

OFG BANCORP  
Form 10-Q  
November 04, 2016

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

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2016**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 001-12647**

**OFG Bancorp**

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

Principal Executive Offices:

254 Muñoz Rivera Avenue

San Juan, Puerto Rico 00918

Telephone Number: (787) 771-6800

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

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

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

Large Accelerated Filer Company	Accelerated Filer <input checked="" type="checkbox"/>	Non-Accelerated Filer (Do not check if a smaller reporting company)	Smaller Reporting Company
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
No

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

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

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## FORWARD-LOOKING STATEMENTS

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

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

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

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

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

**ITEM 1. FINANCIAL STATEMENTS**

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**OFG BANCORP**

**UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

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

**ASSETS**

**Cash and cash equivalents:**

Cash and due from banks

Money market investments

**Total cash and cash equivalents**

**Restricted cash**

**Investments:**

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

Investment securities available-for-sale, at fair value, with amortized cost of \$623,994 (December 31, 2015 - \$955,646)

Investment securities held-to-maturity, at amortized cost, with fair value of \$650,023 (December 31, 2015 - \$614,679)

Federal Home Loan Bank (FHLB) stock, at cost

Other investments

**Total investments**

**Loans:**

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

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

Loans, net of allowance for loan and lease losses of \$119,012 (December 31, 2015 - \$234,132)

**Total loans**

**Other assets:**

FDIC indemnification asset

Foreclosed real estate

Accrued interest receivable

Deferred tax asset, net

Premises and equipment, net

Customers' liability on acceptances

Servicing assets

Derivative assets

Goodwill

Other assets

**Total assets**

**LIABILITIES AND STOCKHOLDERS' EQUITY**

**Deposits:**

Demand deposits

Savings accounts

Time deposits

**Total deposits**

**Borrowings:**

Securities sold under agreements to repurchase

Advances from FHLB

Subordinated capital notes

Other borrowings



**Total borrowings**

**Other liabilities:**

Derivative liabilities

Acceptances executed and outstanding

Accrued expenses and other liabilities

**Total liabilities**

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

**Stockholders' equity:**

Preferred stock; 10,000,000 shares authorized;

1,340,000 shares of Series A, 1,380,000 shares of Series B, and 960,000 shares of Series D

issued and outstanding, (December 31, 2015 - 1,340,000 shares; 1,380,000 shares; and 960,000 shares)

\$25 liquidation value

84,000 shares of Series C issued and outstanding (December 31, 2015 - 84,000 shares); \$1,000 liquidation value

Common stock, \$1 par value; 100,000,000 shares authorized; 52,625,869 shares issued;

43,913,719 shares outstanding (December 31, 2015 - 52,625,869; 43,867,909)

Additional paid-in capital

Legal surplus

Retained earnings

Treasury stock, at cost, 8,712,150 shares (December 31, 2015 - 8,757,960 shares)

Accumulated other comprehensive income, net of tax of \$43 (December 31, 2015 - \$1,182)

**Total stockholders' equity**

**Total liabilities and stockholders' equity**

**See notes to unaudited consolidated financial statements**

\$

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015

	<b>Quarter Ended</b>		<b>Nine-Month Period</b>	
	<b>September 30,</b>		<b>Ended September</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
	<b>(In thousands, except per share data)</b>			
<b>Interest income:</b>				
Loans	\$ 82,604	\$ 97,264	\$ 243,431	\$ 285,251
Mortgage-backed securities	6,997	9,137	23,215	25,724
Investment securities and other	983	846	3,152	2,686
<b>Total interest income</b>	<b>90,584</b>	<b>107,247</b>	<b>269,798</b>	<b>313,661</b>
<b>Interest expense:</b>				
Deposits	7,331	6,651	21,822	20,359
Securities sold under agreements to repurchase	4,272	7,605	14,629	22,163
Advances from FHLB and other borrowings	1,237	2,283	5,574	6,766
Subordinated capital notes	817	885	2,559	2,623
<b>Total interest expense</b>	<b>13,657</b>	<b>17,424</b>	<b>44,584</b>	<b>51,911</b>
<b>Net interest income</b>	<b>76,927</b>	<b>89,823</b>	<b>225,214</b>	<b>261,750</b>
Provision for loan and lease losses, net	23,469	51,579	51,703	109,311
<b>Net interest income after provision for loan and lease losses</b>	<b>53,458</b>	<b>38,244</b>	<b>173,511</b>	<b>152,439</b>
<b>Non-interest income:</b>				
Banking service revenue	10,330	10,826	30,667	31,243
Wealth management revenue	6,526	6,885	19,719	21,325
Mortgage banking activities	1,421	992	3,300	4,717
<b>Total banking and financial service revenues</b>	<b>18,277</b>	<b>18,703</b>	<b>53,686</b>	<b>57,285</b>
Net impairment losses recognized in earnings	-	(246)	-	(246)
FDIC shared-loss expense, net	(3,296)	(2,079)	(10,745)	(38,408)
Reimbursement from FDIC shared-loss coverage in sale of loans	-	20,000	-	20,000
Net gain (loss) on:				
Sale of securities	-	-	12,207	2,572
Derivatives	17	(208)	4	(223)
Early extinguishment of debt	-	-	(12,000)	-
Other non-interest income (loss)	5,217	(193)	5,721	(2,778)
<b>Total non-interest income, net</b>	<b>20,215</b>	<b>35,977</b>	<b>48,873</b>	<b>38,202</b>
<b>Non-interest expense:</b>				
Compensation and employee benefits	19,191	21,015	58,006	60,455
Professional and service fees	3,744	4,000	10,881	12,324
Occupancy and equipment	7,484	8,556	23,413	26,075
Insurance	1,242	2,263	7,547	6,467
Electronic banking charges	5,077	5,496	15,613	16,714
Information technology expenses	1,862	1,364	5,124	4,360
Advertising, business promotion, and strategic initiatives	1,347	1,577	4,133	4,763
Foreclosure, repossession and other real estate expenses	5,279	16,601	13,250	32,384
Loan servicing and clearing expenses	2,804	1,976	6,811	6,923

