, or less than $1 \%$;
higher provision for loan losses by $\$ 220.5$ million;
lower non-interest income of $\$ 3.0$ million, or $2 \%$, mainly due to lower gain on sale of loans and valuation adjustments on loans held-for-sale by $\$ 27.1$ million primarily related to E-LOAN. This unfavorable variance was partially offset by the $\$ 12.8$ million gain on the sale of the Texas branches and $\$ 21.1$ million gain in the sale of real estate.
lower operating expenses by $\$ 46.9$ million, or $14 \%$; and
income tax expense of $\$ 33.4$ million for the nine months ended September 30, 2008, compared to income tax expense of $\$ 10.2$ million for the same period in the previous year.

## FINANCIAL CONDITION

Refer to the consolidated financial statements included in this report for the Corporation s consolidated statements of condition and to Table A for financial highlights on major line items of the statements of condition. At September 30, 2008, total assets were $\$ 40.4$ billion, which included $\$ 969$ million from the discontinued operations. Total assets at December 31, 2007 were $\$ 44.4$ billion and $\$ 47.3$ billion at September 30, 2007. Assets from discontinued operations consisted mostly loans and mortgage servicing related assets. Total liabilities for the discontinued operations were $\$ 180$ million, mostly in the form of secured borrowings.

## Investment securities

A breakdown of the Corporation s investment securities available-for-sale and held-to-maturity is provided in Table F . Notes 6 and 7 to the consolidated financial statements provide additional information by contractual maturity categories and unrealized gains / losses with respect to the Corporation s available-for-sale and held-to-maturity investment securities portfolio. The Corporation holds investment securities primarily for liquidity, yield enhancement and interest rate risk management. The portfolio primarily includes very liquid, high quality debt securities.
TABLE F
Breakdown of Investment Securities Available-for-Sale and Held-to-Maturity

| (In millions) | $\begin{gathered} \text { September } \\ 30, \\ 2008 \end{gathered}$ | $\begin{gathered} \text { December } \\ 31, \\ 2007 \end{gathered}$ | Variance | $\begin{gathered} \text { September } \\ 30, \\ 2007 \end{gathered}$ | Variance |
| :---: | :---: | :---: | :---: | :---: | :---: |
| U.S. Treasury securities | \$ 464.2 | \$ 471.1 | \$ (6.9) | \$ 475.8 | \$ (11.6) |
| Obligations of U.S. Government sponsored entities | 5,111.3 | 5,893.1 | (781.8) | 6,014.6 | (903.3) |
| Obligations of Puerto Rico, States and political subdivisions | 286.4 | 178.0 | 108.4 | 178.3 | 108.1 |
| Collateralized mortgage obligations | 1,553.1 | 1,396.8 | 156.3 | 1,469.7 | 83.4 |
| Mortgage-backed securities | 850.5 | 1,010.1 | (159.6) | 949.5 | (99.0) |
| Equity securities | 14.7 | 34.0 | (19.3) | 41.3 | (26.6) |
| Others | 8.4 | 16.5 | (8.1) | 28.6 | (20.2) |

The vast majority of these investment securities, or approximately $97 \%$, are rated the equivalent of AAA by the major rating agencies. The mortgage-backed securities ( MBS ) and collateralized mortgage obligations ( CMOs ) are investment grade securities, all of which are rated AAA by at least one of the three major rating agencies as of September 30, 2008. All MBS held by the Corporation and approximately $88 \%$ of the CMOs held as of September 30, 2008 are guaranteed by government sponsored entities.

## Table of Contents

The decline in the Corporation s available-for-sale and held-to-maturity investment portfolios from the end of the third quarter of 2007 and year-end 2007 to September 30, 2008 was mainly associated with maturities of securities.

## Loan portfolio

A breakdown of the Corporation s loan portfolio, the principal category of earning assets, at period-end, is presented in Table G.
TABLE G
Loans Ending Balances

| (In thousands) | $\begin{gathered} \text { September 30, } \\ 2008(2) \end{gathered}$ | $\begin{gathered} \text { December 31, } \\ 2007 \end{gathered}$ | Variance September 30, 2008 Vs. December 31, 2007 | $\begin{gathered} \text { September 30, } \\ 2007 \end{gathered}$ | Variance September 30, 2008 Vs. <br> September 30, 2007 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Loans held-in-portfolio, net of unearned: |  |  |  |  |  |
| Commercial | \$13,832,344 | \$13,661,643 | \$ 170,701 | \$13,706,245 | \$ 126,099 |
| Construction | 2,134,250 | 1,941,372 | 192,878 | 1,757,589 | 376,661 |
| Lease financing | 1,124,021 | 1,097,803 | 26,218 | 1,156,773 | $(32,752)$ |
| Mortgage (1) | 4,487,501 | 6,071,374 | $(1,583,873)$ | 10,480,501 | $(5,993,000)$ |
| Consumer | 4,757,919 | 5,249,264 | $(491,345)$ | 5,796,393 | $(1,038,474)$ |
| Total loans held-in-portfolio | \$26,336,035 | \$28,021,456 | \$ $(1,685,421)$ | \$32,897,501 | \$ $(6,561,466)$ |
| Loans held-for-sale measured at lower of cost or market: |  |  |  |  |  |
| Commercial | \$ 24,920 | \$ 24,148 | \$ 772 | \$ 63,228 | \$ $(38,308)$ |
| Lease financing |  | 66,636 | $(66,636)$ |  |  |
| Mortgage | 220,214 | 1,363,426 | $(1,143,212)$ | 360,075 | $(139,861)$ |
| Consumer |  | 435,336 | $(435,336)$ |  |  |
| Total loans held-for-sale measured at lower of cost or market | \$ 245,134 | \$ 1,889,546 | \$ $(1,644,412)$ | \$ 423,303 | \$ $(178,169)$ |

(1) Includes residential construction.
(2) Loans from discontinued operations for the period ended September 30,

2008 are
presented as
part of Assets
from
discontinued
operations in the
consolidated
statement of
condition. Refer
to Note 3 to the consolidated
financial
statements for
further
information.
The growth in the commercial and construction loan portfolio was principally attained at the BPPR and BPNA segments. The growth in the construction loan portfolio included loans to builders and developers of residential real estate and other commercial property.
The reduction in mortgage loans held-in-portfolio from December 31, 2007 to September 30, 2008 was primarily due to the discontinued operations of PFH. As of December 31, 2007 the PFH reportable segment had $\$ 1.4$ billion in mortgage loans held-in-portfolio. Also, the decrease was due to the securitization into FNMA mortgage-backed securities of approximately $\$ 307$ million ( UPB ) of residential mortgage loans by BPPR in the second quarter of 2008. As indicated previously in the Non-Interest Income section of this MD\&A, $\$ 232$ million of these MBS were sold in the secondary markets during the second quarter of 2008. The sale proceeds were reinvested in U.S. agency securities. The objective of the sale was to reduce the Corporation s level of mortgage loans retained in portfolio and enhance its return on risk-weighted capital. The decrease in mortgage loans held-for-sale was associated to the origination and pooling of loans by E-LOAN and the mortgage banking subsidiary in the Puerto Rico operations. The reduction in mortgage loans held-in-portfolio from September 30, 2007 to the same date in 2008 was influenced by similar factors coupled with the impact of the recharacterization transaction completed by PFH in December 2007 which, at that time, resulted in a reduction of approximately $\$ 3.2$ billion in loans. The PFH reportable segment held $\$ 5.9$ billion in mortgage loans held-in-portfolio at September 30, 2007.
The decrease in consumer loans held-in-portfolio from December 31, 2007 to September 30, 2008 was mainly due to the impact of the reclassification of PFH s discontinued operations as well as the sales of auto loan portfolios by E-LOAN during June 2008 and lower volume of personal loans in Banco Popular de Puerto Rico operations. The PFH reportable segment held consumer loans held-in-portfolio amounting to $\$ 242$ million at December 31, 2007 and $\$ 1.0$ billion at September 30, 2007.

## Table of Contents

The reduction in mortgage and consumer loans held-for-sale from the end of 2007 to September 30, 2008 was mainly due to the sale of $\$ 1.4$ billion of PFH s loans to American General on March 1, 2008. The decrease in the lease financing portfolio held-for-sale from December 31, 2007 to September 30, 2008 was principally due to the sale of approximately $\$ 66$ million of lease financings by Popular Equipment Finance, a subsidiary of BPNA, during the first quarter of 2008.

## Other assets

Table H provides a breakdown of the Other Assets caption presented in the consolidated statements of condition. The other assets related to the discontinued operations were disclosed separately.
TABLE H
Breakdown of Other Assets

(1) Other assets
from
discontinued
operations for the period ended
September 30,
2008 are
presented as
part of Assets
from
discontinued operations in the
consolidated
statement of condition. Refer
to Note 3 to the consolidated financial statements for further information on the discontinued operations. Deferred tax assets, net of the valuation allowance, for statement of condition purposes are included as part of continuing operations as of September 30, 2008.

Explanations for the principal variances in the continuing operations from December 31, 2007 and September 30, 2007 to September 30, 2008 were:

Increase in net deferred tax assets was mostly due the net operating losses of the U.S. operations recognized during the nine months ended September 30, 2008 and an increase related to timing differences in the recognition of the provision for loan losses under GAAP and actual net charge offs under the tax code, partially offset by the aforementioned recording of the valuation allowance on deferred tax assets of the U.S. operations. Refer to the Income Tax section of this MD\&A for further information and to Note 21 to the consolidated financial statements for a detail of deferred tax assets.

Securitization advances and related assets as of December 31, 2007 and September 30, 2007 pertained to the PFH reportable segment that was discontinued in 2008. Related balances outstanding as of September 30, 2008 are included as part of Assets from discontinued operations in the consolidated statement of condition. Other assets from the discontinued operations amounted to $\$ 282$ million at September 30, 2008, compared to $\$ 204$ million at December 31, 2007 and $\$ 108$ million at September 30, 2007. These other assets consisted principally of servicing advances. The increase in servicing advance requirements was primarily as a result of slower prepayment rates and higher delinquency levels. The Corporation, acting as a servicer in certain PFH securitization transactions, is required under certain servicing agreements to advance its own funds to meet contractual remittance requirements for investors, process foreclosures and pay property taxes and insurance premiums. Funds are also advanced to maintain and market real estate properties on behalf of investors. As the servicer, the Corporation is required to advance funds only to the extent that it believes the advances are recoverable. The advances have the highest standing in terms of repayment priority over payments made to bondholders of each securitization trust. The Corporation funds these advances from several internal and external funding sources. As of September 30, 2008, the servicing advances were held-for-sale and accounted at lower of cost or market value, with value indicators determined based on the price terms stipulated in the agreement with the prospective third-party buyer indicated in

## Table of Contents

Note 3 to the consolidated financial statements. As of December 31, 2007 and September 30, 2007, the servicing advances were accounted at cost and were deemed collectible in full.

