POPULAR INC
Form 10-Q
November 12, 2013
Table of Contents

## UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION 

Washington, D.C. 20549

## Form 10-Q

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended September 30, 2013

Commission File Number: 001-34084

## POPULAR, INC.

(Exact name of registrant as specified in its charter)

Puerto Rico
(State or other jurisdiction of
Incorporation or organization)
66-0667416
(IRS Employer
Identification Number)

## Popular Center Building

$$
\begin{array}{cc}
209 \text { Muñoz Rivera Avenue } & \\
\text { Hato Rey, Puerto Rico } & 00918 \\
\text { (Address of principal executive offices) } & \text { (787) 765-9800 }
\end{array}
$$

(Registrant s telephone number, including area code)<br>NOT APPLICABLE<br>(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer x
Accelerated filer
Non-accelerated filer * (Do not check if a smaller reporting company)
Smaller reporting company Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). * Yes x No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: Common Stock, \$0.01 par value, 103,349,416 shares outstanding as of November 4, 2013.

## POPULAR, INC.

## INDEX

Page
Part I Financial Information
Item 1. Financial Statements
Unaudited Consolidated Statements of Financial Condition at September 30, 2013 and December 31, 2012 ..... 5
Unaudited Consolidated Statements of Operations for the quarters and nine months ended September 30. 2013 and 2012 ..... 6
Unaudited Consolidated Statements of Comprehensive Income for the quarters and nine months ended September 30, 2013 and 2012 ..... 7
Unaudited Consolidated Statements of Changes in Stockholders Equity for the nine months ended September 30, 2013 and 2012 ..... 8
Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012 ..... 9
Notes to Unaudited Consolidated Financial Statements ..... 10
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations ..... 137
Item 3. Quantitative and Qualitative Disclosures about Market Risk ..... 207
Item 4. Controls and Procedures ..... 207
Part II Other Information
Item 1. Legal Proceedings ..... 207
Item 1A. Risk Factors ..... 207
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds ..... 210
Item 6. Exhibits ..... 211
Signatures ..... 212

## Table of Contents

## Forward-Looking Information

The information included in this Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to Popular, Inc. s (the Corporation , Popular , we, us , our ) financial condition, results of operations, plans, objectives, future performance business, 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 Corporation sfinancial condition and results of operations. All statements contained herein that are not clearly historical in nature are forward-looking, and the words anticipate, believe, continues, expect, estimate, intend, project and similar and future or conditional verbs such as will, would, should, could, might, can, may, or similar expressions generally intended to identify forward-looking statements.

These statements are not guarantees of future performance and involve certain risks, uncertainties, estimates and assumptions by management that are difficult to predict.

Various factors, some of which are beyond Popular s control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements. Factors that might cause such a difference include, but are not limited to:
the rate of growth in the economy and employment levels, as well as general business and economic conditions;
changes in interest rates, as well as the magnitude of such changes;
the fiscal and monetary policies of the federal government and its agencies;
changes in federal bank regulatory and supervisory policies, including required levels of capital and the impact of proposed capital standards on our capital ratios;
the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act ) on our businesses, business practices and cost of operations;
regulatory approvals that may be necessary to undertake certain actions or consummate strategic transactions such as acquisitions and dispositions;
the relative strength or weakness of the consumer and commercial credit sectors and of the real estate markets in Puerto Rico and the other markets in which borrowers are located;
the performance of the stock and bond markets;
competition in the financial services industry;
additional Federal Deposit Insurance Corporation ( FDIC ) assessments;
the resolution of our dispute with the FDIC under our loss share agreement entered into in connection with the Westernbank-FDIC assisted transaction; 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 our 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; our ability to grow our core businesses; decisions to downsize, sell or close units or otherwise change our business mix; and management s ability to identify and manage these and other risks. Moreover, the outcome of legal proceedings, as discussed in Part II, Item I. Legal Proceedings, is inherently uncertain and depends on judicial interpretations of law and the findings of regulators, judges and juries. Investors should refer to the Corporation s Annual Report on Form 10-K for the year ended December 31, 2012 as well as Part II, Item 1A of this Form $10-\mathrm{Q}$ for a discussion of such factors and certain risks and uncertainties to which the Corporation is subject.