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Taxes, other than payroll and income taxes	2,385	2,649	7,386	6,831
Communication	617	774	2,017	2,234
Printing, postage, stationary and supplies	602	624	1,927	1,842
Director and investor relations	233	246	812	829
Other	3,059	1,949	6,688	7,658
<b>Total non-interest expense</b>	<b>54,926</b>	<b>69,090</b>	<b>163,608</b>	<b>189,859</b>
<b>Income before income taxes</b>	<b>18,747</b>	<b>5,131</b>	<b>58,776</b>	<b>782</b>
Income tax expense	3,627	562	15,146	2,310
<b>Net income (loss)</b>	<b>15,120</b>	<b>4,569</b>	<b>43,630</b>	<b>(1,528)</b>
Less: dividends on preferred stock	(3,465)	(3,465)	(10,396)	(10,396)
<b>Net income (loss) available to common shareholders</b>	<b>\$ 11,655</b>	<b>\$ 1,104</b>	<b>\$ 33,234</b>	<b>\$ (11,924)</b>
<b>Earnings (loss) per common share:</b>				
Basic	<b>\$ 0.27</b>	<b>\$ 0.03</b>	<b>\$ 0.76</b>	<b>(0.27)</b>
Diluted	<b>\$ 0.26</b>	<b>\$ 0.03</b>	<b>\$ 0.76</b>	<b>(0.27)</b>
<b>Average common shares outstanding and equivalents</b>	<b>51,111</b>	<b>51,146</b>	<b>51,091</b>	<b>51,609</b>
<b>Cash dividends per share of common stock</b>	<b>\$ 0.06</b>	<b>\$ 0.10</b>	<b>\$ 0.18</b>	<b>0.30</b>

See notes to unaudited consolidated financial statements

## OFG BANCORP

**UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015**

	<b>Quarter Ended September 30,</b>		<b>Nine-Month Period Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
<b>Net income (loss)</b>	<b>\$ 15,120</b>	<b>\$ 4,569</b>	<b>\$ 43,630</b>	<b>\$ (1,528)</b>
<b>Other comprehensive income (loss) before tax:</b>				
Unrealized gain (loss) on securities available-for-sale	(315)	3,958	12,049	(1,582)
Realized gain on investment securities included in net loss	-	-	(12,207)	(2,572)
Other-than-temporary impairment included in net income	-	246	-	246
Unrealized gain on cash flow hedges	853	119	1,504	2,190
<b>Other comprehensive income (loss) before taxes</b>	<b>538</b>	<b>4,323</b>	<b>1,346</b>	<b>(1,718)</b>
Income tax effect	(499)	(468)	501	163
<b>Other comprehensive income (loss) after taxes</b>	<b>39</b>	<b>3,855</b>	<b>1,847</b>	<b>(1,555)</b>
<b>Comprehensive income (loss)</b>	<b>\$ 15,159</b>	<b>\$ 8,424</b>	<b>\$ 45,477</b>	<b>\$ (3,083)</b>

See notes to unaudited consolidated financial statements

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015

Nine-Month Period Ended September 30,  
2016 2015

(In thousands)

<b>Preferred stock:</b>				
Balance at beginning of period	\$	176,000	\$	176,000
<b>Balance at end of period</b>		<b>176,000</b>		<b>176,000</b>
<b>Common stock:</b>				
Balance at beginning of period		52,626		52,626
<b>Balance at end of period</b>		<b>52,626</b>		<b>52,626</b>
<b>Additional paid-in capital:</b>				
Balance at beginning of period		540,512		539,311
Stock-based compensation expense		1,014		1,213
Lapsed restricted stock units		(834)		(436)
<b>Balance at end of period</b>		<b>540,692</b>		<b>540,088</b>
<b>Legal surplus:</b>				
Balance at beginning of period		70,435		70,467
Transfer from (to) retained earnings		4,353		(44)
<b>Balance at end of period</b>		<b>74,788</b>		<b>70,423</b>
<b>Retained earnings:</b>				
Balance at beginning of period		148,886		181,152
Net income (loss)		43,630		(1,528)
Cash dividends declared on common stock		(7,909)		(13,298)
Cash dividends declared on preferred stock		(10,396)		(10,396)
Transfer (to) from legal surplus		(4,353)		44
<b>Balance at end of period</b>		<b>169,858</b>		<b>155,974</b>
<b>Treasury stock:</b>				
Balance at beginning of period		(105,379)		(97,070)
Stock repurchased		-		(8,950)
Lapsed restricted stock units		505		641
<b>Balance at end of period</b>		<b>(104,874)</b>		<b>(105,379)</b>
<b>Accumulated other comprehensive income, net of tax:</b>				
Balance at beginning of period		13,997		19,711
Other comprehensive income (loss), net of tax		1,847		(1,555)
<b>Balance at end of period</b>		<b>15,844</b>		<b>18,156</b>
<b>Total stockholders' equity</b>	<b>\$</b>	<b>924,934</b>	<b>\$</b>	<b>907,888</b>