## Deposits, borrowings and capital

The composition of the Corporation s financing to total assets at September 30, 2008 and December 31, 2007 is included in Table I as follows:
TABLE I
Financing to Total Assets

|  | $\begin{gathered} \text { September } \\ 30, \end{gathered}$ | December 31, | \% increase (decrease) from December 31, 2007 to September 30, 2008 | \% of total assets |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  | September 30, | December 31, |
| (Dollars in millions) | 2008 | 2007 |  | 2008 | 2007 |
| Non-interest bearing deposits | \$ 4,066 | \$ 4,511 | (9.9\%) | 10.0\% | 10.2\% |
| Interest-bearing core deposits | 15,978 | 15,553 | 2.7 | 39.6 | 35.0 |
| Other interest-bearing deposits | 7,868 | 8,271 | (4.9) | 19.5 | 18.6 |
| Federal funds and repurchase agreements | 3,730 | 5,437 | (31.4) | 9.2 | 12.2 |
| Other short-term borrowings | 507 | 1,502 | (66.2) | 1.3 | 3.4 |
| Notes payable | 4,242 | 4,621 | (8.2) | 10.5 | 10.4 |
| Others | 992 | 934 | 6.2 | 2.5 | 2.1 |
| Stockholders equity | 3,007 | 3,582 | (16.1) | 7.4 | 8.1 |

A breakdown of the Corporation s deposits at period-end is included in Table J.
TABLE J
Deposits Ending Balances

|  | September 30, | December 31, | Variance <br> September 30, <br> 2008 Vs. <br> December 31, <br> 2007 | September 30, | Variance <br> September 30, <br> 2008 V. |
| :--- | :---: | :---: | :---: | :---: | :---: |
| September 30, |  |  |  |  |  |
| (In thousands) | 2008 | 2007 |  |  |  |
| Demand deposits * | $\$ 4,731,724$ | $\$ 5,115,875$ | $\$(384,151)$ | $\$ 4,641,736$ | $\$$ |
| Savings, NOW and |  |  |  | 89,988 |  |
| money market deposits | $9,884,674$ | $9,804,605$ | 80,069 | $9,328,094$ | 556,580 |
| Time deposits | $13,294,999$ | $13,413,998$ | $(118,999)$ | $12,631,685$ | 663,314 |
| Total | $\$ 27,911,397$ | $\$ 28,334,478$ | $\$(423,081)$ | $\$ 26,601,515$ | $\$ 1,309,882$ |

* Includes interest and non-interest bearing demand deposits.

Brokered certificates of deposit totaled $\$ 3.1$ billion at September 30, 2008 and December 31, 2007, and represented $11 \%$ of total deposits. Brokered certificates of deposit amounted to $\$ 2.1$ billion at September 30, 2007, or $8 \%$ of total deposits. Brokered certificates of deposit, which are typically sold through an intermediary to small retail investors, provide access to longer-term funds that are available in the market area and provide the ability to raise additional funds without pressuring retail deposit pricing. One of the strategies followed by management in response to the unprecedented market disruptions during 2007 was the utilization of brokered certificates of deposit to replace uncommitted lines of credit. Management reduced partially the overall outstanding balance of brokered certificates of deposit during the quarter ended June 30, 2008 when brokered certificates of deposit totaled $\$ 2.1$ billion. This reduction was replaced with short-term borrowings. During the quarter ended September 30, 2008, the Corporation s banking subsidiary in Puerto Rico increased brokered certificates of deposit to further strengthen its level of on-hand liquidity amidst the recent financial industry developments of the third quarter.
The decrease in demand deposits from December 31, 2007 to September 30, 2008 was mostly related with commercial checking accounts. The decrease in time deposits from December 31, 2007 to September 30, 2008 was in part due to the sale of BPNA s Texas branches in early 2008, which had approximately $\$ 125$ million in deposits at the sale transaction date.
The increase in deposits from September 30, 2007 to the same date in 2008 was influenced principally by the higher volume of brokered certificates of deposit as well as deposits gathered through the acquisition of the

## Table of Contents

retail branches of Citibank in Puerto Rico, principally in savings accounts, partially offset by reductions in the Banco Popular North America reportable segment.
Core deposits have historically provided the Corporation with a sizable source of relatively stable and low-cost funds. For purposes of defining core deposits, the Corporation excludes brokered certificates of deposit with denominations under $\$ 100,000$. The Corporation s core deposits totaled $\$ 20.0$ billion, or $72 \%$ of total deposits, at September 30, 2008, compared to $\$ 20.1$ billion and $71 \%$ at December 31, 2007. Core deposits financed $56 \%$ of the Corporation s earning assets from continuing operations at September 30, 2008.
The distribution of certificates of deposit with denominations of $\$ 100$ thousand and over at September 30, 2008, including brokered certificates of deposit was as follows:
(In millions)
3 months or less
\$2,133,249
3 to 6 months 868,620
6 to 12 months 1,132,231
Over 12 months

The aggregate amount of overdrafts in demand deposit accounts that were reclassified to loans was $\$ 79$ million as of September 30, 2008, $\$ 144$ million as of December 31, 2007 and $\$ 135$ million as of September 30, 2007. At September 30, 2008, borrowed funds from continuing operations totaled $\$ 8.5$ billion. This figure excludes $\$ 166$ million in borrowings from the discontinued operations, which are included as part of Liabilities from discontinued operations in the consolidated statement of condition as of September 30, 2008. Borrowed funds amounted to $\$ 11.6$ billion at December 31, 2007 and $\$ 16.0$ billion at September 30, 2007. Refer to Note 14 to the consolidated financial statements for additional information on the Corporation s borrowings as of such dates. The decline in borrowings from December 31, 2007 to September 30, 2008 was principally impacted by the reduction in financing requirements due to the sale of the PFH loan portfolio to American General, primarily in the form of short-term debt. Also, the decrease was influenced by a general reduction in asset size given the maturities of investment securities not replaced and sales of loan portfolios, including the sale of manufactured housing loans by PFH in September 2008 and auto loans by E-LOAN during 2008.
The decrease in borrowings from September 30, 2007 to the same date in 2008 was also influenced by the PFH recharacterization transaction effected in December 31, 2007, which reduced securitized debt in the form of bond certificates to investors by approximately $\$ 3.1$ billion.
Stockholders equity totaled $\$ 3.0$ billion at September 30, 2008, compared with $\$ 3.6$ billion at December 31, 2007 and $\$ 3.8$ billion at September 30, 2007. Stockholders equity decreased $\$ 574$ million from the end of 2007 to September 30, 2008 as a result of the reduction in retained earnings due to the net loss of $\$ 541.0$ million recorded in the nine-month period ended September 30, 2008 and the $\$ 262$ million negative after-tax adjustment to beginning retained earnings due to the transitional adjustment for electing the fair value option, partially offset by the $\$ 400$ million preferred stock offering during 2008. Similar factors influenced the reduction in stockholders equity from September 30, 2007.
Refer to the consolidated statements of condition and of stockholders equity included in this Form 10-Q for information on the composition of stockholders equity at September 30, 2008, December 31, 2007 and September 30, 2007. Also, the disclosures of accumulated other comprehensive income (loss), an integral component of stockholders equity, are included in the consolidated statements of comprehensive income (loss).
Refer to the Liquidity section of this MD\&A for further information of the Corporation s funding sources and liquidity position.
The average tangible equity amounted to $\$ 2.7$ billion for the period ended September 30, 2008, compared to $\$ 3.1$ billion at December 31, 2007 and September 30, 2007. Total tangible equity was $\$ 2.3$ billion at September 30,

## Table of Contents

compared to $\$ 2.9$ billion at December 31, 2007 and $\$ 3.0$ billion at September 30, 2007. The average tangible equity to average tangible assets ratio was $6.75 \%$ at September 30, 2008, 6.64\% at December 31, 2007, and 6.68\% at September 30, 2007. Tangible equity consists of total stockholders equity less goodwill and other intangibles. The Corporation continues to exceed the well-capitalized guidelines under the federal banking regulations. The regulatory capital ratios and amounts of total risk-based capital, Tier 1 risk-based capital and Tier 1 leverage at September 30, 2008, December 31, 2007, and September 30, 2007 are presented on Table K. As of such dates, BPPR, BPNA and Banco Popular, National Association were all well-capitalized.
TABLE K

## Capital Adequacy Data

| (Dollars in thousands) |  | $\begin{gathered} \text { September 30, } \\ 2008 \end{gathered}$ | December 31, 2007 | September 30, 2007 |
| :---: | :---: | :---: | :---: | :---: |
| Risk-based capital |  |  |  |  |
| Tier I capital |  | \$ 2,835,195 | \$ 3,361,132 | \$ 3,833,675 |
| Supplementary (Tier II) capital |  | 394,452 | 417,132 | 448,673 |
| Total capital |  | \$ 3,229,647 | \$ 3,778,264 | \$ 4,282,348 |
| Risk-weighted assets |  |  |  |  |
| Balance sheet items |  | \$28,203,551 | \$30,294,418 | \$32,849,909 |
| Off-balance sheet items |  | 2,990,003 | 2,915,345 | 2,890,083 |
| Total risk-weighted assets |  | \$31,193,554 | \$33,209,763 | \$35,739,992 |
| Average assets |  | \$39,557,133 | \$45,842,338 | \$46,129,283 |
| Ratios: |  |  |  |  |
| Tier I capital (minimum required | 4.00\%) | 9.09\% | 10.12\% | 10.73\% |
| Total capital (minimum required | 8.00\%) | 10.35 | 11.38 | 11.98 |
| Leverage ratio * |  | 7.17 | 7.33 | 8.31 |

* All banks are required to have a minimum Tier I leverage ratio of $3 \%$ or $4 \%$ of adjusted quarterly average assets, depending on the bank s classification.

As of September 30, 2008, the capital adequacy minimum requirement for Popular, Inc. was (in thousands): Total Capital of $\$ 2,495,484$, Tier I Capital of $\$ 1,247,742$, and Tier I Leverage of $\$ 1,186,714$ based on a $3 \%$ ratio or $\$ 1,582,285$ based on a $4 \%$ ratio according to the Bank s classification.

While the Corporation remains well-capitalized, its Tier I risk-based capital ratio decreased to $9.09 \%$ as of September 30,2008 from $10.50 \%$ as of June 30, 2008. As previously indicated, during the third quarter of 2008, Popular took a series of measures in an effort to improve liquidity and discontinue PFH operations. Specifically, the corporation sold PFH's portfolio of manufactured housing loans and, as described previously in this MD\&A, will divest most of PFH's remaining assets in the fourth quarter of 2008. The transactions and the associated losses have impacted Popular s capital position.
As of September 30, 2008, on a pro-forma basis after giving effect to the sale of PFH s loan and servicing assets described previously (completed on November 3, 2008), the Corporation s capital ratios are estimated as follows: Tier I capital ratio of approximately $9.43 \%$, total capital ratio of approximately $10.69 \%$, and leverage ratio of approximately $7.15 \%$.

## OFF-BALANCE SHEET FINANCING ENTITIES

The Corporation, through certain subsidiaries of the discontinued business of PFH, conducted a program of asset securitizations that involved the transfer of mortgage loans to a special purpose entity depositor, which in turn transferred those mortgage loans to different securitization trusts, thus isolating those loans from the Corporation s assets. The securitization trusts that constituted qualified special purpose entities ( QSPEs ) under the provisions of SFAS No. 140 and are associated with securitizations that qualified for sale accounting under SFAS No. 140 are not consolidated in the Corporation s financial statements. The investors in these off-balance sheet securitizations have no recourse to the Corporation s assets or revenues. The Corporation s creditors have no recourse to any assets or revenues of the special purpose entity depositor, or the securitization trust funds. As of September 30, 2008 and December 31, 2007, the Corporation had mortgage loans of approximately $\$ 4.8$ billion and $\$ 5.4$ billion, respectively, in securitization transactions that qualified for off-balance sheet treatment. These transactions had liabilities in the form of debt securities payable to investors from the assets inside each securitization trust of approximately $\$ 4.5$ billion and $\$ 5.1$ billion as of September 30, 2008 and December 31, 2007, respectively. The Corporation retained servicing responsibilities and certain subordinated interests in these securitizations in the form of residual interests. Their value is subject to credit, prepayment and interest rate risks on the transferred financial assets. The servicing rights and residual interests retained by the Corporation are recorded in the statement of condition as of September 30, 2008 at fair value and are held-for-sale as of such date. The servicing assets and residual interests are included in the line item Assets from discontinued operations in the consolidated statement of condition.

