

OFG BANCORP
Form 10-Q
November 02, 2018

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, 2018

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

Edgar Filing: OFG BANCORP - Form 10-Q

Principal Executive Offices:

254 Muñoz Rivera Avenue

San Juan, Puerto Rico 00918

Telephone Number: (787) 771-6800

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

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

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

Large Accelerated Filer
Company

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

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:

51,293,924 common shares (\$1.00 par value per share) outstanding as of October 31, 2018

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION		Page
Item 1.	<u>Financial Statements</u>	
	<u>Unaudited Consolidated Statements of Financial Condition</u>	1
	<u>Unaudited Consolidated Statements of Operations</u>	3
	<u>Unaudited Consolidated Statements of Comprehensive Income</u>	5
	<u>Unaudited Consolidated Statements of Changes in Stockholders' Equity</u>	6
	<u>Unaudited Consolidated Statements of Cash Flows</u>	7
	<u>Notes to Unaudited Consolidated Financial Statements</u>	
	<u>Note 1 – Organization, Consolidation and Basis of Presentation</u>	10
	<u>Note 2 – Significant Events</u>	12
	<u>Note 3 – Restricted Cash</u>	13
	<u>Note 4 – Investment Securities</u>	14
	<u>Note 5 – Loans</u>	20
	<u>Note 6 – Allowance for Loan and Lease Losses</u>	48
	<u>Note 7 – FDIC Shared-loss Agreements</u>	58
	<u>Note 8 – Foreclosed Real Estate</u>	57
	<u>Note 9 – Derivatives</u>	60
	<u>Note 10 – Accrued Interest Receivable and Other Assets</u>	61
	<u>Note 11 – Deposits and Related Interest</u>	62
	<u>Note 12 – Borrowings and Related Interest</u>	64
	<u>Note 13 – Offsetting of Financial Assets and Liabilities</u>	66
	<u>Note 14 – Income Taxes</u>	68
	<u>Note 15 – Regulatory Capital Requirements</u>	69
	<u>Note 16 – Stockholders' Equity</u>	70
	<u>Note 17 – Accumulated Other Comprehensive Income</u>	71
	<u>Note 18 – Earnings per Common Share</u>	74
	<u>Note 19 – Guarantees</u>	75
	<u>Note 20 – Commitments and Contingencies</u>	76
	<u>Note 21 – Fair Value of Financial Instruments</u>	85
	<u>Note 22 – Banking and Financial Service Revenues</u>	79
	<u>Note 23 – Business Segments</u>	86
	<u>Note 24 – Subsequent Events</u>	86
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	89
	<u>Critical Accounting Policies and Estimates</u>	89
	<u>Overview of Financial Performance:</u>	89

Edgar Filing: OFG BANCORP - Form 10-Q

	<u>Selected Financial Data</u>	91
	<u>Financial Highlights of the Second Quarter of 2018</u>	93
	<u>Analysis of Results of Operations</u>	94
	<u>Analysis of Financial Condition</u>	107
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	135
Item 4.	<u>Controls and Procedures</u>	139
PART II – OTHER INFORMATION		
Item 1.	<u>Legal Proceedings</u>	140
Item 1A.	<u>Risk Factors</u>	140
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	140
Item 3.	<u>Default upon Senior Securities</u>	140
Item 4.	<u>Mine Safety Disclosures</u>	140
Item 5.	<u>Other Information</u>	140
Item 6.	<u>Exhibits</u>	141
<u>Signatures</u>		142

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 “Oriental”), 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 Oriental’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 Oriental’s control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements. Factors that might cause such a difference include, but are not limited to:

- the rate of growth in the economy and employment levels, as well as general business and economic conditions;
- changes in interest rates, as well as the magnitude of such changes;
- the credit default by the municipalities of the government of Puerto Rico;
- amendments to the fiscal plan approved by the Financial Oversight and Management Board for Puerto Rico;
- determinations in the court-supervised debt-restructuring process under Title III of PROMESA for the Puerto Rico government and all of its agencies, including some of its public corporations;
- the impact of property, credit and other losses in Puerto Rico as a result of hurricanes, earthquakes and other natural disasters;
- the amount of government, private and philanthropic financial assistance for the reconstruction of Puerto Rico’s critical infrastructure, which suffered catastrophic damages caused by hurricane Maria;
- the pace and magnitude of Puerto Rico’s economic recovery;
- the fiscal and monetary policies of the federal government and its agencies;
- changes in federal bank regulatory and supervisory policies, including required levels of capital;
- the relative strength or weakness of the commercial and consumer credit sectors and the real estate market in Puerto Rico;

- the performance of the stock and bond markets;
- competition in the financial services industry; and
- possible legislative, tax or regulatory changes.

Other possible events or factors that could cause results or performance to differ materially from those expressed in these forward-looking statements include the following: negative economic conditions that adversely affect the general economy, housing prices, the job market, consumer confidence and spending habits which may affect, among other things, the level of non-performing assets, charge-offs and provision expense; changes in interest rates and market liquidity which may reduce interest margins, impact funding sources and affect the ability to originate and distribute financial products in the primary and secondary markets; adverse movements and volatility in debt and equity capital markets; changes in market rates and prices which may adversely impact the value of financial assets and liabilities; liabilities resulting from litigation and regulatory investigations; changes in accounting standards, rules and interpretations; increased competition; Oriental's ability to grow its core businesses; decisions to downsize, sell or close units or otherwise change Oriental'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 Oriental as of the date of this report, and other than as required by law, including the requirements of applicable securities laws, Oriental assumes no obligation to update or revise any such forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF SEPTEMBER 30, 2018 AND DECEMBER 31, 2017

	September 30, 2018	December 31, 2017
	(In thousands)	
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	\$ 537,945	\$ 478,182
Money market investments	5,805	7,021
Total cash and cash equivalents	543,750	485,203
Restricted cash	3,030	3,030
Investments:		
Trading securities, at fair value, with amortized cost of \$647 (December 31, 2017 - \$647)	405	191
Investment securities available-for-sale, at fair value, with amortized cost of \$872,895 (December 31, 2017 - \$648,800)	848,552	645,797
Investment securities held-to-maturity, at amortized cost, with fair value of \$425,066 (December 31, 2017 - \$497,681)	444,679	506,064
Federal Home Loan Bank (FHLB) stock, at cost	12,461	13,995
Other investments	3	3
Total investments	1,306,100	1,166,050
Loans:		
Loans held-for-sale, at lower of cost or fair value	8,979	12,272
Loans held for investment, net of allowance for loan and lease losses of \$165,742 (December 31, 2017 - \$167,509)	4,344,001	4,044,057
Total loans	4,352,980	4,056,329
Other assets:		
Foreclosed real estate	37,868	44,174
Accrued interest receivable	33,452	49,969
Deferred tax asset, net	122,934	127,421
Premises and equipment, net	67,762	67,860
Customers' liability on acceptances	28,682	27,663
Servicing assets	10,866	9,821
Derivative assets	1,265	771
Goodwill	86,069	86,069
Other assets	61,916	64,693
Total assets	\$ 6,656,674	\$ 6,189,053

See notes to unaudited consolidated financial statements

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF SEPTEMBER 30, 2018 AND DECEMBER 31, 2017 (CONTINUED)

	September 30, 2018		December 31, 2017
	(In thousands)		
LIABILITIES AND STOCKHOLDERS' EQUITY			
Deposits:			
Demand deposits	\$ 2,304,067	\$	2,039,126
Savings accounts	1,243,535		1,251,398
Time deposits	1,541,391		1,508,958
Total deposits	5,088,993		4,799,482
Borrowings:			
Securities sold under agreements to repurchase	378,237		192,869
Advances from FHLB	73,531		99,643
Subordinated capital notes	36,083		36,083
Other borrowings	192		153
Total borrowings	488,043		328,748
Other liabilities:			
Derivative liabilities	622		1,281
Acceptances executed and outstanding	28,682		27,644
Accrued expenses and other liabilities	80,448		86,791
Total liabilities	5,686,788		5,243,946
Commitments and contingencies (See Note 20)			
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, 2017 - 1,340,000 shares; 1,380,000 shares; and 960,000			
shares) \$25 liquidation value	92,000		92,000
84,000 shares of Series C issued and outstanding (December 31, 2017 -			
84,000 shares); \$1,000 liquidation value	84,000		84,000
Common stock, \$1 par value; 100,000,000 shares authorized; 52,625,869 shares			
issued: 44,005,741 shares outstanding (December 31, 2017 - 52,625,869; 43,947,442)	52,626		52,626
Additional paid-in capital	542,078		541,600

Edgar Filing: OFG BANCORP - Form 10-Q

Legal surplus	87,563	81,454
Retained earnings	236,120	200,878
Treasury stock, at cost, 8,620,003 shares (December 31, 2017 - 8,678,427 shares)	(103,706)	(104,502)
Accumulated other comprehensive (loss), net of tax of \$2,904 (December 31, 2017 - \$564)	(20,795)	(2,949)
Total stockholders' equity	969,886	945,107
Total liabilities and stockholders' equity	\$ 6,656,674	\$ 6,189,053

See notes to unaudited consolidated financial statements

2

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2018 AND 2017

	Quarter Ended		Nine-Month Period	
	September 30,		Ended September 30,	
	2018	2017	2018	2017
	(In thousands, except per share data)			
Interest income:				
Loans	\$ 84,016	\$ 82,467	\$ 237,057	\$ 237,355
Mortgage-backed securities	8,173	6,245	23,258	20,728
Investment securities and other	1,948	1,643	4,998	4,390
Total interest income	94,137	90,355	265,313	262,473
Interest expense:				
Deposits	8,605	7,601	23,554	22,606
Securities sold under agreements to repurchase	2,242	1,282	5,159	6,260
Advances from FHLB and other borrowings	517	596	1,339	1,799
Subordinated capital notes	496	398	1,402	1,149
Total interest expense	11,860	9,877	31,454	31,814
Net interest income	82,277	80,478	233,859	230,659
Provision for loan and lease losses, net	14,601	44,042	44,808	88,232
Net interest income after provision for loan and lease losses	67,676	36,436	189,051	142,427
Non-interest income:				
Banking service revenue	10,797	9,923	32,404	31,007
Wealth management revenue	6,407	6,016	18,688	18,747
Mortgage banking activities	1,242	1,274	3,987	2,820
Total banking and financial service revenues	18,446	17,213	55,079	52,574
FDIC shared-loss benefit, net	-	-	-	1,403
Net gain on:				
Sale of securities	-	4	-	6,896
Derivatives	-	-	-	103
Early extinguishment of debt	-	-	-	(80)
Other non-interest income	174	695	758	976
Total non-interest income, net	18,620	17,912	55,837	61,872

See notes to unaudited consolidated financial statements

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2018 AND 2017
(CONTINUED)

	Quarter Ended		Nine-Month Period	
	September 30,	September 30,	Ended September 30,	Ended September 30,
	2018	2017	2018	2017
	(In thousands, except per share data)			
Non-interest expense:				
Compensation and employee benefits	18,495	19,882	57,202	59,546
Professional and service fees	3,077	3,113	8,917	9,575
Occupancy and equipment	8,388	8,276	25,322	24,012
Insurance	1,620	1,052	4,580	3,834
Electronic banking charges	5,586	5,021	15,968	15,373
Information technology expenses	2,056	2,046	6,064	6,114
Advertising, business promotion, and strategic initiatives	1,329	1,405	3,700	4,205
Loss on sale of foreclosed real estate and other repossessed assets	1,210	1,395	2,828	4,508
Loan servicing and clearing expenses	1,251	1,134	3,639	3,592
Taxes, other than payroll and income taxes	2,175	2,243	6,820	7,007
Communication	927	855	2,627	2,682
Printing, postage, stationary and supplies	499	586	1,748	1,889
Director and investor relations	223	221	800	775
Credit related expenses	2,736	1,714	7,052	6,557
Other	1,369	1,526	8,095	5,300
Total non-interest expense	50,941	50,469	155,362	154,969
Income before income taxes	35,355	3,879	89,526	49,330
Income tax expense	12,255	560	29,860	13,757
Net income	23,100	3,319	59,666	35,573
Less: dividends on preferred stock	(3,466)	(3,465)	(10,396)	(10,396)
Income (loss) available to common shareholders	\$ 19,634	\$ (146)	\$ 49,270	\$ 25,177
Earnings per common share:				
Basic	\$ 0.45	\$ -	\$ 1.12	\$ 0.57
Diluted	\$ 0.42	\$ -	\$ 1.07	\$ 0.56
Average common shares outstanding and equivalents	51,464	51,102	51,344	51,095
Cash dividends per share of common stock	\$ 0.06	\$ 0.06	\$ 0.18	\$ 0.18

See notes to unaudited consolidated financial statements

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2018 AND 2017

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Net income	\$ 23,100	\$ 3,319	\$ 59,666	\$ 35,573
Other comprehensive (loss) income before tax:				
Unrealized (loss) gain on securities available-for-sale	(6,375)	1,445	(21,340)	6,766
Realized gain on investment securities included in net income	-	(4)	-	(6,896)
Unrealized gain on cash flow hedges	223	56	1,153	136
Other comprehensive (loss) income before taxes	(6,152)	1,497	(20,187)	6
Income tax effect	619	(348)	2,341	(760)
Other comprehensive (loss) income after taxes	(5,533)	1,149	(17,846)	(754)
Comprehensive income	\$ 17,567	\$ 4,468	\$ 41,820	\$ 34,819

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, 2018 AND 2017

	Nine-Month Period Ended September 30,	
	2018	2017
	(In thousands)	
Preferred stock:		
Balance at beginning of period	\$ 176,000	\$ 176,000
Balance at end of period	176,000	176,000
Common stock:		
Balance at beginning of period	52,626	52,626
Balance at end of period	52,626	52,626
Additional paid-in capital:		
Balance at beginning of period	541,600	540,948
Stock-based compensation expense	978	811
Stock-based compensation excess tax benefit recognized in income	(140)	(99)
Lapsed restricted stock units	(360)	(358)
Balance at end of period	542,078	541,302
Legal surplus:		
Balance at beginning of period	81,454	76,293
Transfer from retained earnings	6,109	3,502
Balance at end of period	87,563	79,795
Retained earnings:		
Balance at beginning of period	200,878	177,808
Net income	59,666	35,573
Cash dividends declared on common stock	(7,919)	(7,916)
Cash dividends declared on preferred stock	(10,396)	(10,396)
Transfer to legal surplus	(6,109)	(3,502)
Balance at end of period	236,120	191,567
Treasury stock:		
Balance at beginning of period	(104,502)	(104,860)
Lapsed restricted stock units	796	358
Balance at end of period	(103,706)	(104,502)
Accumulated other comprehensive (loss), net of tax:		
Balance at beginning of period	(2,949)	1,596
Other comprehensive (loss), net of tax	(17,846)	(754)
Balance at end of period	(20,795)	842
Total stockholders' equity	\$ 969,886	\$ 937,630

See notes to unaudited consolidated financial statements

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2018 AND 2017

	Nine-Month Period Ended September 30, 2018 2017 (In thousands)	
Cash flows from operating activities:		
Net income	\$ 59,666	\$ 35,573
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred loan origination fees and fair value premiums on acquired loans	3,433	2,531
Amortization of investment securities premiums, net of accretion of discounts	4,426	6,108
Amortization of core deposit and customer relationship intangibles	989	1,105
FDIC shared-loss benefit	-	(1,403)
Depreciation and amortization of premises and equipment	6,642	6,654
Deferred income tax expense, net	6,827	(2,619)
Provision for loan and lease losses	44,808	88,232
Stock-based compensation	978	811
Stock-based compensation excess tax benefit recognized in income	(140)	(99)
(Gain) loss on:		
Sale of loans	(275)	(792)
Derivatives	1	(103)
Sale of securities	-	(6,896)
Early extinguishment of debt	-	80
Foreclosed real estate and other repossessed assets	2,828	5,084
Sale of other assets	(107)	(539)
Originations of loans held-for-sale	(72,512)	(103,194)
Proceeds from sale of loans held-for-sale	21,593	68,758
Net (increase) decrease in:		
Trading securities	(214)	63
Accrued interest receivable	16,517	(2,509)
Servicing assets	(1,045)	40
Other assets	2,405	14,260
Net (decrease) in:		
Accrued interest on deposits and borrowings	643	(345)
Accrued expenses and other liabilities	(23,836)	(4,745)
Net cash provided by operating activities	73,627	106,055

See notes to unaudited consolidated financial statements

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2018 AND 2017 (CONTINUED)

	Nine-Month Period Ended September 30,	
	2018	2017
	(In thousands)	
Cash flows from investing activities:		
Purchases of:		
Investment securities available-for-sale	(271,062)	(128,969)
FHLB stock	(113,506)	(26,730)
Maturities and redemptions of:		
Investment securities available-for-sale	89,753	83,669
Investment securities held-to-maturity	58,477	65,877
FHLB stock	115,040	23,507
Proceeds from sales of:		
Investment securities available-for-sale	14,746	256,996
Foreclosed real estate and other repossessed assets, including write-offs	38,816	31,829
Premises and equipment	1,670	569
Origination and purchase of loans, excluding loans held-for-sale	(1,015,960)	(546,616)
Principal repayment of loans	632,333	571,098
Repayments to FDIC on shared-loss agreements	-	(10,125)
Additions to premises and equipment	(8,107)	(4,271)
Net cash (used in) provided by investing activities	(457,800)	316,834
Cash flows from financing activities:		
Net increase (decrease) in:		
Deposits	301,195	180,958
Securities sold under agreements to repurchase	185,308	(369,816)
FHLB advances, federal funds purchased, and other borrowings	(25,904)	(5,436)
Restricted units lapsed	436	-
Dividends paid on preferred stock	(10,397)	(10,396)
Dividends paid on common stock	(7,918)	(7,912)
Net cash provided (used in) financing activities	442,720	\$ (212,602)
Net change in cash, cash equivalents and restricted cash	58,547	210,287
Cash, cash equivalents and restricted cash at beginning of period	488,233	513,469
Cash, cash equivalents and restricted cash at end of period	\$ 546,780	\$ 723,756
Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:		
Interest paid	\$ 29,523	\$ 30,777
Income taxes paid	\$ 13,446	\$ 23
	\$ 59,050	\$ 69,148

Mortgage loans securitized into mortgage-backed securities

Transfer from loans to foreclosed real estate and other repossessed assets	\$	36,848	\$	37,852
Reclassification of loans held-for-investment portfolio to held-for-sale portfolio	\$	5,795	\$	33,647
Reclassification of loans held-for-sale portfolio to held-for-investment portfolio	\$	1,247	\$	112
Financed sales of foreclosed real estate	\$	912	\$	579
Loans booked under the GNMA buy-back option	\$	13,325	\$	12,999

See notes to unaudited consolidated financial statements

8

OFG BANCORP

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2018 AND 2017 (CONTINUED)

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION, CONSOLIDATION AND BASIS OF PRESENTATION

Nature of Operations

OFG Bancorp (“Oriental”) is a publicly-owned financial holding company incorporated under the laws of the Commonwealth of Puerto Rico. Oriental 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”), a retirement plan administrator, Oriental Pension Consultants, Inc. (“OPC”), and two operating subsidiaries of the Bank, OFG USA LLC (“OFG USA”) and Oriental International Bank Inc. (“OIB”). Through these subsidiaries and their respective divisions, Oriental 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 February 6, 2017, the Bank and the FDIC agreed to terminate the shared-loss agreements related to the Eurobank Acquisition. On December 18, 2012, Oriental 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.” These acquired businesses have been integrated with Oriental’s existing business.

New Accounting Updates Not Yet Adopted

Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force). In August 2018, the FASB issued Accounting Standards Update (“ASU”) 2018-15, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). Accordingly, ASU 2018-15 requires an entity (customer) in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The ASU also requires the entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a

service contract over the term of the hosting arrangement, which includes reasonably certain renewals. This ASU is the final version of Proposed Accounting Standards Update 2018-230—Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, which has been deleted. This ASU will be applied prospectively for annual and interim periods in fiscal years beginning after December 15, 2019. Early adoption is permitted. We will assess the impact that the adoption of ASU 2018-15 will have on our consolidated financial statements and related disclosures during the year 2019.

Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement. In August 2018, the FASB issued ASU 2018-13, which improves the effectiveness of fair value measurement disclosures. ASU 2018-13 modifies the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement, based on the concepts in FASB Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements, including the consideration of costs and benefits. This ASU is the final version of Proposed Accounting Standards Update 2015-350—Fair Value Measurement (Topic 820)—Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurements, which has been deleted. This ASU will be applied prospectively for annual and interim periods in fiscal years beginning after December 15, 2019. We will assess the impact that the adoption of ASU 2018-13 will have on our consolidated financial statements and related disclosures during the year 2019.

Codification Improvements. In July 2018, the FASB issued ASU 2018-9, which represents changes to clarify the FASB Accounting Standards Codification (the “Codification”), correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Some of the amendments make the Codification easier to understand and easier to apply by eliminating inconsistencies, providing needed clarifications, and improving the presentation of guidance in the Codification. The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments in this ASU do not require transition guidance and will be effective upon issuance of this ASU. However, many of the amendments in this ASU do have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Premium Amortization on Purchased Callable Debt Securities Receivables. In March 2017, the FASB issued ASU No. 2017-08, which requires the amortization of the premium on callable debt securities to the earliest call date. The amortization period for callable debt securities purchased at a discount would not be impacted by the ASU. This ASU will be applied prospectively for annual and interim periods in fiscal years beginning after December 15, 2018. The ASU is not expected to have a material impact on Oriental's consolidated financial position or results of operations. At September 30, 2018, Oriental does not have callable debt securities.

Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): Employee Benefit Plan Master Trust Reporting (a consensus of the Emerging Issues Task Force). In February 2017, the FASB issued ASU No. 2017-06, which intended to reduce diversity and improve the usefulness of information provided by employee benefit plans that hold interests in master trusts. This ASU will be applied prospectively for annual and interim periods in fiscal years beginning after December 15, 2018. The ASU is not expected to have a material impact on Oriental's consolidated financial position or results of operations.

Simplifying the Test for Goodwill Impairment. In January 2017, the FASB issued ASU No. 2017-04, which simplifies the measurement of goodwill impairment. An entity will no longer perform a hypothetical purchase price allocation to measure goodwill impairment. Instead, impairment will be measured using the difference between the carrying amount and the fair value of the reporting unit. This ASU will be applied prospectively for annual and interim periods in fiscal years beginning after December 15, 2019. We will assess the impact that the adoption of ASU 2017-04 will have on our consolidated financial statements and related disclosures during the year 2019.

Measurement of Credit Losses on Financial Instruments. In June 2016, the FASB issued ASU No. 2016-13, which includes an impairment model (known as the current expected credit loss (CECL) model) that is based on expected losses rather than incurred losses. Under the new guidance, an entity recognizes as an allowance its estimate of expected credit losses. ASU No. 2016-13 is effective for fiscal years, and interim periods, beginning after December 15, 2019. Oriental will implement ASU No. 2016-13 on January 1, 2020. While we continue to assess the impact of ASU No. 2016-13, we have developed a roadmap with time schedules in place from 2016 to implementation date. Oriental's cross-functional implementation team has developed a project plan to ensure we comply with all updates from this ASU at the time of adoption. We recently have selected the software and are in the process of assessing the methodology to be used in order to develop an acceptable model to estimate the expected credit losses. After the model has been developed, reviewed and validated in accordance with our governance policies, Oriental will keep disclosing relevant information of concerning implementation process and impact of ASU No. 2016-13, as well as the updating of policies, procedures and internal controls. Although Oriental expects the allowance for credit losses to increase upon adoption with a corresponding adjustment to retained earnings, the ultimate amount of the increase will depend on the portfolio composition, credit quality, economic conditions and reasonable and supportable forecasts at that time.

Leases. In February 2016, the FASB issued ASU No. 2016-02, the FASB issued ASU No. 2016-02, which requires lessees to recognize a right-of-use (ROU) asset and related lease liability for leases classified as operating leases at the commencement date that have lease terms of more than 12 months. The standard, effective January 1, 2019, with early adoption permitted, would have caused us to recognize virtually all leases on the Consolidated Balance Sheets upon adoption and in the comparative period. However, in July 2018, the FASB issued an update to its guidance providing companies with the option to adopt the provisions of the standard prospectively without adjusting comparative periods; we will elect this option and adopt the standard on January 1, 2019. The new standard provides a number of optional practical expedients in transition. We expect to elect the ‘package of practical expedients’, which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We currently expect to elect the short-term lease recognition exemption for all leases that qualify. This means, for those leases that qualify, we will not recognize ROU assets or lease liabilities, and this includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. Oriental’s leases primarily consist of leased office space. At September 30, 2018, Oriental had \$27.7 million of minimum lease commitments from these operating leases (refer to Note 20). While we continue to assess the potential impacts upon adoption, we do not expect a material impact on our financial position, results of operations, cash flows or regulatory risk-based capital. Preliminarily we expect that the amounts to be recognized as right-of-use assets and lease liabilities will be less than 1% of our total assets.

New Accounting Updates Adopted During the Nine-month Period Ended September 30, 2018

Restricted Cash. In November 2016, the FASB issued ASU No. 2016-18, which amends Topic 230 (Statement of Cash Flows) and requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. ASU No. 2016-18 is intended to reduce diversity in practice in how restricted cash or restricted cash equivalents are presented and classified in the statement of cash flows. ASU No. 2016-18 is

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

effective for fiscal years, and interim periods, beginning after December 15, 2017. The standard requires application using a retrospective transition method. The adoption of ASU No. 2016-18 on January 1, 2018, changed the presentation and classification of restricted cash and restricted cash equivalents in our consolidated statements of cash flows.

Revenue from Contracts with Customers. In May 2014, the FASB issued ASU No. 2014-09, which supersedes the revenue recognition requirements Topic 605 (Revenue Recognition), and most industry-specific guidance. ASU No. 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU No. 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU No. 2014-09 permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). In August 2015, the FASB issued ASU No. 2015-14 to defer the effective date of ASU No. 2014-09 by one year to fiscal years beginning after December 15, 2017. Oriental has adopted this ASU on January 1, 2018 using the modified retrospective method. Oriental's implementation efforts included the identification of revenue streams that are within the scope of the new guidance and the review of related contracts with customers to determine their effect on certain non-interest income items presented in our consolidated statements of operations and the additional presentation disclosures required (refer to note 22). We concluded that substantially all of Oriental's revenues are generated from activities that are outside the scope of this ASU, and the adoption did not have a material impact on our consolidated financial statements. Therefore, there was no cumulative effect adjustment recorded.

NOTE 2 – SIGNIFICANT EVENTS

Hurricanes Irma and Maria

During 2017, Oriental was impacted by hurricanes Irma and Maria, which struck the Island on September 7, 2017 and September 20, 2017, respectively. Hurricane Maria caused catastrophic damages throughout Puerto Rico, including homes, businesses, roads, bridges, power lines, commercial establishments, and public facilities. It caused an unprecedented crisis when it ravaged the Island's electric power grid less than two weeks after hurricane Irma left over a million Puerto Rico residents without power. For several months after the hurricanes, a large part of Puerto Rico was without electricity, many businesses were unable to operate, and government authorities struggled to deliver emergency supplies and clean drinking water to many communities outside the San Juan metropolitan area. Further, payment and delivery systems, including the U.S. Post Office, were unable to operate for weeks after hurricane Maria.

Almost all of Oriental's operations and clients are located in Puerto Rico. Although Oriental's business operations were disrupted by major damages to Puerto Rico's critical infrastructure, including its electric power grid and telecommunications network, Oriental's digital channels, core banking and electronic funds transfer systems continued to function uninterrupted during and after the hurricanes. Within days after hurricane Maria, and upon securing a continuing supply of diesel fuel for its electric power generators, Oriental was able to open its main offices and many of its branches and ATMs in addition to its digital and phone trade channels.

As a result of this event, and based on current assessments of information available for the impact of the hurricanes on our credit portfolio, 2017 third and fourth quarter results included an additional loan loss provision of \$27.0 million and \$5.4 million, respectively.

Oriental implemented its disaster response plan as these storms approached its service areas. To operate in disaster response mode, Oriental incurred expenses for, among other things, buying diesel and generators for electric power, debris removal, security measures, property damages, and emergency communication with customers regarding the status of its banking operations. The estimated total non-credit operating costs as of December 31, 2017 amounted to \$6.6 million. No additional losses have been incurred at September 30, 2018.

Oriental maintains insurance for casualty losses as well as for disaster response costs and certain revenue lost through business interruption. Management believes that recovery of \$2.2 million incurred costs as of December 31, 2017 is probable. Oriental received a \$1.0 million partial payment from the insurance company during the quarter ended December 2017 and a \$0.7 million payment during the nine-month period ended September 30, 2018. Accordingly, a receivable of \$0.5 million and \$1.2 million was included in other assets at September 30, 2018 and December 31, 2017, respectively, for the expected recovery.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 3 – RESTRICTED CASH

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

	September 30, 2018		December 31, 2017
	(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		1,050
	\$ 3,030	\$	3,030

At both September 30, 2018 and December 31, 2017, the Bank's international banking entities, OIB and Oriental Overseas, a division of the Bank, held an unencumbered certificate of deposit and other short-term highly liquid securities in the amount of \$300 thousand and \$325 thousand, respectively, as the legal reserve required for international banking entities under Puerto Rico law. These instruments cannot be withdrawn or transferred by OIB or Oriental Overseas without prior written approval of the Office of the Commissioner of Financial Institutions of Puerto Rico (the "OCFI").

As part of its derivative activities, Oriental has entered into collateral agreements with certain financial counterparties. At both September 30, 2018 and December 31, 2017, Oriental had delivered approximately \$2.0 million of cash as collateral for such derivatives activities.

Oriental has a contract with FNMA which requires collateral to guarantee the repurchase, if necessary, of loans sold with recourse. At both September 30, 2018 and December 31, 2017, Oriental delivered as collateral cash amounting to approximately \$1.1 million.

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, 2018 was \$212.7 million (December 31, 2017 - \$189.2 million). At September 30, 2018 and December 31, 2017, the Bank complied with this requirement. Cash and due from bank as well as other short-term, highly liquid securities, are used to cover the required average reserve balances.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 4 – INVESTMENT SECURITIES

Money Market Investments

Oriental 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, 2018 and December 31, 2017, money market instruments included as part of cash and cash equivalents amounted to \$5.8 million and \$7.0 million, respectively.

Investment Securities

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the securities owned by Oriental at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (In thousands)	Fair Value	Weighted Average Yield
Available-for-sale					
Mortgage-backed securities					
FNMA and FHLMC certificates	\$ 586,097	\$ 20	\$ 15,799	\$ 570,318	2.59%
GNMA certificates	202,585	300	5,431	197,454	3.06%
CMOs issued by US government-sponsored agencies	69,960	-	3,194	66,766	1.90%
Total mortgage-backed securities	858,642	320	24,424	834,538	2.64%
Investment securities					
US Treasury securities	10,617	-	157	10,460	1.32%
Obligations of US government-sponsored agencies	2,484	-	89	2,395	1.38%

Edgar Filing: OFG BANCORP - Form 10-Q

Other debt securities	1,152	7	-	1,159	2.99%
Total investment securities	14,253	7	246	14,014	1.46%
Total securities available for sale	\$ 872,895	\$ 327	\$ 24,670	\$ 848,552	2.62%
Held-to-maturity					
Mortgage-backed securities					
FNMA and FHLMC certificates	\$ 444,679	\$ -	\$ 19,613	\$ 425,066	2.07%

14

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2017				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (In thousands)	Fair Value	Weighted Average Yield
Available-for-sale					
Mortgage-backed securities					
FNMA and FHLMC certificates	\$ 383,194	\$ 1,402	\$ 2,881	\$ 381,715	2.39%
GNMA certificates	166,436	1,486	584	167,338	2.94%
CMOs issued by US government-sponsored agencies	82,026	-	1,955	80,071	1.90%
Total mortgage-backed securities	631,656	2,888	5,420	629,124	2.47%
Investment securities					
US Treasury securities	10,276	-	113	10,163	1.25%
Obligations of US government-sponsored agencies	2,927	-	48	2,879	1.38%
Obligations of Puerto Rico government and public instrumentalities	2,455	-	362	2,093	5.55%
Other debt securities	1,486	52	-	1,538	2.97%
Total investment securities	17,144	52	523	16,673	2.04%
Total securities available-for-sale	\$ 648,800	\$ 2,940	\$ 5,943	\$ 645,797	2.46%
Held-to-maturity					
Mortgage-backed securities					
FNMA and FHLMC certificates	\$ 506,064	\$ -	\$ 8,383	\$ 497,681	2.07%

The amortized cost and fair value of Oriental's investment securities at September 30, 2018, 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.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	September 30, 2018			
	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Mortgage-backed securities				
Due from 1 to 5 years				
FNMA and FHLMC				
certificates	\$ 4,241	\$ 4,142	\$ -	\$ -
Total due from 1 to 5 years	4,241	4,142	-	-
Due after 5 to 10 years				
CMOs issued by US				
government-sponsored agencies	\$ 61,590	\$ 58,617	\$ -	\$ -
FNMA and FHLMC				
certificates	235,031	228,438	-	-
Total due after 5 to 10	296,621	287,055	-	-
years				
Due after 10 years				
FNMA and FHLMC				
certificates	\$ 346,825	\$ 337,738	\$ 444,679	\$ 425,066
GNMA certificates	202,585	197,454	-	-
CMOs issued by US				
government-sponsored agencies	8,370	8,149	-	-
Total due after 10 years	557,780	543,341	444,679	425,066
Total mortgage-backed				
securities	858,642	834,538	444,679	425,066
Investment securities				
Due less than one year				
US Treasury securities	\$ 646	\$ 645	\$ -	\$ -
Total due in less than one				
year	646	645	-	-
Due from 1 to 5 years				
US Treasury securities	\$ 9,971	\$ 9,815	\$ -	\$ -
Obligations of US government				
and sponsored agencies	2,484	2,395	-	-
Total due from 1 to 5 years	12,455	12,210	-	-
Due from 5 to 10 years				
Other debt securities	1,152	1,159	-	-
Total due after 5 to 10				
years	1,152	1,159	-	-
Total investment				
securities	14,253	14,014	-	-
Total	\$ 872,895	\$ 848,552	\$ 444,679	\$ 425,066

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

During the nine month-period ended September 30, 2018, Oriental sold \$14.7 million of available-for-sale Government National Mortgage Association (“GNMA”) certificates from 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, 2017, Oriental sold \$166.0 million of mortgage-backed securities and \$84.1 million of US Treasury securities, and recorded a net gain on sale of securities of \$6.9 million.