See notes to unaudited consolidated financial statements

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015

	<b>Nine-Month Period Ended September 30, 2016      2015 (In thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 43,630	\$ (1,528)
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>		
Amortization of deferred loan origination fees, net of costs	2,849	2,515
Amortization of fair value premiums, net of discounts, on acquired loans	39	2,972
Amortization of investment securities premiums, net of accretion of discounts	6,541	9,312
Amortization of core deposit and customer relationship intangibles	1,258	1,429
Amortization of fair value premiums on acquired deposits	268	569
FDIC shared-loss expense, net	10,745	38,408
Other-than-temporary impairment on securities	-	246
Reimbursement from the FDIC shared-loss coverage in sale of loans	-	(20,000)
Depreciation and amortization of premises and equipment	7,229	8,538
Deferred income tax expense (benefit), net	15,176	(1,329)
Provision for loan and lease losses, net	51,703	109,311
Stock-based compensation	1,014	1,213
(Gain) loss on:		
Sale of securities	(12,207)	(2,572)
Sale of mortgage loans held-for-sale	(1,294)	(2,595)
Derivatives	78	(26)
Early extinguishment of debt	12,000	-
Foreclosed real estate	10,580	30,608
Sale of other repossessed assets	(1,498)	4,585
Sale of premises and equipment	12	193
Originations of loans held-for-sale	(134,189)	(165,333)
Proceeds from sale of mortgage loans held-for-sale	51,238	76,953
Net (increase) decrease in:		
Trading securities	(92)	1,011
Accrued interest receivable	2,671	2,720
Servicing assets	(938)	544
Other assets	(13,394)	(18,263)
Net increase (decrease) in:		
Accrued interest on deposits and borrowings	(1,013)	(745)
Accrued expenses and other liabilities	(5,594)	(11,923)
<b>Net cash provided by operating activities</b>	<b>46,812</b>	<b>66,813</b>
<b>Cash flows from investing activities:</b>		
Purchases of:		
Investment securities available-for-sale	(676)	(3,747)
Investment securities held-to-maturity	(81,261)	(458,229)

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FHLB stock	(20,398)	-
Maturities and redemptions of:		
Investment securities available-for-sale	112,444	187,052
Investment securities held-to-maturity	56,058	24,753
FHLB stock	28,469	365
Proceeds from sales of:		
Investment securities available-for-sale	300,483	103,831
Foreclosed real estate and other repossessed assets, including write-offs	36,983	63,959
Proceeds from sale of loans held-for-investment	1,149	30,669
Premises and equipment	48	(76)
Mortgage servicing rights	-	5,927
Origination and purchase of loans, excluding loans held-for-sale	(555,658)	(611,815)
Principal repayment of loans, including covered loans	616,518	722,579
Reimbursements from the FDIC on shared-loss agreements	824	46,356
Additions to premises and equipment	(3,804)	(3,402)
Net change in restricted cash	319	4,058
<b>Net cash provided by investing activities</b>	<b>491,498</b>	<b>112,280</b>

## OFG BANCORP

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTHS PERIODS ENDED SEPTEMBER 30, 2016 AND 2015 – (CONTINUED)

	Nine-Month Period Ended September 30,	
	2016	2015
	(In thousands)	
<b>Cash flows from financing activities:</b>		
Net increase (decrease) in:		
Deposits	35,449	(211,637)
Securities sold under agreements to repurchase	(287,865)	20,717
FHLB advances, federal funds purchased, and other borrowings	(228,157)	(3,676)
Subordinated capital notes	(66,550)	787
Exercise of stock options and restricted units lapsed, net	(329)	204
Purchase of treasury stock	-	(8,950)
Dividends paid on preferred stock	(10,396)	(10,396)
Dividends paid on common stock	(7,906)	(13,373)
<b>Net cash used in financing activities</b>	<b>\$ (565,754)</b>	<b>\$ (226,324)</b>
<b>Net change in cash and cash equivalents</b>	<b>(27,444)</b>	<b>(47,231)</b>
Cash and cash equivalents at beginning of period	536,709	573,427
<b>Cash and cash equivalents at end of period</b>	<b>\$ 509,265</b>	<b>\$ 526,196</b>
<b>Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:</b>		
Interest paid	\$ 44,316	\$ 51,471
Income taxes paid	\$ 7,389	\$ 10,598
Mortgage loans securitized into mortgage-backed securities	\$ 71,315	\$ 87,609
Transfer from loans to foreclosed real estate and other repossessed assets	\$ 32,535	\$ 56,510
Reclassification of loans held-for-investment to loans held-for-sale	\$ 123,137	\$ 1,453
Reclassification of loans held-for-sale to loans held-for-investment	\$ 182	\$ 156

See notes to unaudited consolidated financial statements



**OFG BANCORP**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - ORGANIZATION, CONSOLIDATION AND BASIS OF PRESENTATION**

*Nature of Operations*

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

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

*Recent Accounting Developments*

In August 2016, the Financial Accounting Standards Board (FASB) issued new accounting guidance that addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The amendments in this update apply to all entities, including both business entities and not-for-profit entities that are required to present a statement of cash flows under Topic 230. The amendments in this update clarifies whether the following items should be categorized as operating, investing or financing in the statement of cash flows: (i) debt prepayments and extinguishment costs, (ii) settlement of zero-coupon debt, (iii) settlement of contingent consideration, (iv) insurance proceeds, (v) settlement of corporate-owned life insurance (COLI) and bank-owned life insurance (BOLI) policies, (vi) distributions from equity method investees, (vii) beneficial interests in securitization transactions, and (viii) receipts and payments with aspects of more than one class of cash flows. The new guidance is effective on January 1, 2018. The Company does not expect the new accounting guidance to have a material impact on its statement of cash flows.

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

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

In February 2016, the FASB issued new accounting guidance that requires substantially all leases to be recorded as assets and liabilities on the balance sheet. This new accounting guidance is effective on January 1, 2019, with early adoption permitted. Upon adoption, the Company will record a right of use asset and a lease payment obligation associated with arrangements previously accounted for as operating leases. The Company is in the process of evaluating the impact of the provisions of this new accounting guidance on its consolidated financial position.