## Table of Contents

## CREDIT RISK MANAGEMENT AND LOAN QUALITY

The allowance for loan losses is management s estimate of credit losses inherent in the loans held-in-portfolio at the balance sheet date. Table L summarizes the detail of the changes in the allowance for loan losses, including charge-offs and recoveries by loan category for the quarters and nine months ended September 30, 2008 and 2007.
TABLE L
Allowance for Loan Losses and Selected Loan Losses Statistics

|  | Third Quarter |  |  |  | Nine months ended September 30, |  |  |  |
| :--- | ---: | :---: | :---: | ---: | ---: | ---: | ---: | :---: |
| (Dollars in thousands) | 2008 | 2007 | Variance | 2008 | 2007 | Variance |  |  |
| Balance at beginning of |  |  |  |  |  |  |  |  |
| period | $\$ 652,730$ | $\$ 564,847$ | $\$ 87,883$ | $\$ 548,832$ | $\$ 522,232$ | $\$ 26,600$ |  |  |
| Provision for loan losses | 252,160 | 86,340 | 165,820 | 602,561 | 219,477 | 383,084 |  |  |
|  | 904,890 | 651,187 | 253,703 | $1,151,393$ | 741,709 | 409,684 |  |  |


| Losses charged to the <br> allowance: |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial | 41,048 | 23,104 | 17,944 | 116,199 | 61,011 | 55,188 |
| Construction | 52,339 |  | 5,939 | 57,529 |  | 57,529 |
| Lease financing | 5,446 | 5,670 | $(224)$ | 16,440 | 18,278 | $(1,838)$ |
| Mortgage | 11,907 | 4,235 | 7,672 | 30,842 | 8,643 | 22,199 |
| Consumer | 71,861 | 44,414 | 27,447 | 188,715 | 124,633 | 64,082 |
|  |  |  |  |  |  |  |
|  | 182,601 | 77,423 | 105,178 | 409,725 | 212,565 | 197,160 |


| Recoveries: |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial | 4,507 | 4,517 | $(10)$ | 10,991 | 11,456 | $(465)$ |
| Construction |  | 1,547 | $(1,547)$ |  | 1,547 | $(1,547)$ |
| Lease financing | 1,200 | 1,503 | $(303)$ | 2,706 | 6,011 | $(3,305)$ |
| Mortgage | 98 | 261 | $(163)$ | 345 | 497 | $(152)$ |
| Consumer | 6,263 | 6,160 | 103 | 19,402 | 19,919 | $(517)$ |
|  | 12,068 | 13,988 | $(1,920)$ | 33,444 | 39,430 | $(5,986)$ |
|  |  |  |  |  |  |  |
| Net loans charged-off: |  |  |  |  |  |  |
| Commercial | 36,541 | 18,587 | 17,954 | 105,208 | 49,555 | 55,653 |
| Construction | 52,339 | $1,547)$ | 53,886 | 57,529 | $(1,547)$ | 59,076 |
| Lease financing | 4,246 | 4,167 | 79 | 13,734 | 12,267 | 1,467 |
| Mortgage | 11,809 | 3,974 | 7,835 | 30,497 | 8,146 | 22,351 |
| Consumer | 65,598 | 38,254 | 27,344 | 169,313 | 104,714 | 64,599 |
|  |  |  |  |  |  | 203,146 |

Write-downs related to loans transferred to loans
held-for-sale

Change in allowance for loan losses from discontinued operations (1)

Balance at end of period $\$ 726,480 \quad \$ 600,273 \quad \$ 126,207 \quad \$ 726,480 \quad \$ 600,273 \quad \$ 126,207$
Balance at end of
Ratios:
Net charge-offs to
Balance at end of
Ratios:
Net charge-offs to average loans held-in-portfolio Provision to net Provision to
charge-offs $(7,877) \quad 12,521$
$(20,398) \quad(45,015) \quad 31,699$
$(76,714)$

| $2.60 \%$ | $1.00 \%$ | $1.92 \%$ | $0.94 \%$ |
| :--- | :--- | :--- | :--- |
| 1.48 x | $1.36 x$ | 1.60 x | 1.27 x |

(1) A positive amount represents higher provision for losses recorded during the period compared to net charge-offs and vice versa for a negative amount.

## Table of Contents

Table M presents annualized net charge-offs to average loans held-in-portfolio for the quarters and nine months ended September 30, 2008 and 2007 by loan category.
TABLE M
Annualized Net Charge-offs to Average Loans Held-in-Portfolio

|  | Quarter ended September |  | Nine months ended September |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
|  | 2008 | 2007 | 2008 | 2007 |
|  |  |  |  |  |
|  | $1.06 \%$ | $0.56 \%$ | $1.03 \%$ | $0.50 \%$ |
| Commercial | 9.82 | $(0.37)$ | 3.76 | $(0.13)$ |
| Construction | 1.52 | 1.43 | 1.66 | 1.38 |
| Lease financing | 1.07 | 0.35 | 0.90 | 0.25 |
| Mortgage | 5.48 | 3.36 | 4.65 | 3.21 |
| Consumer |  |  |  |  |
|  | $2.60 \%$ | $1.00 \%$ | $1.92 \%$ | $0.94 \%$ |

The increase in commercial loans net charge-offs for the quarter ended September 30, 2008 compared to the same quarter in the previous year was mostly associated with continued deterioration in the economic conditions in Puerto Rico which is experiencing a recessionary cycle. Also, the U.S. mainland portfolio experienced deterioration as the U.S. economy is also facing economic challenges. Credit deterioration trends have been reflected across all industry sectors. The ratio of commercial loans net charge-offs to average commercial loans held-in-portfolio in the Banco Popular de Puerto Rico reportable segment was $1.55 \%$ for the quarter ended September 30, 2008, compared to $0.67 \%$ for the third quarter of 2007. Also, an increase was experienced in the Banco Popular North America reportable segment, which had a ratio of $0.44 \%$ for the third quarter of 2008 , compared with $0.40 \%$ for the same quarter in the previous year. Commercial net charge-offs recorded during the third quarter of 2008 were mainly related to credits with specific reserves under SFAS No. 114.
The increase in construction loans net charge-offs for the quarter ended September 30, 2008, compared to the same quarter in the previous year, was related to the Corporation s Puerto Rico and U.S. mainland operations. The construction loans charge-offs for the quarter ended September 30, 2008 included approximately $\$ 32$ million in a $\$ 51$ million syndicated commercial loan that was placed in non-performing status during the quarter ended March 31, 2008 and for which the Corporation established a specific reserve based on a third-party appraisal of value of the collateral less estimated cost to sell at that time. This syndicated commercial loan is collateralized by a marina, commercial real estate, and a high-end apartment complex in the U.S. Virgin Islands. A settlement was reached with the borrower of which $\$ 9.8$ million was collected by BPPR in September 2008. The Corporation also recorded net charge-offs of $\$ 20.5$ million during the quarter ended September 30, 2008 at BPNA. Management has identified construction loans considered impaired under SFAS No. 114 and established specific reserves based on the value of the collateral.
Mortgage loans net charge-offs as a percentage of average mortgage loans held-in-portfolio for the continuing operations increased primarily in the U.S. mainland operations. The Banco Popular North America reportable segment reported a ratio of mortgage loans net charge-offs to average mortgage loans held-in-portfolio of $2.50 \%$ for the third quarter of 2008 , compared with $0.96 \%$ for the same quarter in the previous year. Deteriorating economic conditions in the U.S. mainland housing market have impacted the mortgage industry delinquency rates. As a result of higher delinquency and net charge-offs, BPNA recorded a higher provision for loan losses in the first nine months of 2008 to cover for inherent losses in this portfolio. Refer to the Overview of Mortgage Loan Exposure section in this MD\&A for further information on the BPNA s mortgage loan portfolio. Mortgage loans net charge-offs in the Banco Popular de Puerto Rico reportable segment amounted to $\$ 1.0$ million for the third quarter of 2008, compared to net recoveries of $\$ 0.2$ million in the same quarter of the previous year. The slowdown in the housing sector in Puerto Rico has begun to put pressure on home prices and reduce sale activity. The ratio of mortgage loan net charge-offs to average

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mortgage loans held-in-portfolio in the Banco Popular de Puerto Rico reportable segment was $0.15 \%$ for the quarter ended September 30, 2008.
Consumer loans net charge-offs as a percentage of average consumer loans held-in-portfolio rose mostly due to higher delinquencies in the U.S. mainland and in Puerto Rico. Consumer loans net charge-offs in the BPNA reportable segment rose for the quarter ended September 30, 2008, when compared with the same quarter in the previous year, by $\$ 22.8$ million. The ratio of consumer loans net charge-offs to average consumer loans held-in-

## Table of Contents

portfolio in the Banco Popular North America reportable segment was 8.35\% for the quarter ended September 30, 2008, compared to $1.47 \%$ for the third quarter of 2007. This increase was principally related to home equity lines of credit and second lien mortgage loans which are categorized by the Corporation as consumer loans. A home equity line of credit is a loan secured by a primary residence or second home to the extent of the excess of fair market value over the debt outstanding for the first mortgage. The deterioration in the delinquency profile and the declines in property values have negatively impacted charge-offs. E-LOAN represented approximately $\$ 16.8$ million of that increase in the net charge-offs in consumer loans held-in- portfolio for the BPNA reportable segment. With the downsizing of E-LOAN in late 2007, this subsidiary ceased originating these types of loans. Consumer loans net charge-offs in the Banco Popular de Puerto Rico reportable segment rose for the quarter ended September 30, 2008, when compared with the same quarter in the previous year, by $\$ 4.5$ million. The ratio of consumer loans net charge-offs to average consumer loans held-in-portfolio in the Banco Popular de Puerto Rico reportable segment was $4.41 \%$ for the quarter ended September 30, 2008, compared to $4.06 \%$ for the same quarter of 2007. The increase in Puerto Rico was primarily in personal and auto loans.
Similar factors influenced the variances in net charge-offs for the nine-month period ended September 30, 2008 compared to the same period in 2007.