## Table of Contents

All forward-looking statements included in this document are based upon information available to the Corporation as of the date of this document, and other than as required by law, including the requirements of applicable securities laws, we assume no obligation to update or revise any such forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

Table of Contents

## POPULAR, INC.

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

## (UNAUDITED)

| (In thousands, except share information) | September 30, | $\begin{gathered} \text { December 31, } \\ 2012 \end{gathered}$ |
| :---: | :---: | :---: |
| Assets: |  |  |
| Cash and due from banks | \$ 368,590 | \$ 439,363 |
| Money market investments: |  |  |
| Federal funds sold |  | 33,515 |
| Securities purchased under agreements to resell | 222,396 | 213,462 |
| Time deposits with other banks | 739,392 | 838,603 |
| Total money market investments | 961,788 | 1,085,580 |
| Trading account securities, at fair value: |  |  |
| Pledged securities with creditors right to repledge | 311,597 | 271,624 |
| Other trading securities | 27,251 | 42,901 |
| Investment securities available-for-sale, at fair value: |  |  |
| Pledged securities with creditors right to repledge | 1,374,939 | 1,603,693 |
| Other investment securities available-for-sale | 3,761,679 | 3,480,508 |
| Investment securities held-to-maturity, at amortized cost (fair value 2013\$119,249; 2012 - \$144,233) | 140,355 | 142,817 |
| Other investment securities, at lower of cost or realizable value (realizable value 2013-\$201,349; 2012-\$187,501) | 198,864 | 185,443 |
| Loans held-for-sale, at lower of cost or fair value | 124,532 | 354,468 |
| Loans held-in-portfolio: |  |  |
| Loans not covered under loss sharing agreements with the FDIC | 21,520,054 | 21,080,005 |
| Loans covered under loss sharing agreements with the FDIC | 3,076,009 | 3,755,972 |
| Less - Unearned income | 92,871 | 96,813 |
| Allowance for loan losses | 642,928 | 730,607 |
| Total loans held-in-portfolio, net | 23,860,264 | 24,008,557 |
| FDIC loss share asset | 1,324,711 | 1,399,098 |
| Premises and equipment, net | 519,623 | 535,793 |
| Other real estate not covered under loss sharing agreements with the FDIC | 135,502 | 266,844 |
| Other real estate covered under loss sharing agreements with the FDIC | 159,968 | 139,058 |
| Accrued income receivable | 122,881 | 125,728 |
| Mortgage servicing assets, at fair value | 161,445 | 154,430 |
| Other assets | 1,803,478 | 1,569,578 |
| Goodwill | 647,757 | 647,757 |