In January 2016, the FASB issued new accounting guidance on recognition and measurement of financial instruments. The new guidance makes targeted changes to existing Generally Accepted Accounting Principles (GAAP) including, among other provisions, requiring certain equity investments to be measured at fair value with changes in fair value reported in earnings and requiring changes

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

in instrument-specific credit risk. The new guidance is effective on January 1, 2018. The Company does not expect the provisions of this new accounting guidance to have a material impact on its consolidated financial position or results of operations.

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

## NOTE 2 – RESTRICTED CASH

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

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

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

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

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

The Bank is required by Puerto Rico law to maintain average weekly reserve balances to cover demand deposits. The amount of those minimum average reserve balances for the week that covered September 30, 2016 was \$157.5 million (December 31, 2015 - \$148.3 million). At September 30, 2016 and December 31, 2015, the Bank complied with such requirement. Cash and due from bank as well as other short-term, highly liquid securities are used to cover the required average reserve balances.

### **NOTE 3 – INVESTMENT SECURITIES**

#### ***Money Market Investments***

The Company considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months or less at the date of acquisition. At September 30, 2016 and December 31, 2015, money market instruments included as part of cash and cash equivalents amounted to \$5.5 million and \$4.7 million, respectively.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Investment Securities*

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the securities owned by the Company at September 30, 2016 and December 31, 2015 were as follows:

	September 30, 2016				Weighted Average Yield
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	
	(In thousands)				
<b>Available-for-sale</b>					
<b>Mortgage-backed securities</b>					
FNMA and FHLMC certificates	\$ 376,242	\$ 13,365	\$ -	\$ 389,607	2.60%
GNMA certificates	125,188	5,797	-	130,985	3.02%
CMOs issued by US government-sponsored agencies	111,808	398	370	111,836	1.88%
<b>Total mortgage-backed securities</b>	<b>613,238</b>	<b>19,560</b>	<b>370</b>	<b>632,428</b>	<b>2.56%</b>
<b>Investment securities</b>					
Obligations of US government-sponsored agencies	4,170	-	5	4,165	1.37%
Obligations of Puerto Rico government and public instrumentalities	4,680	-	607	4,073	5.55%
Other debt securities	1,906	111	-	2,017	2.94%
<b>Total investment securities</b>	<b>10,756</b>	<b>111</b>	<b>612</b>	<b>10,255</b>	<b>3.47%</b>
<b>Total securities available for sale</b>	<b>\$ 623,994</b>	<b>\$ 19,671</b>	<b>\$ 982</b>	<b>\$ 642,683</b>	<b>2.57%</b>
<b>Held-to-maturity</b>					
<b>Mortgage-backed securities</b>					
FNMA and FHLMC certificates	\$ 616,883	8,141	18	625,006	2.17%
<b>Investment securities</b>					
US Treasury securities	25,007	10	-	25,017	0.49%
<b>Total securities held to maturity</b>	<b>641,890</b>	<b>8,151</b>	<b>18</b>	<b>650,023</b>	<b>2.11%</b>
<b>Total</b>	<b>\$ 1,265,884</b>	<b>\$ 27,822</b>	<b>\$ 1,000</b>	<b>\$ 1,292,706</b>	<b>2.34%</b>

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

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

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The amortized cost and fair value of the Company's investment securities at September 30, 2016, by contractual maturity, are shown in the next table. Securities not due on a single contractual maturity date, such as collateralized mortgage obligations, are classified in the period of final contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2016			
	Available-for-sale		Held-to-maturity	
	Amortized Cost (In thousands)	Fair Value (In thousands)	Amortized Cost (In thousands)	Fair Value (In thousands)
<b>Mortgage-backed securities</b>				
Due from 1 to 5 years				
FNMA and FHLMC certificates	\$ 11,294	\$ 11,629	\$ -	\$ -
<b>Total due from 1 to 5 years</b>	<b>11,294</b>	<b>11,629</b>	-	-
Due from 5 to 10 years				
CMOs issued by US Government-sponsored agencies	2,244	2,245	-	-
FNMA and FHLMC certificates	27,173	27,837	-	-
<b>Total due from 5 to 10 years</b>	<b>29,417</b>	<b>30,082</b>	-	-
Due after 10 years				
FNMA and FHLMC certificates	337,775	350,141	616,883	625,006
GNMA certificates	125,188	130,985	-	-
CMOs issued by US government-sponsored agencies	109,564	109,591	-	-
<b>Total due after 10 years</b>	<b>572,527</b>	<b>590,717</b>	<b>616,883</b>	<b>625,006</b>
<b>Total mortgage-backed securities</b>	<b>613,238</b>	<b>632,428</b>	<b>616,883</b>	<b>625,006</b>
<b>Investment securities</b>				
US Treasury securities	-	-	25,007	25,017
<b>Total due in less than one year</b>	-	-	<b>25,007</b>	<b>25,017</b>
Due from 1 to 5 years				
Obligations of Puerto Rico government and public instrumentalities	4,680	4,073	-	-
<b>Total due from 1 to 5 years</b>	<b>4,680</b>	<b>4,073</b>	-	-
Due from 5 to 10 years				
Obligations of US government and sponsored agencies	4,170	4,165	-	-
Other debt securities	1,906	2,017	-	-
<b>Total due from 5 to 10 years</b>	<b>6,076</b>	<b>6,182</b>	-	-
<b>Total investment securities</b>	<b>10,756</b>	<b>10,255</b>	<b>25,007</b>	<b>25,017</b>
<b>Total securities available-for-sale and held-to-maturity</b>	<b>\$ 623,994</b>	<b>\$ 642,683</b>	<b>\$ 641,890</b>	<b>\$ 650,023</b>





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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Company, as part of its asset/liability management, may purchase U.S. Treasury securities and U.S. government-sponsored agency discount notes close to their maturities as alternatives to cash deposits at correspondent banks or as a short term vehicle to reinvest the proceeds of sale transactions until investment securities with attractive yields can be purchased. During the nine-month period ended September 30, 2016, the Company retained securitized Government National Mortgage Association ("GNMA") pools totaling \$71.8 million amortized cost, at a yield of 2.99% from its own originations. Previously, the Company was selling all securitized GNMA pools. The GNMA pools were sold until June 2015. During the first half of 2015, the Company sold \$63.5 million of available-for-sale GNMA certificates as part of its recurring mortgage loan origination and securitization activities. These sales did not realize any gains or losses during such period.