## NON-PERFORMING ASSETS

Non-performing assets include past-due loans that are no longer accruing interest, renegotiated loans and real estate property acquired through foreclosure. A summary, including certain credit quality metrics, is presented in Table N . For a summary of the Corporation s policy for placing loans on non-accrual status, refer to the sections of Loans and Allowance for Loan Losses in Note 1 to the audited consolidated financial statements included in Popular, Inc. s 2007 Annual Report.
TABLE N
Non-Performing Assets

|  | September | \$ Variance September |  |  |  |  |  | \$ Variance September |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | As a percentage | As a percentage of |  | 30, |  | As a | 30, |
|  |  |  |  |  | - 2008 |  | percentage | 2008 |
|  |  |  |  |  |  |  | of |  |
|  |  |  | loans |  |  |  | loans |  |
|  |  | of loans |  | HIP | Vs. |  | HIP | Vs. |
|  |  |  | December |  | December | September |  | September |
|  | 30, | HIP (1) | 31, | (1) | 31, | 30, | (1) | 30, |
|  |  | by |  | by |  |  | by |  |
| (Dollars in thousands) | 2008 (2) | category | 2007 | category | 2007 | 2007 | category | 2007 |
| Commercial | \$ 440,466 | 3.2\% | \$266,790 | 2.0\% | \$173,676 | \$ 259,930 | 1.9\% | \$ 180,536 |
| Construction | 235,241 | 11.0 | 95,229 | 4.9 | 140,012 | 68,323 | 3.9 | 166,918 |
| Lease financing | 12,736 | 1.1 | 10,182 | 0.9 | 2,554 | 12,954 | 1.1 | (218) |
| Mortgage | 281,914 | 6.3 | 349,381 | 5.8 | $(67,467)$ | 614,596 | 5.9 | $(332,682)$ |
| Consumer | 58,026 | 1.2 | 49,090 | 0.9 | 8,936 | 52,630 | 0.9 | 5,396 |
| Total non-performing |  |  |  |  |  |  |  |  |
| loans | 1,028,383 | 3.9\% | 770,672 | 2.8\% | 257,711 | 1,008,433 | 3.1\% | 19,950 |
| Other real estate | 72,605 |  | 81,410 |  | $(8,805)$ | 133,508 |  | $(60,903)$ |
| Total non-performing assets | \$1,100,988 |  | \$852,082 |  | \$248,906 | \$1,141,941 |  | \$ (40,953) |

Accruing loans past due 90 days or more
Non-performing assets
\$109,569
\$ 16,110 \$ 108,841
\$ 16,838
to total assets
Allowance for loan losses to loans held-in-portfolio
Allowance for loan
losses to
non-performing assets
Allowance for loan losses to non-performing loans
(1) $\mathrm{HIP}=$
held-in-portfolio
(2) Amounts as of September 30, 2008 exclude assets from discontinued operations. Non-performing loans and other real estate from discontinued operations amounted to $\$ 75$ million and $\$ 18$ million, respectively, as of September 30, 2008.
2.76
70.64
71.21
$2.73 \% \quad 1.92 \% \quad 2.42 \%$
1.82
1.96
1.92\%
52.57
64.41
59.53

## Table of Contents

The allowance for loan losses increased from December 31, 2007 to September 30, 2008 by $\$ 178$ million. The increase is mainly the result of additional reserves for specific commercial and construction loans considered impaired, as well as for certain troubled debt restructured mortgage loans, and higher reserves for Popular s U.S. mainland consumer loan portfolio (mainly home equity lines of credit).
During the quarter ended September 30, 2008, the Corporation recorded $\$ 61.9$ million in specific reserves for loans classified as impaired under SFAS No. 114. As of September 30, 2008, there were $\$ 753$ million of SFAS No. 114 impaired loans in the Corporation s continuing operations with a related specific allowance for loan losses of $\$ 131$ million, compared with impaired loans of $\$ 318$ million and a specific allowance of $\$ 56$ million as of September 30, 2007, including $\$ 23$ million of impaired loans from the PFH reportable segment as of the end of the third quarter of 2007. The allowance for loan losses for commercial and construction credits has been increased based on proactive identification of risk and thorough borrower analysis.
Historically, the Corporation s loss experience with real estate construction loans has been relatively low due the sufficiency of the underlying real estate collateral. In the current stressed housing market, the value of the collateral securing the loan has become one of the most important factors in determining the amount of loss incurred and the appropriate level of allowance for loan losses. Management has increased the allowance for loan losses for construction mainly through specific reserves for the loans considered impaired under SFAS No. 114. Non-performing commercial and construction loans increased from December 31, 2007 to September 30, 2008 primarily in the Banco Popular de Puerto Rico reportable segment by $\$ 245$ million and in the Banco Popular North America reportable segment by $\$ 84$ million.
The reduction in non-performing mortgage loans held-in-portfolio from December 31, 2007 to September 30, 2008 was associated in part to the reclassification of $\$ 65$ million in non-performing mortgage loans of PFH s reportable segment to Assets from discontinued operations in the consolidated statement of condition as of September 30, 2008. PFH reportable segment had $\$ 179$ million in non-performing mortgage loans as of December 31, 2007. This was offset in part by increases in non-performing mortgage loans in both the Banco Popular de Puerto Rico and Banco Popular North America reportable segments. Mortgage loans net charge-offs in the Puerto Rico operations for the nine months ended September 30, 2008 amounted to approximately $\$ 1.8$ million. Banco Popular de Puerto Rico reportable segment s mortgage loan portfolio averaged approximately $\$ 2.8$ billion for the nine months ended September 30, 2008. Mortgage loans net charge-offs in the Banco Popular North America reportable segment amounted to $\$ 28.7$ million for the nine months ended September 30, 2008, an increase of $\$ 21.5$ million compared to the results for the nine-month period ended September 30, 2007. This increase was related to the slowdown in the United States housing sector. The declines in residential real estate values, coupled with the reduced ability of certain homeowners to refinance or repay their residential real estate obligations, have led to higher delinquencies and losses in residential real estate loans.
Refer to the Overview of Mortgage Loan Exposure section later in this MD\&A for further information on BPNA s mortgage loan portfolio.
The increase in non-performing consumer loans as of September 30, 2008, when compared to December 31, 2007, was principally associated with the Banco Popular North America reportable segment. E-LOAN reported an increase of $\$ 14$ million. The increase in the U.S. mainland non-performing consumer loans is mainly attributed to the home equity lines of credit and second lien mortgage loans which are categorized by the Corporation as consumer loans. With the downsizing of E-LOAN in late 2007, this subsidiary ceased originating these types of loans. Other real estate, which represents real estate property acquired through foreclosure, increased by $\$ 9$ million from December 31, 2007 to September 30, 2008. This increase was principally due to an increase in the Banco Popular North America reportable segment by $\$ 18$ million. This increase was partially offset by $\$ 18$ million in other real estate pertaining to PFH s discontinued operations which are presented as part of Assets from discontinued operations as of September 30, 2008. At December 31, 2007, the PFH reportable segment had $\$ 32$ million in other real estate which is included as part of Table P. With the slowdown in the housing market, there is a continued economic deterioration in certain geographic areas, which also has a softening effect on the market for resale of repossessed real estate properties. Defaulted loans have increased, and these loans move through the default process

## Table of Contents

to the other real estate classification. The combination of increased flow of defaulted loans from the loan portfolio to other real estate owned and the slowing of the liquidation market has resulted in an increase in the number of units on hand.
Accruing loans past due 90 days or more are composed primarily of credit cards, FHA / VA and other insured mortgage loans, and delinquent mortgage loans included in the Corporation s financial statements pursuant to GNMA s buy-back option program. Under SFAS No. 140, servicers of loans underlying Ginnie Mae mortgage-backed securities must report as their own assets the defaulted loans that they have the option to purchase, even when they elect not to exercise that option. Also, accruing loans past due 90 days or more include residential conventional loans purchased from other financial institutions that, although delinquent, the Corporation has received timely payment from the sellers / servicers, and, in some instances, have partial guarantees under recourse agreements.
The allowance for loan losses, which represents management s estimate of credit losses inherent in the loan portfolio, is maintained at a sufficient level to provide for these estimated loan losses based on evaluations of inherent risks in the loan portfolios. The Corporation s management evaluates the adequacy of the allowance for loan losses on a monthly basis. In this evaluation, management considers current economic conditions and the resulting impact on Popular s loan portfolio, the composition of the portfolio by loan type and risk characteristics, historical loss experience, loss volatility, results of periodic credit reviews of individual loans, regulatory requirements and loan impairment measurement, among other factors. The increase in the Corporation sallowance level as of September 30, 2008 reflects the prevailing negative economic outlook, and specific reserves for commercial, construction and troubled debt restructured mortgage loans considered impaired under SFAS No. 114.
The Corporation s methodology to determine its allowance for loan losses is based on SFAS No. 114, Accounting by Creditors for Impairment of a Loan (as amended by SFAS No. 118) and SFAS No. 5, Accounting for Contingencies. Under SFAS No. 114, commercial and construction loans over a predetermined amount are identified for evaluation on an individual basis, and specific reserves are calculated based on impairment analyses. SFAS No. 5 provides for the recognition of a loss contingency for a group of homogeneous loans, which are not individually evaluated under SFAS No. 114, when it is probable that a loss has been incurred and the amount can be reasonably estimated. To determine the allowance for loan losses under SFAS No. 5, the Corporation uses historical net charge-offs and volatility experience segregated by loan type and legal entity. Refer to the 2007 Annual Report for additional information on the Corporation s methodology for assessing the adequacy of the allowance for loan losses. Under SFAS No. 114, the Corporation considers a commercial loan to be impaired when the loan amounts to $\$ 250,000$ or more and interest and / or principal is past due 90 days or more, or, when the loan amounts to $\$ 500,000$ or more and based on current information and events, management considers that the debtor will be unable to pay all amounts due according to the contractual terms of the loan agreement. Also, in the third quarter of 2008, the Corporation considered certain mortgage loans that had been negotiated under troubled debt restructurings for evaluation under SFAS No. 114.
The Corporation s recorded investment in impaired commercial loans and the related valuation allowance calculated under SFAS No. 114 as of September 30, 2008, December 31, 2007 and September 30, 2007 were:

|  | September 30, 2008 |  | December 31, 2007 |  | September 30, 2007 |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Recorded | Valuation | Recorded <br> Investment | Valuation <br> Allowance | Recorded <br> Investment | Valuation <br> Allowance | Investment | | Allowance |
| :---: |

With respect to the $\$ 258.9$ million portfolio of impaired commercial loans (including construction) for which no allowance for loan losses was required as of September 30, 2008, management followed SFAS No. 114 guidance. As prescribed by SFAS No. 114, when a loan is impaired, the measurement of the impairment may be based on: (1) the

## Table of Contents

present value of the expected future cash flows of the impaired loan discounted at the loan s original effective interest rate; (2) the observable market price of the impaired loan; or (3) the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. The $\$ 258.9$ million impaired commercial loans were collateral dependent loans in which management performed a detailed analysis based on the fair value of the collateral less estimated costs to sell and determined that the collateral was deemed adequate to cover any losses as of September 30, 2008.
Average impaired loans during the third quarter of 2008 and 2007 were $\$ 718$ million and $\$ 297$ million, respectively. The Corporation recognized interest income on impaired loans of $\$ 2.2$ million and $\$ 2.1$ million for the quarters ended September 30, 2008 and September 30, 2007 and $\$ 5.8$ million and $\$ 6.3$ million for the nine months ended on those same dates, respectively.
In addition to the non-performing loans included in Table N, there were $\$ 144$ million of loans as of September 30, 2008, which in management s opinion are currently subject to potential future classification as non-performing and are considered impaired under SFAS No. 114. As of December 31, 2007 and September 30, 2007, these potential problem loans approximated $\$ 50$ million and $\$ 65$ million, respectively.
Under standard industry practice, closed-end consumer loans are not customarily placed on non-accrual status prior to being charged-off. Excluding the closed-end consumer loans from non-accruing, adjusted non-performing assets would have been $\$ 1.0$ billion as of September 30, 2008, $\$ 803$ million as of December 31, 2007 and $\$ 1.1$ billion as of September 30, 2007.
Commitments to extend credit, which include credit card lines, commercial lines of credit, and other unused credit commitments, amounted to $\$ 7.3$ billion as of September 30, 2008. Commercial letters of credit and stand-by letters of credit amounted to $\$ 28$ million and $\$ 175$ million, respectively, as of September 30, 2008.
The Corporation maintains a reserve of approximately $\$ 10.7$ million for potential losses associated with unfunded loan commitments related to commercial and consumer lines of credit. The estimated reserve is principally based on the expected draws on these facilities using historical trends and the application of the corresponding reserve factors determined under the Corporation s allowance for loan losses methodology. This reserve for unfunded exposures remains separate and distinct from the allowance for loan losses and is reported as part of other liabilities in the consolidated statement of condition.