<u>Description</u>	Nine-Month Period Ended September 30, 2018			
	Sale Price	Book Value at Sale	Gross Gains	Gross Losses
	(In thousands)			
Sale of securities available-for-sale				
Mortgage-backed securities				
GNMA certificates	\$ 14,746	\$ 14,746	\$ -	\$ -
Total	\$ 14,746	\$ 14,746	\$ -	\$ -

<u>Description</u>	Nine-Month Period Ended September 30, 2017			
	Sale Price	Book Value at Sale	Gross Gains	Gross Losses
	(In thousands)			
Sale of securities available-for-sale				
Mortgage-backed securities				
FNMA and FHLMC certificates	\$ 107,510	\$ 102,311	\$ 5,199	\$ -
GNMA certificates	65,284	63,704	1,580	-
Investment securities				
US Treasury securities	84,202	84,085	117	-
Total mortgage-backed securities	\$ 256,996	\$ 250,100	\$ 6,896	\$ -

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following tables show Oriental'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, 2018 and December 31, 2017:

	Amortized Cost	September 30, 2018 12 months or more Unrealized Loss (In thousands)	Fair Value
Securities available-for-sale			
CMOs issued by US Government-sponsored agencies	\$ 68,960	\$ 3,174	\$ 65,786
FNMA and FHLMC certificates	160,420	7,451	152,969
Obligations of US Government and sponsored agencies	2,484	89	2,395
GNMA certificates	28,296	1,606	26,690
US Treasury Securities	9,971	157	9,814
	\$ 270,131	\$ 12,477	\$ 257,654
Securities held to maturity			
FNMA and FHLMC certificates	\$ 381,941	\$ 17,619	\$ 364,322
	Amortized Cost	Less than 12 months Unrealized Loss (In thousands)	Fair Value
Securities available-for-sale			
CMOs issued by US government-sponsored agencies	\$ 1,000	\$ 20	\$ 980
FNMA and FHLMC certificates	425,094	8,348	416,746
GNMA certificates	145,438	3,825	141,613
US Treasury Securities	646	-	646
	\$ 572,178	\$ 12,193	\$ 559,985
Securities held-to-maturity			
FNMA and FHLMC Certificates	\$ 62,738	\$ 1,994	\$ 60,744
	Amortized Cost	Total Unrealized Loss (In thousands)	Fair Value
Securities available-for-sale			
CMOs issued by US government-sponsored agencies	\$ 69,960	\$ 3,194	\$ 66,766
FNMA and FHLMC certificates	585,514	15,799	569,715
Obligations of US government and sponsored agencies	2,484	89	2,395

Edgar Filing: OFG BANCORP - Form 10-Q

GNMA certificates		173,734		5,431		168,303
US Treasury Securities		10,617		157		10,460
	\$	842,309	\$	24,670	\$	817,639
Securities held-to-maturity						
FNMA and FHLMC certificates	\$	444,679	\$	19,613	\$	425,066

18

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Amortized Cost	December 31, 2017 12 months or more Unrealized Loss (In thousands)	Fair Value
Securities available-for-sale			
CMOs issued by US Government-sponsored agencies	\$ 72,562	\$ 1,857	\$ 70,705
FNMA and FHLMC certificates	111,635	2,122	109,513
Obligations of US Government and sponsored agencies	2,927	48	2,879
Obligations of Puerto Rico government and public instrumentalities	2,455	362	2,093
GNMA certificates	20,803	499	20,304
US Treasury Securities	9,952	113	9,839
	\$ 220,334	\$ 5,001	\$ 215,333

Securities available-for-sale			
FNMA and FHLMC certificates	\$ 352,399	7,264	345,135

	Amortized Cost	Less than 12 months Unrealized Loss (In thousands)	Fair Value
Securities available-for-sale			
CMOs issued by US Government-sponsored agencies	9,464	98	9,366
FNMA and FHLMC certificates	125,107	759	124,348
GNMA certificates	14,001	85	13,916
US Treasury Securities	324	-	324
	\$ 148,896	\$ 942	\$ 147,954

Securities held to maturity			
FNMA and FHLMC certificates	\$ 153,665	\$ 1,119	\$ 152,546

	Amortized Cost	Total Unrealized Loss (In thousands)	Fair Value
Securities available-for-sale			
CMOs issued by US Government-sponsored agencies	82,026	1,955	80,071
FNMA and FHLMC certificates	236,742	2,881	233,861
Obligations of Puerto Rico government and public instrumentalities	2,455	362	2,093
	2,927	48	2,879

Edgar Filing: OFG BANCORP - Form 10-Q

Obligations of US government and sponsored agencies

GNMA certificates	34,804		584		34,220
US Treasury Securities	10,276		113		10,163
	\$ 369,230	\$	5,943	\$	363,287

Securities held to maturity

FNMA and FHLMC certificates	\$ 506,064	\$	8,383	\$	497,681
-----------------------------	-------------------	-----------	--------------	-----------	----------------

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Oriental performs valuations of the investment securities on a monthly basis. Moreover, Oriental 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 Oriental believes that the methodology used to value these exposures is reasonable, the methodology is subject to continuing improvement, 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.

All of the investments (\$1.2 billion, amortized cost) with an unrealized loss position at September 30, 2018 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.

NOTE 5 - LOANS

Oriental's loan portfolio 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.

The composition of Oriental's loan portfolio at September 30, 2018 and December 31, 2017 was as follows:

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	September 30, 2018	December 31, 2017
	(In thousands)	
Originated and other loans and leases held for investment:		
Mortgage	\$ 667,224	\$ 683,607
Commercial	1,540,027	1,307,261
Consumer	345,399	330,039
Auto and leasing	1,084,912	883,985
	3,637,562	3,204,892
Allowance for loan and lease losses on originated and other loans and leases	(95,236)	(92,718)
	3,542,326	3,112,174
Deferred loan costs, net	7,556	6,695
Total originated and other loans held for investment, net	3,549,882	3,118,869
Acquired loans:		
Acquired BBVAPR loans:		
Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)		
Commercial	2,778	4,380
Consumer	24,914	28,915
Auto	7,494	21,969
	35,186	55,264
Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-20	(2,350)	(3,862)
	32,836	51,402
Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy)		
Mortgage	503,861	532,053
Commercial	190,178	243,092
Consumer	95	1,431
Auto	20,363	43,696
	714,497	820,272
Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-30	(43,875)	(45,755)
	670,622	774,517
Total acquired BBVAPR loans, net	703,458	825,919
Acquired Eurobank loans:		
Loans secured by 1-4 family residential properties	64,785	69,538
Commercial	49,262	53,793
Consumer	895	1,112
Total acquired Eurobank loans	114,942	124,443
Allowance for loan and lease losses on Eurobank loans	(24,281)	(25,174)
Total acquired Eurobank loans, net	90,661	99,269

Total acquired loans, net		794,119		925,188
Total held for investment, net		4,344,001		4,044,057
Mortgage loans held-for-sale		8,979		12,272
Total loans, net	\$	4,352,980	\$	4,056,329

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

As a result of the devastation caused by hurricanes Irma and Maria, Oriental offered an automatic three-month moratorium for the payment due on certain loans. The level of delinquencies for mortgage and auto loans as of December 31, 2017 was impacted by the loan moratorium. Aging of current and early delinquent loans in moratorium were frozen at September 30, 2017, throughout the moratorium period. In addition, although the repayment schedule was modified as part of the moratorium, certain borrowers continued to make payments shortly after the moratorium, having an impact on the respective delinquency status at December 31, 2017. At September 30, 2018, all of the loan moratoriums have expired, and total delinquency levels have returned to pre-hurricane levels with some improvements.

Originated and Other Loans and Leases Held for Investment

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

The tables below present the aging of the recorded investment in gross originated and other loans held for investment at September 30, 2018 and December 31, 2017, 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.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

September 30, 2018

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
	(In thousands)						
Mortgage							
Traditional (by origination year):							
Up to the year							
2002	\$ 276	\$ 890	\$ 3,272	\$ 4,438	\$ 38,120	\$ 42,558	\$ 240
Years 2003 and 2004	237	1,740	6,587	8,564	69,146	77,710	-
Year 2005	92	858	3,515	4,465	36,710	41,175	-
Year 2006	348	1,484	4,747	6,579	51,392	57,971	-
Years 2007, 2008							
and 2009	178	1,195	7,774	9,147	54,223	63,370	56
Years 2010, 2011, 2012, 2013	258	1,238	7,946	9,442	106,819	116,261	180
Years 2014, 2015, 2016, 2017 and 2018	-	593	1,303	1,896	130,610	132,506	-
	1,389	7,998	35,144	44,531	487,020	531,551	476
Non-traditional Loss mitigation program	-	117	2,740	2,857	11,842	14,699	-
	10,346	5,435	20,797	36,578	70,819	107,397	2,631
	11,735	13,550	58,681	83,966	569,681	653,647	3,107
Home equity secured personal loans	-	-	-	-	252	252	-
GNMA's buy-back option program	-	-	13,325	13,325	-	13,325	-
	11,735	13,550	72,006	97,291	569,933	667,224	3,107
Commercial							
Commercial secured by real estate:							

Edgar Filing: OFG BANCORP - Form 10-Q

Corporate	-	-	-	-	306,372	306,372	-
Institutional	-	-	-	-	72,372	72,372	-
Middle market	839	-	5,481	6,320	175,822	182,142	-
Retail	1,242	309	9,245	10,796	210,101	220,897	-
Floor plan	-	-	-	-	3,579	3,579	-
Real estate	-	-	-	-	19,347	19,347	-
	2,081	309	14,726	17,116	787,593	804,709	-
Other							
commercial and							
industrial:							
Corporate	-	-	-	-	163,766	163,766	-
Institutional	-	-	-	-	143,886	143,886	-
Middle market	-	3,480	2,751	6,231	91,484	97,715	-
Retail	720	131	792	1,643	287,755	289,398	-
Floor plan	150	-	51	201	40,352	40,553	-
	870	3,611	3,594	8,075	727,243	735,318	-
	2,951	3,920	18,320	25,191	1,514,836	1,540,027	-

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

September 30, 2018

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
	(In thousands)						
Consumer							
Credit cards	\$ 580	\$ 200	\$ 602	\$ 1,382	\$ 26,342	\$ 27,724	\$ -
Overdrafts	27	-	-	27	129	156	-
Personal lines of credit	44	3	70	117	1,819	1,936	-
Personal loans	3,864	1,731	1,197	6,792	292,738	299,530	-
Cash collateral personal loans	146	66	-	212	15,841	16,053	-
	4,661	2,000	1,869	8,530	336,869	345,399	-
Auto and leasing	54,888	26,940	12,148	93,976	990,936	1,084,912	-
Total	\$ 74,235	\$ 46,410	\$ 104,343	\$ 224,988	\$ 3,412,574	\$ 3,637,562	\$ 3,107

24

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2017

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due (In thousands)	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
Mortgage							
Traditional (by origination year):							
Up to the year 2002	\$ 86	\$ 938	\$ 3,537	\$ 4,561	\$ 41,579	\$ 46,140	\$ 467
Years 2003 and 2004	92	1,077	6,304	7,473	75,758	83,231	-
Year 2005	101	383	3,348	3,832	40,669	44,501	68
Year 2006	242	604	5,971	6,817	55,966	62,783	66
Years 2007, 2008	358	1,258	8,561	10,177	58,505	68,682	577
and 2009							
Years 2010, 2011, 2012, 2013	233	978	7,393	8,604	116,674	125,278	1,202
Years 2014, 2015, 2016 and 2017	-	75	1,649	1,724	121,194	122,918	-
	1,112	5,313	36,763	43,188	510,345	553,533	2,380
Non-traditional Loss mitigation program	-	326	3,543	3,869	14,401	18,270	-
	7,233	3,331	18,923	29,487	73,793	103,280	4,981
	8,345	8,970	59,229	76,544	598,539	675,083	7,361
Home equity secured personal loans	-	-	-	-	256	256	-
GNMA's buy-back option program	-	-	8,268	8,268	-	8,268	-
	8,345	8,970	67,497	84,812	598,795	683,607	7,361
Commercial							
Commercial secured by real estate:							

Edgar Filing: OFG BANCORP - Form 10-Q

Corporate	-	-	-	-	235,426	235,426	-
Institutional	-	-	118	118	44,648	44,766	-
Middle market	765	-	3,527	4,292	225,649	229,941	-
Retail	352	936	9,695	10,983	235,084	246,067	-
Floor plan	-	-	-	-	3,998	3,998	-
Real estate	-	-	-	-	17,556	17,556	-
	1,117	936	13,340	15,393	762,361	777,754	-
Other							
commercial and							
industrial:							
Corporate	-	-	-	-	170,015	170,015	-
Institutional	-	-	-	-	125,591	125,591	-
Middle market	-	-	881	881	84,482	85,363	-
Retail	455	103	1,616	2,174	111,078	113,252	-
Floor plan	9	-	51	60	35,226	35,286	-
	464	103	2,548	3,115	526,392	529,507	-
	1,581	1,039	15,888	18,508	1,288,753	1,307,261	-
			25				

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2017

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
	(In thousands)						
Consumer							
Credit cards	\$ 246	\$ 130	\$ 1,227	\$ 1,603	\$ 26,827	\$ 28,430	\$ -
Overdrafts	20	6	31	57	157	214	-
Personal lines of credit	259	54	87	400	1,820	2,220	-
Personal loans	3,778	1,494	223	5,495	278,982	284,477	-
Cash collateral personal loans	103	59	312	474	14,224	14,698	-
	4,406	1,743	1,880	8,029	322,010	330,039	-
Auto and leasing	21,760	10,399	4,232	36,391	847,594	883,985	-
Total	\$ 36,092	\$ 22,151	\$ 89,497	\$ 147,740	\$ 3,057,152	\$ 3,204,892	\$ 7,361

At September 30, 2018 and December 31, 2017, Oriental had a carrying balance of \$91.4 million and \$94.9 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 originated and other loans granted to the Puerto Rico government are general obligations of municipalities secured by ad valorem taxation, without limitation as to rate or amount, on all taxable property within the issuing municipalities. The good faith, credit and unlimited taxing power of each issuing municipality are pledged for the payment of its general obligations.

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 the acquisitions of 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 are accounted for under the guidance of ASC 310-20, which requires that any contractually required loan payment receivable in excess of Oriental'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 Oriental'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.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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, 2018 and December 31, 2017, by class of loans:

September 30, 2018								Loans 90+ Days Past Due and Still Accruing
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans		
(In thousands)								
Commercial								
Commercial secured by real estate								
Retail	\$ -	\$ -	\$ 54	\$ 54	\$ -	\$ 54	\$ -	
Floor plan	-	-	899	899	305	1,204	-	
	-	-	953	953	305	1,258	-	
Other commercial and industrial								
Retail	8	-	25	33	1,485	1,518	-	
Floor plan	-	-	2	2	-	2	-	
	8	-	27	35	1,485	1,520	-	
	8	-	980	988	1,790	2,778	-	
Consumer								
Credit cards	330	110	443	883	21,729	22,612	-	
Personal loans	23	7	58	88	2,214	2,302	-	
	353	117	501	971	23,943	24,914	-	
Auto	665	389	202	1,256	6,238	7,494	-	
Total	\$ 1,026	\$ 506	\$ 1,683	\$ 3,215	\$ 31,971	\$ 35,186	\$ -	

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2017

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
(In thousands)							
Commercial							
Commercial secured by real estate							
Retail	\$ -	\$ -	\$ 119	\$ 119	\$ -	\$ 119	\$ -
Floor plan	-	-	928	928	393	1,321	-
	-	-	1,047	1,047	393	1,440	-
Other commercial and industrial							
Retail	36	-	221	257	2,681	2,938	-
Floor plan	-	-	2	2	-	2	-
	36	-	223	259	2,681	2,940	-
	36	-	1,270	1,306	3,074	4,380	-
Consumer							
Credit cards	208	127	1,310	1,645	24,822	26,467	-
Personal loans	139	61	45	245	2,203	2,448	-
	347	188	1,355	1,890	27,025	28,915	-
Auto	602	248	179	1,029	20,940	21,969	-
Total	\$ 985	\$ 436	\$ 2,804	\$ 4,225	\$ 51,039	\$ 55,264	\$ -

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 Oriental in accordance with ASC 310-30.

Edgar Filing: OFG BANCORP - Form 10-Q

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, 2018 and December 31, 2017 is as follows:

		September 30, 2018		December 31, 2017
			(In thousands)	
Contractual required payments receivable:	\$	1,340,064	\$	1,481,616
Less: Non-accretable discount		347,173		352,431
Cash expected to be collected		992,891		1,129,185
Less: Accretable yield		278,394		308,913
Carrying amount, gross		714,497		820,272
Less: allowance for loan and lease losses		43,875		45,755
Carrying amount, net	\$	670,622	\$	774,517

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

At September 30, 2018 and December 31, 2017, Oriental had \$44.0 million and \$50.3 million, respectively, in loans granted to Puerto Rico municipalities as part of its acquired BBVAPR loans accounted for under ASC 310-30. These loans are primarily secured municipal general obligations.

The following tables describe the accretable yield and non-accretable discount activity of acquired BBVAPR loans accounted for under ASC 310-30 for the quarters and nine-month periods ended September 30, 2018 and 2017:

	Quarter Ended September 30, 2018					Total
	Mortgage	Commercial	Auto	Consumer		
	(In thousands)					
Accretable Yield Activity:						
Balance at beginning of period	\$ 243,903	\$ 42,521	\$ 1,071	\$ 497	\$ 287,992	
Accretion	(6,722)	(3,977)	(466)	(88)	(11,253)	
Change in expected cash flows	-	1,334	3	25	1,362	
Transfer from (to) non-accretable discount	1,456	(1,140)	3	(26)	293	
Balance at end of period	\$ 238,637	\$ 38,738	\$ 611	\$ 408	\$ 278,394	
Non-Accretable Discount Activity:						
Balance at beginning of period	\$ 296,137	\$ 11,143	\$ 23,645	\$ 19,332	\$ 350,257	
Change in actual and expected losses	(1,860)	(1,125)	181	13	(2,791)	
Transfer from accretable yield	(1,456)	1,140	(3)	26	(293)	
Balance at end of period	\$ 292,821	\$ 11,158	\$ 23,823	\$ 19,371	\$ 347,173	

	Nine-Month Period Ended September 30, 2018					Total
	Mortgage	Commercial	Auto	Consumer		
	(In thousands)					
Accretable Yield Activity:						
Balance at beginning of period	\$ 258,498	\$ 46,764	\$ 2,766	\$ 885	\$ 308,913	
Accretion	(20,710)	(11,259)	(1,991)	(538)	(34,498)	
Change in expected cash flows	-	7,265	829	156	8,250	

Edgar Filing: OFG BANCORP - Form 10-Q

Transfer (to) non-accretable discount		849		(4,032)		(993)		(95)		(4,271)
Balance at end of period	\$	238,637	\$	38,738	\$	611	\$	408	\$	278,394
Non-Accretable Discount Activity:										
Balance at beginning of period	\$	299,501	\$	10,596	\$	23,050	\$	19,284	\$	352,431
Change in actual and expected losses		(5,831)		(3,470)		(220)		(8)		(9,529)
Transfer from accretable yield		(849)		4,032		993		95		4,271
Balance at end of period	\$	292,821	\$	11,158	\$	23,823	\$	19,371	\$	347,173

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Quarter Ended September 30, 2017				Total
	Mortgage	Commercial	Auto	Consumer	
	(In thousands)				
Accretable Yield Activity:					
Balance at beginning of period	\$ 270,148	\$ 56,038	\$ 4,853	\$ 1,486	\$ 332,525
Accretion	(7,434)	(7,114)	(1,350)	(384)	(16,282)
Change in actual and expected losses	-	3,716	13	37	3,766
Transfer (to) from non-accretable discount	(6,158)	(2,950)	(8)	26	(9,090)
Balance at end of period	\$ 256,556	\$ 49,690	\$ 3,508	\$ 1,165	\$ 310,919
Non-Accretable Discount Activity:					
Balance at beginning of period	\$ 306,504	\$ 16,867	\$ 23,960	\$ 19,431	\$ 366,762
Change in actual and expected losses	(2,310)	(8,679)	(191)	(124)	(11,304)
Transfer from (to) accretable yield	6,158	2,950	8	(26)	9,090
Balance at end of period	\$ 310,352	\$ 11,138	\$ 23,777	\$ 19,281	\$ 364,548
	Nine-Month Period Ended September 30, 2017				Total
	Mortgage	Commercial	Auto	Consumer	
	(In thousands)				
Accretable Yield Activity:					
Balance at beginning of period	\$ 292,115	\$ 50,366	\$ 8,538	\$ 3,682	\$ 354,701
Accretion	(23,018)	(16,608)	(5,273)	(1,542)	(46,441)
Change in actual and expected losses	2	19,907	163	123	20,195
Transfer (to) from non-accretable discount	(12,543)	(3,975)	80	(1,098)	(17,536)
Balance at end of period	\$ 256,556	\$ 49,690	\$ 3,508	\$ 1,165	\$ 310,919
Non-Accretable Discount Activity:					
Balance at beginning of period	\$ 305,615	\$ 16,965	\$ 22,407	\$ 18,120	\$ 363,107
Change in actual and expected losses	(7,806)	(9,802)	1,450	63	(16,095)
Transfer from (to) accretable yield	12,543	3,975	(80)	1,098	17,536

Balance at end of period	\$	310,352	\$	11,138	\$	23,777	\$	19,281	\$	364,548
---------------------------------	-----------	----------------	-----------	---------------	-----------	---------------	-----------	---------------	-----------	----------------

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Acquired Eurobank Loans

The carrying amount of acquired Eurobank loans at September 30, 2018 and December 31, 2017 is as follows:

	September 30 2018	December 31 2017
	(In thousands)	
Contractual required payments receivable:	\$ 162,204	\$ 179,960
Less: Non-accretable discount	4,187	5,845
Cash expected to be collected	158,017	174,115
Less: Accretable yield	43,075	49,672
Carrying amount, gross	114,942	124,443
Less: Allowance for loan and lease losses	24,281	25,174
Carrying amount, net	\$ 90,661	\$ 99,269

The following tables describe the accretable yield and non-accretable discount activity of acquired Eurobank loans for the quarters and nine-month periods ended September 30, 2018 and 2017:

	Quarter Ended September 30, 2018					
	Loans Secured by 1-4 Family Residential Properties	Commercial	Construction & Development Secured by 1-4 Family Residential Properties (In thousands)	Leasing	Consumer	Total
Accretable Yield Activity:						
Balance at beginning of period	\$ 39,269	4,585	1,224	-	-	45,078
Accretion	(1,440)	(1,883)	-	(7)	(155)	(3,485)
Change in expected cash flows	6	2,063	-	(143)	283	2,209
Transfer (to) from non-accretable discount	188	(412)	(525)	150	(128)	(727)
	\$ 38,023	\$ 4,353	\$ 699	\$ -	\$ -	\$ 43,075

Balance at end of period

Non-Accrutable Discount Activity:

Balance at beginning of period

	\$	2,638	-	981	-	200	3,819
Change in actual and expected losses		63	(412)	-	150	(160)	(359)
Transfer from (to) accretable yield		(188)	412	525	(150)	128	727
Balance at end of period	\$	2,513	\$ -	\$ 1,506	\$ -	\$ 168	\$ 4,187

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Nine-Month Period Ended September 30, 2018

	Loans Secured by 1-4 Family Residential Properties	Commercial	Construction & Development Secured by 1-4 Family Residential Properties (In thousands)	Leasing	Consumer	Total
Accretable Yield Activity:						
Balance at beginning of year	\$ 41,474	\$ 6,751	\$ 1,447	\$ -	\$ -	\$ 49,672
Accretion	(4,583)	(5,195)	-	(45)	(369)	(10,192)
Change in expected cash flows	(974)	4,793	-	(317)	697	4,199
Transfer from (to) non-accretable discount	2,106	(1,996)	(748)	362	(328)	(604)
Balance at end of period	\$ 38,023	\$ 4,353	\$ 699	\$ -	\$ -	\$ 43,075
Non-Accretable Discount Activity:						
Balance at beginning of year	\$ 4,576	\$ 276	\$ 758	\$ -	\$ 235	\$ 5,845
Change in actual and expected losses	43	(2,272)	-	362	(395)	(2,262)
Transfer from (to) accretable yield	(2,106)	1,996	748	(362)	328	604
Balance at end of period	\$ 2,513	\$ -	\$ 1,506	\$ -	\$ 168	\$ 4,187

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Quarter Ended September 30, 2017							
	Loans Secured by 1-4 Family Residential Properties		Commercial	Construction & Development Secured by 1-4 Family Residential Properties (In thousands)		Leasing	Consumer	Total
Accretable Yield Activity:								
Balance at beginning of period	\$ 43,012	\$ 9,157	\$ 1,906	-	\$ -	-	\$ 54,075	
Accretion	(1,736)	(2,480)	(39)	(11)	(73)		(4,339)	
Change in actual and expected losses	18	106	39	(49)	346		460	
Transfer from (to) non-accretable discount	1,094	1,448	(142)	60	(273)		2,187	
Balance at end of period	\$ 42,388	\$ 8,231	\$ 1,764	\$ -	\$ -		\$ 52,383	
Non-Accretable Discount Activity:								
Balance at beginning of period	\$ 6,687	\$ 2,010	\$ 299	-	\$ 14		\$ 9,010	
Change in actual and expected losses	20	126	(39)	60	(55)		112	
Transfer (to) from accretable yield	(1,094)	(1,448)	142	(60)	273		(2,187)	
Balance at end of period	\$ 5,613	\$ 688	\$ 402	\$ -	\$ 232		\$ 6,935	

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Nine-Month Period Ended September 30, 2017						
	Loans Secured by 1-4 Family Residential Properties	Commercial	Construction & Development Secured by 1-4 Family Residential Properties (In thousands)	Leasing	Consumer	Total	
Accretable Yield Activity:							
Balance at beginning of period	\$ 45,839	\$ 16,475	\$ 2,194	\$ -	\$ -	\$ 64,508	
Accretion	(5,564)	(11,051)	(82)	(22)	(268)	(16,987)	
Change in expected cash flows	119	1,427	82	(214)	730	2,144	
Transfer from (to) non-accretable discount	1,994	1,380	(430)	236	(462)	2,718	
Balance at end of period	\$ 42,388	\$ 8,231	\$ 1,764	\$ -	\$ -	\$ 52,383	
Non-Accretable Discount Activity:							
Balance at beginning of period	\$ 8,441	\$ 3,880	\$ 11	\$ -	\$ 8	\$ 12,340	
Change in actual and expected cash flows	(834)	(1,812)	(39)	236	(238)	(2,687)	
Transfer (to) from accretable yield	(1,994)	(1,380)	430	(236)	462	(2,718)	
Balance at end of period	\$ 5,613	\$ 688	\$ 402	\$ -	\$ 232	\$ 6,935	

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Non-accrual Loans

The following table presents the recorded investment in loans in non-accrual status by class of loans as of September 30, 2018 and December 31, 2017:

	September 30, 2018		December 31, 2017
	(In thousands)		
<u>Originated and other loans and leases held for investment</u>			
Mortgage			
Traditional (by origination year):			
Up to the year 2002	\$ 3,088	\$	3,070
Years 2003 and 2004	6,587		6,380
Year 2005	3,727		3,280
Year 2006	4,778		5,905
Years 2007, 2008 and 2009	7,717		7,984
Years 2010, 2011, 2012, 2013	7,766		6,259
Years 2014, 2015, 2016, 2017 and 2018	1,303		1,649
	34,966		34,527
Non-traditional	2,740		3,543
Loss mitigation program	23,292		16,783
	60,998		54,853
Commercial			
Commercial secured by real estate			
Institutional	10,155		118
Middle market	7,619		11,394
Retail	15,662		14,438
	33,436		25,950
Other commercial and industrial			
Middle market	6,561		6,323
Retail	2,759		2,929
Floor plan	51		51
	9,371		9,303
	42,807		35,253
Consumer			
Credit cards	602		1,227
Overdrafts	-		31
Personal lines of credit	80		102
Personal loans	2,434		900
Cash collateral personal loans	-		312

		3,116		2,572
Auto and leasing		12,185		4,232
Total non-accrual originated loans	\$	119,106	\$	96,910
	35			

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	September 30, 2018		December 31, 2017
	(In thousands)		
<u>Acquired BBVAPR loans accounted for under ASC 310-20</u>			
Commercial			
Commercial secured by real estate			
Retail	\$	54	\$ 119
Floor plan		899	928
		953	1,047
Other commercial and industrial			
Retail		25	221
Floor plan		2	2
		27	223
		980	1,270
Consumer			
Credit cards		443	1,310
Personal loans		58	45
		501	1,355
Auto			
		202	179
Total non-accrual acquired BBVAPR loans accounted for under ASC 310-20		1,683	2,804
Total non-accrual loans	\$	120,789	\$ 99,714

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

Delinquent residential mortgage loans insured or guaranteed under applicable FHA and VA programs are classified as non-performing loans when they become 90 days or more past due, but are not placed in non-accrual status until they become 12 months or more past due, since they are insured loans. Therefore, these loans are included as non-performing loans but excluded from non-accrual loans. In addition, these loans are excluded from the impairment analysis.

At September 30, 2018 and December 31, 2017, loans whose terms have been extended and which are classified as troubled-debt restructurings that are not included in non-accrual loans amounted to \$97.7 million and \$109.2 million, respectively, as they are performing under their new terms.

At September 30, 2018 and December 31, 2017, loans that are current in their monthly payments, but placed in non-accrual due to credit deterioration amounted to \$23.6 million and \$20.1 million, respectively.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Impaired Loans

Oriental evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. The total investment in impaired commercial loans that were individually evaluated for impairment was \$69.6 million and \$72.3 million at September 30, 2018 and December 31, 2017, respectively. The impairments on these commercial loans were measured based on the fair value of collateral or the present value of cash flows, including those identified as troubled-debt restructurings. The allowance for loan and lease losses for these impaired commercial loans amounted to \$7.6 million and \$10.6 million at September 30, 2018 and December 31, 2017, respectively. The total investment in impaired mortgage loans that were individually evaluated for impairment was \$85.1 million and \$85.4 million at September 30, 2018 and December 31, 2017, respectively. Impairment on mortgage loans assessed as troubled-debt restructurings was measured using the present value of cash flows. The allowance for loan losses for these impaired mortgage loans amounted to \$10.6 million and \$9.1 million at September 30, 2018 and December 31, 2017, respectively.