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

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

<u>Description</u>	Nine-Month Period Ended September 30, 2015			
	Sale Price	Book Value at Sale	Gross Gains	Gross Losses
	(In thousands)			
<b>Sale of securities available-for-sale</b>				
<b>Mortgage-backed securities</b>				
FNMA and FHLMC certificates	\$ 40,307	\$ 37,736	\$ 2,571	\$ -
GNMA certificates	63,524	63,523	1	-

<b>Total</b>	\$	<b>103,831</b>	\$	<b>101,259</b>	\$	<b>2,572</b>	\$	<b>-</b>
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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following tables show the Company's gross unrealized losses and fair value of investment securities available-for-sale and held-to-maturity, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position at September 30, 2016 and December 31, 2015:

	<b>September 30, 2016</b>		
	<b>12 months or more</b>		
	<b>Amortized</b>	<b>Unrealized</b>	<b>Fair</b>
	<b>Cost</b>	<b>Loss</b>	<b>Value</b>
	<b>(In thousands)</b>		
<b>Securities available-for-sale</b>			
CMOs issued by US government-sponsored agencies	\$ 37,579	\$ 320	\$ 37,259
Obligations of Puerto Rico government and public instrumentalities	4,680	607	4,073
	<b>\$ 42,259</b>	<b>\$ 927</b>	<b>\$ 41,332</b>
	<b>Less than 12 months</b>		
	<b>Amortized</b>	<b>Unrealized</b>	<b>Fair</b>
	<b>Cost</b>	<b>Loss</b>	<b>Value</b>
	<b>(In thousands)</b>		
<b>Securities available-for-sale</b>			
CMOs issued by US Government-sponsored agencies	13,181	50	13,131
Obligations of US government and sponsored agencies	4,170	5	4,165
<b>Securities held to maturity</b>			
FNMA and FHLMC certificates	21,240	18	21,222
	<b>\$ 38,591</b>	<b>\$ 73</b>	<b>\$ 38,518</b>
	<b>Amortized</b>	<b>Total</b>	<b>Fair</b>
	<b>Cost</b>	<b>Unrealized</b>	<b>Value</b>
	<b>(In thousands)</b>		
<b>Securities available-for-sale</b>			
CMOs issued by US government-sponsored agencies	\$ 50,760	\$ 370	\$ 50,390
Obligations of Puerto Rico Government and political subdivisions	4,680	607	4,073
Obligations of US government and sponsored agencies	4,170	5	4,165
<b>Securities held to maturity</b>			
FNMA and FHLMC certificates	21,240	18	21,222
	<b>\$ 80,850</b>	<b>\$ 1,000</b>	<b>\$ 79,850</b>

At September 30, 2016 there were no securities held-to-maturity in a continuous unrealized loss position for twelve months or more.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

The Company performs valuations of the investment securities on a monthly basis. Moreover, the Company conducts quarterly reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairment. Any portion of a decline in value associated with credit loss is recognized in the statements of operations

with the remaining noncredit-related component recognized in other comprehensive income (loss). A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered by comparing the present value of cash flows expected to be collected from the security, discounted at the rate equal to the yield used to accrete current and prospective beneficial interest for the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the “credit loss.”

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

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

Most of the investments (\$76.2 million, amortized cost, or 94%) with an unrealized loss position at September 30, 2016 consist of securities issued or guaranteed by the U.S. Treasury or U.S. government-sponsored agencies, all of which are highly liquid securities that have a large and efficient secondary market. Their aggregate losses and their variability from period to period are the result of changes in market conditions, and not due to the repayment capacity or creditworthiness of the issuers or guarantors of such securities.

The remaining investments (\$4.7 million, amortized cost, or 6%) with an unrealized loss position at September 30, 2016 consist of obligations issued or guaranteed by the government of Puerto Rico and its public instrumentalities. The decline in the market value of this security is mainly attributed to an increase in volatility as a result of changes in market conditions that reflect the significant economic and fiscal challenges that Puerto Rico is facing, including the government's credit default, a protracted economic recession, sizable government debt-service obligations and structural budget deficits, high unemployment and a shrinking population.

The only obligation issued or guaranteed by the government of Puerto Rico and its instrumentalities held at the end of the third quarter of 2016 by the Company was the Puerto Rico Highways and Transportation Authority ("PRHTA") – Teodoro Moscoso Bridge revenue bond. The pledged income of this bond comes from gross revenues from Teodoro Moscoso Bridge operations. Although PRHTA is included in the Puerto Rico Governor's executive order of November 30, 2015 ordering the "clawback" of certain government revenues, the toll bridge revenues for the repayment of such bonds were not subject to the "clawback." All other Puerto Rico government securities were sold during the first quarter of 2016. The PRHTA bond with a principal amount of \$4.6 million had an aggregate fair value of \$4.1 million at September 30, 2016 (87% of the bond's cost). The discounted cash flow analysis for the investments showed a cumulative default probability at maturity of 8.9%, thus reflecting that it is more likely than not that the bond will not default during its remaining term. Based on this analysis, the Company determined that it is more likely than not that it will recover all interest and principal invested in this Puerto Rico government bond and is, therefore, not required to recognize a credit loss as of September 30, 2016. Also, the Company's conclusion is based on the assessment of the specific source of repayment of the outstanding bond, which continues to perform. PRHTA started principal repayments on July 1, 2014. All scheduled principal and interest payments to date have been collected. On July 1, 2016, the Company received the scheduled principal payment of \$2.0 million. The next payment is due on July 1, 2017. As a result of the aforementioned analysis, no other-than-temporary losses were recorded during the quarter ended September 30, 2016.