## Geographical and government risk

As explained in the 2007 Annual Report, the Corporation is exposed to geographical and government risk. The Corporation s assets and revenue composition by geographical area and by business segment reporting are presented in Note 25 to the consolidated financial statements.
As of September 30, 2008, the Corporation had $\$ 1$ billion of credit facilities granted to or guaranteed by the Puerto Rico Government and its political subdivisions, of which $\$ 215$ million are uncommitted lines of credit. Of these total credit facilities granted, $\$ 962$ million in loans were outstanding as of September 30, 2008. A substantial portion of the Corporation s credit exposure to the Government of Puerto Rico is either collateralized loans or obligations that have a specific source of income or revenues identified for their repayment. Some of these obligations consist of senior and subordinated loans to public corporations that obtain revenues from rates charged for services or products, such as water and electric power utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from the central Government. The Corporation also has 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 of its general obligation bonds and loans. 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 full faith and credit obligations of the municipalities have a first lien on the basic property taxes.
Furthermore, as of September 30, 2008, the Corporation had outstanding $\$ 286$ million in Obligations of Puerto Rico, States and Political Subdivisions as part of its investment portfolio. Refer to Notes 6 and 7 to the consolidated

## Table of Contents

financial statements for additional information. Of that total, $\$ 264$ million is exposed to the creditworthiness of the Puerto Rico Government and its municipalities. Of that portfolio, $\$ 48$ million are in the form of Puerto Rico Commonwealth Appropriation Bonds, which are currently rated Ba1, one notch below investment grade, by Moody s, while Standard \& Poor s Rating Services rates them as investment grade.

## Overview of Mortgage Loan Exposure

Given the instability in the residential housing sector, primarily in subprime mortgage loans, Table O provides information on the Corporation s mortgage loan exposure (for loans held-in-portfolio, and excluding loans held-for-sale measured at lower of cost or market and loans measured at fair value) as of September 30, 2008. Subprime mortgage loans refer to mortgage loans made to individuals with a FICO ${ }^{\circledR}$ score of 660 or below. FICO $^{\circledR}$ scores are used as an indicator of the probability of default for loans.
TABLE $O$
Mortgage Loans Exposure

|  | Subprime <br> loans |  |  |
| :--- | :---: | :---: | ---: |
| (In millions) | Prime loans | Total |  |
| Banco Popular de Puerto Rico | $\$ 1,016$ | $\$ 1,191$ | $\$ 2,207$ |
| Banco Popular North America: |  |  | 1,174 |
| - Banco Popular North America | 465 | 11 | 1,639 |
| - E-LOAN | 69 |  | 80 |
| Sub-total | $\$ 1,550$ | $\$ 2,376$ | $\$ 3,926$ |
| Others not classified as prime or subprime loans |  |  | 561 |
| Total |  |  | $\$ 4,487$ |

Mortgage loans held-in-portfolio that are considered subprime under the above definition for the Banco Popular de Puerto Rico reportable segment approximated $43 \%$ of its total mortgage loans held-in-portfolio as of September 30, 2008 and $42 \%$ as of December 31, 2007. The Corporation, however, believes that the particular characteristics of BPPR s subprime portfolio limit its exposure under current market conditions. BPPR s subprime loans are fixed-rate fully amortizing, full-documentation loans that do not have the level of layered risk associated with subprime loans offered by certain major U.S. mortgage loan originators. While deteriorating economic conditions have impacted the mortgage delinquency rates in Puerto Rico increasing the levels of non-accruing mortgage loans, BPPR has not to date experienced significant increases in losses. The annualized ratio of mortgage loans net charge-offs to average mortgage loans held-in-portfolio was $0.09 \%$ for the nine months ended September 30, 2008, compared with $0.04 \%$ for the year ended December 31, 2007.
BPNA s mortgage loans held-in-portfolio considered subprime under the above definition, excluding E-LOAN, approximated $72 \%$ of its total mortgage loans held-in-portfolio as of September 30, 2008, compared with $71 \%$ as of December 31, 2007. This portfolio has principally two products either 7/1 ARMs (fixed-rate interest until end of year seven in which interest rate begins to reset annually until maturity) or 30-year fixed-rate mortgages that do not have the level of layered risk associated with subprime loans offered by certain major U.S. mortgage loan originators. For example, BPNA s subprime mortgage loan portfolio has minimal California market exposure, loans are underwritten to the fully indexed rate, and there are no interest-only, piggybacks or option ARM loans (Refer to the Glossary included in the 2007 Annual Report for general descriptions of these loan types). Furthermore, the loans are $100 \%$ owner occupied. Also, the first interest rate reset on the 7/1 ARMs is not until 2012. Deteriorating economic conditions in the U.S. mainland housing market have impacted the mortgage industry delinquency rates. The non-accruing loans to loans held-in-portfolio ratio for BPNA s subprime mortgage loans was $6.27 \%$ as of September 30, 2008, compared with $3.67 \%$ as of December 31, 2007. The annualized ratio of mortgage loans net charge-offs to average mortgage loans held-in-portfolio for this subprime portfolio was $2.87 \%$ for the nine months ended September 30, 2008,
compared with $1.28 \%$ for the year ended December 31, 2007. As a result of higher delinquency and net charge-offs, BPNA recorded a higher provision for loan losses in the first nine months of 2008 to cover for inherent losses in this portfolio. The average loan-to-value ( LTV ) for BPNA s subprime mortgage loans held-in-portfolio as of September 30, 2008 was $86 \%$. Effective late December 2007, BPNA launched several initiatives designed to reduce the overall credit exposure in the portfolio that involve the purchase, by either the borrower or BPNA, of private mortgage insurance. BPNA will not originate subprime mortgage loans with a loan-to-value higher than $85 \%$ without private mortgage insurance. This insurance is a

## Table of Contents

financial guaranty in which an insurer assumes a portion of the lender s risk in making a mortgage loan, normally the top portion of the mortgage (i.e. the top $10 \%$ of a loan).

## Item 3. Quantitative and Qualitative Disclosures About Market Risk MARKET RISK

Market risk is the risk of loss arising from volatility in the fair value of financial instruments or other assets due to changes in interest rates, currency exchange rates, prices, market volatilities and liquidity. The financial results and capital levels of Popular, Inc. are constantly exposed to market risk.
Interest rate risk ( IRR ), a component of market risk, is the exposure to adverse changes in net interest income due to changes in interest rates, which can be affected by the shape and the slope of the yield curves to which the financial products of the Corporation are related. Management considers IRR a predominant market risk in terms of its potential impact on profitability or market value. IRR may occur for one or more reasons, such as the maturity or repricing of assets and liabilities at different times, changes in credit spreads, changes in short and long-term market interest rates, or the maturity of assets or liabilities may be shortened or lengthened as interest rates change. Depending on the duration and repricing characteristics of the Corporation s assets, liabilities and off-balance sheet items, changes in interest rates could either increase or decrease the level of net interest income. In addition, interest rates may have an indirect impact on loan demand, credit losses, loan origination volume, the value of the Corporation $s$ investment securities holdings, including residual interests, gains and losses on sales of securities and loans, the value of mortgage servicing rights, and other sources of earnings.
The techniques for measuring the potential impact of the Corporation s exposure to market risk from changing interest rates, which were described in the 2007 Annual Report, have remained substantially constant from the end of 2007. The Corporation maintains a formal asset and liability management process to quantify, monitor and control interest rate risk and to assist management in maintaining stability in the net interest margin under varying interest rate environments. Management employs a variety of measurement techniques including the use of an earnings simulation model to analyze the net interest income sensitivity to changing interest rates. Sensitivity analysis is calculated on a monthly basis using a simulation model which incorporates actual balance sheet figures detailed by maturity and interest yields or costs. It also incorporates assumptions on balance sheet growth and expected changes in its composition, estimated prepayments in accordance with projected interest rates, pricing and maturity expectations on new volumes and other non-interest related data. Simulations are processed using various interest rate scenarios to determine potential changes to the future earnings of the Corporation. The asset and liability management group also performs validation procedures on various assumptions used as part of the sensitivity analysis as well as validations of results on a monthly basis. Due to the importance of critical assumptions in measuring market risk, the risk models incorporate third-party developed data for critical assumptions such as prepayment speeds on mortgage-related products, estimates on the duration of the Corporation s deposits and interest rate scenarios.
Computations of the prospective effects of hypothetical interest rate changes are based on many assumptions, including relative levels of market interest rates, interest rate spreads, loan prepayments and deposit decay. Thus, they should not be relied upon as indicative of actual results. Furthermore, the computations do not contemplate actions that management could take to respond to changes in interest rates. By their nature, these forward-looking computations are only estimates and may be different from what actually may occur in the future.
Based on the results of the sensitivity analyses as of September 30, 2008, the Corporation s net interest income for the next twelve months is estimated to increase by $\$ 55.1$ million in a hypothetical 200 basis points rising rate scenario, and the change for the same period, utilizing a similar hypothetical decline in the rate scenario, is an estimated decrease of $\$ 51.1$ million. Both hypothetical rate scenarios consider the gradual change to be achieved during a twelve-month period from the prevailing rates as of September 30, 2008.

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## Table of Contents

The Corporation maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in net interest income or market value that are caused by interest rate volatility. The market value of these derivatives is subject to interest rate fluctuations and, as a result, could have a positive or negative effect in the Corporation s net interest income. Refer to Note 10 to the consolidated financial statements for further information on the Corporation $s$ derivative instruments.
The Corporation conducts business in certain Latin American markets through several of its processing and information technology services and products subsidiaries. Also, it holds interests in Consorcio de Tarjetas
Dominicanas, S.A. ( CONTADO ) and Centro Financiero BHD, S.A. ( BHD ) in the Dominican Republic. Although not significant, some of these businesses are conducted in the country s foreign currency. The resulting foreign currency translation adjustment, from operations for which the functional currency is other than the U.S. dollar, is reported in accumulated other comprehensive income (loss) in the consolidated statements of condition, except for highly-inflationary environments in which the effects are included in other operating income in the consolidated statements of operations. As of September 30, 2008, the Corporation had approximately $\$ 37$ million in an unfavorable foreign currency translation adjustment as part of accumulated other comprehensive loss, compared with an unfavorable adjustment of $\$ 35$ million as of December 31, 2007 and September 30, 2007.

## Recent Market Developments

The global and U.S. economies are experiencing a significant slowdown in business activity as a result of, among other factors, disruptions in the financial system in the past year and declines in home prices. Dramatic declines in the housing market during the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail.
Because of this crisis, the governments of major world economic powers, including the United States, have taken extraordinary steps to stabilize the financial system. For example, the U.S. Government has passed the EESA, which provides the U.S. Treasury Department the ability to purchase or insure troubled assets held by financial institutions. In addition, the Treasury Department has the ability to purchase equity stakes in financial institutions. Other extraordinary measures taken by U.S. governmental agencies include increasing deposit insurance limits, providing financing to money market mutual funds, and purchasing commercial paper. It is not clear at this time what impact these measures, as well as other extraordinary measures previously announced or announced in the future, will have on us or the financial markets as a whole. Management will continue to monitor the effects of these programs as they relate to the Corporation and its future operations. Refer to the Subsequent Events section of this MD\&A for additional information on the legislation.