Originated and Other Loans and Leases Held for Investment

Oriental's recorded investment in commercial and mortgage loans categorized as originated and other loans and leases held for investment that were individually evaluated for impairment and the related allowance for loan and lease losses at September 30, 2018 and 2017 are as follows:

	September 30, 2018			
	Unpaid Principal	Recorded Investment	Related Allowance	Coverage
	(In thousands)			
Impaired loans with specific allowance:				
Commercial	\$ 38,650	\$ 33,379	\$ 7,607	23%
Residential impaired and troubled-debt restructuring	95,673	85,119	10,620	12%
Impaired loans with no specific allowance:				
Commercial	41,393	35,513	N/A	0%
Total investment in impaired loans	\$ 175,716	\$ 154,011	\$ 18,227	12%

	Unpaid Principal	December 31, 2017 Recorded Investment (In thousands)	Related Allowance	Coverage
Impaired loans with specific allowance:				
Commercial	\$ 57,922	\$ 52,585	\$ 10,573	20%
Residential impaired and troubled-debt restructuring	94,971	85,403	9,121	11%
Impaired loans with no specific allowance				
Commercial	22,022	18,953	N/A	0%
Total investment in impaired loans	\$ 174,915	\$ 156,941	\$ 19,694	13%

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

Oriental's recorded investment in acquired BBVAPR commercial loans accounted for under ASC 310-20 that were individually evaluated for impairment and the related allowance for loan and lease losses at September 30, 2018 and December 31, 2017 are as follows:

			September 30, 2018			
	Unpaid Principal		Recorded Investment	Related Allowance	Coverage	
			(In thousands)			
Impaired loans with specific allowance						
Commercial	\$	926	\$	747	\$ 4	1%
Impaired loans with no specific allowance						
Commercial	\$	-	\$	-	N/A	0%
Total investment in impaired loans	\$	926	\$	747	\$ 4	1%

			December 31, 2017			
	Unpaid Principal		Recorded Investment	Specific Allowance	Coverage	
			(In thousands)			
Impaired loans with specific allowance						
Commercial	\$	926	\$	747	\$ 20	3%
Impaired loans with no specific allowance						
Commercial	\$	-	\$	-	N/A	0%
Total investment in impaired loans	\$	926	\$	747	\$ 20	3%

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

Oriental's recorded investment in acquired BBVAPR loan pools accounted for under ASC 310-30 that have recorded impairments and their related allowance for loan and lease losses at September 30, 2018 and December 31, 2017 are as follows:

September 30, 2018

	Unpaid Principal	Recorded Investment	Allowance	Coverage to Recorded Investment
	(In thousands)			
Impaired loan pools with specific allowance:				
Mortgage	\$ 510,426	\$ 503,860	\$ 15,258	3%
Commercial	197,516	189,164	22,256	12%
Consumer	1,016	96	18	19%
Auto	22,079	20,364	6,343	31%
Total investment in impaired loan pools	\$ 731,037	\$ 713,484	\$ 43,875	6%

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2017			Coverage to Recorded Investment
	Unpaid Principal	Recorded Investment (In thousands)	Allowance	
Impaired loan pools with specific allowance:				
Mortgage	\$ 547,064	\$ 532,052	\$ 14,085	3%
Commercial	250,451	241,124	23,691	10%
Consumer	2,468	1,431	18	1%
Auto	43,440	43,696	7,961	18%
Total investment in impaired loan pools	\$ 843,423	\$ 818,303	\$ 45,755	6%

The tables above only present information with respect to acquired BBVAPR loan pools accounted for under ASC 310-30 if there is a recorded impairment to such loan pools and a specific allowance for loan losses.

Acquired Eurobank Loans

Oriental's recorded investment in acquired Eurobank loan pools that have recorded impairments and their related allowance for loan and lease losses as of September 30, 2018 and December 31, 2017 are as follows:

	September 30, 2018			Coverage to Recorded Investment
	Unpaid Principal	Recorded Investment (In thousands)	Allowance	
Impaired loan pools with specific allowance:				
Loans secured by 1-4 family residential properties	\$ 72,874	\$ 64,785	\$ 15,155	23%
Commercial	50,430	49,262	9,122	19%
Consumer	13	4	4	100%
Total investment in impaired loan pools	\$ 123,317	\$ 114,051	\$ 24,281	21%

December 31, 2017

	Unpaid Principal	Recorded Investment	Specific Allowance	Coverage to Recorded Investment
	(In thousands)			
Impaired loan pools with specific allowance				
Loans secured by 1-4 family residential properties	\$ 81,132	\$ 69,538	\$ 15,187	22%
Commercial	58,099	53,793	9,983	19%
Consumer	15	4	4	100%
Total investment in impaired loan pools	\$ 139,246	\$ 123,335	\$ 25,174	20%

The tables above only present information with respect to acquired Eurobank loan pools accounted for under ASC 310-30 if there is a recorded impairment to such loan pools and a specific allowance for loan losses.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the interest recognized in commercial and mortgage loans that were individually evaluated for impairment, which excludes loans accounted for under ASC 310-30, for the quarters and nine-month periods ended September 30, 2018 and 2017:

	Quarter Ended September 30,			
	2018			2017
	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment
	(In thousands)			
Originated and other loans held for investment:				
Impaired loans with specific allowance				
Commercial	\$ 150	\$ 35,765	\$ 306	\$ 24,178
Residential troubled-debt restructuring	695	84,787	576	86,694
Impaired loans with no specific allowance				
Commercial	271	31,315	675	36,133
	1,116	151,867	1,557	147,005
Acquired loans accounted for under ASC 310-20:				
Impaired loans with specific allowance				
Commercial	-	747	-	751
Impaired loans with no specific allowance				
Commercial	-	-	-	-
Total interest income from impaired loans	\$ 1,116	\$ 152,614	\$ 1,557	\$ 147,756

	Nine-Month Period Ended September 30,			
	2018			2017
	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment
	(In thousands)			
Originated and other loans held for investment:				

Originated and other loans held for investment:

Impaired loans with specific allowance								
Commercial	\$	432	\$	44,691	\$	612	\$	17,298
Residential troubled-debt restructuring		2,028		84,671		1,685		87,951
Impaired loans with no specific allowance								
Commercial		812		23,736		1,350		41,519
Total interest income from impaired loans	\$	3,272	\$	153,098	\$	3,647	\$	146,768

Acquired loans accounted for under ASC 310-20:

Impaired loans with specific allowance								
Commercial	\$	-	\$	747	\$	-	\$	810
Impaired loans with no specific allowance								
Total interest income from impaired loans	\$	3,272	\$	153,845	\$	3,647	\$	147,578

Modifications

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following tables present the troubled-debt restructurings in all loan portfolios during the quarters and nine-month periods ended September 30, 2018 and 2017.

	Quarter Ended September 30, 2018						
	Pre-Modification		Pre-Modification			Post-Modification	
	Number of contracts	Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Weighted Average Term (in Months)	Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Weighted Average Term (in Months)
		\$			\$		
Mortgage	21	2,621	5.42%	373	2,579	4.19%	344
Commercial	5	3,007	5.79%	71	3,002	5.10%	83
Consumer	52	758	15.06%	66	765	12.04%	73
Auto	2	40	10.28%	37	40	10.28%	37

	Nine-Month Period Ended September 30, 2018						
	Pre-Modification		Pre-Modification			Post-Modification	
	Number of contracts	Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Weighted Average Term (in Months)	Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Weighted Average Term (in Months)
		\$			\$		
Mortgage	104	14,087	5.61%	382	13,597	4.82%	344
Commercial	13	10,341	5.50%	53	10,332	5.74%	60
Consumer	101	1,469	15.58%	59	1,477	11.51%	72
Auto	2	40	10.28%	37	40	10.28%	37

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Quarter Ended September 30, 2017						
	Pre-Modification		Pre-Modification		Post-Modification		
	Number of contracts	Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Weighted Average Term (in Months)	Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Weighted Average Term (in Months)
Mortgage	15	\$ 1,796	6.18%	401	\$ 1,804	4.28%	409
Commercial	2	154	7.99%	53	154	8.45%	51
Consumer	30	383	11.52%	61	383	11.21%	68
Auto	2	23	6.42%	63	23	8.13%	31

	Nine-Month Period Ended September 30, 2017						
	Pre-Modification		Pre-Modification		Post-Modification		
	Number of contracts	Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Weighted Average Term (in Months)	Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Weighted Average Term (in Months)
Mortgage	74	\$ 9,149	6.27%	390	\$ 9,132	4.26%	384
Commercial	20	3,527	6.51%	55	3,528	5.55%	66
Consumer	93	1,262	11.87%	64	1,301	10.79%	70
Auto	9	134	7.24%	66	135	11.75%	37

The following table presents troubled-debt restructurings for which there was a payment default during the twelve-month periods ended September 30, 2018 and 2017:

	Twelve-Month Period Ended September 30,			
	2018		2017	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
		(Dollars in thousands)		
Mortgage	19	\$ 2,756	28	\$ 2,663
Commercial	2	\$ 281	8	\$ 868
Consumer	11	\$ 107	22	\$ 248

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Credit Quality Indicators

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

Oriental uses the following definitions for risk ratings:

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

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

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

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

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

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

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

As of September 30, 2018 and December 31, 2017, and based on the most recent analysis performed, the risk category of gross originated and other loans and BBVAPR acquired loans accounted for under ASC 310-20 subject to risk rating by class of loans is as follows:

	September 30, 2018					
	Risk Ratings					
Balance Outstanding	Pass	Special Mention (In thousands)	Substandard	Doubtful	Loss	
Commercial - originated and other loans held for investment						
Commercial secured by real estate:						
Corporate	\$ 306,372	\$ 263,522	\$ 26,887	\$ 15,963	\$ -	
Institutional	72,372	62,021	-	10,351	-	
Middle market	182,142	133,506	31,912	16,724	-	
Retail	220,897	194,554	4,024	22,319	-	
Floor plan	3,579	2,281	-	1,298	-	
Real estate	19,347	19,347	-	-	-	
	804,709	675,231	62,823	66,655	-	
Other commercial and industrial:						
Corporate	163,766	135,269	28,497	-	-	
Institutional	143,886	143,886	-	-	-	
Middle market	97,715	74,204	4,948	18,563	-	
Retail	289,398	286,090	213	3,095	-	
Floor plan	40,553	37,766	2,736	51	-	
	735,318	677,215	36,394	21,709	-	
Total	1,540,027	1,352,446	99,217	88,364	-	

Commercial - acquired loans**(under ASC 310-20)**

Commercial secured by real estate:

Edgar Filing: OFG BANCORP - Form 10-Q

Retail	54	-	-	54	-	-
Floor plan	1,204	305	-	899	-	-
	1,258	305	-	953	-	-
Other						
commercial and						
industrial:						
Retail	1,518	1,518	-	-	-	-
Floor plan	2	-	-	2	-	-
	1,520	1,518	-	2	-	-
Total	2,778	1,823	-	955	-	-

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

September 30, 2018

Risk Ratings

	Balance Outstanding	Pass	Special Mention	Substandard	Doubtful	Loss
	(In thousands)					
Retail - originated and other loans held for investment						
Mortgage:						
Traditional	531,551	496,407	-	35,144	-	-
Non-traditional	14,699	11,959	-	2,740	-	-
Loss mitigation program	107,397	86,600	-	20,797	-	-
Home equity secured personal loans	252	252	-	-	-	-
GNMA's buy-back option program	13,325	-	-	13,325	-	-
	667,224	595,218	-	72,006	-	-
Consumer:						
Credit cards	27,724	27,122	-	602	-	-
Overdrafts	156	129	-	27	-	-
Unsecured personal lines of credit	1,936	1,865	-	71	-	-
Unsecured personal loans	299,530	298,334	-	1,196	-	-
Cash collateral personal loans	16,053	16,053	-	-	-	-
	345,399	343,503	-	1,896	-	-
Auto and Leasing	1,084,912	1,072,764	-	12,148	-	-
Total	2,097,535	2,011,485	-	86,050	-	-
Retail - acquired loans (accounted for under ASC 310-20)						
Consumer:						
Credit cards	22,612	22,169	-	443	-	-
Personal loans	2,302	2,244	-	58	-	-
	24,914	24,413	-	501	-	-
Auto	7,494	7,292	-	202	-	-
	32,408	31,705	-	703	-	-
	\$ 3,672,748	\$ 3,397,459	\$ 99,217	\$ 176,072	\$ -	\$ -

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2017
Risk Ratings

	Balance Outstanding	Pass	Special Mention (In thousands)	Substandard	Doubtful	Loss
Commercial - originated and other loans held for investment						
Commercial secured by real estate:						
Corporate	\$ 235,426	\$ 200,395	\$ 33,094	\$ 1,937	\$ -	\$ -
Institutional	44,766	33,856	-	10,910	-	-
Middle market	229,941	196,058	4,749	29,134	-	-
Retail	246,067	215,121	8,058	22,888	-	-
Floor plan	3,998	2,678	1,320	-	-	-
Real estate	17,556	17,556	-	-	-	-
	777,754	665,664	47,221	64,869	-	-
Other commercial and industrial:						
Corporate	170,015	157,683	12,332	-	-	-
Institutional	125,591	125,591	-	-	-	-
Middle market	85,363	71,222	6,386	7,755	-	-
Retail	113,252	109,477	562	3,213	-	-
Floor plan	35,286	32,165	3,070	51	-	-
	529,507	496,138	22,350	11,019	-	-
Total	1,307,261	1,161,802	69,571	75,888	-	-
Commercial - acquired loans						
(under ASC 310-20)						
Commercial secured by real estate:						
Retail	119	-	-	119	-	-
Floor plan	1,321	393	-	928	-	-
	1,440	393	-	1,047	-	-
Other commercial and industrial:						

Edgar Filing: OFG BANCORP - Form 10-Q

Retail	2,938	2,933	-	5	-	-
Floor plan	2	-	-	2	-	-
	2,940	2,933	-	7	-	-
Total	4,380	3,326	-	1,054	-	-

46

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

December 31, 2017

Risk Ratings

	Balance Outstanding	Pass	Special Mention	Substandard	Doubtful	Loss
Retail - originated and other loans held for investment						
Mortgage:						
Traditional	553,533	516,770	-	36,763	-	-
Non-traditional	18,270	14,727	-	3,543	-	-
Loss mitigation program	103,280	84,357	-	18,923	-	-
Home equity secured personal loans	256	256	-	-	-	-
GNMA's buy-back option program	8,268	-	-	8,268	-	-
	683,607	616,110	-	67,497	-	-
Consumer:						
Credit cards	28,430	27,203	-	1,227	-	-
Overdrafts	214	158	-	56	-	-
Unsecured personal lines of credit	2,220	2,133	-	87	-	-
Unsecured personal loans	284,477	284,255	-	222	-	-
Cash collateral personal loans	14,698	14,386	-	312	-	-
	330,039	328,135	-	1,904	-	-
Auto and Leasing	883,985	879,753	-	4,232	-	-
Total	1,897,631	1,823,998	-	73,633	-	-
Retail - acquired loans						
(under ASC 310-20)						
Consumer:						
Credit cards	26,467	25,156	-	1,311	-	-
Personal loans	2,448	2,402	-	46	-	-
	28,915	27,558	-	1,357	-	-
Auto	21,969	21,790	-	179	-	-
Total	50,884	49,348	-	1,536	-	-
	\$ 3,260,156	\$ 3,038,474	\$ 69,571	\$ 152,111	\$ -	\$ -

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 6 – ALLOWANCE FOR LOAN AND LEASE LOSSES

The composition of Oriental's allowance for loan and lease losses at September 30, 2018 and December 31, 2017 was as follows:

	September 30, 2018		December 31, 2017
	(In thousands)		
Allowance for loans and lease losses:			
Originated and other loans and leases held for investment:			
Mortgage	\$ 19,545	\$	20,439
Commercial	32,491		30,258
Consumer	15,715		16,454
Auto and leasing	27,485		25,567
Total allowance for originated and other loans and lease losses	95,236		92,718
Acquired BBVAPR loans:			
Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)			
Commercial	17		42
Consumer	2,140		3,225
Auto	193		595
	2,350		3,862
Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy)			
Mortgage	15,258		14,085
Commercial	22,256		23,691
Consumer	18		18
Auto	6,343		7,961
	43,875		45,755
Total allowance for acquired BBVAPR loans and lease losses	46,225		49,617
Acquired Eurobank loans:			
Loans secured by 1-4 family residential properties	15,155		15,187
Commercial	9,122		9,983
Consumer	4		4
Total allowance for acquired Eurobank loan and lease losses	24,281		25,174
Total allowance for loan and lease losses	\$ 165,742	\$	167,509

Oriental maintains an allowance for loan and lease losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. Oriental's allowance for loan and lease losses policy provides for a detailed quarterly analysis of probable losses. The analysis includes a review of historical loan loss experience, value of underlying collateral, current economic conditions, financial condition of borrowers and other pertinent factors. While management uses available information in estimating probable loan losses, future additions to the allowance may be required based on factors beyond Oriental's control. We also maintain an allowance for loan losses on acquired loans when: (i) for loans accounted for under ASC 310-30, there is deterioration in credit quality subsequent to acquisition, and (ii) for loans accounted for under ASC 310-20, the inherent losses in the loans exceed the remaining credit discount recorded at the time of acquisition.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

As discussed in Note 2, during 2017, hurricanes Irma and Maria caused catastrophic damages throughout Puerto Rico. Management performed an evaluation of the loan portfolios to assess the impact on repayment sources and underlying collateral that could result in additional losses.

For the commercial portfolio, the framework for the analysis was based on our current ALLL methodology with additional considerations according to the estimated impact categorized as low, medium or high. From this impact assessment, additional reserve levels were estimated by increasing default probabilities (“PD”) and loss given default expectations (“LGD”) of each allowance segment.

As part of the process, Oriental contacted its clients to evaluate the impact of the hurricanes on their business operations and collateral. The impact was then categorized as follows: (i) low risk, for clients that had no business impact or relatively insignificant impact; (ii) medium risk, for clients that had a business impact on their primary or secondary sources of repayment, but still had adequate cash flow to cover operations and to satisfy their obligations; or (iii) high risk, for clients that had potentially significant problems that affected primary, secondary and tertiary (collateral) sources of repayment. This criterion was used to model adjusted PDs and LGDs considering internal and external sources of information available to support our estimation process and output.

During the fourth quarter of 2017, Oriental performed an update of the initial estimate, taking into consideration the most recent available information gathered through additional visits and interviews with clients and the economic environment in Puerto Rico.

For the retail portfolios, mortgage, consumer and auto, the assumptions established in the initial estimate were based on the historical losses of each ALLL segment and then further adjusted based on parameters used as key risk indicators, such as the industry of employment for all portfolios and the location of the collateral for mortgage loans. During the fourth quarter of 2017, Oriental performed additional procedures to evaluate the reasonability of the initial estimate based on the payment experience percentage of borrowers for which the deferral period expired. The analysis took into consideration historical payment behavior and loss experience of borrowers (PDs and LGDs) of each portfolio segment to develop a range of estimated potential losses. Management understands that this approach is reasonable given the lack of historical information related to the behavior of local borrowers in such an unprecedented event. The amount used in the analysis represents the average of potential outcomes of expected losses.

During the first quarter of 2018, Oriental updated the previous performed analysis to estimate probable losses related to the hurricanes. Analyses were based on the payment experience percentage of borrowers for which the deferral period expired in retail portfolios. For commercial portfolio, no changes in the level of impact assessed were identified based on communications with credit officers. During the second and third quarter of 2018, Oriental continued its

monitoring process of the performance of those affected borrowers. As information became available, it was incorporated into the allowance framework.

At September 30, 2018 and December 31, 2017, Oriental's allowance for loan and lease losses incorporated all risks associated to our loan portfolio, including the impact of hurricanes Irma and Maria.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Allowance for Originated and Other Loan and Lease Losses Held for Investment

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

	Quarter Ended September 30, 2018					Total
	Mortgage	Commercial	Consumer	Auto and Leasing		
	(In thousands)					
Allowance for loan and lease losses for originated and other loans:						
Balance at beginning of period	\$ 19,323	\$ 31,480	\$ 16,192	\$ 27,223	\$	94,218
Charge-offs	(1,429)	(3,249)	(4,591)	(9,111)		(18,380)
Recoveries	139	119	278	5,442		5,978
Provision for loan and lease losses	1,512	4,141	3,836	3,931		13,420
Balance at end of period	\$ 19,545	\$ 32,491	\$ 15,715	\$ 27,485	\$	95,236

	Nine-Month Period Ended September 30, 2018					Total
	Mortgage	Commercial	Consumer	Auto and Leasing		
	(In thousands)					
Allowance for loan and lease losses for originated and other loans:						
Balance at beginning of period	\$ 20,439	\$ 30,258	\$ 16,454	\$ 25,567	\$	92,718
Charge-offs	(3,727)	(6,396)	(13,438)	(31,842)		(55,403)
Recoveries	919	528	757	14,498		16,702
Provision for loan and lease losses	1,914	8,101	11,942	19,262		41,219
Balance at end of period	\$ 19,545	\$ 32,491	\$ 15,715	\$ 27,485	\$	95,236

	September 30, 2018			Total
	Mortgage	Commercial	Consumer	

**Auto and
Leasing**

(In thousands)

**Allowance for loan and
lease losses on originated
and other loans:**Ending allowance
balance attributable

to loans:

Individually evaluated for impairment	\$ 10,620	\$ 7,607	\$ -	\$ -	\$ 18,227
Collectively evaluated for impairment	8,925	24,884	15,715	27,485	77,009
Total ending allowance balance	\$ 19,545	\$ 32,491	\$ 15,715	\$ 27,485	\$ 95,236

Loans:

Individually evaluated for impairment	\$ 85,119	\$ 68,892	\$ -	\$ -	\$ 154,011
Collectively evaluated for impairment	582,105	1,471,135	345,399	1,084,912	3,483,551
Total ending loan balance	\$ 667,224	\$ 1,540,027	\$ 345,399	\$ 1,084,912	\$ 3,637,562

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Quarter Ended September 30, 2017						Total
	Mortgage	Commercial	Consumer	Auto and Leasing	Unallocated		
	(In thousands)						
Allowance for loan and lease losses for originated and other loans:							
Balance at beginning of period	\$ 18,664	\$ 17,279	\$ 14,981	\$ 18,742	\$ -	\$ -	\$ 69,666
Charge-offs	(834)	(727)	(4,424)	(9,387)	-	-	(15,372)
Recoveries	341	654	168	2,394	-	-	3,557
Provision (recapture) for originated and other loan and lease losses	4,137	7,072	5,068	13,413	-	-	29,690
Balance at end of period	\$ 22,308	\$ 24,278	\$ 15,793	\$ 25,162	\$ -	\$ -	\$ 87,541

	Nine-Month Period Ended September 30, 2017						Total
	Mortgage	Commercial	Consumer	Auto and Leasing	Unallocated		
	(In thousands)						
Allowance for loan and lease losses for originated and other loans:							
Balance at beginning of period	\$ 17,344	\$ 8,995	\$ 13,067	\$ 19,463	\$ 431	\$ -	\$ 59,300
Charge-offs	(5,375)	(6,424)	(11,792)	(24,726)	-	-	(48,317)
Recoveries	458	880	1,113	9,864	-	-	12,315
Provision (recapture) for originated and other loan and lease losses	9,881	20,827	13,405	20,561	(431)	-	64,243
Balance at end of period	\$ 22,308	\$ 24,278	\$ 15,793	\$ 25,162	\$ -	\$ -	\$ 87,541

	December 31, 2017						Total
	Mortgage	Commercial	Consumer	Auto and Leasing	Unallocated		
	(In thousands)						

**Allowance for loan and
lease losses on
originated and other
loans:**

Ending allowance
balance attributable

to loans:

Individually evaluated for impairment	\$ 9,121	\$ 10,573	\$ -	\$ -	\$ -	\$ 19,694
Collectively evaluated for impairment	11,318	19,685	16,454	25,567	-	73,024
Total ending allowance balance	\$ 20,439	\$ 30,258	\$ 16,454	\$ 25,567	\$ -	\$ 92,718

Loans:

Individually evaluated for impairment	\$ 85,403	\$ 71,538	\$ -	\$ -	\$ -	\$ 156,941
Collectively evaluated for impairment	598,204	1,235,723	330,039	883,985	-	3,047,951
Total ending loan balance	\$ 683,607	\$ 1,307,261	\$ 330,039	\$ 883,985	\$ -	\$ 3,204,892

Allowance for BBVAPR Acquired Loan Losses

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

The following tables present the activity in our allowance for loan losses and related recorded investment of the associated loans in our BBVAPR acquired loan portfolio accounted for under ASC 310-20, for the periods indicated:

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Commercial	Quarter Ended September 30, 2018		Total
		Consumer	Auto	
(In thousands)				
Allowance for loan and lease losses				
for acquired BBVAPR loans				
accounted for under ASC 310-20:				
Balance at beginning of period	\$ 86	\$ 2,357	\$ 283	\$ 2,726
Charge-offs	(1)	(638)	(72)	(711)
Recoveries	3	95	169	267
Provision (recapture) for acquired BBVAPR				
loan and lease losses accounted for				
under ASC 310-20	(71)	326	(187)	68
Balance at end of period	\$ 17	\$ 2,140	\$ 193	\$ 2,350

	Commercial	Nine-Month Period Ended September 30, 2018		Total
		Consumer	Auto	
(In thousands)				
Allowance for loan and lease losses				
for acquired BBVAPR loans				
accounted for under ASC				
310-20:				
Balance at beginning of period	\$ 42	\$ 3,225	\$ 595	\$ 3,862
Charge-offs	(6)	(2,080)	(285)	(2,371)
Recoveries	18	243	641	902
Provision (recapture) for acquired BBVAPR				
loan and lease losses accounted for				
under ASC 310-20	(37)	752	(758)	(43)
Balance at end of period	\$ 17	\$ 2,140	\$ 193	\$ 2,350

	Commercial	September 30, 2018		Total
		Consumer	Auto	

(In thousands)

Allowance for loan and lease losses**for acquired BBVAPR loans****accounted for under ASC 310-20:**

Ending allowance balance attributable

to loans:

Individually evaluated for impairment	\$	4	\$	-	\$	-	\$	4
Collectively evaluated for impairment		13		2,140		193		2,346
Total ending allowance balance	\$	17	\$	2,140	\$	193	\$	2,350
Loans:								
Individually evaluated for impairment	\$	747	\$	-	\$	-	\$	747
Collectively evaluated for impairment		2,031		24,914		7,494		34,439
Total ending loan balance	\$	2,778	\$	24,914	\$	7,494	\$	35,186

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Commercial	Quarter Ended September 30, 2017			Total
		Consumer	Auto		
	(In thousands)				
Allowance for loan and lease losses					
for acquired BBVAPR loans					
accounted for under ASC 310-20:					
Balance at beginning of period \$	41	\$ 2,623	\$ 684	\$ 3,348	
Charge-offs	-	(711)	(222)	(933)	
Recoveries	1	33	202	236	
Provision (recapture) for acquired loan and lease losses accounted for					
under ASC 310-20	(1)	646	67	712	
Balance at end of period \$	41	\$ 2,591	\$ 731	\$ 3,363	
	Commercial	Nine-Month Period Ended September 30, 2017			Total
		Consumer	Auto		
	(In thousands)				
Allowance for loan and lease losses					
for acquired BBVAPR loans					
accounted for under ASC 310-20:					
Balance at beginning of year \$	169	\$ 3,028	\$ 1,103	\$ 4,300	
Charge-offs	(132)	(2,367)	(705)	(3,204)	
Recoveries	6	392	1,251	1,649	
Provision (recapture) for acquired loan and lease losses accounted for					
under ASC 310-20	(2)	1,538	(918)	618	
Balance at end of period \$	41	\$ 2,591	\$ 731	\$ 3,363	

	Commercial	December 31, 2017			
		Consumer		Auto	Total
		(In thousands)			
Allowance for loan and lease losses					
for acquired BBVAPR loans					
accounted for under ASC 310-20:					
Ending allowance balance attributable					
to loans:					
Individually evaluated for impairment	\$ 20	\$ -	\$ -	\$ -	\$ 20
Collectively evaluated for impairment	22	3,225		595	3,842
Total ending allowance balance	\$ 42	\$ 3,225	\$ 595	\$ 3,862	\$ 3,862
Loans:					
Individually evaluated for impairment	\$ 747	\$ -	\$ -	\$ -	\$ 747
Collectively evaluated for impairment	3,633	28,915		21,969	54,517
Total ending loan balance	\$ 4,380	\$ 28,915	\$ 21,969	\$ 55,264	\$ 55,264

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

For loans accounted for under ASC 310-30, as part of the evaluation of actual versus expected cash flows, Oriental assesses on a quarterly basis the credit quality of these loans based on delinquency, severity factors and risk ratings, among other assumptions. Migration and credit quality trends are assessed at the pool level, by comparing information from the latest evaluation period through the end of the reporting period.

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

	Mortgage	Quarter Ended September 30, 2018			Total
		Commercial	Consumer	Auto	
(In thousands)					
Allowance for loan and lease losses for acquired BBVAPR loans accounted for under ASC 310-30:					
Balance at beginning of period	\$ 14,567	\$ 23,019	\$ 18	\$ 6,572	44,176
Provision for acquired BBVAPR loans and lease losses accounted for under ASC 310-30	746	61	-	-	807
Allowance de-recognition	(55)	(824)	-	(229)	(1,108)
Balance at end of period	\$ 15,258	\$ 22,256	\$ 18	\$ 6,343	43,875

	Mortgage	Nine-Month Period Ended September 30, 2018			Total
		Commercial	Consumer	Auto	
(In thousands)					
Allowance for loan and lease losses for acquired BBVAPR loans accounted for under ASC 310-30:					
Balance at beginning of period	\$ 14,085	\$ 23,691	\$ 18	\$ 7,961	45,755
Provision (recapture) for acquired BBVAPR loans and	1,296	2,119	-	(887)	2,528

lease losses accounted for under
ASC 310-30

Allowance de-recognition	(123)	(3,554)	-	(731)	(4,408)
Balance at end of					
period	\$ 15,258	\$ 22,256	\$ 18	\$ 6,343	43,875

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Mortgage	Quarter Ended September 30, 2017		Total
		Commercial	Auto	
(In thousands)				
Allowance for loan and lease losses for acquired BBVAPR loans accounted for under ASC 310-30:				
Balance at beginning of period \$	4,141	\$ 25,614	\$ 7,739	\$ 37,494
Provision (recapture) for acquired BBVAPR loans and lease losses accounted for under ASC 310-30	4,790	6,810	(501)	11,099
Allowance de-recognition	-	(8,483)	-	(8,483)
Balance at end of period \$	8,931	\$ 23,941	\$ 7,238	\$ 40,110

	Mortgage	Nine-Month Period Ended September 30, 2017		Total
		Commercial	Auto	
(In thousands)				
Allowance for loan and lease losses for acquired BBVAPR loans accounted for under ASC 310-30:				
Balance at beginning of period \$	2,682	\$ 23,452	\$ 4,922	\$ 31,056
Provision for acquired BBVAPR loans and lease losses accounted for under ASC 310-30	6,345	9,768	2,685	18,798
Allowance de-recognition	(96)	(9,279)	(369)	(9,744)
Balance at end of period \$	8,931	\$ 23,941	\$ 7,238	\$ 40,110

Allowance for Acquired Eurobank Loan Losses

The changes in the allowance for loan and lease losses on acquired Eurobank loans for the quarters and nine-month periods ended September 30, 2018 and 2017 were as follows:

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Quarter Ended September 30, 2018

	Loans Secured by 1-4 Family Residential Properties	Commercial	Consumer	Total
		(In thousands)		
Allowance for loan and lease losses for acquired Eurobank loans:				
Balance at beginning of period	\$ 15,170	\$ 9,140	\$ 4	\$ 24,314
Provision for loan and lease losses, net	231	75	-	306
Allowance de-recognition	(246)	(93)	-	(339)
Balance at end of period	\$ 15,155	\$ 9,122	\$ 4	\$ 24,281

Nine-Month Period Ended September 30, 2018

	Loans Secured by 1-4 Family Residential Properties	Commercial	Consumer	Total
		(In thousands)		
Allowance for loan and lease losses for acquired Eurobank loans:				
Balance at beginning of period	\$ 15,187	\$ 9,983	\$ 4	\$ 25,174
Provision for loan and lease losses, net	1,015	95	-	1,110
Allowance de-recognition	(1,047)	(956)	-	(2,003)
Balance at end of period	\$ 15,155	\$ 9,122	\$ 4	\$ 24,281

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Quarter Ended September 30, 2017

	Loans secured by 1-4 Family Residential Properties	Commercial	Consumer	Total
		(In thousands)		
Allowance for loan and lease losses for acquired Eurobank loans:				
Balance at beginning of period	\$ 13,651	\$ 8,131	\$ 4	\$ 21,786
Provision for (recapture) acquired				
Eurobank loan and lease losses, net	1,139	1,402	-	2,541
Allowance de-recognition	(571)	(611)	-	(1,182)
Balance at end of period	\$ 14,219	\$ 8,922	\$ 4	\$ 23,145

Nine-Month Period Ended September 30, 2017

	Loans secured by 1-4 Family Residential Properties	Commercial	Consumer	Total
		(In thousands)		
Allowance for loan and lease losses for Eurobank loans:				
Balance at beginning of period	\$ 11,947	\$ 9,328	\$ 6	\$ 21,281
Provision for (recapture) acquired				
Eurobank loan and lease losses, net	4,011	562	-	4,573
Allowance de-recognition	(1,739)	(968)	(2)	(2,709)
Balance at end of period	\$ 14,219	\$ 8,922	\$ 4	\$ 23,145

NOTE 7- FDIC SHARED-LOSS AGREEMENTS

On February 6, 2017, the Bank and the FDIC agreed to terminate the single family and commercial shared-loss agreements related to the FDIC assisted acquisition of Eurobank on April 30, 2010. As part of the loss share termination transaction, the Bank made a payment of \$10.1 million to the FDIC and recorded a net benefit of \$1.4 million. Such termination payment took into account the anticipated reimbursements over the life of the shared-loss agreements and the true-up payment liability of the Bank anticipated at the end of the ten-year term of the single family shared-loss agreement. All rights and obligations of the parties under the shared-loss agreements terminated as of the closing date of the agreement.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 8 — FORECLOSED REAL ESTATE

The following tables present the activity related to foreclosed real estate for the quarters and nine-months periods ended September 30, 2018 and 2017:

	Quarter Ended September 30, 2018			
	Originated and other loans and leases held for investment	Acquired BBVAPR loans (In thousands)	Acquired Eurobank loans	Total
Balance at beginning of period	\$ 12,186	\$ 17,492	\$ 10,873	\$ 40,551
Decline in value	(359)	(244)	(302)	(905)
Additions	1,547	2,476	928	4,951
Sales	(3,080)	(2,680)	(969)	(6,729)
Balance at end of period	\$ 10,294	\$ 17,044	\$ 10,530	\$ 37,868
	Quarter Ended September 30, 2017			
	Originated and other loans and leases held for investment	Acquired BBVAPR loans (In thousands)	Acquired Eurobank loans	Total
Balance at beginning of period	\$ 15,842	\$ 21,671	\$ 12,710	\$ 50,223
Decline in value	(592)	(680)	(340)	(1,612)
Additions	1,482	2,122	665	4,269
Sales	(1,996)	(2,410)	(1,108)	(5,514)
Other adjustments	(59)	(32)	-	(91)
Balance at end of period	\$ 14,677	\$ 20,671	\$ 11,927	\$ 47,275

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Nine-Month Period Ended September 30, 2018

	Originated and other loans and leases held for investment	Acquired BBVAPR loans (In thousands)	Acquired Eurobank loans	Total
Balance at beginning of period	\$ 14,283	\$ 18,347	\$ 11,544	\$ 44,174
Decline in value	(1,017)	(1,758)	(1,054)	(3,829)
Additions	4,816	7,401	2,868	15,085
Sales	(7,788)	(6,946)	(2,828)	(17,562)
Balance at end of period	\$ 10,294	\$ 17,044	\$ 10,530	\$ 37,868

Nine-Month Period Ended September 30, 2017

	Originated and other loans and leases held for investment	Acquired BBVAPR loans (In thousands)	Acquired Eurobank loans	Total
Balance at beginning of period	\$ 12,389	\$ 21,379	\$ 13,752	\$ 47,520
Decline in value	(1,672)	(2,309)	(1,610)	(5,591)
Additions	9,338	9,210	2,597	21,145
Sales	(5,235)	(7,464)	(2,812)	(15,511)
Other adjustments	(143)	(145)	-	(288)
Balance at end of period	\$ 14,677	\$ 20,671	\$ 11,927	\$ 47,275

After hurricanes Irma and Maria in September 2017, management evaluated the potential impact these events brought to Oriental's foreclosed real estate, considering the related underlying insurance coverage. Oriental has performed property inspections and taking into consideration all available information, the fair value of these properties was not materially impacted.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 9 — DERIVATIVES

The following table presents Oriental's derivative assets and liabilities at September 30, 2018 and December 31, 2017:

	September 30, 2018		December 31, 2017
	(In thousands)		
Derivative assets:			
Interest rate swaps designated as cash flow hedges	\$ 643	\$	-
Interest rate swaps not designated as hedges	227		618
Interest rate caps	395		153
	\$ 1,265	\$	771
Derivative liabilities:			
Interest rate swaps designated as cash flow hedges	-		510
Interest rate swaps not designated as hedges	227		618
Interest rate caps	395		153
	\$ 622	\$	1,281

Interest Rate Swaps

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

The following table shows a summary of these swaps and their terms at September 30, 2018:

Type	Notional Amount (In thousands)	Fixed Rate	Variable Rate Index	Trade Date	Settlement Date	Maturity Date
Interest Rate Swaps	\$ 33,964	2.4210%	1-Month LIBOR	07/03/13	07/03/13	08/01/23
	\$ 33,964					

An accumulated unrealized gain of \$643 thousand and a loss of \$510 thousand were recognized in accumulated other comprehensive income related to the valuation of these swaps at September 30, 2018 and December 31, 2017, respectively, and the related asset or liability is being reflected in the consolidated statements of financial condition.