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

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

and maturity date.

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

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

	<b>Nine-Mon Period End September 2016</b>	<b>2015</b>
Balance at beginning of period	\$ 1,490	\$ 2,000
Reductions for securities sold during the period (realized)	(1,490)	-
Additions from credit losses recognized on available-for-sale securities that had no previous impairment losses	-	2,000
Balance at end of period	\$ -	\$ 2,000

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

## NOTE 4 - LOANS

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

The coverage for the single family residential loans will expire on June 30, 2020. At September 30, 2016, the remaining covered loans, amounting to \$62.8 million, net carrying amount (\$75.0 million gross amount), are included as part of acquired Eurobank loans under the name "loans secured by 1-4 family residential properties." At December 31, 2015, covered loans amounted to \$67.2 million, net carrying amount (\$92.3 million gross amount). Interest income recognized for covered loans during the nine-month periods ended September 30, 2016 and 2015 was \$6.4 million and \$31.4 million, respectively. The decrease in interest income recognized for covered loans is mainly due to the expiration of the FDIC loss-share coverage related to commercial and other-non single family residential loans on June 30, 2015.

Effective June 30, 2016, pursuant to supervisory direction, the Company changed the purchase credit impaired policy for all loans accounted for under ASC 310-30 (*Loans and Debt Securities Acquired with Deteriorated Credit Quality*). Under the revised policy, the Company writes-off the loan's recorded investment and derecognizes the associated allowance for loan and lease losses for loans that exit the acquired pools. The revised policy was implemented prospectively due to the immaterial impact of retrospective adoption. Prior to June 30, 2016, the pool's carrying value and allowance was determined by discounting expected cash flows at the pool's effective yield. The allowance for loan and lease losses was maintained until all of the loans in the pool were paid off or charged-off. The transition to this revised policy during the second quarter of 2016 resulted in the de-recognition of \$8.9 million and \$73.1 million in the recorded investment balance and associated allowance for loans that had exited the pools, for acquired BBVAPR loans and acquired Eurobank loans, respectively, with no impact to the provision for loan and lease losses. Refer to Note 5 Allowances for Loan and Lease Losses.

During the third quarter of 2016, the Company entered into an agreement to sell its outstanding \$200.0 million participation in the Puerto Rico Electric Power Authority ("PREPA") line of credit for \$123.5 million, slightly lower than the adjusted book balance, net of reserves. As a result of this transaction, the Company recognized a \$56.2



million charge-off and \$2.9 million provision for loan and lease losses during the quarter ended September 30, 2016. At September 30, 2016, this line of credit was reported as other loans held for sale, at fair value of \$123.1 million. The sale transaction settled on October 7, 2016.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

	September 30, 2016	Decem 31, 2015
	(In thousands)	
<b>Originated and other loans and leases held for investment:</b>		
Mortgage	\$ 735,367	\$ 757,117
Commercial (c)	1,267,177	1,447,117
Consumer	278,666	242,117
Auto and leasing	730,589	669,117
	<b>3,011,799</b>	<b>3,115,568</b>
Allowance for loan and lease losses on originated and other loans and leases	(62,168)	(112,117)
	<b>2,949,631</b>	<b>2,998,451</b>
Deferred loan costs, net	5,421	4,117
<b>Total originated and other loans held for investment, net</b>	<b>2,955,052</b>	<b>3,002,568</b>
<b>Acquired loans:</b>		
<b>Acquired BBVAPR loans:</b>		
<b>Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)</b>		
Commercial	5,755	7,117
Consumer	34,215	38,117
Auto	64,393	100,117
	<b>104,363</b>	<b>145,351</b>
Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-20 (b)	(4,213)	(5,117)
	<b>100,150</b>	<b>140,234</b>
<b>Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy) (a)</b>		
Mortgage	579,769	608,117
Commercial	230,163	287,117
Construction	71,436	88,117
Consumer	5,768	11,117
Auto	100,475	153,117
	<b>987,611</b>	<b>1,147,685</b>
Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-30	(29,819)	(25,117)
	<b>957,792</b>	<b>1,122,568</b>
<b>Total acquired BBVAPR loans, net</b>	<b>1,057,942</b>	<b>1,270,802</b>
<b>Acquired Eurobank loans: (a)</b>		
Loans secured by 1-4 family residential properties	75,043	92,117
Commercial and construction	82,753	142,117
Consumer	1,488	2,117
Total Eurobank loans	<b>159,284</b>	<b>236,351</b>
Allowance for loan and lease losses on Eurobank loans (b)	(22,812)	(90,117)

<b>Total Eurobank loans, net</b>	<b>136,472</b>	<b>146,417</b>
<b>Total acquired loans, net</b>	<b>1,194,414</b>	<b>1,417,417</b>
<b>Total held for investment, net</b>	<b>4,149,466</b>	<b>4,420,417</b>
Mortgage loans held for sale	26,362	13,362
Other loans held for sale (c)	123,137	123,137
<b>Total loans, net</b>	<b>\$ 4,298,965</b>	<b>\$ 4,434,417</b>

(a) Current period amounts have been re-measured using the revised de-recognition policy for purchased credit impaired loans implemented in the second quarter of 2016.

(b) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was de-recognized due to the revision in the de-recognition policy for these loans implemented during the second quarter of 2016.