## LIQUIDITY

For a financial institution, such as the Corporation, liquidity risk may arise whenever the institution cannot generate enough cash from either assets or liabilities to meet its obligations when they become due, without incurring material losses. Cash requirements for a financial institution are primarily made up of deposit withdrawals, contractual loan funding, the repayment of borrowings as they mature and the ability to fund new and existing investments as opportunities arise. An institution s liquidity may be pressured if, for example, its credit rating is downgraded, it experiences a sudden and unexpected substantial cash outflow, or some other event causes counterparties to avoid exposure to the institution. An institution is also exposed to liquidity risk if markets on which it depends are subject to loss of liquidity. The objective of effective liquidity management is to ensure that the Corporation remains sufficiently liquid to meet all of its financial obligations, finance expected future growth and maintain a reasonable safety margin for cash commitments under both normal operating conditions and under unpredictable circumstances of industry or market stress.
Liquidity is managed at the level of the holding companies that own the banking and non-banking subsidiaries. Also, it is managed at the level of the banking and non-banking subsidiaries.
As of September 30, 2008, the following events impacted the Corporation s funding activities and strategy from those described in the MD\&A included in Popular, Inc. s 2007 Annual Report for the year ended December 31, 2007:

## Table of Contents

n During the second quarter of 2008, the Corporation completed the public offering of $\$ 400$ million of $8.25 \%$ Non-cumulative Monthly Income Preferred Stock, Series B, which qualifies in its entirety as Tier I capital for risk-based capital ratios. Net proceeds were used for general corporate purposes, including funding subsidiaries and increasing Popular s liquidity and capital.
n During the third quarter and early fourth quarter of 2008, Popular, Inc. issued an aggregate principal amount of $\$ 350$ million of notes in private offerings to certain institutional investors. The notes mature in 2011 subject to specific provisions under the note indentures. Refer to the forms 8-K filed with the SEC on September 16, 2008 and October 1, 2008 for specific terms on the notes. The proceeds from the issuances, coupled with the proceeds from the sale of the PFH assets, will be used for general corporate purposes, including the repayment of medium-term notes due in 2009.
n There were reductions in short-term borrowings in the normal course of business related in part to lower volume of investment securities and loans, including reductions from the sales by PFH.
n Brokered certificates of deposit increased to $\$ 3.1$ billion as of September 30, 2008, compared to a reduced level of $\$ 2.1$ billion as of June 30, 2008. Brokered certificates of deposit at December 31, 2007 amounted to $\$ 3.1$ billion. Although management reduced reliance on brokered certificates of deposit during the second quarter of 2008 and financed the reduction with short-term borrowings, during the quarter ended September 30, 2008, the Corporation s banking subsidiary in Puerto Rico increased its use of brokered certificates of deposit to further strengthen its level of on-hand liquidity amidst the recent financial industry developments in the third quarter of 2008. This coincided with a substantial reduction in unsecured short-term borrowings.
n The Corporation repaid $\$ 500$ million in medium-term notes upon their maturity in April 2008.
n On August 28, 2008, the Corporation announced that its Board of Directors declared a quarterly cash dividend of $\$ 0.08$ cents per common share. The new dividend payment rate represents a reduction of 50 percent from its previous quarterly dividend payment rate. The reduction will help preserve $\$ 90$ million of capital a year. The dividend payment is reviewed on a quarterly basis.
n As indicated previously, in August 2008, the Corporation announced that it entered into an agreement with Goldman Sachs to sell a substantial amount of the assets remaining at PFH. The transaction closed on November 3, 2008 and provided over $\$ 700$ million in additional liquidity to the bank holding companies. The securities issuances described above, the reduction in the dividend payment as well as the sales of PFH assets substantially improves the Corporation s liquidity position. Management believes that the measures that have been taken will provide sufficient liquidity for the Corporation to meet the repayment of debt maturities during 2008 and 2009 and other operational needs.
The Corporation s core deposit base and various secured borrowing facilities provide additional liquidity. Other than as described above, there have been no significant changes in the Corporation s aggregate contractual obligations since the end of 2007.
Refer to Note 14 to the consolidated financial statements for the composition of the Corporation s borrowings as of September 30, 2008. Also, refer to Note 17 to the consolidated financial statements for the Corporation s involvement in certain commitments as of September 30, 2008.

## Liquidity, Funding and Capital Resources

Sources of liquidity include both the retail deposit base and that available with other third-party providers. The former include access to stable base of core deposits and those available in the national markets (brokered deposits). The latter include unsecured and secured credit lines and anticipated debt offerings in the capital markets. In addition to these, asset sales could be a source of liquidity to the Corporation. Even if some of these alternatives may not be available temporarily, it is expected that in the normal course of business, our funding sources are adequate.

The following sections provide further information on the Corporation s major funding activities and needs, as well as the risks involved in these activities. A more detailed description of the Corporation s borrowings, including its terms, is included in Note 14 to the consolidated financial statements. Also, the consolidated statements of cash

## Table of Contents

flows in the accompanying consolidated financial statements provide information on the Corporation s cash inflows and outflows.

## Banking Subsidiaries

Primary sources of funding for the Corporation s banking subsidiaries (BPPR, BPNA and BP,N.A., or the banking subsidiaries ) include retail and commercial deposits, purchased funds, institutional borrowings and, to a lesser extent, loan sales. The principal uses of funds for the banking subsidiaries include loan and investment portfolio growth, repayment of obligations as they become due, dividend payments to the holding company, and operational needs. In addition, the Corporation s banking subsidiaries maintain borrowing facilities with the Federal Home Loan Banks ( FHLB ) and at the discount window of the Federal Reserve Bank of New York ( FED ), and have a considerable amount of collateral that can be used to raise funds under these facilities. Borrowings from the FHLB or the FED discount window require the Corporation to post securities or whole loans as collateral. The banking subsidiaries must maintain their FHLB memberships to continue accessing this source of funding.
The Corporation s ability to compete successfully in the marketplace for deposits depends on various factors, including pricing, service, convenience and financial stability as reflected by operating results and credit ratings (by nationally recognized credit rating agencies). Although a downgrade in the credit rating of the Corporation may impact its ability to raise deposits or the rate it is required to pay on such deposits, management does not believe that the impact should be material. Deposits at all of the Corporation s banking subsidiaries are federally insured and this is expected to mitigate the effect of a downgrade in credit ratings.
The Corporation s banking subsidiaries have the ability to borrow funds from the FHLB at competitive prices. As of September 30, 2008, the banking subsidiaries had short-term and long-term credit facilities authorized with the FHLB aggregating $\$ 2.1$ billion based on assets pledged with the FHLB at that date, compared with $\$ 2.6$ billion as of December 31, 2007. Outstanding borrowings under these credit facilities totaled $\$ 1.4$ billion as of September 30, 2008, compared with $\$ 1.7$ billion as of December 31, 2007. Such advances are collateralized by securities and mortgage loans, do not have restrictive covenants and, in the most, part do not have any callable features. Refer to Note 14 to the consolidated financial statements for additional information.
As of September 30, 2008, the banking subsidiaries had a borrowing capacity at the FED discount window of approximately $\$ 3.3$ billion, of which $\$ 2.9$ billion remained unused as of that date. This compares to a borrowing capacity at the FED discount window of $\$ 3.0$ billion as of December 31, 2007, which was unused at that date. This facility is a collateralized source of credit that is highly reliable even under difficult market conditions. The amount available under this line is dependent upon the balance of loans and securities pledged as collateral.

## Bank Holding Companies

The principal sources of funding for the holding companies have included dividends received from its banking and non-banking subsidiaries, asset sales and proceeds from the issuance of medium-term notes, junior subordinated debentures and equity. Banking laws place certain restrictions on the amount of dividends a bank may make to its parent company. Such restrictions have not had, and are not expected to have, any material effect on the Corporation s ability to meet its cash obligations. The principal uses of these funds include the repayment of maturing debt, dividend payments to shareholders and subsidiary funding through capital or debt.
The Corporation s bank holding companies ( BHCs , Popular, Inc., Popular North America and Popular International Bank, Inc.) have borrowed in the money markets and the corporate debt market primarily to finance their non-banking subsidiaries.
The BHCs have additional sources of liquidity available, in the form of credit facilities available from affiliate banking subsidiaries and third-party providers, as well as dividends that can be paid by the subsidiaries and assets that could be sold or financed. Other potential sources of funding include the issuance of shares of common or preferred stock, or hybrid securities.
The principal source of income for the PIHC consists of dividends from BPPR. As members subject to the

## Table of Contents

regulations of the Federal Reserve System, BPPR and BPNA must obtain the approval of the Federal Reserve Board for any dividend if the total of all dividends declared by each entity during the calendar year would exceed the total of its net income for that year, as defined by the Federal Reserve Board, combined with its retained net income for the preceding two years, less any required transfers to surplus or to a fund for the retirement of any preferred stock. The payment of dividends by BPPR may also be affected by other regulatory requirements and policies, such as the maintenance of certain minimum capital levels. As of September 30, 2008, BPPR could have declared a dividend of approximately $\$ 92$ million without the approval of the Federal Reserve Board. As of September 30, 2008, BPNA was required to obtain the approval of the Federal Reserve Board to be able to declare a dividend. The Corporation has never received dividend payments from its U.S. subsidiaries. Refer to Popular, Inc. s Form 10-K for the year ended December 31, 2007 for further information on dividend restrictions imposed by regulatory requirements and policies on the payment of dividends by BPPR, BPNA and BP, N.A.

## Risks to Liquidity

The importance of the Puerto Rico market for the Corporation is an additional risk factor that could affect its financing activities. In the case of an extended economic slowdown in Puerto Rico, the credit quality of the Corporation could be affected and, as a result of higher credit costs, profitability may decrease. The substantial integration of Puerto Rico with the U.S. economy may mitigate the impact of a recession in Puerto Rico, but a U.S. recession, concurrently with a slowdown in Puerto Rico, may make a recovery in the local economic cycle more challenging.
Factors that the Corporation does not control, such as the economic outlook of its principal markets and regulatory changes, could affect its ability to obtain funding. In order to prepare for the possibility of such a scenario, management has adopted contingency plans for raising financing under stress scenarios when important sources of funds that are usually fully available, are temporarily unavailable. These plans call for using alternate funding mechanisms such as the pledging of certain asset classes and accessing secured credit lines and loan facilities put in place with the FHLB and the FED. The Corporation has a substantial amount of assets available for raising funds through these channels and is confident that it has adequate alternatives to rely on under a scenario where some primary funding sources are temporarily unavailable.
The BHCs have raised a considerable amount of liquidity in recent quarters through a combination of senior debt and preferred securities offerings, and asset sales, including the recent sale of PFH s assets. As a result of these transactions, management understands that the BHCs now have enough liquidity resources to meet all obligations due in 2009.
Maintaining adequate credit ratings on Popular s debt obligations is an important factor for liquidity because the credit ratings impact the Corporation s ability to borrow, the cost at which it can raise financing and access to funding sources. The credit ratings are based on the financial strength, credit quality and concentrations in the loan portfolio, the level and volatility of earnings, capital adequacy, the quality of management, the liquidity of the balance sheet, the availability of a significant base of core retail and commercial deposits, and the Corporation s ability to access a broad array of wholesale funding sources, among other factors. Changes in the credit rating of the Corporation or any of its subsidiaries to a level below investment grade may affect the Corporation s ability to raise funds in the capital markets. The Corporation s counterparties are sensitive to the risk of a rating downgrade. In the event of a downgrade, it may be expected that the cost of borrowing funds in the institutional market would increase. In addition, the ability of the Corporation to raise new funds or renew maturing debt may be more difficult.