At September 30, 2018 and December 31, 2017, interest rate swaps not designated as hedging instruments that were offered to clients represented an asset of \$227 thousand and \$618 thousand, respectively, and were included as part of derivative assets in the consolidated statements of financial position. The credit risk to these clients stemming from these derivatives, if any, is not material. At September 30, 2018 and December 31, 2017, interest rate swaps not designated as hedging instruments that are the mirror-images of the derivatives offered to clients represented a liability of \$227 thousand and \$618 thousand, respectively, and were included as part of derivative liabilities in the consolidated statements of financial condition.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table shows a summary of these interest rate swaps not designated as hedging instruments and their terms at September 30, 2018:

Type	Notional Amount (In thousands)	Fixed Rate	Variable Rate Index	Settlement Date	Maturity Date
Interest Rate Swaps - Derivatives Offered to Clients	\$ 12,500	5.5050%	1-Month LIBOR	04/11/09	04/11/19
	\$ 12,500				
Interest Rate Swaps - Mirror Image Derivatives	\$ 12,500	5.5050%	1-Month LIBOR	04/11/09	04/11/19
	\$ 12,500				

Interest Rate Caps

Oriental has entered into interest rate cap transactions with various clients with floating-rate debt who wish to protect their financial results against increases in interest rates. In these cases, Oriental simultaneously enters into mirror-image interest rate cap transactions with financial counterparties. None of these cap transactions qualify for hedge accounting, and therefore, they are marked to market through earnings. As of September 30, 2018 and December 31, 2017, the outstanding total notional amount of interest rate caps was \$151.4 million and \$152.6 million, respectively. At September 30, 2018 and December 31, 2017, the interest rate caps sold to clients represented a liability of \$395 thousand and \$153 thousand, respectively, and were included as part of derivative liabilities in the consolidated statements of financial condition. At September 30, 2018 and December 31, 2017, the interest rate caps purchased as mirror-images represented an asset of \$395 thousand and \$153 thousand, respectively, and were included as part of derivative assets in the consolidated statements of financial condition.

NOTE 10 — ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

Accrued interest receivable at September 30, 2018 and December 31, 2017 consists of the following:

	September 30, 2018	(In thousands)		December 31, 2017
Loans, excluding acquired loans	\$	29,671	\$	46,936
Investments		3,781		3,033
	\$	33,452	\$	49,969

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Accrued interest receivable at December 31, 2017, included \$39.7 million, resulting from the loan payment moratorium. Accrued interest receivable resulting from the loan payment moratorium has been decreasing, as most moratoriums have expired. Some of these accrued interests are payable at the end of the loan term.

Other assets at September 30, 2018 and December 31, 2017 consist of the following:

	September 30, 2018		December 31, 2017
		(In thousands)	
Prepaid expenses	\$ 12,762	\$	9,200
Other repossessed assets	4,146		3,548
Core deposit and customer relationship intangibles	3,697		4,687
Tax credits	2,277		4,277
Investment in Statutory Trust	1,083		1,083
Accounts receivable and other assets	37,951		41,898
	\$ 61,916	\$	64,693

Prepaid expenses amounting to \$12.8 million and \$9.2 million at September 30, 2018 and December 31, 2017, respectively, include prepaid municipal, property and income taxes aggregating to \$7.3 million and \$5.7 million, respectively.

In connection with the FDIC-assisted acquisition and the BBVAPR Acquisition, Oriental recorded a core deposit intangible representing the value of checking and savings deposits acquired. At September 30, 2018 and December 31, 2017 this core deposit intangible amounted to \$2.7 million and \$3.3 million, respectively. In addition, Oriental recorded a customer relationship intangible representing the value of customer relationships acquired with the acquisition of the securities broker-dealer and insurance agency in the BBVAPR Acquisition. At September 30, 2018 and December 31, 2017, this customer relationship intangible amounted to \$1.0 million and \$1.4 million, respectively.

Other repossessed assets totaled \$4.1 million and \$3.5 million at September 30, 2018 and December 31, 2017, respectively, that consist mainly of repossessed automobiles, which are recorded at their net realizable value.

At September 30, 2018 and December 31, 2017, tax credits for Oriental totaled \$2.3 million and \$4.3 million, respectively. These tax credits do not have an expiration date.

NOTE 11— DEPOSITS AND RELATED INTEREST

Total deposits, including related accrued interest payable, as of September 30, 2018 and December 31, 2017 consist of the following:

	September 30, 2018		December 31, 2017
	(In thousands)		
Non-interest bearing demand deposits	\$ 1,107,567	\$	969,525
Interest-bearing savings and demand deposits	2,412,690		2,274,116
Individual retirement accounts	204,715		231,376
Retail certificates of deposit	610,118		595,983
Institutional certificates of deposit	223,025		209,951
Total core deposits	4,558,115		4,280,951
Brokered deposits	530,878		518,531
Total deposits	\$ 5,088,993	\$	4,799,482

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Brokered deposits include \$503.5 million in certificates of deposits and \$27.3 million in money market accounts at September 30, 2018, and \$471.6 million in certificates of deposits and \$46.9 million in money market accounts at December 31, 2017.

The weighted average interest rate of Oriental's deposits was 0.65% at September 30, 2018 and December 31, 2017. Interest expense for the quarters and nine-month periods ended September 30, 2018 and 2017 was as follows:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,					
	2018	2017	2018		2017			
	(In thousands)							
Demand and savings deposits	\$	3,157	\$	2,715	\$	8,924	\$	8,563
Certificates of deposit		5,448		4,886		14,630		14,043
	\$	8,605	\$	7,601	\$	23,554	\$	22,606

At September 30, 2018 and December 31, 2017, time deposits in denominations of \$250 thousand or higher, excluding accrued interest and unamortized discounts, amounted to \$367.8 million and \$359.6 million, respectively. Such amounts include public funds time deposits from various Puerto Rico government municipalities, agencies and corporations of \$43.7 million and \$3.5 million at a weighted average rate of 0.54% and 0.28% at September 30, 2018 and December 31, 2017, respectively.

At September 30, 2018 and December 31, 2017, total public fund deposits from various Puerto Rico government municipalities, agencies and corporations amounted to \$285.0 million and \$153.1 million, respectively. These public funds were collateralized with commercial loans amounting to \$265.1 million and \$173.0 million at September 30, 2018 and December 31, 2017, respectively.

Excluding accrued interest of approximately \$2.6 million, the scheduled maturities of certificates of deposit at September 30, 2018 and December 31, 2017 are as follows:

	September 30,	December 31,
	2018	2017
	(In thousands)	
Within one year:		

Edgar Filing: OFG BANCORP - Form 10-Q

Three (3) months or less	\$	239,716	\$	316,382
Over 3 months through 1 year		578,308		508,285
		818,024		824,667
Over 1 through 2 years		506,842		470,670
Over 2 through 3 years		137,738		137,016
Over 3 through 4 years		31,088		36,125
Over 4 through 5 years		45,100		38,623
	\$	1,538,792	\$	1,507,101

The table of scheduled maturities of certificates of deposits above includes brokered-deposits and individual retirement accounts.

The aggregate amount of overdrafts in demand deposit accounts that were reclassified to loans amounted to \$360 thousand and \$2.2 million as of September 30, 2018 and December 31, 2017, respectively.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 12 — BORROWINGS AND RELATED INTEREST

Securities Sold under Agreements to Repurchase

At September 30, 2018, securities underlying agreements to repurchase were delivered to, and are being held by, the counterparties with whom the repurchase agreements were transacted. The counterparties have agreed to resell to Oriental the same or similar securities at the maturity of these agreements. The purpose of these transactions is to provide financing for Oriental's securities portfolio.

At September 30, 2018 and December 31, 2017, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of \$429 thousand and \$369 thousand, respectively, were as follows:

	September 30, 2018		December 31, 2017	
	Borrowing Balance	Fair Value of Underlying Collateral	Borrowing Balance	Fair Value of Underlying Collateral
	(In thousands)			
South Street Securities, LLC	12,000	12,590	-	-
JP Morgan Chase Bank NA	130,000	140,364	82,500	88,974
Nomura Securities International, Inc	53,294	56,199	-	-
JVB Financial Group, LLC	32,525	34,116	-	-
Federal Home Loan Bank	110,000	116,432	110,000	116,509
Citigroup Global Markets Inc.	39,989	42,524	-	-
Total	\$ 377,808	\$ 402,225	\$ 192,500	\$ 205,483

The following table shows a summary of Oriental's repurchase agreements and their terms, excluding accrued interest in the amount of \$429 thousand, at September 30, 2018:

Year of Maturity	Borrowing Balance (In thousands)	Weighted- Average Coupon	Settlement Date	Maturity Date
2018	32,525	2.19%	9/10/2018	10/10/2018
	39,989	2.30%	9/18/2018	10/2/2018
	53,294	2.45%	9/24/2018	10/25/2018
	12,000	2.40%	9/25/2018	10/15/2018
2019	50,000	1.72%	3/2/2017	9/3/2019
2020	60,000	1.85%	3/2/2017	3/2/2020
	50,000	2.61%	3/15/2018	3/15/2020
	30,000	2.70%	3/23/2018	3/23/2020
	50,000	2.86%	7/6/2018	7/6/2020
	\$ 377,808	2.31%		

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

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the repurchase liability associated with the repurchase agreement transactions (excluding accrued interest) by maturity. Also, it includes the carrying value and approximate market value of collateral (excluding accrued interest) at September 30, 2018 and December 31, 2017. There was no cash collateral at September 30, 2018 and December 31, 2017.

	September 30, 2018		December 31, 2017			
	Repurchase Liability	Weighted Average Rate	Market Value of Underlying Collateral FNMA and FHLMC Certificates	Repurchase Liability	Weighted Average Rate	Market Value of Underlying Collateral FNMA and FHLMC Certificates
	(Dollars in thousands)					
Less than 90 days	\$ 137,808	2.34%	\$ 145,429	\$ -	-	\$ -
Over 90 days	240,000	2.30%	256,796	192,500	1.63%	205,483
Total	\$ 377,808	2.31%	\$ 402,225	\$ 192,500	1.63%	\$ 205,483

Advances from the Federal Home Loan Bank of New York

Advances are received from the FHLB-NY under an agreement whereby Oriental is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances. At September 30, 2018 and December 31, 2017, these advances were secured by mortgage and commercial loans amounting to \$905.3 million and \$1.3 billion, respectively. Also, at September 30, 2018 and December 31, 2017, Oriental had an additional borrowing capacity with the FHLB-NY of \$830.7 million and \$920.0 million, respectively. At September 30, 2018 and December 31, 2017, the weighted average remaining maturity of FHLB's advances was 26.2 months and 3.2 months, respectively. The original terms of these advances range between one month and seven years, and the FHLB-NY does not have the right to exercise put options at par on any advances outstanding as of September 30, 2018.

The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of \$153 thousand, at September 30, 2018:

Year of Maturity	Borrowing Balance	Weighted-Average Coupon	Settlement Date	Maturity Date
------------------	-------------------	-------------------------	-----------------	---------------

Edgar Filing: OFG BANCORP - Form 10-Q

	(In thousands)			
2018	33,964	2.32%	9/4/2018	10/1/2018
2020	8,953	2.59%	7/19/2013	7/20/2020
2023	12,152	2.94%	5/9/2018	5/9/2023
	2,087	2.92%	6/8/2018	6/8/2023
	16,222	2.92%	7/13/2018	7/13/2023
\$	73,378	2.61%		

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

Subordinated Capital Notes

Subordinated capital notes amounted to \$36.1 million at September 30, 2018 and December 31, 2017, for both periods.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 13 – OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES

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

The following table presents the potential effect of rights of set-off associated with Oriental's recognized financial assets and liabilities at September 30, 2018 and December 31, 2017:

	September 30, 2018			Gross Amounts Not Offset in the Statement of Financial Condition		
	Gross Amount of Recognized Assets	Gross Amounts Offset in the Statement of Financial Condition	Net Amount of Assets Presented in Statement of Financial Condition (In thousands)	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	\$ 1,265	\$ -	\$ 1,265	\$ 1,986	\$ -	\$ (721)

December 31, 2017

	December 31, 2017			Gross Amounts Not Offset in the Statement of Financial Condition		
	Gross Amount	Gross Amounts Offset in the Statement of Financial Condition	Net amount of Assets Presented in Statement of Financial Condition	Financial	Cash Collateral	Net

	of Recognized Assets	Condition	Condition	Instruments	Received	Amount
			(In thousands)			
Derivatives	\$ 771	\$ -	\$ 771	\$ 2,010	\$ -	\$ (1,239)
			66			

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	September 30, 2018			Gross Amounts Not Offset in the Statement of Financial Condition		
	Gross Amount of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Condition	Net Amount of Liabilities Presented in Statement of Financial Condition (In thousands)	Financial Instruments	Cash Collateral Provided	Net Amount
Derivatives	\$ 622	\$ -	\$ 622	\$ -	\$ 1,980	\$ (1,358)
Securities sold under agreements to repurchase	377,808	-	377,808	402,225	-	(24,417)
Total	\$ 378,430	\$ -	\$ 378,430	\$ 402,225	\$ 1,980	\$ (25,775)

	December 31, 2017			Gross Amounts Not Offset in the Statement of Financial Condition		
	Gross Amount of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Condition	Net Amount of Liabilities Presented in Statement of Financial Condition (In thousands)	Financial Instruments	Cash Collateral Provided	Net Amount
Derivatives	\$ 1,281	\$ -	\$ 1,281	\$ -	\$ 1,980	\$ (699)
Securities sold under agreements to repurchase	192,500	-	192,500	205,483	-	(12,983)
Total	\$ 193,781	\$ -	\$ 193,781	\$ 205,483	\$ 1,980	\$ (13,682)

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 14 — INCOME TAXES

Oriental is subject to the provisions of the Puerto Rico Internal Revenue Code of 2011, as amended (the “Code”), which imposes a maximum statutory corporate tax rate of 39% on a corporation’s net taxable income. Under the Code, all corporations are treated as separate taxable entities and are not entitled to file consolidated tax returns. Such entities are subject to Puerto Rico regular income tax or the alternative minimum tax (“AMT”) on income earned from all sources pursuant to the Code. The AMT is payable if it exceeds regular income tax. The excess of AMT over regular income tax paid in any one year may be used to offset regular income tax in future years, subject to certain limitations.

Oriental also has operations in the United States mainland through its wholly owned subsidiary, OPC, a retirement plan administrator based in Florida. In October 2017, Oriental expanded its operations in the United States through the Bank’s wholly owned subsidiary, OFG USA. Both subsidiaries are subject to federal income taxes at the corporate level. In addition, OPC is subject to Florida state taxes and OFG USA is subject to North Carolina state taxes.

At September 30, 2018 and December 31, 2017, Oriental’s net deferred tax asset amounted to \$122.9 million and \$127.4 million, respectively. In assessing the realizability of the deferred tax asset, management considers whether it is more likely than not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of the deferred tax asset is mainly dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax asset is deductible, management believes it is more likely than not that Oriental will realize the deferred tax asset, net of the existing valuation allowances recorded at September 30, 2018 and December 31, 2017. The amount of the deferred tax asset that is considered realizable could be reduced in the near term if there are changes in estimates of future taxable income.

Oriental maintained an effective tax rate lower than statutory rate for the nine-month periods ended September 30, 2018 and 2017 of 33.7% and 29.8%, respectively, mainly by investing in tax-exempt obligations, doing business through its international banking entity, and by expanding its operations in the U.S, which are taxed at a lower rate.

Oriental classifies unrecognized tax benefits in other liabilities. These gross unrecognized tax benefits would affect the effective tax rate if realized. At September 30, 2018 and December 31, 2017, unrecognized tax benefits amounted at \$858 thousand and \$1.3 million, respectively. The change in unrecognized tax benefits is mainly related to the expiration of a statute of limitation, resulting in a benefit of \$468 thousand. Oriental had accrued \$64 thousand at September 30, 2018 (December 31, 2017 - \$97 thousand) for the payment of interest and penalties relating to

unrecognized tax benefits.

Income tax expense for the quarters ended September 30, 2018 and 2017 was \$12.3 million and \$560 thousand, respectively. Income tax expense for the nine-month periods ended September 30, 2018 and 2017 was \$29.9 million and \$13.8 million, respectively.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 15 — REGULATORY CAPITAL REQUIREMENTS

Regulatory Capital Requirements

OFG Bancorp (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by federal and Puerto Rico banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on Oriental's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Oriental and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Pursuant to the Dodd-Frank Act, federal banking regulators adopted capital rules that became effective January 1, 2015 for Oriental and the Bank (subject to certain phase-in periods through January 1, 2019) and that replaced their general risk-based capital rules, advanced approaches rule, market risk rule, and leverage rules. Among other matters, the new capital rules: (i) introduce a new capital measure called "Common Equity Tier 1" ("CET1") and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to prior regulations. The current capital rules prescribe a new standardized approach for risk weightings that expand the risk-weighting categories from the previous four Basel I-derived categories (0%, 20%, 50% and 100%) to a larger and more risk-sensitive number of categories, depending on the nature of the assets, and resulting in higher risk weights for a variety of asset classes.

Pursuant to the current capital rules, the minimum capital ratios requirements are as follows:

4.5% CET1 to risk-weighted assets;

6.0% Tier 1 capital (that is, CET1 *plus* Additional Tier 1 capital) to risk-weighted assets;

8.0% Total capital (that is, Tier 1 capital *plus* Tier 2 capital) to risk-weighted assets; and

4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the "leverage ratio").

As of September 30, 2018 and December 31, 2017, OFG Bancorp and the Bank met all capital adequacy requirements to which they are subject. As of September 30, 2018 and December 31, 2017, the Bank is “well capitalized” under the regulatory framework for prompt corrective action. To be categorized as “well capitalized,” an institution must maintain minimum CET1 risk-based, Tier 1 risk-based, total risk-based, and Tier 1 leverage ratios as set forth in the tables presented below.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

OFG Bancorp's and the Bank's actual capital amounts and ratios as of September 30, 2018 and December 31, 2017 are as follows:

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
OFG Bancorp Ratios						
<u>As of September 30, 2018</u>						
Total capital to risk-weighted assets	\$ 953,543	19.84%	\$ 384,508	8.00%	\$ 480,635	10.00%
Tier 1 capital to risk-weighted assets	\$ 891,807	18.55%	\$ 288,381	6.00%	\$ 384,508	8.00%
Common equity tier 1 capital to risk-weighted assets	\$ 690,937	14.38%	\$ 216,286	4.50%	\$ 312,413	6.50%
Tier 1 capital to average total assets	\$ 891,807	13.93%	\$ 255,993	4.00%	\$ 319,992	5.00%
<u>As of December 31, 2017</u>						
Total capital to risk-weighted assets	\$ 899,258	20.34%	\$ 353,653	8.00%	\$ 442,067	10.00%
Tier 1 capital to risk-weighted assets	\$ 842,133	19.05%	\$ 265,240	6.00%	\$ 353,653	8.00%
Common equity tier 1 capital to risk-weighted assets	\$ 644,804	14.59%	\$ 198,930	4.50%	\$ 287,343	6.50%
Tier 1 capital to average total assets	\$ 842,133	13.92%	\$ 242,057	4.00%	\$ 302,571	5.00%
	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
Bank Ratios						
<u>As of September 30, 2018</u>						
Total capital to risk-weighted assets	\$ 925,447	19.28%	\$ 383,971	8.00%	\$ 479,964	10.00%
Tier 1 capital to risk-weighted assets	\$ 863,978	18.00%	\$ 287,979	6.00%	\$ 383,971	8.00%
	\$ 863,978	18.00%	\$ 215,984	4.50%	\$ 311,977	6.50%

Common equity tier 1
capital to risk-weighted
assets

Tier 1 capital to average total assets	\$	863,978	13.56%	\$	254,847	4.00%	\$	318,559	5.00%
---	----	---------	---------------	----	---------	--------------	----	---------	--------------

As of December 31, 2017

Total capital to risk-weighted assets	\$	879,648	19.92%	\$	353,265	8.00%	\$	441,581	10.00%
--	----	---------	---------------	----	---------	--------------	----	---------	---------------

Tier 1 capital to risk-weighted assets	\$	822,776	18.63%	\$	264,949	6.00%	\$	353,265	8.00%
---	----	---------	---------------	----	---------	--------------	----	---------	--------------

Common equity tier 1 capital to risk-weighted assets	\$	822,776	18.63%	\$	198,712	4.50%	\$	287,028	6.50%
--	----	---------	---------------	----	---------	--------------	----	---------	--------------

Tier 1 capital to average total assets	\$	822,776	13.63%	\$	241,417	4.00%	\$	301,771	5.00%
---	----	---------	---------------	----	---------	--------------	----	---------	--------------

NOTE 16 – STOCKHOLDERS' EQUITY

Additional Paid-in Capital

Additional paid-in capital represents contributed capital in excess of par value of common and preferred stock net of the costs of issuance. As of both September 30, 2018 and December 31, 2017, accumulated issuance costs charged against additional paid-in capital amounted to \$13.6 million and \$10.1 million for preferred and common stock, respectively.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Legal Surplus

The Puerto Rico Banking Act requires that a minimum of 10% of the Bank's net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid in capital on common and preferred stock. At September 30, 2018 and December 31, 2017, the Bank's legal surplus amounted to \$87.6 million and \$81.5 million, respectively. The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders.

Treasury Stock

Under Oriental's current stock repurchase program it is authorized to purchase in the open market up to \$7.7 million of its outstanding shares of common stock. The shares of common stock repurchased are to be held by Oriental as treasury shares. During the nine-month periods ended September 30, 2018 and 2017, Oriental did not purchase any shares under the program.

At September 30, 2018 the number of shares that may yet be purchased under the \$70 million program is estimated at 478,691 and was calculated by dividing the remaining balance of \$7.7 million by \$16.15 (closing price of Oriental's common stock at September 30, 2018).

The activity in connection with common shares held in treasury by Oriental for the nine-month periods ended September 30, 2018 and 2017 is set forth below:

	Nine-Month Period Ended September 30,			
	2018		2017	
	Shares	Dollar Amount	Shares	Dollar Amount
	(In thousands, except shares data)			
Beginning of period	8,678,427	\$ 104,502	8,711,025	\$ 104,860
Common shares used upon lapse of restricted stock units	(58,424)	(796)	(32,598)	(358)
End of period	8,620,003	\$ 103,706	8,678,427	\$ 104,502

NOTE 17 - ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income, net of income taxes, as of September 30, 2018 and December 31, 2017 consisted of:

	September 30, 2018	December 31, 2017
	(In thousands)	
Unrealized loss on securities available-for-sale which are not		
other-than-temporarily impaired	\$ (24,343)	\$ (3,003)
Income tax effect of unrealized loss on securities available-for-sale	3,155	365
Net unrealized gain on securities available-for-sale which are not		
other-than-temporarily impaired	(21,188)	(2,638)
Unrealized gain (loss) on cash flow hedges	643	(510)
Income tax effect of unrealized (gain) loss on cash flow hedges	(250)	199
Net unrealized gain (loss) on cash flow hedges	393	(311)
Accumulated other comprehensive (loss), net of income taxes	\$ (20,795)	\$ (2,949)

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents changes in accumulated other comprehensive income by component, net of taxes, for the quarters and nine-month periods ended September 30, 2018 and 2017:

	Quarter Ended September 30,					
	Net unrealized gains on securities available-for-sale	2018 Net unrealized loss on cash flow hedges	Accumulated other comprehensive (loss) income	Net unrealized gains on securities available-for-sale	2017 Net unrealized loss on cash flow hedges	Accumulated other comprehensive (loss) income
	(In thousands)					
Beginning balance	\$ (15,518)	\$ 256	\$ (15,262)	\$ 256	\$ (563)	\$ (307)
Other comprehensive loss before reclassifications	(5,607)	(380)	(5,987)	1,185	(74)	1,111
Amounts reclassified out of accumulated other comprehensive income (loss)	(63)	517	454	(70)	108	38
Other comprehensive income (loss)	(5,670)	137	(5,533)	1,115	34	1,149
Ending balance	\$ (21,188)	\$ 393	\$ (20,795)	\$ 1,371	\$ (529)	\$ 842
	Nine-Month Period Ended September 30,					
	Net unrealized gains on securities available-for-sale	2018 Net unrealized loss on cash flow hedges	Accumulated other comprehensive (loss) income	Net unrealized gains on securities available-for-sale	2017 Net unrealized loss on cash flow hedges	Accumulated other comprehensive (loss) income
	(In thousands)					
Beginning balance	\$ (2,638)	\$ (311)	\$ (2,949)	\$ 2,209	\$ (613)	\$ 1,596
Other comprehensive loss before reclassifications	(18,361)	(635)	(18,996)	(726)	(301)	(1,027)
Amounts reclassified out of accumulated other comprehensive income (loss)	(189)	1,339	1,150	(112)	385	273
Other comprehensive income (loss)	(18,550)	704	(17,846)	(838)	84	(754)
Ending balance	\$ (21,188)	\$ 393	\$ (20,795)	\$ 1,371	\$ (529)	\$ 842

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents reclassifications out of accumulated other comprehensive income for the quarters and nine-month periods ended September 30, 2018 and 2017:

	Amount reclassified out of accumulated other comprehensive income Quarter Ended September 30,		Affected Line Item in Consolidated Statement of Operations
	2018	2017	
	(In thousands)		
Cash flow hedges:			
Interest-rate contracts	\$ 517	\$ 108	Net interest expense
Available-for-sale securities:			
Gain on sale of investments	-		4Income tax expense
Residual tax effect from OIB's change in applicable tax rate	-		1Income tax expense
Tax effect from changes in tax rates	(63)	(71)	Income tax expense
	\$ 454	\$ 42	

	Amount reclassified out of accumulated other comprehensive income Nine-Month Period Ended September 30,		Affected Line Item in Consolidated Statement of Operations
	2018	2017	
	(In thousands)		
Cash flow hedges:			
Interest-rate contracts	\$ 1,339	\$ 385	Net interest expense
Available-for-sale securities:			
Gain on sale of investments	-	6,896	Income tax expense
Residual tax effect from OIB's change in applicable tax rate	5	104	Income tax expense
Tax effect from changes in tax rates	(194)	(216)	Income tax expense
	\$ 1,150	\$ 7,169	

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 18 – EARNINGS PER COMMON SHARE

The calculation of earnings per common share for the quarters and nine-month periods ended September 30, 2018 and 2017 is as follows:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2018	2017	2018	2017
	(In thousands, except per share data)			
Net income	\$ 23,100	\$ 3,319	\$ 59,666	\$ 35,573
Less: Dividends on preferred stock				
Non-convertible preferred stock (Series A, B, and D)	(1,628)	(1,627)	(4,883)	(4,883)
Convertible preferred stock (Series C)	(1,838)	(1,838)	(5,513)	(5,513)
Income available to common shareholders	\$ 19,634	\$ (146)	\$ 49,270	\$ 25,177
Effect of assumed conversion of the convertible preferred stock	1,838	1,838	5,513	5,513
Income available to common shareholders assuming conversion	\$ 21,472	\$ 1,692	\$ 54,783	\$ 30,690
Weighted average common shares and share equivalents:				
Average common shares outstanding	43,996	43,947	43,975	43,937
Effect of dilutive securities:				
Average potential common shares-options	209	17	110	20
Average potential common shares-assuming conversion of convertible preferred stock	7,259	7,138	7,259	7,138
Total weighted average common shares outstanding and equivalents	51,464	51,102	51,344	51,095

Earnings per common share							
- basic	\$	0.45	\$	-	\$	1.12	\$ 0.57
Earnings per common share							
- diluted	\$	0.42	\$	-	\$	1.07	\$ 0.56

74

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

In computing diluted earnings per common share, the 84,000 shares of convertible preferred stock, which remain outstanding at September 30, 2018, with a conversion rate, subject to certain conditions, of 86.4225 shares of common stock per share, were included as average potential common shares from the date they were issued and outstanding. Moreover, in computing diluted earnings per common share, the dividends declared during the quarters and nine-month periods ended September 30, 2018 and 2017 on the convertible preferred stock were added back as income available to common shareholders.

For the quarters ended September 30, 2018 and 2017, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 307,925 and 922,601, respectively. For the nine-month period ended September 30, 2018 and 2017, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 435,950 and 935,740, respectively.

NOTE 19 – GUARANTEES

At September 30, 2018 and December 31, 2017, the unamortized balance of the obligations undertaken in issuing the guarantees under standby letters of credit represented a liability of \$15.7 million and \$21.1 million, respectively.

Oriental has a liability for residential mortgage loans sold subject to credit recourse pursuant to FNMA's residential mortgage loan sales and securitization programs. At September 30, 2018 and December 31, 2017, the unpaid principal balance of residential mortgage loans sold subject to credit recourse was \$5.5 million and \$6.4 million, respectively.

The following table shows the changes in Oriental's liability for estimated losses from these credit recourse agreements, included in the consolidated statements of financial condition during the quarters and nine-month periods ended September 30, 2018 and 2017.

	Quarter Ended September 30,		Nine-Month Period Ended	
	2018	2017	September 30,	2017
	(In thousands)			
Balance at beginning of period	\$ 264	\$ 570	\$ 358	\$ 710
Net (charge-offs/terminations)				
recoveries	(60)	(118)	(154)	(258)
Balance at end of period	\$ 204	\$ 452	\$ 204	\$ 452

The estimated losses to be absorbed under the credit recourse arrangements were recorded as a liability when the credit recourse was assumed, and are updated on a quarterly basis. The expected loss, which represents the amount expected to be lost on a given loan, considers the probability of default and loss severity. The probability of default represents the probability that a loan in good standing would become 120 days delinquent, in which case Oriental is obligated to repurchase the loan.