(c) During the third quarter of 2016, the Company entered into an agreement to sell its outstanding participation in the PREPA of credit. At September 30, 2016 this line of credit was reported as other loans held for sale, at fair value of \$123.1 million.

## OFG BANCORP

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Originated and Other Loans and Leases Held for Investment*

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

The following tables present the aging of the recorded investment in gross originated and other loans held for investment as of September 30, 2016 and December 31, 2015 by class of loans. Mortgage loans past due include delinquent loans in the GNMA buy-back option program. Servicers of loans underlying GNMA mortgage-backed securities must report as their own assets the defaulted loans that they have the option (but not the obligation) to repurchase, even when they elect not to exercise that option.

	September 30, 2016							Total Loans	Loans 90+ Days Past Due and Still Accruing
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current in Non- Accrual	Current Accruing	Total Loans		
(In thousands)									
<b>Mortgage</b>									
Traditional (by origination year):									
Up to the year 2002	\$ 190	\$ 1,607	\$ 3,388	\$ 5,185	\$ 92	\$ 47,169	\$ 52,446	\$ 114	
Years 2003 and 2004	249	4,271	6,142	10,662	332	81,915	92,909	-	
Year 2005	123	1,810	3,930	5,863	202	44,617	50,682	-	
Year 2006	781	3,434	7,045	11,260	321	60,358	71,939	-	
Years 2007, 2008									
and 2009	929	2,182	11,283	14,394	46	66,407	80,847	569	
Years 2010, 2011, 2012, 2013	452	2,777	10,497	13,726	-	129,710	143,436	571	
Years 2014, 2015 and 2016	-	430	1,150	1,580	47	102,789	104,416	-	
	2,724	16,511	43,435	62,670	1,040	532,965	596,675	1,254	
Non-traditional	-	301	5,002	5,303	-	19,036	24,339	-	
Loss mitigation program	10,908	6,571	18,315	35,794	2,704	65,918	104,416	2,120	
	13,632	23,383	66,752	103,767	3,744	617,919	725,430	3,374	
Home equity secured personal loans	-	-	-	-	-	339	339	-	
GNMA's buy-back option program	-	-	9,598	9,598	-	-	9,598	-	
<b>Total mortgage</b>	<b>13,632</b>	<b>23,383</b>	<b>76,350</b>	<b>113,365</b>	<b>3,744</b>	<b>618,258</b>	<b>735,367</b>	<b>3,374</b>	

**Commercial**

## Commercial secured by real estate:

Corporate	-	-	-	-	-	240,458	240,458	-	
Institutional	-	-	-	-	1,495	27,265	28,760	-	
Middle market	-	205	3,114	3,319	1,406	232,088	236,813	-	
Retail	672	707	6,477	7,856	3,710	236,983	248,549	-	
Floor plan	-	-	-	-	-	2,793	2,793	-	
Real estate	-	-	-	-	-	15,783	15,783	-	
	672	912	9,591	11,175	6,611	755,370	773,156	-	
Other commercial and industrial:									
Corporate	-	-	-	-	-	126,325	126,325	-	
Institutional	500	-	-	500	1,345	172,988	174,833	-	
Middle market	-	-	-	-	1,350	85,349	86,699	-	
Retail	1,112	311	1,060	2,483	210	71,252	73,945	-	
Floor plan	670	-	119	789	-	31,430	32,219	-	
	2,282	311	1,179	3,772	2,905	487,344	494,021	-	
<b>Total commercial</b>	<b>2,954</b>	<b>1,223</b>	<b>10,770</b>	<b>14,947</b>	<b>9,516</b>	<b>1,242,714</b>	<b>1,267,177</b>	-	

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

September 30, 2016

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current in Non- Accrual	Current Accruing	Total Loans	Loans 90+ Days Past Due and Still Accruing
(In thousands)								
<b>Consumer</b>								
Credit cards	486	264	510	1,260	-	24,204	25,464	-
Overdrafts	12	3	3	18	-	178	196	-
Personal lines of credit	38	18	37	93	-	2,199	2,292	-
Personal loans	2,154	1,657	926	4,737	778	229,480	234,995	-
Cash collateral personal loans	162	2	30	194	-	15,525	15,719	-
<b>Total consumer</b>	<b>2,852</b>	<b>1,944</b>	<b>1,506</b>	<b>6,302</b>	<b>778</b>	<b>271,586</b>	<b>278,666</b>	<b>-</b>
<b>Auto and leasing</b>	<b>46,564</b>	<b>18,738</b>	<b>8,407</b>	<b>73,709</b>	<b>115</b>	<b>656,765</b>	<b>730,589</b>	<b>-</b>
<b>Total</b>	<b>\$ 66,002</b>	<b>\$ 45,288</b>	<b>\$ 97,033</b>	<b>\$ 208,323</b>	<b>\$ 14,153</b>	<b>\$ 2,789,323</b>	<b>\$ 3,011,799</b>	<b>\$ 3,374</b>

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

<b>Total commercial</b>	<b>2,593</b>	<b>1,868</b>	<b>16,677</b>	<b>21,138</b>	<b>195,545</b>	<b>1,224,966</b>	<b>1,441,649</b>	<b>-</b>
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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2015

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

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

At September 30, 2016 and December 31, 2015, the Company had carrying balances of \$136.8 million and \$334.6 million, respectively, in originated and other loans held for investment granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities as part of the institutional commercial loan segment. All loans granted to the Puerto Rico government were current at September 30, 2016 and December 31, 2015.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

*Acquired Loans*

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

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

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

The following tables present the aging of the recorded investment in gross acquired BBVAPR loans accounted for under ASC 310-20 as of September 30, 2016 and December 31, 2015, by class of loans:

September 30, 2016							Loans 90+ Days Past Due and Still Accruing
30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current in Non- Accrual	Current Accruing	Total Loans	
(In thousands)							