## Table of Contents

Credit ratings are an important factor in accessing the credit markets. Even though the Corporation s senior debt ratings is currently several notches above the investment-grade threshold with each of the rating agencies, the possibility of ratings downgrades can affect our ability to raise unsecured financing at competitive rates. The Corporation and BPPR s debt ratings and outlook as of September 30, 2008 were as follows:

|  | Popular, Inc. |  |  | BPPR |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
|  | Short-term <br> debt | Long-term <br> debt | Outlook | debt | Short-term |
| debt |  |  |  |  |  |
| Leng-term |  |  |  |  |  |

Refer to the Corporation s Form 10-K for more detailed information on the ratings agencies perspective on Popular s outlook. Ratings and outlook have remained similar to those reported as of December 31, 2007, except for Moody s that changed their outlook to negative in May 2008 and S\&P that revised their outlook from stable to negative in October 2008. The recent S\&P outlook revision results from several factors, including reduced profitability, trends in credit quality, and lower capital ratios. At the same time, S\&P reaffirmed the listed counterparty credit ratings on Popular. The ratings above are subject to revisions or withdrawal at any time by the assigning rating agency. Each rating should be evaluated independently of any other rating.
Some of the Corporation s borrowings and deposits are subject to rating triggers , contractual provisions that accelerate the maturity of the underlying obligations in the case of a change in rating. Therefore, the need for the Corporation to raise funding in the marketplace could increase more than usual in the case of a rating downgrade. The amount of obligations subject to rating triggers that could accelerate the maturity of the underlying obligations was $\$ 313$ million as of September 30, 2008.

## Item 4. Controls and Procedures

## Disclosure Controls and Procedures

The Corporation s management, with the participation of the Corporation s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Corporation s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on such evaluation, the Corporation s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Corporation $s$ disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Corporation in the reports that it files or submits under the Exchange Act and such information is accumulated and communicated to management, as appropriate, to allow timely decisions regarding required disclosures.

## Internal Control Over Financial Reporting

There have been no changes in the Corporation s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended on September 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

## Part II Other Information

## Item 1. Legal Proceedings

The Corporation and its subsidiaries are defendants in various lawsuits arising in the ordinary course of business. Management believes, based on the opinion of legal counsel, that the aggregate liabilities, if any, arising from such actions will not have a material adverse effect on the financial position and results of operations of the Corporation.

## Table of Contents

## Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed under Part I Item 1A Risk Factors in our 2007 Form 10-K, as supplemented and updated by the discussion below. These factors could materially adversely affect our business, financial condition, liquidity, results of operations and capital position, and could cause our actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report. Also refer to the discussion in Part I Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations in this report for additional information that may supplement or update the discussion of risk factors in our 2007 Form 10-K.
The risks described in our 2007 Form $10-\mathrm{K}$ and in this report are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or results of operations

## Current levels of market volatility are unprecedented.

The capital and credit markets have been experiencing volatility and disruption for more than 12 months. In recent months, the volatility and disruption has reached unprecedented levels. The markets have produced downward pressure on stock prices and credit availability for certain issuers, often without regard to those issuers underlying financial strength. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

## Current market developments may adversely affect our industry, business and results of operations.

Dramatic declines in the housing market, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks, and also in sales of those assets at significantly discounted prices. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers including other financial institutions. The resulting lack of available credit, lack of confidence in the financial sector, increased volatility in the financial markets and reduced business activity could materially and adversely affect our business, financial condition and results of operations.

## The soundness of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due us. There is no assurance that any such losses would not materially and adversely affect our results of operations or earnings.

## There can be no assurance that the recently enacted Emergency Economic Stabilization Act of 2008 will help stabilize the U.S. financial system.

In response to the financial crises affecting the banking system and financial markets and the going concern threats to the ability of investment banks and other financial institutions, the U.S. Congress adopted the Emergency Economic Stabilization Act of 2008 ( EESA ), signed into law on October 3, 2008. The U.S. Treasury and banking regulators are implementing a number of programs under this legislation to address capital and liquidity issues in the banking system. There can be no assurance, however, as to the actual impact that EESA will have on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. If EESA and other measures are not effective in helping to stabilize the financial markets, a continuation or worsening

## Table of Contents

of current financial market conditions could result or could materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of our common stock.
The U.S. government splan to purchase large amounts of illiquid, mortgage-backed and other securities from financial institutions may not be effective and/or may not be available to us.
A primary feature of the EESA is the establishment of a troubled asset relief program ( TARP ).TARP gave the United States Treasury Department ( Treasury ) authority to deploy up to $\$ 750$ billion into the financial system with an objective of improving liquidity in capital markets. On October 24, 2008, Treasury announced plans to direct $\$ 250$ billion of this authority into preferred stock investments in certain qualifying financial institutions. The general terms of this preferred stock program are as follows for a participating financial institution:

Pay 5\% dividends on the Treasury s preferred stock for the first five years, and then $9 \%$ dividends thereafter,
Can not increase common stock dividends for three years while Treasury is an investor,
Can not redeem the Treasury preferred stock for three years unless the participating financial institution raises high-quality equity capital,

Must receive Treasury s consent to buy back their own stock,
Treasury receives warrants entitling Treasury to buy participating financial institution s common stock equal to $15 \%$ of Treasury s total investment in the participating financial institution, and
Participating bank executives must agree to certain compensation restrictions, and restrictions on the amount of executive compensation which is tax deductible.
The terms related to this Treasury preferred stock investment could reduce investment returns to participating financial institutions shareholders by restricting dividends to common shareholders, diluting existing shareholders interests, and restricting capital management practices.
The FDIC may increase premium assessments to maintain adequate funding of the Deposit Insurance Fund. The behavior of depositors in regard to the level of FDIC insurance could cause our existing customers to reduce the amount of deposits held at the Bank, and could cause new customers to open deposit accounts at the Bank.
The Federal Deposit Insurance Corporation ( FDIC ) insures deposits at FDIC insured financial institutions up to certain limits. The FDIC charges insured financial institutions premiums to maintain the Deposit Insurance Fund. Current economic conditions have increased expectations for bank failures, in which case the FDIC would take control of failed banks and ensure payment of deposits up to insured limits using the resources of the Deposit Insurance Fund. In such case, the FDIC may increase premium assessments to maintain adequate funding of the Deposit Insurance Fund.
The Emergency Economic Stabilization Act of 2008 included a provision for an increase in the amount of deposits insured by the FDIC to $\$ 250,000$. On October 14, 2008, the FDIC announced a new program the Temporary Liquidity Guarantee Program that provides unlimited deposit insurance on funds in noninterest-bearing transaction deposit accounts not otherwise covered by the existing deposit insurance limit of $\$ 250,000$. All eligible institutions will be covered under the program for the first 30 days without incurring any costs. After the initial period, participating institutions will be assessed a 10 basis point surcharge on the additional insured deposits.
The behavior of depositors in regard to the level of FDIC insurance could cause our existing customers to reduce the amount of deposits held at the BPPR, BPNA and BP, National Association (the Banks ), and could cause new customers to open deposit accounts at the Banks. The level and composition of the Banks deposit portfolios directly impacts the Banks funding costs and net interest margin.

## Weakness in the economy and in the real estate market in Puerto Rico has adversely impacted and may continue to adversely impact us.

A significant portion of our financial activities and credit exposure is concentrated in Puerto Rico (the Island ) and the Island s economy has been deteriorating.
This decline in the Island s economy has resulted in, among other things, a downturn in our loan originations, an

## Table of Contents

increase in the level of our non-performing assets and loan loss provisions, particularly in our construction loan portfolio, an increase in the rate of foreclosure loss on mortgage loans and a reduction in the value of our loans and loan servicing portfolio, all of which have adversely affected our profitability. If the decline in economic activity continues, there could be further adverse effects on our profitability.
The current state of the economy and uncertainty in the private and public sectors has had an adverse effect on the credit quality of our loan portfolios. The continuation of the economic slowdown could cause those adverse effects to continue, as delinquency rates may increase in the short-term, until more sustainable growth resumes. Also, a potential reduction in consumer spending may also impact growth in our other interest and non-interest revenue sources.
A prolonged economic slowdown, a continuing decline in the real estate market in the U.S. mainland, and ongoing disruptions in the capital markets have harmed and could continue to harm the results of operations of Popular, Inc.
The residential mortgage loan origination business has historically been cyclical, enjoying periods of strong growth and profitability followed by periods of shrinking volumes and industry-wide losses. Bust cycles in the housing sector affect our business by decreasing the volume of loans originated and increasing the level of credit losses related to its mortgage loans.
The housing market in the U.S. is undergoing a correction of historic proportions. After a period of several years of booming housing markets, fueled by liberal credit conditions and rapidly rising property values, since early 2007 the sector has been in the midst of a substantial dislocation. This dislocation has had a significant impact on some of our U.S-based business segments and has the potential to affect its ongoing financial results and condition. The general level of property values in the U.S., as measured by several indices widely followed by the market, has declined. These declines are the result of ongoing market adjustments that are aligning property values with income levels and home inventories. The supply of homes in the market has increased substantially, and additional property value decreases may be required to clear the overhang of excess inventory in the U.S. market. Declining property values could impact the credit quality of our U.S. mortgage loan portfolio because the value of the homes underlying the loans is a primary source of repayment in the event of foreclosure. It is possible that in the event of foreclosure in a loan from this portfolio, the current market value of the underlying collateral is insufficient to cover the loan amount owed.
Any sustained period of increased delinquencies, foreclosures or losses could harm our ability to sell loans, the prices we receive for loans sold, or the values of its mortgage loans held-for-sale. In addition, any material decline in real estate values would weaken our collateral loan-to-value ratios and increase the possibility of loss if a borrower defaults. In such event, we will be subject to the risk of loss on such mortgage assets arising from borrower defaults. A prolonged economic downturn or recession would likely result in an increase in delinquencies, defaults and foreclosures and in a reduction of the loan origination activity which would adversely affect our financial results. Many economists are predicting that a U.S. recession started in the second half of 2008.
A period of reduced economic growth or a recession has historically resulted in a reduction in lending activity and an increase in the rate of defaults in commercial loans, consumer loans and residential mortgages. A recession may have a significant adverse impact on the net interest income and fee income. We may also experience significant losses on the loan portfolio due to a higher level of defaults on commercial loans, consumer loans and residential mortgages.