If a borrower defaults, pursuant to the credit recourse provided, Oriental is required to repurchase the loan or reimburse the third-party investor for the incurred loss. The maximum potential amount of future payments that Oriental would be required to make under the recourse arrangements is equivalent to the total outstanding balance of the residential mortgage loans serviced with recourse and interest, if applicable. During the quarter ended September 30, 2018, Oriental repurchased approximately \$234 thousand of unpaid principal balance in mortgage loans subject to the credit recourse provisions. During the quarter ended September 30, 2017, Oriental did not repurchase any unpaid principal balance of mortgage loans subject to credit recourse provisions. During the nine-month periods ended September 30, 2018 and 2017, Oriental repurchased approximately \$569 thousand and \$107 thousand, respectively, of unpaid principal balance in mortgage loans subject to the credit recourse provisions. If a borrower defaults, Oriental has rights to the underlying collateral securing the mortgage loan. Oriental suffers losses on these mortgage loans when the proceeds from a foreclosure sale of the collateral property are less than the outstanding principal balance of the loan, any uncollected interest advanced, and the costs of holding and disposing the related property. At September 30, 2018, Oriental's liability for estimated credit losses related to loans sold with credit recourse amounted to \$204 thousand (December 31, 2017– \$358 thousand).

When Oriental sells or securitizes mortgage loans, it generally makes customary representations and warranties regarding the characteristics of the loans sold. Oriental's mortgage operations division groups conforming mortgage loans into pools which are exchanged for FNMA and GNMA mortgage-backed securities, which are generally sold to private investors, or are sold directly to

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

FNMA or other private investors for cash. As required under such mortgage backed securities programs, quality review procedures are performed by Oriental to ensure that asset guideline qualifications are met. To the extent the loans do not meet specified characteristics, Oriental may be required to repurchase such loans or indemnify for losses and bear any subsequent loss related to the loans. During the quarter ended September 30, 2018, Oriental repurchased \$1.6 million (September 30, 2017 – \$625 thousand) of unpaid principal balance in mortgage loans, excluding mortgage loans subject to credit recourse provision referred above. During the nine-month periods ended September 30, 2018, Oriental repurchased \$5.9 million (September 30, 2017 – \$3.0 million) of unpaid principal balance in mortgage loans, excluding mortgage loans subject to credit recourse provision referred above.

During the quarter ended September 30, 2018, Oriental recognized \$30 thousand in losses from the repurchase of residential mortgage loans sold subject to credit recourse, and \$41 thousand in losses from the repurchase of residential mortgage loans as a result of breaches of customary representations and warranties. During the quarter ended September 30, 2017, Oriental did not recognize any gains or losses from the repurchase of residential mortgage loans sold subject to credit recourse, but did recognize \$74 thousand in losses from the repurchase of residential mortgage loans as a result of breaches of customary representations and warranties. During the nine-month periods ended September 30, 2018 and 2017, Oriental recognized \$406 thousand and \$354 thousand, respectively, in losses from the repurchase of residential mortgage loans sold subject to credit recourse, and \$71 thousand and \$517 thousand, respectively, in losses from the repurchase of residential mortgage loans as a result of breaches of customary representations and warranties.

Servicing agreements relating to the mortgage-backed securities programs of FNMA and GNMA, and to mortgage loans sold or serviced to certain other investors, including the FHLMC, require Oriental to advance funds to make scheduled payments of principal, interest, taxes and insurance, if such payments have not been received from the borrowers. At September 30, 2018, Oriental serviced \$891.0 million (December 31, 2017 - \$864.9 million) in mortgage loans for third-parties. Oriental generally recovers funds advanced pursuant to these arrangements from the mortgage owner, from liquidation proceeds when the mortgage loan is foreclosed or, in the case of FHA/VA loans, under the applicable FHA and VA insurance and guarantees programs. However, in the meantime, Oriental must absorb the cost of the funds it advances during the time the advance is outstanding. Oriental must also bear the costs of attempting to collect on delinquent and defaulted mortgage loans. In addition, if a defaulted loan is not cured, the mortgage loan would be canceled as part of the foreclosure proceedings and Oriental would not receive any future servicing income with respect to that loan. At September 30, 2018, the outstanding balance of funds advanced by Oriental under such mortgage loan servicing agreements was approximately \$798 thousand (December 31, 2017 - \$440 thousand). To the extent the mortgage loans underlying Oriental's servicing portfolio experience increased delinquencies, Oriental would be required to dedicate additional cash resources to comply with its obligation to advance funds as well as incur additional administrative costs related to increases in collection efforts.

NOTE 20— COMMITMENTS AND CONTINGENCIES

Loan Commitments

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

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

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Credit-related financial instruments at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
Commitments to extend credit	\$ 566,030	\$ 485,019
Commercial letters of credit	1,464	494

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

At September 30, 2018 and December 31, 2017, commitments to extend credit consisted mainly of undisbursed available amounts on commercial lines of credit, construction loans, and revolving credit card arrangements. Since many of the unused commitments are expected to expire unused or be only partially used, the total amount of these unused commitments does not necessarily represent future cash requirements. These lines of credit had a reserve of \$742 thousand and \$567 thousand, at September 30, 2018 and December 31, 2017, respectively.

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

The summary of instruments that are considered financial guarantees in accordance with the authoritative guidance related to guarantor's accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others, at September 30, 2018 and December 31, 2017, is as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
Standby letters of credit and financial guarantees	\$ 15,721	\$ 21,107
Loans sold with recourse	5,490	6,420

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

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

Oriental has entered into various operating lease agreements for branch facilities and administrative offices. Rent expense for both quarters ended September 30, 2018 and 2017, amounted to \$2.0 million. For the nine-month periods ended September 30, 2018 and 2017, rent expense amounted to \$7.4 million and \$6.5 million, respectively, and is included in the "occupancy and equipment" caption in the unaudited consolidated statements of operations. Future rental commitments under leases in effect at September 30, 2018, exclusive of taxes, insurance, and maintenance expenses payable by Oriental, are summarized as follows:

<u>Year Ending December 31,</u>		Minimum Rent (In thousands)
2018	\$	4,868
2019		5,977
2020		4,062
2021		3,360
2022		2,494
Thereafter	\$	27,687

Contingencies

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

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

Subject to the accounting and disclosure framework under the provisions of ASC 450, it is the opinion of Oriental's management, based on current knowledge and after taking into account its current legal accruals, that the eventual outcome of all matters would not be likely to have a material adverse effect on the consolidated statements of financial condition of Oriental. Nonetheless, given the substantial or indeterminate amounts sought in certain of these matters, and the inherent unpredictability of such matters, an adverse outcome in certain of these matters could, from time to time, have a material adverse effect on Oriental's consolidated results of operations or cash flows in particular

quarterly or annual periods. Oriental has evaluated all arbitration, litigation and regulatory matters where the likelihood of a potential loss is deemed reasonably possible. Oriental has determined that the estimate of the reasonably possible loss is not significant.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 21 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Oriental follows the fair value measurement framework under U.S. Generally Accepted Accounting Principles (“GAAP”).

Fair Value Measurement

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

Money market investments

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

Investment securities

The fair value of investment securities is based on quoted market prices, when available, or market prices provided by Interactive Data Corporation (“IDC”), an independent, well-recognized pricing company. Such securities are classified as Level 1 or Level 2 depending on the basis for determining fair value. If listed prices or quotes are not available, fair value is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument, and such securities are classified as Level 3. At September 30, 2018 and December 31, 2017, Oriental did not have investment securities classified as Level 3.

Securities purchased under agreements to resell

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

Derivative instruments

The fair value of the interest rate swaps is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future. The fair value of most of these derivative instruments is based on observable market parameters, which include discounting the instruments' cash flows using the U.S. dollar LIBOR-based discount rates, and also applying yield curves that account for the industry sector and the credit rating of the counterparty and/or Oriental. Certain other derivative instruments with limited market activity are valued using externally developed models that consider unobservable market parameters. Based on their valuation methodology, derivative instruments are classified as Level 2 or Level 3.

Servicing assets

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

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

Impaired loans are carried at the present value of expected future cash flows using the loan's existing rate in a discounted cash flow calculation, or the fair value of the collateral if the loan is collateral-dependent. Expected cash flows are based on internal inputs reflecting expected default rates on contractual cash flows. This method of estimating fair value does not incorporate the exit-price concept of fair value described in ASC 820-10 and would generally result in a higher value than the exit-price approach. For loans measured using the estimated fair value of collateral less costs to sell, fair value is generally determined based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations, in accordance with the provisions of ASC 310-10-35 less disposition costs. Currently, the associated loans considered impaired are classified as Level 3.

Foreclosed real estate

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

Other repossessed assets

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

Assets and liabilities measured at fair value on a recurring and non-recurring basis are summarized below:

	September 30, 2018		
	Fair Value Measurements		
Level 1	Level 2	Level 3	Total
	(In thousands)		

Edgar Filing: OFG BANCORP - Form 10-Q

Recurring fair value
measurements:

Investment securities available-for-sale	\$	-	\$	848,552	\$	-	\$	848,552
Trading securities		-		405		-		405
Money market investments		5,805		-		-		5,805
Derivative assets		-		1,265		-		1,265
Servicing assets		-		-		10,866		10,866
Derivative liabilities		-		(622)		-		(622)
	\$	5,805	\$	849,600	\$	10,866	\$	866,271

Non-recurring fair value
measurements:

Impaired commercial loans	\$	-	\$	-	\$	69,639	\$	69,639
Foreclosed real estate		-		-		37,868		37,868
Other repossessed assets		-		-		4,146		4,146
	\$	-	\$	-	\$	111,653	\$	111,653

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2017					
	Fair Value Measurements					
	Level 1	Level 2		Level 3		Total
(In thousands)						
Recurring fair value measurements:						
Investment securities available-for-sale	\$ -	\$ 645,797		\$ -		\$ 645,797
Trading securities	-	191		-		191
Money market investments	7,021	-		-		7,021
Derivative assets	-	771		-		771
Servicing assets	-	-		9,821		9,821
Derivative liabilities	-	(1,281)		-		(1,281)
	\$ 7,021	\$ 645,478		\$ 9,821		\$ 662,320
Non-recurring fair value measurements:						
Impaired commercial loans	\$ -	\$ -		\$ 72,285		\$ 72,285
Foreclosed real estate	-	-		44,174		44,174
Other repossessed assets	-	-		3,548		3,548
	\$ -	\$ -		\$ 120,007		\$ 120,007

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarters and nine-month periods ended September 30, 2018 and 2017:

Level 3 Instruments Only	Servicing assets			
	Quarter Ended September 30,			
	2018		2017	
(In thousands)				
Balance at beginning of period	\$	10,829	\$	9,866
New instruments acquired		417		429
Principal repayments		(184)		(152)
Changes in fair value of servicing assets		(196)		(325)
Balance at end of period	\$	10,866	\$	9,818

Level 3 Instruments Only	Servicing assets			
	Nine-Month Period Ended September 30,			
	2018		2017	
(In thousands)				
Balance at beginning of period	\$	9,821	\$	9,858
New instruments acquired		1,158		1,503

Edgar Filing: OFG BANCORP - Form 10-Q

Principal repayments		(593)		(478)
Changes in fair value of servicing assets		480		(1,065)
Balance at end of period	\$	10,866	\$	9,818

During the quarters and nine-month periods ended September 30, 2018 and 2017, there were purchases and sales of assets and liabilities measured at fair value on a recurring basis. There were no transfers into and out of Level 1 and Level 2 fair value measurements during such periods.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The table below presents quantitative information for all assets and liabilities measured at fair value on a recurring and non-recurring basis using significant unobservable inputs (Level 3) at September 30, 2018:

		September 30, 2018		
	Fair Value (In thousands)	Valuation Technique	Unobservable Input	Range
Servicing assets	\$ 10,866	Cash flow valuation	Constant prepayment rate	4.45% - 8.33%
			Discount rate	10.00% - 12.00%
Collateral dependent impaired loans	\$ 30,522	Fair value of property or collateral	Appraised value less disposition costs	17.20% - 31.20%
Other non-collateral dependent impaired loans	\$ 39,117	Cash flow valuation	Discount rate	4.25% - 11.00%
Foreclosed real estate	\$ 37,868	Fair value of property or collateral	Appraised value less disposition costs	17.20% - 31.20%
Other repossessed assets	\$ 4,146	Fair value of property or collateral	Estimated net realizable value less disposition costs	36.00% - 64.00%

Information about Sensitivity to Changes in Significant Unobservable Inputs

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

discount rates and prepayment speed assumptions) and other changes, including changes due to collection/realization of expected cash flows.

Fair Value of Financial Instruments

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

The estimated fair value is subjective in nature, involves uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could affect these fair value estimates. The fair value estimates do not take into consideration the value of future business and the value of assets and liabilities that are not financial instruments. Other significant tangible and intangible assets that are not considered financial instruments are the value of long-term customer relationships of retail deposits, and premises and equipment.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The estimated fair value and carrying value of Oriental's financial instruments at September 30, 2018 and December 31, 2017 is as follows:

	September 30, 2018		December 31, 2017	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	(In thousands)			
Level 1				
Financial Assets:				
Cash and cash equivalents	\$ 543,750	\$ 543,750	\$ 485,203	\$ 485,203
Restricted cash	\$ 3,030	\$ 3,030	\$ 3,030	\$ 3,030
Level 2				
Financial Assets:				
Trading securities	\$ 405	\$ 405	\$ 191	\$ 191
Investment securities available-for-sale	\$ 848,552	\$ 848,552	\$ 645,797	\$ 645,797
Investment securities held-to-maturity	\$ 425,066	\$ 444,679	\$ 497,681	\$ 506,064
Federal Home Loan Bank (FHLB) stock	\$ 12,461	\$ 12,461	\$ 13,995	\$ 13,995
Other investments	\$ 3	\$ 3	\$ 3	\$ 3
Derivative assets	\$ 1,265	\$ 1,265	\$ 771	\$ 771
Financial Liabilities:				
Derivative liabilities	\$ 622	\$ 622	\$ 1,281	\$ 1,281
Level 3				
Financial Assets:				
Total loans (including loans held-for-sale)	\$ 4,016,912	\$ 4,352,980	\$ 3,842,907	\$ 4,056,329
Accrued interest receivable	\$ 33,452	\$ 33,452	\$ 49,969	\$ 49,969
Servicing assets	\$ 10,866	\$ 10,866	\$ 9,821	\$ 9,821
Accounts receivable and other assets	\$ 37,951	\$ 37,951	\$ 41,898	\$ 41,898
Financial Liabilities:				
Deposits	\$ 5,057,209	\$ 5,088,993	\$ 4,782,197	\$ 4,799,482
Securities sold under agreements to repurchase	\$ 375,345	\$ 378,237	\$ 191,104	\$ 192,869
Advances from FHLB	\$ 74,331	\$ 73,531	\$ 99,509	\$ 99,643
Other borrowings	\$ 192	\$ 192	\$ 153	\$ 153
Subordinated capital notes	\$ 33,369	\$ 36,083	\$ 33,080	\$ 36,083
Accrued expenses and other liabilities	\$ 80,448	\$ 80,448	\$ 86,791	\$ 86,791

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following methods and assumptions were used to estimate the fair values of significant financial instruments at September 30, 2018 and December 31, 2017:

- Cash and cash equivalents (including money market investments and time deposits with other banks), restricted cash, accrued interest receivable, accounts receivable and other assets and accrued expenses and other liabilities have been valued at the carrying amounts reflected in the consolidated statements of financial condition as these are reasonable estimates of fair value given the short-term nature of the instruments.
- Investments in FHLB-NY stock are valued at their redemption value.
- The fair value of investment securities, including trading securities and other investments, is based on quoted market prices, when available or prices provided from contracted pricing providers, or market prices provided by recognized broker-dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument.
- The fair value of servicing asset is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration actual and expected loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions.
- The fair values of the derivative instruments are provided by valuation experts and counterparties. Certain derivatives with limited market activity are valued using externally developed models that consider unobservable market parameters.
- Fair value of derivative liabilities, which include interest rate swaps and forward-settlement swaps, are based on the net discounted value of the contractual projected cash flows of both the pay-fixed receive-variable legs of the contracts. The projected cash flows are based on the forward yield curve, and discounted using current estimated market rates.
- The fair value of the loan portfolio (including loans held-for-sale and non-performing loans) is based on the exit market price, which is estimated by segregating by type, such as mortgage, commercial, consumer, auto and leasing.

Each loan segment is further segmented into fixed and adjustable interest rates. The fair value is calculated by discounting contractual cash flows, adjusted for prepayment estimates (voluntary and involuntary), if any, using estimated current market discount rates that reflect the credit and interest rate risk inherent in the loan.

- The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is based on the discounted value of the contractual cash flows, using estimated current market discount rates for deposits of similar remaining maturities.
- The fair value of long-term borrowings, which include securities sold under agreements to repurchase, advances from FHLB, and subordinated capital notes is based on the discounted value of the contractual cash flows using current estimated market discount rates for borrowings with similar terms, remaining maturities and put dates.

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 22 – BANKING AND FINANCIAL SERVICE REVENUES

The following table presents the major categories of banking and financial service revenues for the quarters and nine-month periods ended September 30, 2018 and 2017:

	Quarter Ended September 30,		Nine-Month Period Ended	
	2018	2017	September 30,	2017
	(In thousands)			
Banking service revenues:				
Checking accounts fees	\$ 1,502	\$ 1,767	\$ 4,386	\$ 5,470
Savings accounts fees	161	152	473	470
Electronic banking fees	8,104	6,851	23,960	22,211
Credit life commissions	142	127	401	430
Branch service commissions	365	82	1,089	333
Servicing and other loan fees	334	771	1,554	1,560
International fees	185	170	534	519
Miscellaneous income	4	3	7	14
Total banking service revenues	10,797	9,923	32,404	31,007
Wealth management revenue:				
Insurance income	1,654	1,278	4,298	4,378
Broker fees	1,941	1,675	5,387	5,345
Trust fees	2,541	2,840	8,138	8,187
Retirement plan and administration fees	271	223	856	808
Investment banking fees	-	-	9	29
Total wealth management revenue	6,407	6,016	18,688	18,747
Mortgage banking activities:				
Net servicing fees	1,059	925	4,130	2,931
Net gains on sale of mortgage loans and valuation	103	275	182	760
Other	80	74	(325)	(871)
Total mortgage banking activities	1,242	1,274	3,987	2,820
Total banking and financial service revenues	\$ 18,446	\$ 17,213	\$ 55,079	\$ 52,574

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 23 – BUSINESS SEGMENTS

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

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

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

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

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Following are the results of operations and the selected financial information by operating segment for the quarters and nine-month periods ended September 30, 2018 and 2017:

	Quarter Ended September 30, 2018						Consolidated Total
	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations		
	(In thousands)						
Interest income	\$ 83,664	\$ 9	\$ 10,464	\$ 94,137	\$ -	\$ -	\$ 94,137
Interest expense	(7,701)	-	(4,159)	(11,860)	-	-	(11,860)
Net interest income	75,963	9	6,305	82,277	-	-	82,277
Provision for loan and lease losses	(14,478)	-	(123)	(14,601)	-	-	(14,601)
Non-interest income	12,157	6,463	-	18,620	-	-	18,620
Non-interest expenses	(46,049)	(3,720)	(1,172)	(50,941)	-	-	(50,941)
Intersegment revenue	616	-	-	616	(616)	-	-
Intersegment expenses	-	(273)	(343)	(616)	616	-	-
Income before income taxes	\$ 28,209	\$ 2,479	\$ 4,667	\$ 35,355	\$ -	\$ -	\$ 35,355
Income tax expense	11,001	967	287	12,255	-	-	12,255
Net income	\$ 17,208	\$ 1,512	\$ 4,380	\$ 23,100	\$ -	\$ -	\$ 23,100
Total assets	\$ 6,156,500	\$ 25,243	\$ 1,459,682	\$ 7,641,425	\$ (984,751)	\$ -	\$ 6,656,674

	Quarter Ended September 30, 2017						Consolidated Total
	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations		
	(In thousands)						
Interest income	\$ 82,162	\$ 13	\$ 8,180	\$ 90,355	\$ -	\$ -	\$ 90,355
Interest expense	(6,342)	-	(3,535)	(9,877)	-	-	(9,877)
Net interest income	75,820	13	4,645	80,478	-	-	80,478

Edgar Filing: OFG BANCORP - Form 10-Q

Provision for loan and lease losses	(44,042)	-	-	(44,042)	-	(44,042)
Non-interest income	10,384	6,695	833	17,912	-	17,912
Non-interest expenses	(43,819)	(5,048)	(1,602)	(50,469)	-	(50,469)
Intersegment revenue	431	-	-	431	(431)	-
Intersegment expenses	-	(324)	(107)	(431)	431	-
Income before income taxes	\$ (1,226)	\$ 1,336	\$ 3,769	\$ 3,879	\$ -	\$ 3,879
Income tax expense (benefit)	(475)	521	514	560	-	560
Net income	\$ (751)	\$ 815	\$ 3,255	\$ 3,319	\$ -	\$ 3,319
Total assets	\$ 5,605,922	\$ 23,148	\$ 1,620,919	\$ 7,249,989	\$ (961,772)	\$ 6,288,217

OFG BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Nine-Month Period Ended September 30, 2018						Consolidated Total
	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations		
	(In thousands)						
Interest income	\$ 236,171	\$ 35	\$ 29,107	\$ 265,313	\$ -	\$ 265,313	
Interest expense	(21,123)	-	(10,331)	(31,454)	-	(31,454)	
Net interest income	215,048	35	18,776	233,859	-	233,859	
Provision for loan and lease losses, net	(44,677)	-	(131)	(44,808)	-	(44,808)	
Non-interest income	36,590	19,219	28	55,837	-	55,837	
Non-interest expenses	(140,239)	(12,288)	(2,835)	(155,362)	-	(155,362)	
Intersegment revenue	1,519	-	-	1,519	(1,519)	-	
Intersegment expenses	-	(660)	(859)	(1,519)	1,519	-	
Income before income taxes	\$ 68,241	\$ 6,306	\$ 14,979	\$ 89,526	\$ -	\$ 89,526	
Income tax expense	26,614	2,459	787	29,860	-	29,860	
Net income	\$ 41,627	\$ 3,847	\$ 14,192	\$ 59,666	\$ -	\$ 59,666	
Total assets	\$ 6,156,500	\$ 25,243	\$ 1,459,682	\$ 7,641,425	\$ (984,751)	\$ 6,656,674	

	Nine-Month Period Ended September 30, 2017						Consolidated Total
	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations		
	(In thousands)						
Interest income	\$ 236,754	\$ 43	\$ 25,676	\$ 262,473	\$ -	\$ 262,473	
Interest expense	(19,976)	-	(11,838)	(31,814)	-	(31,814)	
Net interest income	216,778	43	13,838	230,659	-	230,659	
Provision for loan and lease losses, net	(88,210)	-	(22)	(88,232)	-	(88,232)	
Non-interest income	35,387	18,952	7,533	61,872	-	61,872	
Non-interest expenses	(137,275)	(13,368)	(4,326)	(154,969)	-	(154,969)	
Intersegment revenue	1,243	-	140	1,383	(1,383)	-	
Intersegment expenses	(140)	(889)	(354)	(1,383)	1,383	-	
Income before income taxes	\$ 27,783	\$ 4,738	\$ 16,809	\$ 49,330	\$ -	\$ 49,330	
Income tax expense	10,836	1,848	1,073	13,757	-	13,757	
Net income	\$ 16,947	\$ 2,890	\$ 15,736	\$ 35,573	\$ -	\$ 35,573	
Total assets	\$ 5,605,922	\$ 23,148	\$ 1,620,919	\$ 7,249,989	\$ (961,772)	\$ 6,288,217	

NOTE 24 – SUBSEQUENT EVENTS

During the third quarter of 2018, Oriental announced the mandatory conversion of its Series C preferred stock into common stock, effective on October 22, 2018. Each share of Series C preferred stock was converted into 86.4225 shares of common stock. There were 84,000 shares of Series C preferred stock outstanding, all of which were converted to common stock on October 22, 2018. Upon conversion, the Series C preferred stock is no longer outstanding and all rights with respect to the Series C preferred stock have ceased and terminated, except the right to receive the number of whole shares of common stock issuable upon conversion of the Series C preferred stock and any required cash-in-lieu of fractional shares.

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

INTRODUCTION

The following discussion of Oriental's financial condition and results of operations should be read in conjunction with the "Selected Financial Data" and Oriental's consolidated financial statements and related notes. This discussion and analysis contains forward-looking statements. Please see "Forward-Looking Statements" and the risk factors set forth in our Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K"), for discussion of the uncertainties, risks and assumptions associated with these statements.

Oriental is a publicly-owned financial holding company that provides a full range of banking and financial services through its subsidiaries, including commercial, consumer, auto and mortgage lending; checking and savings accounts; financial planning, insurance and securities brokerage services; and corporate and individual trust and retirement services. Oriental operates through three major business segments: Banking, Wealth Management, and Treasury, and distinguishes itself based on quality service. Oriental has 39 branches in Puerto Rico and a subsidiary in Boca Raton, Florida, and a non-bank operating subsidiary in Cornelius, North Carolina. Oriental's long-term goal is to strengthen its banking and financial services franchise by expanding its lending businesses, increasing the level of integration in the marketing and delivery of banking and financial services, maintaining effective asset-liability management, growing non-interest revenue from banking and financial services, and improving operating efficiencies.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We provide a summary of our significant accounting policies in “Note 1—Summary of Significant Accounting Policies” of our 2017 Form 10-K.

In the “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” section of our 2017 Form 10-K, we identified several accounting policies as critical, including the following, because they require significant judgments and assumptions about highly complex and inherently uncertain matters and the use of reasonably different estimates and assumptions could have a material impact on our reported results of operations or financial condition:

- Fair value measurements of financial instruments
- Interest on loans and allowance for loan and lease losses
- Accounting for purchased credit-impaired loan

We evaluate our critical accounting estimates and judgments on an ongoing basis and update them as necessary based on changing conditions. Management has reviewed and approved these critical accounting policies and has discussed its judgments and assumptions with the Audit Committee of our Board of Directors. As part of Oriental’s continuous enhancement to the allowance for loan and lease losses methodology, during the quarter ended June 30, 2018, an assessment of the look-back period and historical loss factor was performed for auto and leasing, consumer, and commercial loan portfolios. The analysis was based on the trends observed and their relation with the economic cycle as of the period ended June 30, 2018. As a result, for a segment of the corporate and institutional portfolio, the look-back period was revised to 60 months from 48 months. For the remaining commercial portfolios, the look-back period was maintained at 48 months. This determination was made considering the modification of certain criteria during the quarter used to classified commercial loans within the Bank’s current segmentation policy. Also, for auto and consumer portfolios, a look back period of 24 months was maintained. For the residential mortgages portfolio, the factor was reviewed to 24 months from 12 months. In addition, during the quarter ended June 30, 2018, an assessment of environmental factors was performed for commercial, auto, and consumer portfolios. As a result, the environmental factors continue to reflect our assessment of the impact to our portfolio, taking into consideration the current evolution of the portfolio and expected impact, due to recent economic developments, changes in values of collateral and delinquencies, among others. These changes in the allowance for loan and lease losses’ look-back period and the result of the assessment in economic factors for the commercial, auto, and consumer portfolios are considered a change in accounting estimate as per ASC 250-10 provisions, where adjustments should be made prospectively. Apart from these changes, there have been no other material changes in the methods used to formulate these critical accounting estimates from those discussed in our 2017 Form 10-K.

OVERVIEW OF FINANCIAL PERFORMANCE**SELECTED FINANCIAL DATA**

	Quarter Ended September 30,			Nine-Month Period Ended September 30,		
	2018	2017	Variance %	2018	2017	Variance %
EARNINGS DATA: (In thousands, except per share data)						
Interest income	\$ 94,137	\$ 90,355	4.2%	\$ 265,313	\$ 262,473	1.1%
Interest expense	11,860	9,877	20.1%	31,454	31,814	-1.1%
Net interest income	82,277	80,478	2.2%	233,859	230,659	1.4%
Provision for loan and lease losses, net	14,601	44,042	-66.8%	44,808	88,232	-49.2%
Net interest income after provision for loan and lease losses	67,676	36,436	85.7%	189,051	142,427	32.7%
Non-interest income	18,620	17,912	4.0%	55,837	61,872	-9.8%
Non-interest expenses	50,941	50,469	0.9%	155,362	154,969	0.3%
Income before taxes	35,355	3,879	811.4%	89,526	49,330	81.5%
Income tax expense	12,255	560	2088.4%	29,860	13,757	117.1%
Net income	23,100	3,319	596.0%	59,666	35,573	67.7%
Less: dividends on preferred stock	(3,466)	(3,465)	0.0%	(10,396)	(10,396)	0.0%
Income (loss) available to common shareholders	\$ 19,634	\$ (146)	13547.9%	\$ 49,270	\$ 25,177	95.7%
PER SHARE DATA:						
Basic	\$ 0.45	\$ -	100.0%	\$ 1.12	\$ 0.57	96.5%
Diluted	\$ 0.42	\$ -	100.0%	\$ 1.07	\$ 0.56	91.1%
Average common shares outstanding	43,996	43,947	0.1%	43,975	43,937	0.1%
Average common shares outstanding and equivalents	51,464	51,102	0.7%	51,344	51,095	0.5%
Cash dividends declared per common share	\$ 0.06	\$ 0.06	0.0%	\$ 0.18	\$ 0.18	0.0%
Cash dividends declared on common shares	\$ 2,641	\$ 2,638	0.1%	\$ 7,919	\$ 7,915	0.1%
PERFORMANCE RATIOS:						
Return on average assets (ROA)	1.42%	0.22%	545.5%	1.25%	0.76%	64.5%
Return on average tangible common equity	10.94%	-0.08%	13775.0%	9.30%	4.94%	88.3%
Return on average common equity (ROE)	9.72%	-0.07%	13985.7%	8.25%	4.35%	89.7%

Edgar Filing: OFG BANCORP - Form 10-Q

Efficiency ratio	50.58%	51.66%	-2.1%	53.77%	54.71%	-1.7%
Interest rate spread	5.29%	5.56%	-4.9%	5.20%	5.16%	0.8%
Interest rate margin	5.38%	5.64%	-4.6%	5.28%	5.25%	0.6%

91

SELECTED FINANCIAL DATA - (Continued)

	September 30, 2018	December 31, 2017	Variance %
PERIOD END BALANCES AND CAPITAL RATIOS:			
(In thousands, except per share data)			
Investments and loans			
Investment securities	\$ 1,306,100	\$ 1,166,050	12.0%
Loans and leases, net	4,352,980	4,056,329	7.3%
Total investments and loans	\$ 5,659,080	\$ 5,222,379	8.4%
Deposits and borrowings			
Deposits	\$ 5,088,993	\$ 4,799,482	6.0%
Securities sold under agreements to repurchase	378,237	192,869	96.1%
Other borrowings	109,806	135,879	-19.2%
Total deposits and borrowings	\$ 5,577,036	\$ 5,128,230	8.8%
Stockholders' equity			
Preferred stock	\$ 176,000	\$ 176,000	0.0%
Common stock	52,626	52,626	0.0%
Additional paid-in capital	542,078	541,600	0.1%
Legal surplus	87,563	81,454	7.5%
Retained earnings	236,120	200,878	17.5%
Treasury stock, at cost	(103,706)	(104,502)	0.8%
Accumulated other comprehensive (loss)	(20,795)	(2,949)	-605.2%
Total stockholders' equity	\$ 969,886	\$ 945,107	2.6%
Per share data			
Book value per common share	\$ 18.27	\$ 17.73	3.0%
Tangible book value per common share	\$ 16.23	\$ 15.67	3.6%
Market price at end of period	\$ 16.15	\$ 9.40	71.8%
Capital ratios			
Leverage capital	13.93%	13.92%	0.1%
Common equity Tier 1 capital ratio	14.38%	14.59%	-1.5%
Tier 1 risk-based capital	18.55%	19.05%	-2.6%
Total risk-based capital	19.84%	20.34%	-2.5%
Equity to assets ratio	14.57%	15.27%	-4.6%
Financial assets managed			
Trust assets managed	\$ 2,973,457	\$ 3,039,998	-2.2%
Broker-dealer assets gathered	\$ 2,312,245	\$ 2,250,460	2.7%

FINANCIAL HIGHLIGHTS

Earnings per share for the quarter ended September 30, 2018 is up more than 20% sequentially and significantly better year over year. All financial metrics continued to build strong momentum going forward.

Key to our success has been the effectiveness of strategies we have been working on for years. This has enabled us to get closer to our commercial and retail customers through value-added service, increased convenience and highly efficient technology.

With customer count up 4% year over year, we are achieving growth in part through increased customer adoption of automated and interactive teller machines, and online and mobile channels.

Until now, economic activity has been driven primarily by businesses and consumers rebuilding. We believe businesses are starting to gain new confidence to invest and expand going forward. We are excited about our prospects for continued growth.

Summary of third quarter of 2018

- All key performance metrics improved, including net interest margin at 5.38%, return on average assets at 1.42%, return on average tangible common stockholders' equity at 10.94%, and efficiency ratio at 50.58%.
- Increased profitability was driven by new loan production of \$354 million, higher average loan yields of 7.55%, annualized increase in average loan balances of 9.7%, and lower non-interest expenses.
- Core deposit balances of \$4.56 billion rose 3.2% from the prior quarter as customer count grew 1.2% sequentially and 4.0% year over year.
- Tangible book value per common share of \$16.23 at September 30, 2018 increased 6.8% annualized from June 30, 2018.
- Regulatory capital is expected to benefit by \$84.0 million as a result of the mandatory conversion, effective October 22, 2018, of the 8.750% Non-Cumulative Convertible Perpetual Preferred Stock, Series C (the "Series C Preferred Stock").