**Commercial**

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Commercial secured by real estate																
Retail	\$	-	\$	-	\$	150	\$	150	\$	-	\$	-	\$	150	\$	-
Floor plan		969		-		227		1,196		-		1,286		2,482		-
		969		-		377		1,346		-		1,286		2,632		-
Other commercial and industrial																
Retail		67		56		78		201		-		2,919		3,120		-
Floor plan		-		-		3		3		-		-		3		-
		67		56		81		204		-		2,919		3,123		-
		<b>1,036</b>		<b>56</b>		<b>458</b>		<b>1,550</b>		-		<b>4,205</b>		<b>5,755</b>		-
<b>Consumer</b>																
Credit cards		827		443		641		1,911		-		29,452		31,363		-
Personal loans		95		15		62		172		-		2,680		2,852		-
		<b>922</b>		<b>458</b>		<b>703</b>		<b>2,083</b>		-		<b>32,132</b>		<b>34,215</b>		-
<b>Auto</b>		<b>4,321</b>		<b>1,608</b>		<b>739</b>		<b>6,668</b>		<b>4</b>		<b>57,721</b>		<b>64,393</b>		-
<b>Total</b>	<b>\$</b>	<b>6,279</b>	<b>\$</b>	<b>2,122</b>	<b>\$</b>	<b>1,900</b>	<b>\$</b>	<b>10,301</b>	<b>\$</b>	<b>4</b>	<b>\$</b>	<b>94,058</b>	<b>\$</b>	<b>104,363</b>	<b>\$</b>	<b>-</b>

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2015

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

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

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

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

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
	<b>(In thousands)</b>	
Contractual required payments receivable (a)	\$ 1,716,721	\$ 1,945,098
Less: Non-accretable discount	367,754	434,190
Cash expected to be collected	1,348,967	1,510,908
Less: Accretable yield	361,356	361,688
Carrying amount, gross	987,611	1,149,220
Less: allowance for loan and lease losses (b)	29,819	25,785
<b>Carrying amount, net</b>	<b>\$ 957,792</b>	<b>\$ 1,123,435</b>

(a) Current period amounts have been re-measured using the revised de-recognition policy for purchased credit impaired loans implemented in the second quarter of 2016.

(b) A portion of the allowance for loan and lease losses associated with purchased credit impaired loans was de-recognized due to the revision in the de-recognition policy for these loans implemented during the second quarter of 2016.

At September 30, 2016 and December 31, 2015, the Company had \$65.6 million and \$80.9 million, respectively, in loans granted to the Puerto Rico government, including its instrumentalities, public corporations and municipalities as part of its acquired BBVAPR loans accounted for under ASC 310-30.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

## Quarter Ended September 30, 2016

	Mortgage	Commercial	Construction	Auto	Consumer	Total
	(In thousands)					
<b>Accretible Yield Activity:</b>						
<b>Balance at beginning of period</b>	\$ 283,823	\$ 37,059	\$ 15,248	\$ 14,103	\$ 4,885	\$ 355,118
Accretion	(8,197)	(5,201)	(1,485)	(3,107)	(662)	(18,652)
Change in expected cash flows	(1)	1,764	(1)	618	(241)	2,139
Transfer from (to) non-accretible discount	24,056	(1,296)	283	(525)	233	22,751
<b>Balance at end of period</b>	<b>\$ 299,681</b>	<b>\$ 32,326</b>	<b>\$ 14,045</b>	<b>\$ 11,089</b>	<b>\$ 4,215</b>	<b>\$ 361,356</b>
<b>Non-Accretible Discount Activity:</b>						
<b>Balance at beginning of period</b>	\$ 336,153	\$ 10,582	\$ 7,419	\$ 22,121	\$ 18,225	\$ 394,500
Change in actual and expected losses	(2,591)	(1,215)	(1)	(309)	121	(3,995)
Transfer (to) from accretible yield	(24,056)	1,296	(283)	525	(233)	(22,751)
<b>Balance at end of period</b>	<b>\$ 309,506</b>	<b>\$ 10,663</b>	<b>\$ 7,135</b>	<b>\$ 22,337</b>	<b>\$ 18,113</b>	<b>\$ 367,754</b>

## Nine-Month Period Ended September 30, 2016

	Mortgage	Commercial	Construction	Auto	Consumer	Total
	(In thousands)					
<b>Accretible Yield Activity:</b>						
<b>Balance at beginning of period</b>	\$ 268,794	\$ 45,411	\$ 19,615	\$ 21,578	\$ 6,290	\$ 361,688
Accretion	(24,798)	(16,312)	(4,661)	(10,934)	(2,470)	(59,175)
Change in expected cash flows	(1)	4,954	(209)	1,249	(242)	5,751
Transfer from (to) non-accretible discount	55,686	(1,727)	(700)	(804)	637	53,092
<b>Balance at end of period</b>	<b>\$ 299,681</b>	<b>\$ 32,326</b>	<b>\$ 14,045</b>	<b>\$ 11,089</b>	<b>\$ 4,215</b>	<b>\$ 361,356</b>
<b>Non-Accretible Discount Activity:</b>						
<b>Balance at beginning of period</b>	\$ 374,772	\$ 11,781	\$ 6,764	\$ 22,039	\$ 18,834	\$ 434,190
Change in actual and expected losses	(9,580)	(2,845)	(329)	(506)	(84)	(13,344)
Transfer (to) from accretible yield	(55,686)	1,727	700	804	(637)	(53,092)
<b>Balance at end of period</b>	<b>\$ 309,506</b>	<b>\$ 10,663</b>	<b>\$ 7,135</b>	<b>\$ 22,337</b>	<b>\$ 18,113</b>	<b>\$ 367,754</b>

**OFG BANCORP**

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