## Financial results are constantly exposed to market risk.

Market risk refers to the probability of variations in the net interest income or the market value of assets and liabilities due to interest rate volatility. Despite the varied nature of market risks, the primary source of this risk to us is the impact of changes in interest rates on net interest income.
Net interest income is the difference between the revenue generated on earning assets and the interest cost of funding those assets. Depending on the duration and repricing characteristics of the assets, liabilities and off-balance sheet items, changes in interest rates could either increase or decrease the level of net interest income. For any given period, the pricing structure of the assets and liabilities is matched when an equal amount of such assets and

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## Table of Contents

liabilities mature or reprice in that period. Any mismatch of interest-earning assets and interest-bearing liabilities is known as a gap position. A positive gap denotes asset sensitivity, which means that an increase in interest rates could have a positive effect on net interest income, while a decrease in interest rates could have a negative effect on net interest income. As of September 30, 2008, the Corporation had a positive gap position.
The Board of Governors of the Federal Reserve, which influences interest rates, has changed interbank borrowing rates four times during the first nine months of 2008 by an aggregate 225 basis-point decrease. In October 2008, further rate decreases totaling 100 basis-points were announced. The Board of Governors of the Federal Reserve has also expressed concerns about a variety of economic conditions, as well as possible further reductions of interest rates in future periods. Many of the Corporation s commercial loans are variable-rate and, accordingly, rate decreases may result in lower interest income to Popular in the near term; however, depositors will continue to expect reasonable rates of interest on their accounts, potentially compressing net interest margins further. The future outlook on interest rates and their impact on Popular s interest income, interest expense and net interest income is uncertain.
Reductions in our credit ratings or those of any of our subsidiaries would increase the cost of borrowing funds and make our ability to raise new funds or renew maturing debt more difficult.
Credit ratings are an important component of our liquidity profile. Among other factors, credit ratings are based on the financial strength, the credit quality of and concentrations in our loan portfolio, the level and volatility of earnings, capital adequacy, the quality of management, the liquidity of our balance sheet, the availability of a significant base of core retail and commercial deposits, and the ability to access a broad array of wholesale funding sources. In December 2007, Moody s Investor Service ( Moody s ) downgraded by one notch to A3 the senior debt rating of Popular, Inc. and reduced the short-term rating to P-2 due to concerns about funding challenges at the bank holding company as well as the profitability of the U.S. business. The funding challenges were mitigated with the completion of the sale of certain PFH consumer and mortgage loans to American General Financial on March 1, 2008. On September 3, 2008, Moody s affirmed the ratings of Popular, Inc. and its subsidiaries. The bank holding company continues to be rated A3 for senior debt and the lead bank, Banco Popular de Puerto Rico, is rated C+ for bank financial strength and A2 for long-term deposits. The outlook is negative. The rating affirmation followed our announcement of a sale of the majority of the assets remaining at PFH to various affiliates of The Goldman Sachs Group, Inc.
Moody s outlook could return to stable if our 2009 holding company liquidity needs were fully resolved without any additional weakness in our capital position and/or our near-term earnings. On the other hand, a downgrade of our ratings would result if the bank holding company s liquidity does not strengthen as anticipated. In addition, further weakness in our capital position or earnings would be the source of negative rating pressure. The latter could arise from an inability to strengthen the profitability of our remaining U.S. mainland franchise or from unexpected deterioration in our core Puerto Rico business.
After the end of the third quarter of 2007, Fitch Ratings reduced the short-term credit rating of Popular, Inc. to F-2 from F-1 , and placed its long-term senior debt rating of A- on negative rating watch. Fitch Ratings mentioned that the rating actions reflected credit quality pressures from our sub-prime loan exposure as well as a more difficult environment for bank holding company funding. In both cases, Fitch Ratings maintained that it believes that both situations are challenging but manageable. In January 2008, Fitch Ratings announced that it was affirming our senior debt rating at A- as well as removing the rating from negative watch . The outlook was maintained negative . Management actions related to bank holding company liquidity were highlighted by the agency as underlying the removal of the watch , but U.S. business profitability concerns may keep the ratings outlook negative until these challenges are resolved.
On October 22, 2008, Standard \& Poor s Rating Services (S\&P ) revised its outlook on Popular Inc. to negative from stable. At the same time, S\&P affirmed Popular, Inc. s debt BBB+ for long-term debt and A-2 for short-term obligations. The outlook revision results from several factors, including reduced profitability, deterioration in credit quality, and lower capital ratios. S\&P is concerned about increased delinquency levels, notably in the mortgage and construction loan portfolios, as they see pressure on home prices and reduced sale activity. Furthermore, capital ratios declined in the third quarter, hurt by losses on asset sales and impairments on deferred tax assets. S\&P expects net earnings to remain under pressure in the near term amid a weak economic environment. S\&P

## Table of Contents

considers liquidity to be adequate. The ratings also reflect the bank s strong competitive position in Puerto Rico, its diversified loan portfolio, and adequate capital ratios.
Changes in our credit ratings or the credit ratings of any of our subsidiaries to a level below investment grade would adversely affect our ability to raise funds in the capital markets and adversely affect our cost of funds and related margins and liquidity. Our counterparties are also sensitive to the risk of a ratings downgrade.
Our ability to compete successfully in the marketplace for deposits depends on various factors, including service, convenience and financial stability as reflected by the operating results and credit ratings by nationally recognized credit agencies. Our ratings are subject to change at any time at the sole discretion of the rating agencies without previous notice. A downgrade in credit ratings may impact the ability to raise deposits, but we believe that the impact should not be material. Deposits at all of our banking subsidiaries are federally insured (subject to limitations established by the FDIC), which is expected to mitigate the effect of a downgrade in the credit ratings.
Our income tax provision and other tax liabilities may be insufficient if taxing authorities are successful in asserting tax positions that are contrary to our position. Additionally, continued loss from U.S. operations in future reporting periods may require us to adjust further the valuation allowance against our deferred tax assets.
From time to time, we are audited by various federal, state and local authorities regarding income tax matters. Significant judgment is required to determine our provision for income taxes and our liabilities for federal, state, local and other taxes. Our audits are in various stages of completion; however, no outcome for a particular audit can be determined with certainty prior to the conclusion of the audit, appeal and, in some cases, litigation process. Although we believe our approach to determining the appropriate tax treatment is supportable and in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, and FASB Interpretation No. 48,
Accounting for Uncertainty in Income Taxes, it is possible that the final tax authority will take a tax position that is materially different than that which is reflected in our income tax provision and other tax reserves. As each audit is conducted, adjustments, if any, are appropriately recorded in our Consolidated Financial Statements in the period determined. Such differences could have a material adverse effect on our income tax provision or benefit, or other tax reserves, in the reporting period in which such determination is made and, consequently, on our results of operations, financial position and/or cash flows for such period.
We evaluate our deferred tax assets for recoverability based on all available evidence. This process involves significant management judgment about assumptions that are subject to change from period to period based on changes in tax laws or variances between our future projected operating performance and our actual results. We are required to establish a valuation allowance for deferred tax assets if we determine, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. In determining the more-likely-than-not criterion, we evaluate all positive and negative evidence as of the end of each reporting period. Future adjustments, either increases or decreases, to our deferred tax asset valuation allowance will be determined based upon changes in the expected realization of our net deferred tax assets. The realization of our deferred tax assets ultimately depends on the existence of sufficient taxable income in either the carryback or carryforward periods under the tax law. During the third quarter of 2008, we recorded a valuation allowance of $\$ 360.4$ million related to our U.S. mainland operations. Due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we will be required to record further adjustments to the valuation allowance in future reporting periods. Such a charge could have a material adverse effect on our results of operations, financial condition and capital position.

## Our share price will fluctuate.

The market price of our common stock could be subject to significant fluctuations due to a change in sentiment in the market regarding our operations or business prospects. Risk factors may include the following:
operating results that may be worse than the expectations of management, securities analysts and investors; developments in our business or in the financial sector generally; regulatory changes affecting our industry generally or our business and operations; the operating and securities price performance of companies that investors consider to be comparable to us;

## Table of Contents

announcements of strategic developments, acquisitions and other material events by us or our competitors; changes in the credit, mortgage and real estate markets, including the markets for mortgage-related securities; and changes in global financial markets and global economies and general market conditions, such as interest or foreign exchange rates, stock, commodity, credit or asset valuations or volatility.
Stock markets, in general, and our common stock, in particular, have over the past year experienced, and continue to be experiencing, significant price and volume volatility and the market price of our common stock may continue to be subject to similar market fluctuations that may be unrelated to our operating performance or prospects. Increased volatility could result in a decline in the market price of our common stock.
You may not receive dividends on the common stock.
Holders of our common stock are only entitled to receive such dividends as our board of directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so, and we have reduced the amount of cash dividends payable on our common stock. Any reduction of, or the elimination of, our common stock dividend in the future could adversely affect the market price of our common stock.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds Issuer Purchases of Equity Securities

In April 2004, the Corporation s shareholders adopted the Popular, Inc. 2004 Omnibus Incentive Plan. The maximum number of shares of common stock issuable under this Plan is $10,000,000$.
The following table sets forth the details of purchases of Common Stock during the quarter ended September 30, 2008 under the 2004 Omnibus Incentive Plan.

Not in thousands

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs (a) |
| :---: | :---: | :---: | :---: | :---: |
| July 1 July 31 |  |  |  | 8,525,349 |
| August 1 August 31 | 5,468 | \$ 6.97 | 5,468 | 8,519,881 |
| September 1 September 30 |  |  |  | 8,519,881 |
| Total September 30, 2008 | 5,468 | \$ 6.97 | 5,468 | 8,519,881 |

(a) Includes shares forfeited.

## Item 5. Other Information

Mr. Roberto R. Herencia will retire as Executive Vice President of the Corporation and President of Banco Popular North America ( BPNA ), the Corporation s principal U.S.-based banking subsidiary, effective December 31, 2008. On November 6, 2008, the Board of Directors of the Corporation approved the principal terms of a Resignation and Transition Agreement (the Agreement ) with Mr. Herencia.
Pursuant to the terms of the Agreement, Mr. Herencia will receive a severance payment equal to $\$ 3,289,432$. Of this amount, $85 \%$ will be paid on November 12, 2008, with the remainder payable in a lump sum amount in early January 2009.

Under the terms of the Agreement, all restricted stock awards previously granted to Mr. Herencia will vest immediately upon resignation and all stock options exercisable as of December 31, 2008 will remain exercisable through the earlier of (1) the expiration date or (2) June 30, 2009, in the case of stock options issued under the

Corporation s 2001 Stock Option Plan or (3) March 31, 2009, for stock options issued under the Corporation s 2004 Omnibus Incentive Plan. With respect to performance share awards, Mr. Herencia will be entitled to a payment in the form of common stock of the applicable target award pro-rated for the period of time employed during the performance cycle. In addition, Mr. Herencia will receive continuation of certain medical benefits through December 31, 2009 as well as continued participation in BPNA s preferred mortgage loan interest rate program for employees. The Corporation estimates that the aggregate value of severance benefits payable to Mr. Herencia under the Agreement are equal to $\$ 3,568,878$ or 2.99 times his average annual compensation over the past five years. Mr. Herencia will receive these benefits in consideration for agreeing to certain covenants in the Agreement including non-solicitation, non-disparagement, cooperation and confidentiality covenants for the benefit of the Corporation, as well as general release of claims. Mr. Herencia will report to Richard Carrion, Chairman of the Board, President and CEO of the Corporation until the effective date of his resignation, at which time David H. Chafey, Jr., Senior Executive Vice President of the Corporation and President of Banco Popular de Puerto Rico, will also assume the position of President of BPNA. Mr. Chafey has not, as of the date of this report, been awarded any additional compensation for assuming this position.
The Agreement is attached as Exhibit 10.1 to this Quarterly Report on Form 10-Q.

## Item 6. Exhibits

Exhibit No. Exhibit Description
10.1 Resignation and Transition Agreement, dated as of November 6, 2008, between the Corporation, BPPR, BPNA and Roberto R. Herencia.
10.2 Asset Purchase Agreement by and among Goldman Sachs Mortgage Company, Goldman, Sachs \& Co., Litton Loan Servicing, LP and Popular Mortgage Servicing, Inc., Equity One, Inc., Equity One, Incorporated, Equity One Consumer Loan Company, Inc., E-LOAN Auto Fund Two, LLC, Popular Financial Services, LLC, Popular FS, LLC, and Popular, Inc. and Popular North America, Inc.*
12.1 Computation of the ratios of earnings to fixed charges and preferred stock dividends.
31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Confidential portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission under a confidential treatment request.


## Table of Contents

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

POPULAR, INC.
(Registrant)

Date: November 10, 2008

Date: November 10, 2008

By:/s/ Jorge A. Junquera
Jorge A. Junquera
Senior Executive Vice President \& Chief Financial Officer

By: /s/ Ileana González Quevedo

Ileana González Quevedo
Senior Vice President \& Corporate Comptroller


[^0]:    Includes commercial construction * loans.

[^1]:    Table of Contents