ANALYSIS OF RESULTS OF OPERATIONS

The following tables show major categories of interest-earning assets and interest-bearing liabilities, their respective interest income, expenses, yields and costs, and their impact on net interest income due to changes in volume and rates for the quarters and nine-month periods ended September 30, 2018 and 2017:

TABLE 1 - ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE QUARTERS ENDED SEPTEMBER 30, 2018 AND 2017

	Interest		Average rate		Average balance	
	September 2018	September 2017	September 2018	September 2017	September 2018	September 2017
(Dollars in thousands)						
A - TAX EQUIVALENT SPREAD						
Interest-earning assets	\$ 94,137	\$ 90,355	6.16%	6.33%	\$ 6,066,821	\$ 5,658,953
Tax equivalent adjustment	1,934	1,084	0.13%	0.08%	-	-
Interest-earning assets - tax equivalent	96,071	91,439	6.29%	6.41%	6,066,821	5,658,953
Interest-bearing liabilities	11,860	9,877	0.87%	0.77%	5,437,442	5,071,668
Tax equivalent net interest income / spread	84,211	81,562	5.42%	5.64%	629,379	587,285
Tax equivalent interest rate margin			5.55%	5.72%		
B - NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	8,445	6,584	2.52%	2.23%	1,327,180	1,170,714
Interest bearing cash and money market investments	1,676	1,304	2.05%	1.21%	325,058	426,197
Total investments	10,121	7,888	2.43%	1.96%	1,652,238	1,596,911
Non-acquired loans						
Mortgage	8,781	9,303	5.18%	5.33%	672,526	692,782
Commercial	23,411	21,337	6.14%	6.83%	1,513,556	1,239,390
Consumer	9,254	8,423	11.38%	11.10%	322,553	301,121
Auto and leasing	25,397	19,876	9.61%	9.51%	1,048,617	829,446
Total non-acquired loans	66,843	58,939	7.46%	7.63%	3,557,252	3,062,739
Acquired loans:						
Acquired BBVAPR						

Edgar Filing: OFG BANCORP - Form 10-Q

Mortgage	6,722	7,434	5.29%	5.54%	503,978	532,664
Commercial	3,984	7,084	9.21%	12.60%	171,661	222,978
Consumer	2,239	2,602	16.51%	17.32%	53,803	59,596
Auto	743	2,069	8.13%	10.48%	36,263	78,358
Total acquired						
BBVAPR loans	13,688	19,189	7.09%	8.52%	765,705	893,596
Acquired Eurobank	3,485	4,339	15.09%	16.29%	91,626	105,707
Total loans	84,016	82,467	7.55%	8.05%	4,414,583	4,062,042
Total						
interest-earning assets	94,137	90,355	6.16%	6.33%	6,066,821	5,658,953

	Interest		Average rate		Average balance	
	September 2018	September 2017	September 2018	September 2017	September 2018	September 2017
			(Dollars in thousands)			
Interest-bearing liabilities:						
Deposits:						
NOW Accounts	1,196	880	0.43%	0.34%	1,096,023	1,024,480
Savings and money market	1,571	1,426	0.51%	0.50%	1,211,693	1,142,338
Individual retirement accounts	322	391	0.62%	0.66%	206,786	236,385
Retail certificates of deposits	1,896	2,482	1.25%	1.67%	600,687	590,057
Total core deposits	4,985	5,179	0.63%	0.70%	3,115,189	2,993,260
Institutional deposits	678	29	1.22%	0.05%	219,651	226,468
Brokered deposits	2,727	2,163	2.08%	1.55%	519,502	554,650
Total wholesale deposits	3,405	2,192	1.83%	1.14%	739,153	781,118
	8,390	7,371	0.86%	0.77%	3,854,342	3,774,378
Non-interest bearing deposits	-	-	0.00%	0.00%	1,079,833	835,255
Core deposit intangible amortization	215	230	0.00%	0.00%	-	-
Total deposits	8,605	7,601	0.69%	0.65%	4,934,175	4,609,633
Borrowings:						
Securities sold under agreements to repurchase	2,242	1,282	2.28%	1.56%	390,225	325,201
Advances from FHLB and other borrowings	517	596	2.67%	2.35%	76,960	100,751
Subordinated capital notes	496	398	5.45%	4.38%	36,083	36,083
Total borrowings	3,255	2,276	2.57%	1.95%	503,268	462,035
Total interest bearing liabilities	11,860	9,877	0.87%	0.77%	5,437,443	5,071,668
Net interest income / spread	\$ 82,277	\$ 80,478	5.29%	5.56%		
Interest rate margin Excess of average interest-earning assets			5.38%	5.64%		
over average interest-bearing liabilities					\$ 629,379	\$ 587,284
Average interest-earning assets to average interest-bearing liabilities ratio					111.57%	111.58%

C - CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
	(In thousands)		
Interest Income:			
Investments	\$ 273	\$ 1,960	\$ 2,233
Loans	6,192	(4,643)	1,549
Total interest income	6,465	(2,683)	3,782
Interest Expense:			
Deposits	535	469	1,004
Repurchase agreements	256	704	960
Other borrowings	(173)	192	19
Total interest expense	618	1,365	1,983
Net Interest Income	\$ 5,847	\$ (4,048)	\$ 1,799

TABLE 1A - ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE NINE-MONTH PERIODS ENDED SEPTIEMBRE 30, 2018 AND 2017

	Interest		Average rate		Average balance	
	September 2018	September 2017	September 2018	September 2017	September 2018	September 2017
	(Dollars in thousands)					
A - TAX EQUIVALENT SPREAD						
Interest-earning assets	\$ 265,313	\$ 262,472	5.99%	5.97%	\$ 5,918,041	\$ 5,875,784
Tax equivalent adjustment	5,800	3,661	0.13%	0.08%	-	-
Interest-earning assets - tax equivalent	271,113	266,133	6.12%	6.05%	5,918,041	5,875,784
Interest-bearing liabilities	31,454	31,813	0.79%	0.81%	5,295,170	5,253,584
Tax equivalent net interest income / spread	239,659	234,320	5.33%	5.24%	622,871	622,200
Tax equivalent interest rate margin			5.46%	5.33%		
B - NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	24,131	22,014	2.48%	2.29%	1,299,357	1,287,919
Interest bearing cash and money market investments	4,125	3,104	1.76%	7.40%	312,665	417,892
Total investments	28,256	25,118	2.34%	0.99%	1,612,022	1,705,811
Non-acquired loans						
Mortgage	26,539	28,298	5.23%	5.40%	678,334	701,039
Commercial	62,207	54,023	5.89%	5.79%	1,412,108	1,247,249
Consumer	26,519	24,146	11.16%	11.09%	317,673	291,140
Auto and leasing	69,546	57,940	9.40%	9.64%	988,830	803,821
Total non-acquired loans	184,811	164,407	7.27%	7.22%	3,396,945	3,043,249
Acquired loans:						
Acquired BBVAPR						
Mortgage	20,710	22,921	5.39%	5.05%	514,076	606,636
Commercial	11,273	16,617	7.66%	9.14%	196,810	243,183
Consumer	6,964	8,381	16.79%	18.47%	55,454	60,669
Auto	3,107	8,043	8.69%	11.04%	47,801	97,382
Total acquired BBVAPR loans	42,054	55,962	6.91%	7.42%	814,141	1,007,870
Acquired Eurobank	10,192	16,986	14.35%	19.11%	94,933	118,854
Total loans	237,057	237,355	7.36%	7.61%	4,306,019	4,169,973
Total interest-earning assets	265,313	262,473	5.99%	5.97%	5,918,041	5,875,784

	Interest		Average rate		Average balance	
	September 2018	September 2017	September 2018	September 2017	September 2018	September 2017
	(Dollars in thousands)					
Interest-bearing liabilities:						
Deposits:						
NOW Accounts	\$ 3,064	\$ 2,972	0.38%	0.37%	\$ 1,069,341	\$ 1,065,419
Savings and money market	4,623	4,392	0.51%	0.51%	1,216,198	1,152,597
Individual retirement accounts	953	1,196	0.59%	0.66%	214,881	243,944
Retail certificates of deposits	5,515	5,902	1.24%	1.39%	596,366	567,853
Total core deposits	14,155	14,462	0.65%	0.65%	3,096,786	3,029,813
Institutional deposits	2,007	1,322	1.28%	0.79%	210,160	224,826
Brokered deposits	6,748	6,132	1.86%	1.44%	485,832	568,207
Total wholesale deposits	8,755	7,454	1.68%	1.90%	695,992	793,033
	22,910	21,916	0.81%	0.77%	3,792,778	3,822,846
Non-interest bearing deposits	-	-	0.00%	0.00%	1,062,582	\$ 834,325
Core deposit intangible amortization	644	690	0.00%	0.00%	-	-
Total deposits	23,554	22,606	0.65%	0.65%	4,855,360	4,657,171
Borrowings:						
Securities sold under agreements to repurchase	5,159	6,260	2.08%	1.83%	332,215	456,523
Advances from FHLB and other borrowings	1,339	1,799	2.50%	2.32%	71,512	103,807
Subordinated capital notes	1,402	1,149	5.19%	4.26%	36,083	36,083
Total borrowings	7,900	9,208	2.40%	2.06%	439,810	596,413
Total interest-bearing liabilities	31,454	31,814	0.79%	0.81%	5,295,170	5,253,584
Net interest income / spread	\$ 233,859	\$ 230,659	5.20%	5.16%		
Interest rate margin			5.28%	5.25%		
Excess of average interest-earning assets over						
average interest-bearing liabilities					\$ 622,872	\$ 622,199
Average interest-earning assets to average						
interest-bearing liabilities ratio					111.76%	111.84%

C - CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
	(In thousands)		
Interest Income:			
Investments	\$ (1,381)	\$ 4,519	\$ 3,138
Loans	5,284	(5,582)	(298)
Total interest income	3,903	(1,063)	2,840
Interest Expense:			
Deposits	962	(14)	948
Repurchase agreements	(1,705)	605	(1,100)
Other borrowings	(682)	474	(208)
Total interest expense	(1,425)	1,065	(360)
Net Interest Income	\$ 5,328	\$ (2,128)	\$ 3,200

Net Interest Income

Net interest income is a function of the difference between rates earned on Oriental's interest-earning assets and rates paid on its interest-bearing liabilities (interest rate spread) and the relative amounts of its interest earning assets and interest-bearing liabilities (interest rate margin). Oriental constantly monitors the composition and re-pricing of its assets and liabilities to maintain its net interest income at adequate levels.

Comparison for the quarters ended September 30, 2018 and 2017

Net interest income of \$82.3 million increased \$1.8 million from \$80.5 million. Interest rate spread decreased 27 basis points to 5.29% from 5.56% and net interest margin decreased 26 basis points to 5.38% from 5.64%. These decreases are mainly due to the net effect of a decrease of 17 basis points in the average yield of total interest earning assets and an increase of 10 basis point in average cost of interest-bearing liabilities.

Net interest income increased as a result of:

- Higher interest income from originated loans of \$7.9 million, reflecting higher balances in the commercial and auto portfolios; and
- Higher interest income from investment of \$2.2 million, reflecting increases in interest rates of \$2.0 million and in volume of \$273 thousand.

Such increases in net interest income were partially offset by:

- A decrease of \$6.4 million in the interest income from acquired loans as such loans continue to be repaid, and a decrease of \$1.4 million in cost recoveries.

Comparison of nine-month periods ended September, 2018 and 2017

Net interest income of \$233.9 million increased \$3.2 million compared with \$230.7 million. Interest rate spread increased 4 basis points from 5.16% to 5.20% and net interest margin increased 3 basis points from 5.25% to 5.28%. These increases are mainly due to the net effect of 2 basis points increase in the average yield of interest-earning assets from 5.97% to 5.99% and to 2 basis points decrease in average costs of interest-bearing liabilities from 0.81% to 0.79%

Net interest income increased as a result of:

- Higher interest income from originated loans of \$20.4 million, reflecting higher balances in the commercial, auto and consumer portfolios;
- Higher interest income from investment of \$3.1 million, reflecting an increase in interest rates of \$4.5 million, partially offset by a decrease in volume of \$1.4 million; and
- Lower interest expenses on repurchase agreements and other borrowings of \$1.3 million as a result of the repayment of high cost repurchase agreements and FHLB advances.

Such increase in net interest income was partially offset by:

- A decrease of \$20.7 million in the interest income from acquired loans as such loans continue to be repaid and a decrease in cost recoveries of \$2.7 million.

TABLE 2 - NON-INTEREST INCOME SUMMARY

	Quarter Ended September 30,			Nine-Month Period Ended September 30,		
	2018	2017	Variance	2018	2017	Variance
	(Dollars in thousands)					
Banking service revenue	\$ 10,797	\$ 9,923	8.8%	\$ 32,404	\$ 31,007	4.5%
Wealth management revenue	6,407	6,016	6.5%	18,688	18,747	-0.3%
Mortgage banking activities	1,242	1,274	-2.5%	3,987	2,820	41.4%
Total banking and financial service revenue	18,446	17,213	7.2%	55,079	52,574	4.8%
FDIC shared-loss benefit	-	-	0.0%	-	1,403	-100.0%
Net gain on:						
Sale of securities available for sale	-	4	-100.0%	-	6,896	-100.0%
Derivatives	-	-	0.0%	-	103	-100.0%
Early extinguishment of debt	-	-	0.0%	-	(80)	100.0%
Other non-interest income	174	695	-75.0%	758	976	-22.3%
	174	699	-75.1%	758	9,298	-91.8%
Total non-interest income, net	\$ 18,620	\$ 17,912	4.0%	\$ 55,837	\$ 61,872	-9.8%

Non-Interest Income

Non-interest income is affected by the amount of the trust department assets under management, transactions generated by clients' financial assets serviced by the securities broker-dealer and insurance agency subsidiaries, the level of mortgage banking activities, fees generated from loans and deposit accounts, and gains on sales of assets.

Comparison of quarters ended September 30, 2018 and 2017

Oriental recorded non-interest income, net, in the amount of \$18.6 million, compared to \$17.9 million, an increase of 4.0%, or \$708 thousand. The increase in non-interest income was mainly due to:

- An increase of \$874 thousand in banking service revenue, mainly from higher electronic banking fees of \$1.3 million related to transaction volume, partially offset by a decrease of \$436 thousand in commercial loan prepayment fees.

Comparison of nine-month periods ended September 30, 2018 and 2017

Oriental recorded non-interest income, net, in the amount of \$55.8 million, compared to \$61.9 million, a decrease of 9.8%, or \$6.0 million. The decrease in non-interest income was mainly due to:

- The sale of \$166.0 million in mortgage-backed securities during the second quarter of 2017, which generated a gain of \$6.9 million; and
- The termination of the FDIC shared-loss agreement during the first quarter of 2017 resulting in the recognition of a \$1.4 million gain.

The decrease was partially offset by:

- An increase of \$1.4 million banking service revenue, mainly from higher electronic banking fees of \$1.7 million related to transaction volume.
- An increase of \$1.2 million in mortgage banking activities which included \$1.1 million in other income from servicing assets due to higher book balances of mortgage loans, mainly attributed to the hurricane-related moratorium.

TABLE 3 - NON-INTEREST EXPENSES SUMMARY

	Quarter Ended September 30,			Nine-Month Period Ended September 30,		
	2018	2017	Variance %	2018	2017	Variance %
(Dollars in thousands)						
Compensation and employee benefits	\$ 18,495	\$ 19,882	-7.0%	\$ 57,202	\$ 59,546	-3.9%
Professional and service fees	3,077	3,113	-1.2%	8,917	9,575	-6.9%
Occupancy and equipment	8,388	8,276	1.4%	25,322	24,012	5.5%
Insurance	1,620	1,052	54.0%	4,580	3,834	19.5%
Electronic banking charges	5,586	5,021	11.3%	15,968	15,373	3.9%
Information technology expenses	2,056	2,046	0.5%	6,064	6,114	-0.8%
Advertising, business promotion, and strategic initiatives	1,329	1,405	-5.4%	3,700	4,205	-12.0%
Loss on sale of foreclosed real estate and other repossessed assets	1,210	1,395	-13.3%	2,828	4,508	-37.3%
Loan servicing and clearing expenses	1,251	1,134	10.3%	3,639	3,592	1.3%
Taxes, other than payroll and income taxes	2,175	2,243	-3.0%	6,820	7,007	-2.7%
Communication	927	855	8.4%	2,627	2,682	-2.1%
Printing, postage, stationery and supplies	499	586	-14.8%	1,748	1,889	-7.5%
Director and investor relations	223	221	0.9%	800	775	3.2%
Credit related expenses	2,736	1,714	59.6%	7,052	6,557	7.5%
Other operating expenses	1,369	1,526	-10.3%	8,095	5,300	52.7%
Total non-interest expenses	\$ 50,941	\$ 50,469	0.9%	\$ 155,362	\$ 154,969	0.3%
Relevant ratios and data:						
Efficiency ratio	50.58%	51.66%		53.77%	54.71%	
Compensation and benefits to non-interest expense	36.31%	39.39%		36.82%	38.42%	
Compensation to average total assets owned	1.11%	1.32%		1.72%	1.91%	
Average number of employees	1,365	1,464		1,365	1,464	
Average compensation per employee	\$ 13.55	\$ 13.58		\$ 41.91	\$ 40.67	
Average loans per average employee	\$ 3,234	\$ 2,775		\$ 3,155	\$ 2,848	

Non-Interest Expenses

Comparison of quarters ended September 30, 2018 and 2017

Non-interest expense was \$50.9 million, representing a slight increase of 0.9% compared to \$50.5 million.

The increase in non-interest expenses was driven by:

- Higher credit-related expenses of \$1.0 million related to higher legal fees on foreclosed properties of \$562 thousand and other real estate owned expenses of \$459 thousand;
- Higher insurance expenses of \$568 thousand related to an increase of the Company's insurance premiums renewal in July 2018 as a consequence of hurricane Maria; and
- Higher electronic banking charges of \$565 thousand due to an increase in transaction volume.

The increases in the foregoing non-interest expenses were offset by:

- Lower compensation and employee benefits by \$1.4 million, mainly due to a decrease in the average number of employees.

The efficiency ratio improved from 51.66% to 50.58%. The efficiency ratio measures how much of Oriental's revenues is used to pay operating expenses. Oriental computes its efficiency ratio by dividing non-interest expenses by the sum of its net interest income and non-interest income, but excluding gains on the sale of investment securities, derivatives gains or losses, FDIC shared-loss benefit, losses on the early extinguishment of debt, other gains and losses, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permits consistent comparability. Amounts presented as part of non-interest income that are excluded from efficiency ratio computation for the quarters ended September 30, 2018 and 2017 amounted to \$174 thousand and \$699 thousand, respectively.

Oriental implemented its disaster response plan as hurricanes Irma and Maria approached its service areas. To operate in disaster response mode, Oriental incurred expenses for, among other things, buying diesel and generators for electric power, debris removal, security services, property damages, and emergency communication with customers regarding the status of its banking operations. Estimated losses at December 31, 2017 amounted to \$6.6 million. No additional losses have been incurred at September 30, 2018.

Oriental maintains insurance for casualty losses as well as for disaster response costs and certain revenue lost through business interruption. Management believes that recovery of \$2.2 million incurred costs as of December 31, 2017 is probable. Oriental received a \$1.0 million partial payment from the insurance company in December 2017 and a \$0.7 million payment during the nine-month period ended September 30, 2018. Accordingly, a receivable of \$0.5 million and \$1.2 million was included in other assets at September 30, 2018 and December 31, 2017, respectively, for the expected recovery.

Comparison of nine-month periods ended September 30, 2018 and 2017

Non-interest expense was \$155.4 million, representing a slight increase of 0.3% compared to \$155.0 million.

The increase in non-interest expenses for the nine-month period ended September 30, 2018 was driven by:

- Higher other operating expenses by \$2.8 million, mainly attributed to an increase in claims and settlements accruals and other losses, and to minor repairs to physical assets related to the impact of hurricanes.

The decreases in the foregoing non-interest expenses were offset by:

- Lower compensation and employee benefits by \$2.3 million, mainly due to a decrease in the average number of employees.

The efficiency ratio improved from 54.71% to 53.77% for the same period in 2017. Amounts presented as part of non-interest income that are excluded from efficiency ratio computation for the nine-month periods ended September 30, 2018 and 2017 amounted to \$758 thousand and \$9.3 million, respectively.

Provision for Loan and Lease Losses

Comparison of quarters ended September 30, 2018 and 2017

Based on an analysis of the credit quality and the composition of Oriental's loan portfolio, management determined that the provision for the quarter was adequate to maintain the allowance for loan and lease losses at an appropriate level to provide for probable losses based upon an evaluation of known and inherent risks.

Provision for loan and lease losses decreased 66.8%, or \$29.4 million, to \$14.6 million. Such decrease is directly related to the \$27 million provisioned in September 2017 (\$16.8 million corresponding to originated loan portfolio and \$10.2 corresponding to acquired portfolio), due to the assessment made related to the hurricanes Irma and Maria which struck the Island in September 2017. In addition, provision for acquired loan portfolio decreased \$3.0 million, mainly from lower portfolio balances due to repayments and maturities.

Comparison of nine-month periods ended September 30, 2018 and 2017

Provision for loan and lease losses decreased 49.2%, or \$43.4 million, to \$44.8 million. The decrease in the provision was mostly due to:

- Hurricanes provision of \$27 million in the third quarter of 2017 and \$5.4 million in the fourth quarter of 2017;
- A \$4.3 million provision in the second quarter of 2017 to charge-off the loss on sale of a loan to a Puerto Rico government municipality and a \$5.9 million provision to increase the general allowance on the remaining municipal loan portfolio; and
- Decrease in acquired loan portfolio provision of \$4.5 million, mainly from lower portfolio balances.

Such decreases were offset by a \$3.7 million increase in the originated portfolio provision related to higher balances as compared to the same period in 2017.

Please refer to the "Allowance for Loan and Lease Losses" in the "Credit Risk Management" section of this MD&A for a more detailed analysis of the allowance for loan and lease losses.

Income Taxes

Comparison of quarters ended September 30, 2018 and 2017

Income tax expense was \$12.3 million, compared to \$560 thousand, reflecting the effective income tax rate of 33.7% and the net income before income taxes of \$35.4 million for 2018.

Comparison of nine-month periods ended September 30, 2018 and 2017

Income tax expense was \$29.9 million, compared to \$13.8 million, reflecting the effective income tax rate of 33.7% and the net income before income taxes of \$89.5 million for 2018.

Business Segments

Oriental segregates its businesses into the following major reportable segments: Banking, Wealth Management, and Treasury. Management established the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as Oriental's organization, nature of its products, distribution channels and economic characteristics of its services were also considered in the determination of the reportable segments. Oriental measures the performance of these reportable segments based on pre-established goals of different financial parameters such as net income, net interest income, loan production, and fees generated. Oriental's methodology for allocating non-interest expenses among segments is based on several factors such as revenue, employee headcount, occupied space, dedicated services or time, among others. Following are the results of operations and the selected financial information by operating segment for the quarters and nine-month periods ended September 30, 2018 and 2017.

Quarter Ended September 30, 2018

	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations	Consolidated Total
	(In thousands)					
Interest income	\$ 83,664	\$ 9	\$ 10,464	\$ 94,137	\$ -	\$ 94,137
Interest expense	(7,701)	-	(4,159)	(11,860)	-	(11,860)
Net interest income	75,963	9	6,305	82,277	-	82,277
Provision for loan and lease losses	(14,478)	-	(123)	(14,601)	-	(14,601)
Non-interest income	12,157	6,463	-	18,620	-	18,620
Non-interest expenses	(46,049)	(3,720)	(1,172)	(50,941)	-	(50,941)
Intersegment revenue	616	-	-	616	(616)	-
Intersegment expenses	-	(273)	(343)	(616)	616	-
Income before income taxes	\$ 28,209	\$ 2,479	\$ 4,667	\$ 35,355	\$ -	\$ 35,355
Income tax expense	11,001	967	287	12,255	-	12,255
Net income	\$ 17,208	\$ 1,512	\$ 4,380	\$ 23,100	\$ -	\$ 23,100
Total assets	\$ 6,156,500	\$ 25,243	\$ 1,459,682	\$ 7,641,425	\$ (984,751)	\$ 6,656,674

Quarter Ended September 30, 2017

	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations	Consolidated Total
	(In thousands)					
Interest income	\$ 82,162	\$ 13	\$ 8,180	\$ 90,355	\$ -	\$ 90,355
Interest expense	(6,342)	-	(3,535)	(9,877)	-	(9,877)
Net interest income	75,820	13	4,645	80,478	-	80,478
Provision for loan and lease losses	(44,042)	-	-	(44,042)	-	(44,042)
Non-interest income	10,384	6,695	833	17,912	-	17,912
Non-interest expenses	(43,819)	(5,048)	(1,602)	(50,469)	-	(50,469)
Intersegment revenue	431	-	-	431	(431)	-
Intersegment expenses	-	(324)	(107)	(431)	431	-
Income before income taxes	\$ (1,226)	\$ 1,336	\$ 3,769	\$ 3,879	\$ -	\$ 3,879
Income tax expense (benefit)	(475)	521	514	560	-	560

Edgar Filing: OFG BANCORP - Form 10-Q

Net income	\$	(751)	\$	815	\$	3,255	\$	3,319	\$	-	\$	3,319
Total assets	\$	5,605,922	\$	23,148	\$	1,620,919	\$	7,249,989	\$	(961,772)	\$	6,288,217

Nine-Month Period Ended September 30, 2018

	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations	Consolidated Total
	(In thousands)					
Interest income	\$ 236,171	\$ 35	\$ 29,107	\$ 265,313	\$ -	\$ 265,313
Interest expense	(21,123)	-	(10,331)	(31,454)	-	(31,454)
Net interest income	215,048	35	18,776	233,859	-	233,859
Provision for loan and lease losses	(44,677)	-	(131)	(44,808)	-	(44,808)
Non-interest income	36,590	19,219	28	55,837	-	55,837
Non-interest expenses	(140,239)	(12,288)	(2,835)	(155,362)	-	(155,362)
Intersegment revenue	1,519	-	-	1,519	(1,519)	-
Intersegment expenses	-	(660)	(859)	(1,519)	1,519	-
Income before income taxes	\$ 68,241	\$ 6,306	\$ 14,979	\$ 89,526	\$ -	\$ 89,526
Income tax expense	26,614	2,459	787	29,860	-	29,860
Net income	\$ 41,627	\$ 3,847	\$ 14,192	\$ 59,666	\$ -	\$ 59,666
Total assets	\$ 6,156,500	\$ 25,243	\$ 1,459,682	\$ 7,641,425	\$ (984,751)	\$ 6,656,674

Nine-Month Period Ended September 30, 2017

	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations	Consolidated Total
	(In thousands)					
Interest income	\$ 236,754	\$ 43	\$ 25,676	\$ 262,473	\$ -	\$ 262,473
Interest expense	(19,976)	-	(11,838)	(31,814)	-	(31,814)
Net interest income	216,778	43	13,838	230,659	-	230,659
Provision for loan and lease losses	(88,210)	-	(22)	(88,232)	-	(88,232)
Non-interest income	35,387	18,952	7,533	61,872	-	61,872
Non-interest expenses	(137,275)	(13,368)	(4,326)	(154,969)	-	(154,969)
Intersegment revenue	1,243	-	140	1,383	(1,383)	-
Intersegment expenses	(140)	(889)	(354)	(1,383)	1,383	-
Income before income taxes	\$ 27,783	\$ 4,738	\$ 16,809	\$ 49,330	\$ -	\$ 49,330
Income tax expense	10,836	1,848	1,073	13,757	-	13,757

Edgar Filing: OFG BANCORP - Form 10-Q

Net income	\$	16,947	\$	2,890	\$	15,736	\$	35,573	\$	-	\$	35,573
Total assets	\$	5,605,922	\$	23,148	\$	1,620,919	\$	7,249,989	\$	(961,772)	\$	6,288,217

Comparison of quarters ended September 30, 2018 and 2017

Banking

Oriental's banking segment net income before taxes increased \$29.4 million from a loss of \$1.2 million to \$28.2 million, reflecting that the provision for loan and lease losses decreased 66.8%, or \$29.4 million, to \$14.6 million. Such decrease is directly related to the \$27 million provisioned in September 2017 (\$16.8 million corresponding to originated loan portfolio and \$10.2 corresponding to acquired portfolio), due to the assessment made related to the hurricanes Irma and Maria which struck the Island in September 2017. In addition, provision for acquired loan portfolio decreased \$3.0 million, mainly from lower portfolio balances due to repayments and maturities.

Wealth Management

Wealth management segment revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, increased \$1.1 million to \$2.5 million thousand due to lower expenses by \$1.3 million, mainly in compensation and employee benefits.

Treasury

Treasury segment net income before taxes, which consists of Oriental's asset/liability management activities, such as purchase and sale of investment securities, interest rate risk management, derivatives, and borrowings, increased from \$3.8 million to \$4.7 million, reflecting less interest income from investments by \$2.3 million, mainly due to increase in interest rates of \$2.0 million and in volume by \$273 thousand.

Comparison of nine-month periods ended September 30, 2018 and 2017

Banking

Oriental's banking segment net income before taxes increased \$40.5 million to \$68.2 million, mainly reflecting a decrease in provision for loan and lease losses of 49.2%, or \$43.4 million, to \$44.8 million, mainly from hurricanes provision of \$27 million and \$5.4 million in the third and fourth quarters of 2017, respectively. In addition, during the second quarter of 2017, Oriental recognized a \$4.3 million provision to charge-off the loss on sale of a loan to a Puerto Rico government municipality and a \$5.9 million provision to increase the general allowance on the remaining

municipal loan portfolio.

Wealth Management

Wealth management revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, increased \$1.6 million to \$6.3 million, mainly from lower expenses of \$1.1 million, mainly in compensation and employee benefits.

Treasury

Treasury segment net income before taxes decreased \$1.8 million from \$16.8 million to \$15.0 million, reflecting:

- The sale of \$166.0 million in mortgage-backed securities during the second quarter of 2017, which generated a gain of \$6.9 million.

Such decrease was partially offset by:

- Higher interest income from investment of \$3.1 million, reflecting an increase in interest rates of \$4.5 million, partially offset by a decrease in volume of \$1.4 million; and
- Lower interest expenses on repurchase agreements and other borrowings of \$1.3 million as a result of the repayment of high cost repurchase agreements and FHLB advances.

ANALYSIS OF FINANCIAL CONDITION

Assets Owned

At September 30, 2018, Oriental's total assets amounted to \$6.657 billion representing an increase of 7.6% when compared to \$6.189 billion at December 31, 2017. This increase is attributable to an increase in the loans and investments portfolios of \$296.7 million and \$140.1 million, respectively, and an increase in cash and cash equivalents of \$58.5 million.

Oriental's loan portfolio is comprised of residential mortgage loans, commercial loans collateralized by mortgages on real estate, other commercial and industrial loans, consumer loans, and auto loans. At September 30, 2018, Oriental's loan portfolio increased 7.3%. Loan production during the nine-month period ended September 30, 2018, reached \$1.088 billion compared to \$664.1 million in the year ago period, a 65.0% increase. The non-acquired loan portfolio increased \$432.7 million from December 31, 2017 to \$3.638 billion at September 30, 2018. From December 31, 2017, the BBVAPR acquired loan portfolio decreased \$122.5 million to \$703.5 million and the Eurobank acquired loan portfolio decreased \$8.6 million to \$90.7 million at September 30, 2018.

Oriental's investment portfolio increased 12.0% to \$1.306 billion at September 30, 2018, mainly attributed to the purchase of \$271.4 million mortgage-backed securities available-for-sale and retained securitized GNMA pools totaling \$58.7 million, partially offset by paydowns in the investment available-for-sale portfolio of \$86.6 million and in the investment securities held-to-maturity portfolio of \$58.5 million during the nine-month period ended September 30, 2018.

Cash and cash equivalents increased 12.1% to \$543.8 million, mainly attributed to an increase in deposits.

Accrued interest receivable resulting from Oriental's loan payment moratoriums after hurricanes Irma and Maria have decreased from December 31, 2017, as such moratoriums have expired. Some of these accrued interest is payable upon maturity of the loan.

Financial Assets Managed

Oriental's financial assets include those managed by Oriental's trust division, retirement plan administration subsidiary, and assets gathered by its broker-dealer and insurance subsidiaries. Oriental's trust division offers various types of

individual retirement accounts ("IRAs") and manages 401(k) and Keogh retirement plans and custodian and corporate trust accounts, while the retirement plan administration subsidiary, OPC, manages private retirement plans. At September 30, 2018, total assets managed by Oriental's trust division and OPC amounted to \$2.973 billion, compared to \$3.040 billion at December 31, 2017. Oriental Financial Services offers a wide array of investment alternatives to its client base, such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money management wrap-fee programs. At September 30, 2018, total assets gathered by Oriental Financial Services and Oriental Insurance from its customer investment accounts amounted to \$2.312 billion, compared to \$2.250 billion at December 31, 2017. Changes in trust and broker-dealer related assets primarily reflect changes in portfolio balances and differences in market values.

Goodwill

Goodwill recorded in connection with the BBVAPR Acquisition and the FDIC-assisted Eurobank acquisition is not amortized to expense but is tested at least annually for impairment. A quantitative annual impairment test is not required if, based on a qualitative analysis, Oriental determines that the existence of events and circumstances indicate that it is more likely than not that goodwill is not impaired. Oriental completes its annual goodwill impairment test as of October 31 of each year. Oriental tests for impairment by first allocating its goodwill and other assets and liabilities, as necessary, to defined reporting units. A fair value is then determined for each reporting unit. If the fair values of the reporting units exceed their book values, no write-down of the recorded goodwill is necessary. If the fair values are less than the book values, an additional valuation procedure is necessary to assess the proper carrying value of the goodwill.

Reporting unit valuation is inherently subjective, with a number of factors based on assumptions and management judgments or estimates. Actual values may differ significantly from such estimates. Among these are future growth rates for the reporting units, selection of comparable market transactions, discount rates and earnings capitalization rates. Changes in assumptions and results due to economic conditions, industry factors, and reporting unit performance and cash flow projections could result in different assessments of the fair values of reporting units and could result in impairment charges. If an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount, an interim impairment test is required.

Relevant events and circumstances for evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount may include macroeconomic conditions (such as a further deterioration of the Puerto Rico economy or the liquidity for Puerto Rico securities or loans secured by assets in Puerto Rico), adverse changes in legal factors or in the business climate, adverse actions by a regulator, unanticipated competition, the loss of key employees, or similar events. Oriental's loan portfolio, which is the largest component of its interest-earning assets, is concentrated in Puerto Rico and is directly affected by adverse local economic and fiscal conditions. Such conditions have generally affected the market demand for non-conforming loans secured by assets in Puerto Rico and, therefore, affect the valuation of Oriental's assets.

As of September 30, 2018, Oriental had \$86.1 million of goodwill allocated as follows: \$84.1 million to the Banking unit and \$2.0 million to the Wealth Management unit. During the last quarter of 2017, based on its annual goodwill impairment test, Oriental determined that the Banking unit failed step one of the two-step impairment test and that the Wealth Management unit passed such step. As a result of step one, the Banking unit's adjusted net book value exceeded its fair value by approximately \$236.4 million, or 26%. Accordingly, Oriental proceeded to perform step two of the analysis. Based on the results of step two, Oriental determined that the carrying value of the goodwill allocated to the Banking unit was not impaired as of the valuation date. During the nine-month period ended September 30, 2018, Oriental performed an assessment of events or circumstances that could trigger reductions in the book value of the goodwill. Based on this assessment, no events were identified that triggered changes in the book value of goodwill at September 30, 2018.

FDIC Indemnification Asset

On February 6, 2017, the Bank and the FDIC agreed to terminate the single family and commercial shared-loss agreements related to the FDIC assisted acquisition of Eurobank on April 30, 2010. As part of the loss share termination transaction, the Bank made a payment of \$10.1 million to the FDIC and recorded a net benefit of \$1.4 million. Such termination payment took into account the anticipated reimbursements over the life of the shared-loss agreements and the true-up payment liability of the Bank anticipated at the end of the ten-year term of the single family shared-loss agreement. All rights and obligations of the parties under the shared-loss agreements terminated as of the closing date of the agreement.

TABLE 4 - ASSETS SUMMARY AND COMPOSITION

	September 30 2018		December 31 2017	Variance %
	(Dollars in thousands)			
Investments:				
FNMA and FHLMC certificates	\$ 1,014,997		\$ 887,779	14.3%
Obligations of US government-sponsored agencies	2,395		2,879	-16.8%
US Treasury securities	10,460		10,163	2.9%
CMOs issued by US government-sponsored agencies	66,766		80,071	-16.6%
GNMA certificates	197,454		167,338	18.0%
Puerto Rico government and public instrumentalities	-		2,093	-100.0%
FHLB stock	12,461		13,995	-11.0%
Other debt securities	1,159		1,538	-24.6%
Other investments	408		194	110.3%
Total investments	1,306,100		1,166,050	12.0%
Loans	4,352,980		4,056,329	7.3%
Total investments and loans	5,659,080		5,222,379	8.4%
Other assets:				
Cash and due from banks (including restricted cash)	540,975		481,212	12.4%
Money market investments	5,805		7,021	-17.3%
Foreclosed real estate	37,868		44,174	-14.3%
Accrued interest receivable	33,452		49,969	-33.1%
Deferred tax asset, net	122,934		127,421	-3.5%
Premises and equipment, net	67,762		67,860	-0.1%
Servicing assets	10,866		9,821	10.6%
Derivative assets	1,265		771	64.1%
Goodwill	86,069		86,069	0.0%
Other assets and customers' liability on acceptances	90,598		92,356	-1.9%
Total other assets	997,594		966,674	3.2%
Total assets	\$ 6,656,674		\$ 6,189,053	7.6%
Investment portfolio composition:				
FNMA and FHLMC certificates	77.7%		76.1%	
Obligations of US government-sponsored agencies	0.2%		0.2%	
US Treasury securities	0.8%		0.9%	
CMOs issued by US government-sponsored agencies	5.1%		6.9%	
GNMA certificates	15.1%		14.4%	
Puerto Rico government and public instrumentalities	0.0%		0.2%	
FHLB stock	1.0%		1.2%	
Other debt securities and other investments	0.1%		0.1%	
	100.0%		100.0%	

TABLE 5 — LOANS RECEIVABLE COMPOSITION

	September 30 2018	December 31 2017	Variance %
(In thousands)			
Originated and other loans and leases held for investment:			
Mortgage	\$ 667,224	\$ 683,607	-2.4%
Commercial	1,540,027	1,307,261	17.8%
Consumer	345,399	330,039	4.7%
Auto and leasing	1,084,912	883,985	22.7%
	3,637,562	3,204,892	13.5%
Allowance for loan and lease losses on originated and other loans and leases	(95,236)	(92,718)	2.7%
	3,542,326	3,112,174	13.8%
Deferred loan costs, net	7,556	6,695	12.9%
Total originated and other loans held for investment, net	3,549,882	3,118,869	13.8%
Acquired loans:			
Acquired BBVAPR loans:			
Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)			
Commercial	2,778	4,380	-36.6%
Consumer	24,914	28,915	-13.8%
Auto	7,494	21,969	-65.9%
	35,186	55,264	-36.3%
Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-20	(2,350)	(3,862)	-39.2%
	32,836	51,402	-36.1%
Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy)			
Mortgage	503,861	532,053	-5.3%
Commercial	190,178	243,092	-21.8%
Consumer	95	1,431	-93.4%
Auto	20,363	43,696	-53.4%
	714,497	820,272	-12.9%
Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-30	(43,875)	(45,755)	-4.1%
	670,622	774,517	-13.4%
Total acquired BBVAPR loans, net	703,458	825,919	-14.8%
Acquired Eurobank loans:			
Loans secured by 1-4 family residential properties	64,785	69,538	-6.8%
Commercial	49,262	53,793	-8.4%
Consumer	895	1,112	-19.5%

Edgar Filing: OFG BANCORP - Form 10-Q

	114,942		124,443	-7.6%
Allowance for loan and lease losses on Eurobank loans	(24,281)		(25,174)	-3.5%
Total acquired Eurobank loans, net	90,661		99,269	-8.7%
Total acquired loans, net	794,119		925,188	-14.2%
Total held for investment, net	4,344,001		4,044,057	7.4%
Mortgage loans held for sale	8,979		12,272	-26.8%
Total loans, net	\$ 4,352,980	\$	4,056,329	7.3%
	111			

Oriental's loan portfolio 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, which were terminated on February 6, 2017.

As shown in Table 5 above, total loans, net, amounted to \$4.353 billion at September 30, 2018 and \$4.056 billion at December 31, 2017. Oriental's originated and other loans held-for-investment portfolio composition and trends were as follows:

- Mortgage loan portfolio amounted to \$667.2 million (18.3% of the gross originated loan portfolio) compared to \$683.6 million (21.3% of the gross originated loan portfolio) at December 31, 2017. Mortgage loan production totaled \$27.9 million and \$86.3 million, for the quarter and nine-month period ended September 30, 2018, which represents a decrease of 14.4% and 29.2% from \$32.6 million and \$121.9 million, respectively, for the same periods in 2017. Mortgage loans included delinquent loans in the GNMA buy-back option program amounting to \$13.3 million and \$8.3 million at September 30, 2018 and December 31, 2017, respectively. Servicers of loans underlying GNMA mortgage-backed securities must report as their own assets the defaulted loans that they have the option (but not the obligation) to repurchase, even when they elect not to exercise that option.
- Commercial loan portfolio amounted to \$1.540 billion (42.3% of the gross originated loan portfolio) compared to \$1.307 billion (40.8% of the gross originated loan portfolio) at December 31, 2017. Commercial loan production, including the U.S. loan program production of \$37.4 million and \$211.4 million for the quarter and nine-month period ended September 30, 2018, respectively, increased 209.01% and 181.34% to \$142.7 million and \$486.7 million, respectively, from \$46.2 million and \$173.0 million for the same periods in 2017.
- Consumer loan portfolio amounted to \$345.4 million (9.5% of the gross originated loan portfolio) compared to \$330.0 million (10.3% of the gross originated loan portfolio) at December 31, 2017. Consumer loan production increased 27.4% to \$43.0 million for the quarter ended September 30, 2018 from \$33.7 million for the same period in 2017, but decreased 2.2% to \$122.8 million for the nine-month period ended September 30, 2018 from \$125.5 million when compared to the same period in 2017.
- Auto and leasing portfolio amounted to \$1.085 billion (29.9% of the gross originated loan portfolio) compared to \$884.0 million (27.6% of the gross originated loan portfolio) at December 31, 2017. Auto production increased by 79.3% and 64.0% to \$140.4 million and \$399.6 million, respectively, for the quarter and nine-month period ended September 30, 2018, compared to \$78.3 million and \$243.7 million, respectively, for the same periods in 2017.

TABLE 6 — HIGHER RISK RESIDENTIAL MORTGAGE LOANS

September 30, 2018
Higher-Risk Residential Mortgage Loans*

	Junior Lien Mortgages			Interest Only Loans			High Loan-to-Value Ratio			
	Carrying			Carrying			Mortgages			
	Value	Allowance	Coverage	Value	Allowance	Coverage	Value	Allowance	Coverage	
	(In thousands)									
<u>Delinquency:</u>										
0 - 89 days	\$ 9,021	\$ 327	3.62%	\$ 8,044	\$ 319	3.97%	\$ 61,860	\$ 1,468	2.37%	
90 - 119 days	170	10	5.88%	-	-	0.00%	1,623	31	1.91%	
120 - 179 days	132	10	7.58%	128	17	13.28%	829	47	5.67%	
180 - 364 days	94	7	7.45%	472	60	12.71%	1,541	117	7.59%	
365+ days	297	39	13.13%	1,399	194	13.87%	7,750	558	7.20%	
Total	\$ 9,714	\$ 393	4.05%	\$ 10,043	\$ 590	5.87%	\$ 73,603	\$ 2,221	3.02%	
Percentage of total loans excluding										
acquired loans accounted for under ASC										
310-30	0.26%			0.27%			2.00%			
<u>Refinanced or Modified Loans:</u>										
Amount	\$ 2,277	\$ 283	12.43%	\$ 517	\$ 64	12.38%	\$ 16,627	\$ 1,354	8.14%	
Percentage of Higher-Risk Loan										
Category	23.44%			5.15%			22.59%			
<u>Loan-to-Value Ratio:</u>										
Under 70%	\$ 6,426	\$ 235	3.66%	\$ 976	\$ 33	3.38%	\$ -	\$ -	-	
70% - 79%	1,480	88	5.95%	2,445	102	4.17%	-	-	-	
80% - 89%	1,004	7	0.70%	2,630	176	6.69%	-	-	-	
90% and over	804	63	7.84%	3,992	279	6.99%	73,603	2,221	3.02%	
	\$ 9,714	\$ 393	4.05%	\$ 10,043	\$ 590	5.87%	\$ 73,603	\$ 2,221	3.02%	

* Loans may be included in more than one higher-risk loan category and excludes acquired residential mortgage loans.

Deposits from the Puerto Rico government totaled \$285.0 million at September 30, 2018. The following table includes the maturities of Oriental's lending and investment exposure to the Puerto Rico government, which is limited solely to loans to municipalities secured by ad valorem taxation, without limitation as to rate or amount, on all taxable property within the issuing municipalities. The good faith, credit and unlimited taxing power of each issuing municipality are pledged for the payment of its general obligations.

TABLE 7 - PUERTO RICO GOVERNMENT RELATED LOANS AND SECURITIES

		September 30, 2018						
Loans and Securities:		Carrying	Less than 1	Maturity				
		Value	Year	1 to 3 Years	More than			
			(In thousands)		3 Years			
Municipalities	\$	135,341	\$	18,567	\$	73,167	\$	43,607

Credit Risk Management

Allowance for Loan and Lease Losses

Oriental maintains an allowance for loan and lease losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. Oriental's allowance for loan and lease losses ("ALLL") policy provides for a detailed quarterly analysis of probable losses.

The analysis includes a review of historical loan loss experience, value of underlying collateral, current economic conditions, financial condition of borrowers and other pertinent factors. While management uses available information in estimating probable loan losses, future additions to the allowance may be required based on factors beyond Oriental's control. We also maintain an allowance for loan losses on acquired loans when: (i) for loans accounted for under ASC 310-30, there is deterioration in credit quality subsequent to the acquisition, and (ii) for loans accounted for under ASC 310-20, the inherent losses in the loans exceed the remaining credit discount recorded at the time of acquisition.

At September 30, 2018, Oriental's allowance for loan and lease losses amounted to \$165.7 million, a \$1.8 million decrease from \$167.5 million at December 31, 2017.

As discussed in Note 2, hurricanes Irma and Maria caused catastrophic damages throughout Puerto Rico in 2017. Management performed an evaluation of the loan portfolios in order to assess the impact on repayment sources and underlying collateral that could result in additional losses.

For the commercial portfolio, the framework for the analysis was based on our current allowance for loan and lease losses methodology with additional considerations according to the estimated impact categorized as low, medium or high. From this impact assessment, additional reserve levels were estimated by increasing default probabilities ("PD") and loss given default expectations ("LGD") of each allowance segment.

As part of the process, Oriental contacted its clients to evaluate the impact of the hurricanes on their business operations and collateral. The impact was then categorized as follows: (i) low risk, for clients that had no business impact or relatively insignificant impact; (ii) medium risk, for clients that had a business impact on their primary or secondary sources of repayment, but had adequate cash flow to cover operations and to satisfy their obligations; or (iii) high risk, for clients that had potentially significant problems that affected primary, secondary and tertiary (collateral) sources of repayment. This criterion was used to model adjusted PDs and LGDs considering internal and external sources of information available to support our estimation process and output.

During the fourth quarter of 2017, Oriental performed an update of the initial estimate, taking into consideration the most recent available information gathered through additional visits and interviews with clients and the economic environment in Puerto Rico.

For the retail portfolios, mortgage, consumer and auto, the assumptions established in the initial estimate were based on the historical losses of each ALLL segment and then further adjusted based on parameters used as key risk indicators, such as the industry of employment for all portfolios and the location of the collateral for mortgage loans. During the fourth quarter of 2017, Oriental performed additional procedures to evaluate the reasonability of the initial estimate based on the payment experience percentage of borrowers for which the deferral period expired. The analysis took into consideration historical payment behavior and loss experience of borrowers (PDs and LGDs) of each portfolio segment to develop a range of estimated potential losses. Management understands that this approach is reasonable given the lack of historical information related to the behavior of local borrowers in such an unprecedented event. The amount used in the analysis represents the average of potential outcomes of expected losses.

During the first quarter of 2018, Oriental updated the previously performed analysis to estimate probable losses related to the hurricanes. Analyses were based on the payment experience percentage of borrowers for which the deferral period expired in retail portfolios. For the commercial portfolio, no changes in the level of impact assessed were identified based on communications with credit officers. During the second and third quarters of 2018, Oriental continued its monitoring process of the performance of those affected borrowers. As additional information became available, it was incorporated into the allowance framework.

At September 30, 2018 and December 31, 2017, Oriental's allowance for loan and lease losses incorporated all risks associated to our loan portfolio, including the impact of hurricanes Irma and Maria. At September 30, 2018 and December 31, 2017, allowance for loan and lease losses related to hurricanes Irma and María was \$17.5 million and \$32.4 million, respectively.

Tables 8 through 10 set forth an analysis of activity in the allowance for loan and lease losses and present selected loan loss statistics. In addition, Table 5 sets forth the composition of the loan portfolio.

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

Non-performing Assets

Oriental's non-performing assets include non-performing loans and foreclosed real estate (see Tables 11 and 12). At September 30, 2018 and December 31, 2017, Oriental had \$120.8 million and \$99.7 million, respectively, of non-accrual loans, including acquired BBVAPR loans accounted for under ASC 310-20 (loans with revolving feature and/or acquired at a premium).

At September 30, 2018 and December 31, 2017, loans whose terms have been extended and which are classified as troubled-debt restructuring that are not included in non-performing assets amounted to \$97.7 million and \$109.2 million, respectively.

At September 30, 2018 and December 31, 2017, loans that are current in their monthly payments, but placed in non-accrual amounted to \$23.6 million and \$20.1 million, respectively. During the nine-month period ended September 30, 2018, a \$8.9 million loan that is current in its monthly payments was placed in non-accrual due to credit deterioration after the hurricanes.

Delinquent residential mortgage loans insured or guaranteed under applicable FHA and VA programs are classified as non-performing loans when they become 90 days or more past due, but are not placed in non-accrual status until they become 12 months or more past due, since they are insured loans. Therefore, these loans are included as non-performing loans but excluded from non-accrual loans.

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

Following hurricanes Irma and Maria, Oriental offered automatic payment deferrals and 90-day extensions for most loan categories. All of these payment moratoriums expired during the nine-month period ended September 30, 2018 with most credit metrics better than, or returned to, pre-hurricanes levels.

At September 30, 2018, Oriental's non-performing assets increased by 7.9% to \$169.0 million (2.65% of total assets, excluding acquired loans with deteriorated credit quality) from \$156.7 million (2.95% of total assets, excluding acquired loans with deteriorated credit quality) at December 31, 2017. Foreclosed real estate and other repossessed assets amounting to \$37.9 million and \$4.1 million, respectively, at September 30, 2018, and \$44.2 million and \$3.5 million, respectively, at December 31, 2017, were recorded at fair value. Oriental does not expect non-performing loans to result in significantly higher losses. At September 30, 2018, the allowance coverage ratio for originated loan

and lease losses to non-performing loans was 75.98% (87.35% at December 31, 2017).

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

The following items comprise non-performing assets:

- Originated and other loans held for investment:

Residential mortgage loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan, except for FHA and VA insured mortgage loans which are placed in non-accrual when they become 12 months or more past due. At September 30, 2018, Oriental's originated non-performing mortgage loans totaled \$67.2 million (52.8% of Oriental's non-performing loans), a 4.9% increase from \$64.1 million (58.7% of Oriental's non-performing loans) at December 31, 2017.

Commercial loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the underlying collateral, if any. At September 30, 2018, Oriental's originated non-performing commercial loans amounted to \$42.8 million (33.7% of Oriental's non-performing loans), a 21.4% increase from \$35.3 million at December 31, 2017 (32.4% of Oriental's non-performing loans). This increase is mainly from a \$8.9 million loan that is current in its monthly payments but was placed in non-accrual during the nine-month period ended September 30, 2018 due to credit deterioration after the hurricanes.

Consumer loans — are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 120 days in personal loans and 180 days in credit cards and personal lines of credit. At September 30, 2018, Oriental's originated non-performing consumer loans amounted to \$3.1 million (2.5% of Oriental's non-performing loans), a 21.2% increase from \$2.6 million at December 31, 2017 (2.4% of Oriental's non-performing loans).

Auto loans and leases — are placed on non-accrual status when they become 90 days past due, partially written-off to collateral value when payments are delinquent 120 days, and fully written-off when payments are delinquent 180 days. At September 30, 2018, Oriental's originated non-performing auto loans and leases amounted to \$12.2 million (9.6% of Oriental's total non-performing loans), an increase of 187.9% from \$4.2 million at December 31, 2017 (3.9% of Oriental's total non-performing loans), mainly due to higher balance in the portfolio.

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

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

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

In order to apply for any of the loan modification programs, if the borrower is active in Chapter 13 bankruptcy, it must request an authorization from the bankruptcy trustee to allow for the loan modification. Borrowers with discharged Chapter 7 bankruptcies may also apply. Loans in these programs are evaluated by designated underwriters for troubled-debt restructuring classification if Oriental grants a concession for legal or economic reasons due to the debtor's financial difficulties.

TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES BREAKDOWN

	September 30, 2018	December 31, 2017	Variance %
	(Dollars in thousands)		
<u>Originated and other loans held for investment</u>			
Allowance balance:			
Mortgage	\$ 19,545	\$ 20,439	-4.4%
Commercial	32,491	30,258	7.4%
Consumer	15,715	16,454	-4.5%
Auto and leasing	27,485	25,567	7.5%
Total allowance balance	\$ 95,236	\$ 92,718	2.7%
Allowance composition:			
Mortgage	20.5%	22.0%	-6.9%
Commercial	34.1%	32.6%	4.6%
Consumer	16.5%	17.8%	-7.0%
Auto and leasing	28.9%	27.6%	4.6%
	100.0%	100.0%	
Allowance coverage ratio at end of period applicable to:			
Mortgage	2.93%	2.99%	-2.0%
Commercial	2.11%	2.31%	-8.7%
Consumer	4.55%	4.99%	-8.8%
Auto and leasing	2.53%	2.89%	-12.5%
Total allowance to total originated loans	2.62%	2.89%	-9.3%
Allowance coverage ratio to non-performing loans:			
Mortgage	29.07%	31.89%	-8.8%
Commercial	75.90%	85.83%	-11.6%
Consumer	504.33%	639.74%	-21.2%
Auto and leasing	225.56%	604.14%	-62.7%
Total	75.98%	87.35%	-13.0%

TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES BREAKDOWN (CONTINUED)

	September 30, 2018	December 31, 2017	Variance %
	(Dollars in thousands)		
<u>Acquired BBVAPR loans accounted for under ASC 310-20</u>			
Allowance balance:			
Commercial	\$ 17	\$ 42	-59.5%
Consumer	2,140	3,225	-33.6%
Auto	193	595	-67.6%
Total allowance balance	\$ 2,350	\$ 3,862	-39.2%
Allowance composition:			
Commercial	0.7%	1.09%	-33.9%
Consumer	91.1%	83.50%	9.1%
Auto	8.2%	15.41%	-46.7%
	100.0%	100.00%	
Allowance coverage ratio at end of period applicable to:			
Commercial	0.61%	0.96%	-36.5%
Consumer	8.59%	11.15%	-23.0%
Auto	2.58%	2.71%	-4.8%
Total allowance to total acquired loans	6.68%	6.99%	-4.4%
Allowance coverage ratio to non-performing loans:			
Commercial	1.73%	3.31%	-47.7%
Consumer	427.15%	238.01%	79.5%
Auto	95.54%	332.40%	-71.3%
Total	139.63%	137.73%	1.4%

TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES BREAKDOWN (CONTINUED)

	September 30, 2018		December 31, 2017	Variance %
	(Dollars in thousands)			
<u>Acquired BBVAPR loans accounted for under ASC 310-30</u>				
Allowance balance:				
Mortgage	\$ 15,258		\$ 14,085	8.3%
Commercial	22,256		23,691	-6.1%
Consumer	18		18	0.0%
Auto	6,343		7,961	-20.3%
Total allowance balance	\$ 43,875		\$ 45,755	-4.1%
Allowance composition:				
Mortgage	34.8%		30.8%	13.0%
Commercial	50.7%		51.8%	-2.0%
Auto	14.5%		17.4%	-16.9%
	100.0%		100.0%	
<u>Acquired Eurobank loans accounted for under ASC 310-30</u>				
Allowance balance:				
Mortgage	\$ 15,155		\$ 15,187	-0.2%
Commercial	9,122		9,983	-8.6%
Consumer	4		4	0.0%
Total allowance balance	\$ 24,281		\$ 25,174	-3.5%
Allowance composition:				
Mortgage	62.4%		60.3%	3.5%
Commercial	37.6%		39.7%	-5.3%
	100.0%		100.0%	

TABLE 9 — ALLOWANCE FOR LOAN AND LEASE LOSSES SUMMARY

	Quarter Ended September 30,			Nine-Month Period Ended September 30,		
	2018	2017	Variance %	2018	2017	Variance %
(Dollars in thousands)						
<u>Originated and other loans:</u>						
Balance at beginning of period	\$ 94,218	\$ 69,666	35.2%	\$ 92,718	\$ 59,300	56.4%
Provision for loan and lease losses	13,420	29,690	-54.8%	41,219	64,243	-35.8%
Charge-offs	(18,380)	(15,372)	19.6%	(55,403)	(48,317)	14.7%
Recoveries	5,978	3,557	68.1%	16,702	12,315	35.6%
Balance at end of period	\$ 95,236	\$ 87,541	8.8%	\$ 95,236	\$ 87,541	8.8%
<u>Acquired loans:</u>						
<u>BBVAPR loans</u>						
Acquired loans accounted for						
under ASC 310-20:						
Balance at beginning of period	\$ 2,726	\$ 3,348	-18.6%	\$ 3,862	\$ 4,300	-10.2%
Provision for loan and lease losses	68	712	-90.4%	(43)	618	-107.0%
Charge-offs	(711)	(933)	-23.8%	(2,371)	(3,204)	-26.0%
Recoveries	267	236	13.1%	902	1,649	-45.3%
Balance at end of period	\$ 2,350	\$ 3,363	-30.1%	\$ 2,350	\$ 3,363	-30.1%
Acquired loans accounted for						
under ASC 310-30:						
Balance at beginning of period	\$ 44,176	\$ 37,494	17.8%	\$ 45,755	\$ 31,056	47.3%
Provision for loan and lease losses	807	11,099	-92.7%	2,528	18,798	-86.6%
Allowance de-recognition	(1,108)	(8,483)	-86.9%	(4,408)	(9,744)	-54.8%
Balance at end of period	\$ 43,875	\$ 40,110	9.4%	\$ 43,875	\$ 40,110	9.4%
<u>Eurobank loans</u>						
Balance at beginning of period	\$ 24,314	\$ 21,786	11.6%	\$ 25,174	\$ 21,281	18.3%
Provision for loan and lease losses	306	2,541	-88.0%	1,110	4,573	-75.7%
	(339)	(1,182)	-71.3%	(2,003)	(2,709)	-26.1%

Edgar Filing: OFG BANCORP - Form 10-Q

Allowance de-recognition										
Balance at end of period	\$	24,281	\$	23,145	4.9%	\$	24,281	\$	23,145	4.9%

TABLE 10 — NET CREDIT LOSSES STATISTICS ON LOAN AND LEASES, EXCLUDING LOANS ACCOUNTED FOR UNDER ASC 310-30

	Quarter Ended September 30,			Nine-Month Period Ended September 30,		
	2018	2017	Variance %	2018	2017	Variance %
(Dollars in thousands)						
Originated and other loans and leases:						
Mortgage						
Charge-offs	\$ (1,429)	\$ (834)	71.3%	\$ (3,727)	\$ (5,375)	-30.7%
Recoveries	139	341	-59.2%	919	458	100.7%
Total	(1,290)	(493)	161.7%	(2,808)	(4,917)	-42.9%
Commercial						
Charge-offs	(3,249)	(727)	346.9%	(6,396)	(6,424)	-0.4%
Recoveries	119	654	-81.8%	528	880	-40.0%
Total	(3,130)	(73)	4187.7%	(5,868)	(5,544)	5.8%
Consumer						
Charge-offs	(4,591)	(4,424)	3.8%	(13,438)	(11,792)	14.0%
Recoveries	278	168	65.5%	757	1,113	-32.0%
Total	(4,313)	(4,256)	1.3%	(12,681)	(10,679)	18.7%
Auto						
Charge-offs	(9,111)	(9,387)	-2.9%	(31,842)	(24,726)	28.8%
Recoveries	5,442	2,394	127.3%	14,498	9,864	47.0%
Total	(3,669)	(6,993)	-47.5%	(17,344)	(14,862)	16.7%
Net credit losses						
Total charge-offs	(18,380)	(15,372)	19.6%	(55,403)	(48,317)	14.7%
Total recoveries	5,978	3,557	68.1%	16,702	12,315	35.6%
Total	\$ (12,402)	\$ (11,815)	5.0%	\$ (38,701)	\$ (36,002)	7.5%
Net credit losses to average						
loans outstanding:						
Mortgage	0.77%	0.28%	175.0%	0.55%	0.94%	-41.2%
Commercial	0.83%	0.02%	4050.0%	0.55%	0.59%	-7.2%
Consumer	5.35%	5.65%	-5.3%	5.32%	4.89%	8.8%
Auto	1.40%	3.37%	-58.5%	2.34%	2.47%	-5.1%
Total	1.39%	1.54%	-9.7%	1.52%	1.58%	-3.6%
Recoveries to charge-offs						
	32.52%	23.14%	40.5%	30.15%	25.49%	18.3%
Average originated loans:						
Mortgage	\$ 672,526	692,782	-2.9%	\$ 678,334	701,039	-3.2%
Commercial	1,513,556	1,239,390	22.1%	1,412,108	1,247,249	13.2%
Consumer	322,553	301,121	7.1%	317,673	291,140	9.1%
Auto	1,048,617	829,446	26.4%	988,830	803,821	23.0%
Total	\$ 3,557,252	\$ 3,062,739	16.1%	\$ 3,396,945	\$ 3,043,249	11.6%

TABLE 10 — NET CREDIT LOSSES STATISTICS ON LOAN AND LEASES, EXCLUDING LOANS ACCOUNTED FOR UNDER ASC 310-30 (CONTINUED)

	Quarter Ended September 30,			Nine-Month Period Ended September 30,		
	2018	2017	Variance %	2018	2017	Variance %
(Dollars in thousands)						
Acquired loans accounted for under ASC 310-20:						
Commercial						
Charge-offs	\$ (1)	\$ -	-100.0%	\$ (6)	\$ (132)	-95.5%
Recoveries	3	1	200.0%	18	6	200.0%
Total	2	1	100.0%	12	(126)	-109.5%
Consumer						
Charge-offs	(638)	(711)	-10.3%	(2,080)	(2,367)	-12.1%
Recoveries	95	33	187.9%	243	392	-38.0%
Total	(543)	(678)	-19.9%	(1,837)	(1,975)	-7.0%
Auto						
Charge-offs	(72)	(222)	-67.6%	(285)	(705)	-59.6%
Recoveries	169	202	-16.3%	641	1,251	-48.8%
Total	97	(20)	-585.0%	356	546	-34.8%
Net credit losses						
Total charge-offs	(711)	(933)	-23.8%	(2,371)	(3,204)	-26.0%
Total recoveries	267	236	13.1%	902	1,649	-45.3%
Total	\$ (444)	\$ (697)	-36.3%	\$ (1,469)	\$ (1,555)	-5.5%
Net credit losses to average						
loans outstanding:						
Commercial	-2.76%	-1.06%	160.7%	-4.79%	42.64%	-111.2%
Consumer	4.06%	4.69%	-13.4%	4.48%	6.91%	-35.2%
Auto	-2.05%	0.23%	-977.8%	-2.04%	-1.75%	16.7%
Total	2.44%	3.01%	-18.9%	2.50%	2.59%	-3.3%
Recoveries to charge-offs	37.55%	25.29%	48.5%	38.04%	51.47%	-26.1%
Average loans accounted for under ASC 310-20:						
Commercial	\$ 290	378	-23.3%	\$ 334	394	-15.2%
Consumer	53,474	57,839	-7.5%	54,687	38,088	43.6%
Auto	18,971	34,334	-44.7%	23,265	41,632	-44.1%
Total	\$ 72,735	\$ 92,551	-21.4%	\$ 78,286	\$ 80,114	-2.3%

TABLE 11 — NON-PERFORMING ASSETS

	September 30, 2018	December 31, 2017	Variance (%)
	(Dollars in thousands)		
Non-performing assets:			
Non-accruing loans			
Troubled-Debt Restructuring loans	\$ 42,278	\$ 25,354	66.8%
Other loans	78,511	74,360	5.6%
Accruing loans			
Troubled-Debt Restructuring loans	5,484	6,704	-18.2%
Other loans	754	2,528	-70.2%
Total non-performing loans	\$ 127,027	\$ 108,946	16.6%
Foreclosed real estate	37,868	44,174	-14.3%
Other repossessed assets	4,146	3,548	16.9%
	\$ 169,041	\$ 156,668	7.9%
Non-performing assets to total assets, excluding acquired loans with deteriorated credit quality (including those by analogy)	2.65%	2.95%	-10.2%
Non-performing assets to total capital	17.43%	16.58%	5.1%

	Quarter Ended September 30,		Nine-Month Period Ended	
	2018	2017	September 30,	September 30,
	(In thousands)			
Interest that would have been recorded in the period if the				
loans had not been classified as non-accruing loans	\$ 1,101	\$ 1,037	\$ 2,652	\$ 2,459

TABLE 12 — NON-PERFORMING LOANS

	September 30, 2018		December 31, 2017	Variance %
	(Dollars in thousands)			
Non-performing loans:				
Originated and other loans held for investment				
Mortgage	\$ 67,236		\$ 64,085	4.9%
Commercial	42,807		35,253	21.4%
Consumer	3,116		2,572	21.2%
Auto and leasing	12,185		4,232	187.9%
	125,344		106,142	18.1%
Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)				
Commercial	980		1,270	-22.8%
Consumer	501		1,355	-63.0%
Auto	202		179	12.8%
	1,683		2,804	-40.0%
Total	\$ 127,027		\$ 108,946	16.6%
Non-performing loans composition percentages:				
Originated loans				
Mortgage	52.8%		58.7%	
Commercial	33.7%		32.4%	
Consumer	2.5%		2.4%	
Auto and leasing	9.6%		3.9%	
Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)				
Commercial	0.8%		1.2%	
Consumer	0.4%		1.2%	
Auto	0.2%		0.2%	
Total	100.0%		100.0%	
Non-performing loans to:				
Total loans, excluding loans accounted for under ASC 310-30 (including those by analogy)				
	3.46%		3.34%	3.6%
Total assets, excluding loans accounted for under ASC 310-30 (including those by analogy)				
	1.99%		2.05%	-2.9%
Total capital	13.10%		11.53%	13.6%

Non-performing loans with partial charge-offs to:

Total loans, excluding loans accounted for			
under ASC 310-30 (including those by analogy)	1.19%	1.15%	3.48%
Non-performing loans	34.44%	34.49%	-0.1%
Other non-performing loans ratios:			
Charge-off rate on non-performing loans to non-performing loans			
on which charge-offs have been taken	55.96%	57.69%	-3.0%
Allowance for loan and lease losses to non-performing			
loans on which no charge-offs have been taken	117.17%	134.26%	-12.7%

127

TABLE 13 - LIABILITIES SUMMARY AND COMPOSITION

	September 30, 2018	December 31, 2017	Variance %
(Dollars in thousands)			
Deposits:			
Non-interest bearing deposits	\$ 1,107,567	\$ 969,525	14.2%
NOW accounts	1,196,464	1,069,572	11.9%
Savings and money market accounts	1,243,533	1,251,396	-0.6%
Certificates of deposit	1,538,792	1,507,101	2.1%
Total deposits	5,086,356	4,797,594	6.0%
Accrued interest payable	2,637	1,888	39.7%
Total deposits and accrued interest payable	5,088,993	4,799,482	6.0%
Borrowings:			
Securities sold under agreements to repurchase	378,237	192,869	96.1%
Advances from FHLB	73,531	99,643	-26.2%
Subordinated capital notes	36,083	36,083	0.0%
Other term notes	192	153	25.5%
Total borrowings	488,043	328,748	48.5%
Total deposits and borrowings	5,577,036	5,128,230	8.8%
Other Liabilities:			
Derivative liabilities	622	1,281	-51.4%
Acceptances outstanding	28,682	27,644	3.8%
Other liabilities	80,448	86,791	-7.3%
Total liabilities	\$ 5,686,788	\$ 5,243,946	8.4%
Deposits portfolio composition percentages:			
Non-interest bearing deposits	21.8%	20.2%	
NOW accounts	23.5%	22.3%	
Savings and money market accounts	24.4%	26.1%	
Certificates of deposit	30.3%	31.4%	
	100.0%	100.0%	
Borrowings portfolio composition percentages:			
Securities sold under agreements to repurchase	77.5%	58.7%	
Advances from FHLB	15.1%	30.3%	
Other term notes	0.0%	0.0%	
Subordinated capital notes	7.4%	11.0%	
	100.0%	100.0%	
Securities sold under agreements to repurchase (excluding accrued interest)			
Amount outstanding at period-end	\$ 377,808	\$ 192,500	
Daily average outstanding balance	\$ 332,215	\$ 393,133	
Maximum outstanding balance at any month-end	\$ 394,164	\$ 606,210	

Liabilities and Funding Sources

As shown in Table 13 above, at September 30, 2018, Oriental's total liabilities were \$5.687 billion, 8.4% more than the \$5.244 billion reported at December 31, 2017. Deposits and borrowings, Oriental's funding sources, amounted to \$5.577 billion at September 30, 2018 versus \$5.128 billion at December 31, 2017, a 8.8% increase.

Borrowings consist mainly of repurchase agreements, FHLB-NY advances and subordinated capital notes. At September 30, 2018, borrowings amounted to \$488.0 million, representing an increase of 48.5% when compared with the \$328.7 million reported at December 31, 2017. The increase in borrowings reflects:

- An increase of \$185.3 million in new repurchase agreements used for the purchase of investment securities during the nine-month period ended September 30, 2018; and
- A decrease of \$25.9 million in advances from the FHLB-NY attributable to \$64.4 million of new advances, offset by the maturing of \$90.0 million of advances that were not renewed.

At September 30, 2018, deposits represented 90% and borrowings represented 10% of interest-bearing liabilities. At September 30, 2018, deposits, the largest category of Oriental's interest-bearing liabilities, were \$5.086 billion, an increase of 6.0% from \$4.798 billion at December 31, 2017.

Stockholders' Equity

At September 30, 2018, Oriental's total stockholders' equity was \$969.9 million, a 2.6% increase when compared to \$945.1 million at December 31, 2017. This increase in stockholders' equity reflects increases in retained earnings of \$35.2 million, legal surplus of \$6.1 million, reduction in treasury stock, at cost, of \$796 thousand, and an increase in additional paid-in capital of \$478 thousand, partially offset by a decrease in accumulated other comprehensive loss, net of tax of \$17.8 million. Book value per share was \$18.27 at September 30, 2018 compared to \$17.73 at December 31, 2017.

From December 31, 2017 to September 30, 2018, tangible common equity to total assets decreased from 11.12% to 10.73%, Leverage capital ratio increased from 13.92% to 13.93%, Common Equity Tier 1 capital ratio decreased from 14.59% to 14.38%, Tier 1 Risk-Based capital ratio decreased from 19.05% to 18.55%, and Total Risk-Based capital ratio decreased from 20.34% to 19.84%. The decrease in these ratios reflect an increase of \$467.6 million in total

assets, including \$296.7 million in loans and \$140.1 million in investments.

During the third quarter of 2018, Oriental announced the mandatory conversion of its Series C Preferred Stock into common stock, effective on October 22, 2018. Each share of Series C Preferred Stock was converted into 86.4225 shares of common stock. There were 84,000 shares of Series C Preferred Stock outstanding, all of which were converted to common stock on October 22, 2018. Upon conversion, the Series C Preferred Stock is no longer outstanding and all rights with respect to the Series C Preferred Stock have ceased and terminated, except the right to receive the number of whole shares of common stock issuable upon conversion of the Series C Preferred Stock and any required cash-in-lieu of fractional shares.

Capital Rules to Implement Basel III Capital Requirements

OFG Bancorp and the Bank are subject to regulatory capital requirements established by the Federal Reserve Board and the FDIC. The current risk-based capital standards applicable to OFG Bancorp and the Bank (“Basel III capital rules”), which have been effective since January 1, 2015, are based on the final capital framework for strengthening international capital standards, known as Basel III, of the Basel Committee on Banking Supervision. As of September 30, 2018, OFG Bancorp’s and the Bank’s capital ratios continue to exceed the minimum requirements for being “well-capitalized” under the Basel III capital rules.

The risk-based capital ratios presented in Table 14, which include common equity tier 1, tier 1 capital, total capital and leverage capital as of September 30, 2018 and December 31, 2017, are calculated based on the Basel III capital rules related to the measurement of capital, risk-weighted assets and average assets.

The following are the consolidated capital ratios of Oriental under the Basel III capital rules at September 30, 2018 and December 31, 2017:

TABLE 14 — CAPITAL, DIVIDENDS AND STOCK DATA

	September 30, 2018		December 31, 2017	Variance %
(Dollars in thousands, except per share data)				
Capital data:				
Stockholders' equity	\$ 969,886		\$ 945,107	2.6%
Regulatory Capital Ratios data:				
Common equity tier 1 capital ratio	14.38%		14.59%	-1.4%
Minimum common equity tier 1 capital ratio required	4.50%		4.50%	0.0%
Actual common equity tier 1 capital	\$ 690,937		644,804	7.2%
Minimum common equity tier 1 capital required	\$ 216,286		198,930	8.7%
Minimum capital conservation buffer required	\$ 90,119		55,258	63.1%
Excess over regulatory requirement	\$ 384,532		390,615	-1.6%
Risk-weighted assets	\$ 4,806,348		4,420,667	8.7%
Tier 1 risk-based capital ratio	18.55%		19.05%	-2.6%
Minimum tier 1 risk-based capital ratio required	6.00%		6.00%	0.0%
Actual tier 1 risk-based capital	\$ 891,807		\$ 842,133	5.9%
Minimum tier 1 risk-based capital required	\$ 288,381		\$ 265,240	8.7%
Excess over regulatory requirement	\$ 603,426		\$ 576,893	4.6%
Risk-weighted assets	\$ 4,806,348		\$ 4,420,667	8.7%
Total risk-based capital ratio	19.84%		20.34%	-2.5%
Minimum total risk-based capital ratio required	8.00%		8.00%	0.0%
Actual total risk-based capital	\$ 953,543		\$ 899,258	6.0%
Minimum total risk-based capital required	\$ 384,508		\$ 353,653	8.7%
Excess over regulatory requirement	\$ 569,035		\$ 545,604	4.3%
Risk-weighted assets	\$ 4,806,348		\$ 4,420,667	8.7%
Leverage capital ratio	13.93%		13.92%	0.1%
Minimum leverage capital ratio required	4.00%		4.00%	0.0%
Actual tier 1 capital	\$ 891,807		\$ 842,133	5.9%
Minimum tier 1 capital required	\$ 255,993		\$ 242,057	5.8%
Excess over regulatory requirement	\$ 635,814		\$ 600,076	6.0%
Tangible common equity to total assets	10.73%		11.12%	-3.5%
Tangible common equity to risk-weighted assets	14.86%		15.57%	-4.6%
Total equity to total assets	14.57%		15.27%	-4.6%
Total equity to risk-weighted assets	20.18%		21.38%	-5.6%
Stock data:				

Edgar Filing: OFG BANCORP - Form 10-Q

Outstanding common shares		44,005,741		43,947,442	0.1%
Book value per common share	\$	18.27	\$	17.73	3.0%
Tangible book value per common share	\$	16.23	\$	15.67	3.6%
Market price at end of period	\$	16.15	\$	9.40	71.8%
Market capitalization at end of period	\$	710,693	\$	413,106	72.0%

The following table presents a reconciliation of Oriental's total stockholders' equity to tangible common equity and total assets to tangible assets at September 30, 2018, and December 31, 2017:

	September 30, 2018		December 31, 2017
	(In thousands, except share or per share information)		
Total stockholders' equity	\$	969,886	\$ 945,107
Preferred stock		(176,000)	(176,000)
Preferred stock issuance costs		10,130	10,130
Goodwill		(86,069)	(86,069)
Core deposit intangible		(2,695)	(3,339)
Customer relationship intangible		(1,003)	(1,348)
Total tangible common equity (non-GAAP)	\$	714,249	\$ 688,481
Total assets		6,656,674	6,189,053
Goodwill		(86,069)	(86,069)
Core deposit intangible		(2,695)	(3,339)
Customer relationship intangible		(1,003)	(1,348)
Total tangible assets	\$	6,566,907	\$ 6,098,297
Tangible common equity to tangible assets		10.88%	11.29%
Common shares outstanding at end of period		44,005,741	43,947,442
Tangible book value per common share	\$	16.23	\$ 15.67

The tangible common equity ratio and tangible book value per common share are non-GAAP measures and, unlike Tier 1 capital and Common Equity Tier 1 capital, are not codified in the federal banking regulations. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations. Neither tangible common equity nor tangible assets or related measures should be considered in isolation or as a substitute for stockholders' equity, total assets or any other measure calculated in accordance with GAAP. Moreover, the manner in which Oriental calculates its tangible common equity, tangible assets and any other related measures may differ from that of other companies reporting measures with similar names.

Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied, and are not audited. To mitigate these limitations, Oriental has procedures in place to calculate these measures using the appropriate GAAP or regulatory components. Although these non-GAAP financial measures are frequently used by stakeholders in the evaluation of a company, they have limitations as analytical tools and should not be considered in isolation or as a substitute for analyses of results as reported under GAAP.

The following table presents Oriental's capital adequacy information under the Basel III capital rules:

	September 30, 2018	December 31, 2017	Variance %
	(Dollars in thousands)		
<u>Risk-based capital:</u>			
Common equity tier 1 capital	\$ 690,937	\$ 644,804	7.2%
Additional tier 1 capital	200,870	197,329	1.8%
Tier 1 capital	891,807	842,133	5.9%
Additional Tier 2 capital	61,736	57,125	8.1%
Total risk-based capital	\$ 953,543	\$ 899,258	6.0%
<u>Risk-weighted assets:</u>			
Balance sheet items	\$ 4,605,685	\$ 4,249,042	8.4%
Off-balance sheet items	200,663	171,625	16.9%
Total risk-weighted assets	\$ 4,806,348	\$ 4,420,667	8.7%
<u>Ratios:</u>			
Common equity tier 1 capital (minimum required - 4.5%)	14.38%	14.59%	-1.4%
Tier 1 capital (minimum required - 6%)	18.55%	19.05%	-2.6%
Total capital (minimum required - 8%)	19.84%	20.34%	-2.5%
Leverage ratio (minimum required - 4%)	13.93%	13.92%	0.1%
Equity to assets	14.57%	15.27%	-4.6%
Tangible common equity to assets	10.73%	11.12%	-3.5%

The Bank is considered “well capitalized” under the regulatory framework for prompt corrective action. The table below shows the Bank’s regulatory capital ratios at September 30, 2018 and December 31, 2017:

	September 30, 2018	December 31, 2017	Variance %
(Dollars in thousands)			
<u>Oriental Bank Regulatory Capital Ratios:</u>			
Common Equity Tier 1 Capital to Risk-Weighted Assets			
Actual common equity tier 1 capital	\$ 863,978	\$ 822,776	5.0%
Minimum capital requirement (4.5%)	\$ 215,984	\$ 198,712	8.7%
Minimum capital conservation buffer requirement (1.875% at September 30, 2018 - 1.25% at December 31, 2017)	\$ 89,993	\$ 55,198	63.0%
Minimum to be well capitalized (6.5%)	\$ 311,977	\$ 287,028	8.7%
Tier 1 Capital to Risk-Weighted Assets	18.00%	18.63%	-3.4%
Actual tier 1 risk-based capital	\$ 863,978	\$ 822,776	5.0%
Minimum capital requirement (6%)	\$ 287,979	\$ 264,949	8.7%
Minimum to be well capitalized (8%)	\$ 383,971	\$ 353,265	8.7%
Total Capital to Risk-Weighted Assets	19.28%	19.92%	-3.2%
Actual total risk-based capital	\$ 925,447	\$ 879,648	5.2%
Minimum capital requirement (8%)	\$ 383,971	\$ 353,265	8.7%
Minimum to be well capitalized (10%)	\$ 479,964	\$ 441,581	8.7%
Total Tier 1 Capital to Average Total Assets	13.56%	13.63%	-0.5%
Actual tier 1 capital	\$ 863,978	\$ 822,776	5.0%
Minimum capital requirement (4%)	\$ 254,847	\$ 241,417	5.6%
Minimum to be well capitalized (5%)	\$ 318,559	\$ 301,771	5.6%
	133		

Oriental's common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "OFG." At September 30, 2018 and December 31, 2017, Oriental's market capitalization for its outstanding common stock was \$710.7 million (\$16.15 per share) and \$413.1 million (\$9.40 per share), respectively.

The following table provides the high and low prices and dividends per share of Oriental's common stock for each quarter of the last three calendar years:

		Price			Cash Dividend Per share
		High	Low		
2018					
September 30, 2018	\$	17.60	\$	14.45	\$ 0.06
June 30, 2018	\$	14.75	\$	10.60	\$ 0.06
March 31, 2018	\$	12.05	\$	8.60	\$ 0.06
2017					
December 31, 2017	\$	10.25	\$	7.90	\$ 0.06
September 30, 2017	\$	10.40	\$	8.40	\$ 0.06
June 30, 2017	\$	12.03	\$	9.19	\$ 0.06
March 31, 2017	\$	13.80	\$	10.90	\$ 0.06
2016					
December 31, 2016	\$	14.30	\$	9.56	\$ 0.06
September 30, 2016	\$	11.09	\$	8.07	\$ 0.06
June 30, 2016	\$	9.14	\$	6.32	\$ 0.06
March 31, 2016	\$	7.32	\$	4.77	\$ 0.06

Under Oriental's current stock repurchase program, it is authorized to purchase in the open market up to \$7.7 million of its outstanding shares of common stock. The shares of common stock repurchased are to be held by Oriental as treasury shares. There were no repurchases during the quarter ended September 30, 2018.

At September 30, 2018, the number of shares that may yet be purchased under such program is estimated at 478,691 and was calculated by dividing the remaining balance of \$7.7 million by \$16.15 (closing price of Oriental's common stock at September 30, 2018).

ITEM 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Background

Oriental's risk management policies are established by its Board of Directors (the "Board") and implemented by management through the adoption of a risk management program, which is overseen and monitored by the Chief Risk and Compliance Officer, the Board Risk and Compliance Committee and the executive Risk and Compliance Team. Oriental has continued to refine and enhance its risk management program by strengthening policies, processes and procedures necessary to maintain effective risk management.

All aspects of Oriental's business activities are susceptible to risk. Consequently, risk identification and monitoring are essential to risk management. As more fully discussed below, Oriental's primary risk exposures include, market, interest rate, credit, liquidity, operational and concentration risks.

Market Risk

Market risk is the risk to earnings or capital arising from adverse movements in market rates or prices, such as interest rates or prices. Oriental evaluates market risk together with interest rate risk. Oriental's financial results and capital levels are constantly exposed to market risk. The Board and management are primarily responsible for ensuring that the market risk assumed by Oriental complies with the guidelines established by policies approved by the Board. The Board has delegated the management of this risk to the Asset/Liability Management Committee ("ALCO") which is composed of certain executive officers from the business, treasury and finance areas. One of ALCO's primary goals is to ensure that the market risk assumed by Oriental is within the parameters established in such policies.

Interest Rate Risk

Interest rate risk is the exposure of Oriental's earnings or capital to adverse movements in interest rates. It is a predominant market risk in terms of its potential impact on earnings. Oriental manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income. ALCO oversees interest rate risk, liquidity management and other related matters.

In executing its responsibilities, ALCO examines current and expected conditions in global financial markets, competition and prevailing rates in the local deposit market, liquidity, unrealized gains and losses in securities, recent

or proposed changes to the investment portfolio, alternative funding sources and their costs, hedging and the possible purchase of derivatives such as swaps, and any tax or regulatory issues which may be pertinent to these areas.

On a quarterly basis, Oriental performs a net interest income simulation analysis on a consolidated basis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a five-year time horizon, assuming certain gradual upward and downward interest rate movements, achieved during a twelve-month period. Instantaneous interest rate movements are also modeled. Simulations are carried out in two ways:

- (i) using a static balance sheet as Oriental had on the simulation date, and
- (ii) using a dynamic balance sheet based on recent growth patterns and business strategies.

The balance sheet is divided into groups of assets and liabilities detailed by maturity or re-pricing and their corresponding interest yields and costs. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and costs, the possible exercise of options, changes in prepayment rates, deposits decay and other factors which may be important in projecting the future growth of net interest income.

Oriental uses a software application to project future movements in Oriental's balance sheet and income statement. The starting point of the projections generally corresponds to the actual values of the balance sheet on the date of the simulations.

These simulations are complex, and use many assumptions that are intended to reflect the general behavior of Oriental over the period in question. There can be no assurance that actual events will match these assumptions in all cases. For this reason, the results of these simulations are only approximations of the true sensitivity of net interest income to changes in market interest rates. The following table presents the results of the simulations at September 30, 2018 for the most likely scenario, assuming a one-year time horizon:

	Net Interest Income Risk (one-year projection)			
	Static Balance Sheet		Growing Simulation	
	Amount	Percent	Amount	Percent
<u>Change in interest rate</u>	Change	Change	Change	Change
	(Dollars in thousands)			
+ 200 Basis points	\$ 12,617	4.01%	\$ 12,853	4.19%
+ 100 Basis points	\$ 6,281	2.00%	\$ 6,407	2.09%
- 100 Basis points	\$ (5,962)	-1.90%	\$ (6,096)	-1.99%
- 200 Basis points	\$ (11,944)	-3.80%	\$ (12,212)	-3.98%

Future net interest income could be affected by Oriental's investments in callable securities, prepayment risk related to mortgage loans and mortgage-backed securities, and any structured repurchase agreements and advances from the FHLB-NY in which it may enter into from time to time. As part of the strategy to limit the interest rate risk and reduce the re-pricing gaps of Oriental's assets and liabilities, Oriental has executed certain transactions which include extending the maturity and the re-pricing frequency of the liabilities to longer terms reducing the amounts of its structured repurchase agreements and entering into hedge-designated swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings that only consist of advances from the FHLB-NY as of September 30, 2018.

Oriental maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. Oriental's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not, on a material basis, adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. Also, for some fixed-rate assets or liabilities, the effect of this variability in earnings is expected to be substantially offset by Oriental's gains and losses on the derivative instruments that are linked to the forecasted cash flows of these hedged assets and liabilities. Oriental considers its strategic use of derivatives to be a prudent method of managing interest-rate sensitivity as it reduces the exposure of earnings and the market value of its equity to undue risk posed by changes in interest rates. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by Oriental's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result of interest rate fluctuations is that the contractual interest income and interest expense of hedged variable-rate assets and liabilities, respectively, will increase or decrease.

Derivative instruments that are used as part of Oriental's interest risk management strategy include interest rate swaps, forward-settlement swaps, futures contracts, and option contracts that have indices related to the pricing of specific balance sheet assets and liabilities. Interest rate swaps generally involve the exchange of fixed and variable-rate interest payments between two parties based on a common notional principal amount and maturity date. Interest rate futures generally involve exchanged-traded contracts to buy or sell U.S. Treasury bonds and notes in the future at specified prices. Interest rate options represent contracts that allow the holder of the option to (i) receive cash or (ii) purchase, sell, or enter into a financial instrument at a specified price within a specified period. Some purchased option contracts give Oriental the right to enter into interest rate swaps and cap and floor agreements with the writer of the option. In addition, Oriental enters into certain transactions that contain embedded derivatives. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated and carried at fair value. Please refer to Note 9 to the accompanying consolidated financial statements for further information concerning Oriental's derivative activities.

Following is a summary of certain strategies, including derivative activities, currently used by Oriental to manage interest rate risk:

Interest rate swaps — Oriental entered into hedge-designated swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings attributable to changes in the one-month LIBOR rate. Once the forecasted wholesale borrowings transactions occurred, the interest rate swap effectively fixes Oriental's interest payments on an amount of forecasted interest expense attributable to the one-month LIBOR rate corresponding to the swap notional stated rate. A derivative asset of \$643 thousand (notional amount of \$34.0 million) was recognized at September 30, 2018 related to the valuation of these swaps.

In addition, Oriental has certain derivative contracts, including interest rate swaps not designated as hedging instruments, which are utilized to convert certain variable-rate loans to fixed-rate loans, and the mirror-images of these interest rate swaps in which Oriental enters into to minimize its interest rate risk exposure that results from offering the derivatives to clients. These interest rate swaps are marked to market through earnings. At September 30, 2018, interest rate swaps offered to clients not designated as hedging instruments represented a derivative asset of \$227 thousand (notional amounts of \$12.5 million), and the mirror-image interest rate swaps in which Oriental entered into represented a derivative liability of \$227 thousand (notional amounts of \$12.5 million).

Wholesale borrowings — Oriental uses interest rate swaps to hedge the variability of interest cash flows of certain advances from the FHLB-NY that are tied to a variable rate index. The interest rate swaps effectively fix Oriental's interest payments on these borrowings. As of September 30, 2018, Oriental had \$34.0 million in interest rate swaps at an average rate of 2.4% designated as cash flow hedges for \$34.0 million in advances from the FHLB-NY that reprice or are being rolled over on a monthly basis.

Credit Risk

Credit risk is the possibility of loss arising from a borrower or counterparty in a credit-related contract failing to perform in accordance with its terms. The principal source of credit risk for Oriental is its lending activities. In Puerto Rico, Oriental's principal market, economic conditions are very challenging, as they have been for the last twelve years, due to a shrinking population, a protracted economic recession, a housing sector that remains under pressure, the Puerto Rico government's fiscal and liquidity crisis, and the payment defaults on various Puerto Rico government bonds, with severe austerity measures expected for the Puerto Rico government to be able to restructure its debts under the supervision of the federally-created Fiscal Oversight and Management Board for Puerto Rico. In addition, as was demonstrated with hurricanes Irma and Maria during the month of September 2017, Puerto Rico is susceptible to natural disasters, such as hurricanes and earthquakes, which can have a disproportionate impact on Puerto Rico because of the logistical difficulties of bringing relief to an island far from the United States mainland. Moreover, the Puerto Rico government's fiscal challenges and Puerto Rico's unique relationship with the United States also complicate any relief efforts after a natural disaster. These events increase credit risk as debtors may no longer be capable of operating their businesses and the collateral securing Oriental's loans may suffer significant damages.

Oriental manages its credit risk through a comprehensive credit policy which establishes sound underwriting standards by monitoring and evaluating loan portfolio quality, and by the constant assessment of reserves and loan concentrations. Oriental also employs proactive collection and loss mitigation practices.

Oriental may also encounter risk of default in relation to its securities portfolio. The securities held by Oriental are all agency mortgage-backed securities. Thus, these instruments are guaranteed by mortgages, a U.S. government-sponsored entity, or the full faith and credit of the U.S. government.

Oriental's executive Credit Risk Team, composed of its Chief Operating Officer, Chief Risk and Compliance Officer, and other senior executives, has primary responsibility for setting strategies to achieve Oriental's credit risk goals and objectives. Those goals and objectives are set forth in Oriental's Credit Policy as approved by the Board.

Liquidity Risk

Liquidity risk is the risk of Oriental not being able to generate sufficient cash from either assets or liabilities to meet obligations as they become due without incurring substantial losses. The Board has established a policy to manage this risk. Oriental's cash requirements principally consist of deposit withdrawals, contractual loan funding, repayment of borrowings as these mature, and funding of new and existing investments as required.

Oriental's business requires continuous access to various funding sources. While Oriental is able to fund its operations through deposits as well as through advances from the FHLB-NY and other alternative sources, Oriental's business is dependent upon other external wholesale funding sources. Oriental has selectively reduced its use of certain wholesale funding sources, such as repurchase agreements and brokered deposits. As of September 30, 2018, Oriental had \$377.8 million in repurchase agreements, excluding accrued interest, and \$530.9 million in brokered deposits.

Brokered deposits are typically offered through an intermediary to small retail investors. Oriental's ability to continue to attract brokered deposits is subject to variability based upon a number of factors, including volume and volatility in the global securities markets, Oriental's credit rating, and the relative interest rates that it is prepared to pay for these liabilities. Brokered deposits are generally considered a less stable source of funding than core deposits obtained through retail bank branches. Investors in brokered deposits are generally more sensitive to interest rates and will generally move funds from one depository institution to another based on small differences in interest rates offered on deposits.

Although Oriental expects to have continued access to credit from the foregoing sources of funds, there can be no assurance that such financing sources will continue to be available or will be available on favorable terms. In a period of financial disruption or if negative developments occur with respect to Oriental, the availability and cost of Oriental's funding sources could be adversely affected. In that event, Oriental's cost of funds may increase, thereby reducing its net interest income, or Oriental may need to dispose of a portion of its investment portfolio, which depending upon market conditions, could result in realizing a loss or experiencing other adverse accounting consequences upon any such dispositions. Oriental's efforts to monitor and manage liquidity risk may not be successful to deal with dramatic or unanticipated changes in the global securities markets or other reductions in liquidity driven by Oriental or market-related events. In the event that such sources of funds are reduced or eliminated and Oriental is not able to replace these on a cost-effective basis, Oriental may be forced to curtail or cease its loan origination business and treasury activities, which would have a material adverse effect on its operations and financial condition.

As of September 30, 2018, Oriental had approximately \$543.8 million in unrestricted cash and cash equivalents, \$745.3 million in investment securities that are not pledged as collateral, \$830.7 million in borrowing capacity at the FHLB-NY.

Operational Risk

Operational risk is the risk of loss from inadequate or failed internal processes, personnel and systems or from external events. All functions, products and services of Oriental are susceptible to operational risk.

Oriental faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products and services. Coupled with external influences such as the risk of natural disasters, market conditions, security risks, and legal risks, the potential for operational and reputational loss has increased. In order to mitigate and control operational risk, Oriental has developed, and continues to enhance, specific internal controls, policies and procedures that are designed to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these policies and procedures is to provide reasonable assurance that Oriental's business operations are functioning within established limits.

Oriental classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate-wide risks, such as information security, business recovery, legal and compliance, Oriental has specialized groups, such as Information Security, Enterprise Risk Management, Corporate Compliance, Information Technology, Legal and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups. All these matters are reviewed and discussed in the executive Risk and Compliance Team. Oriental also has a Business Continuity Plan to address situations where its capacity to perform critical functions is affected. Under such circumstances, a Crisis Management Team is activated to restore such critical functions within established timeframes.

Oriental is subject to extensive United States federal and Puerto Rico regulations, and this regulatory scrutiny has been significantly increasing over the last several years. Oriental has established and continues to enhance procedures based on legal and regulatory requirements that are reasonably designed to ensure compliance with all applicable statutory and regulatory requirements. Oriental has a corporate compliance function headed by a Chief Risk and Compliance Officer who reports to the Chief Executive Officer and supervises the BSA Officer and Regulatory Compliance Officer. The Chief Risk and Compliance Officer is responsible for the oversight of regulatory compliance and implementation of a company-wide compliance program, including the Bank Secrecy Act/Anti-Money Laundering compliance program.

Concentration Risk

Substantially all of Oriental's business activities and a significant portion of its credit exposure are concentrated in Puerto Rico. As a consequence, Oriental's profitability and financial condition may be adversely affected by an extended economic slowdown, adverse political, fiscal or economic developments in Puerto Rico or the effects of a natural disaster, all of which could result in a reduction in loan originations, an increase in non-performing assets, an increase in foreclosure losses on mortgage loans, and a reduction in the value of its loans and loan servicing portfolio.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this quarterly report on Form 10-Q, an evaluation was carried out under the supervision and with the participation of Oriental's management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of Oriental's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon such evaluation, the CEO and the CFO have concluded that, as of the end of such period, Oriental's disclosure controls and procedures provided reasonable assurance of effectiveness in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by Oriental in the reports that it files or submits under the Exchange Act. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute assurance that it will detect or uncover failures within Oriental to disclose material information otherwise required to be set forth in Oriental's periodic reports.

Internal Control over Financial Reporting

There have not been any changes in Oriental's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2018, that has materially affected, or is reasonably likely to materially affect, Oriental's internal control over financial reporting.

PART - II OTHER INFORMATION

ITEM 1. *LEGAL PROCEEDINGS*

Oriental and its subsidiaries are defendants in a number of legal proceedings incidental to their business. Oriental is vigorously contesting such claims. Based upon a review by legal counsel and the development of these matters to date, management is of the opinion that the ultimate aggregate liability, if any, resulting from these claims will not have a material adverse effect on Oriental's financial condition or results of operations.

ITEM 1A. *RISK FACTORS*

There have been no material changes to the risk factors previously disclosed in Oriental's annual report on Form 10-K for the year ended December 31, 2017. In addition to other information set forth in this report, you should carefully consider the risk factors included in Oriental's annual report on Form 10-K, as updated by this report or other filings Oriental makes with the SEC under the Exchange Act. Additional risks and uncertainties not presently known to Oriental at this time or that Oriental currently deems immaterial may also adversely affect Oriental's business, financial condition or results of operations.

ITEM 2. *UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS*

None

ITEM 3. *DEFAULTS UPON SENIOR SECURITIES*

None.

ITEM 4. *MINE SAFETY DISCLOSURES*

Not applicable.

ITEM 5. *OTHER INFORMATION*

None.

ITEM 6. EXHIBITS

Exhibit No. Description of Document:

- 10.1 2007 Omnibus Performance Incentive Plan Performance Shares Award and Agreement.

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following materials from OFG Bancorp's Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Consolidated Statements of Financial Condition, (ii) Unaudited Consolidated Statements of Operations, (iii) Unaudited Consolidated Statements of Comprehensive Income, (iv) Unaudited Consolidated Statements of Changes in Stockholders' Equity, (v) Unaudited Consolidated Statements of Cash Flows, and (vi) Notes to Unaudited Consolidated Financial Statements.

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.

OFG Bancorp

(Registrant)

By: /s/ José Rafael Fernández

Date: November 2, 2018

José Rafael Fernández
President and Chief Executive Officer

By: /s/ Maritza Arizmendi

Date: November 2, 2018

Maritza Arizmendi
Executive Vice President, Chief Financial Officer
and

Chief Accounting Officer