| Other intangible assets | 46,892 |  | 54,295 |  |
| :---: | :---: | :---: | :---: | :---: |
| Total assets | \$ | 36,052,116 | \$ | 36,507,535 |
| Liabilities and Stockholders Equity |  |  |  |  |
| Liabilities: |  |  |  |  |
| Deposits: |  |  |  |  |
| Non-interest bearing | \$ | 5,762,554 | \$ | 5,794,629 |
| Interest bearing |  | 20,632,500 |  | 21,205,984 |
| Total deposits |  | 26,395,054 |  | 27,000,613 |
| Federal funds purchased and assets sold under agreements to repurchase |  | 1,793,208 |  | 2,016,752 |
| Other short-term borrowings |  | 826,200 |  | 636,200 |
| Notes payable |  | 1,544,696 |  | 1,777,721 |
| Other liabilities |  | 1,099,073 |  | 966,249 |
| Total liabilities |  | 31,658,231 |  | 32,397,535 |
| Commitments and contingencies (See Note 21) |  |  |  |  |
| Stockholders equity: |  |  |  |  |
| Preferred stock, $30,000,000$ shares authorized; 2,006,391 shares issued and outstanding |  | 50,160 |  | 50,160 |
| Common stock, $\$ 0.01$ par value; 170,000,000 shares authorized; 103,365,275 shares issued (2012-103,193,303) and 103,327,146 shares outstanding (2012 $103,169,806$ ) |  | 1,034 |  | 1,032 |
| Surplus |  | 4,155,244 |  | 4,150,294 |
| Retained earnings |  | 445,330 |  | 11,826 |
| Treasury stock - at cost, 38,129 shares (2012-23,497) |  | (877) |  | (444) |
| Accumulated other comprehensive loss, net of tax |  | $(257,006)$ |  | $(102,868)$ |
| Total stockholders equity |  | 4,393,885 |  | 4,110,000 |
| Total liabilities and stockholders equity | \$ | 36,052,116 | \$ | 36,507,535 |

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

Table of Contents

## POPULAR, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

## (UNAUDITED)



Edgar Filing: POPULAR INC - Form 10-Q

| Net occupancy expenses |  | 24,711 |  | 23,615 |  | 72,292 |  | 71,143 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Equipment expenses |  | 11,768 |  | 11,447 |  | 35,561 |  | 33,688 |
| Other taxes |  | 17,749 |  | 12,666 |  | 44,623 |  | 38,178 |
| Professional fees |  | 72,039 |  | 70,952 |  | 212,500 |  | 206,692 |
| Communications |  | 6,558 |  | 6,500 |  | 20,034 |  | 20,276 |
| Business promotion |  | 14,982 |  | 14,924 |  | 43,461 |  | 44,754 |
| FDIC deposit insurance |  | 16,100 |  | 24,173 |  | 44,883 |  | 72,006 |
| Loss on early extinguishment of debt |  | 3,388 |  | 43 |  | 3,388 |  | 25,184 |
| Other real estate owned (OREO) expenses |  | 17,175 |  | 5,896 |  | 69,678 |  | 22,441 |
| Other operating expenses |  | 22,822 |  | 22,786 |  | 68,553 |  | 73,456 |
| Amortization of intangibles |  | 2,468 |  | 2,481 |  | 7,403 |  | 7,605 |
| Total operating expenses |  | 326,599 |  | 307,033 |  | 969,883 |  | 964,800 |
| Income before income tax |  | 246,903 |  | 62,572 |  | 159,807 |  | 115,018 |
| Income tax expense (benefit) |  | 17,768 |  | 15,384 |  | $(276,489)$ |  | $(46,317)$ |
| Net Income | \$ | 229,135 | \$ | 47,188 | \$ | 436,296 | \$ | 161,335 |
| Net Income Applicable to Common Stock | \$ | 228,204 | \$ | 46,257 | \$ | 433,504 | \$ | 158,543 |
| Net Income per Common Share - Basic | \$ | 2.22 | \$ | 0.45 | \$ | 4.22 | \$ | 1.55 |
| Net Income per Common Share - Diluted | \$ | 2.22 | \$ | 0.45 | \$ | 4.21 | \$ | 1.55 |

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

Table of Contents

## POPULAR, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

## (Unaudited)

| (In thousands) | Quarters ended, September 30, |  | Nine months ended, September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2013 | 2012 | 2013 | 2012 |
| Net income | \$ 229,135 | \$47,188 | \$ 436,296 | \$ 161,335 |
| Other comprehensive loss before tax: |  |  |  |  |
| Foreign currency translation adjustment | $(2,013)$ | (120) | $(3,942)$ | $(1,066)$ |
| Amortization of net losses of pension and postretirement benefit plans | 6,168 | 6,289 | 18,506 | 18,868 |
| Amortization of prior service cost of pension and postretirement benefit plans |  | (50) |  | (150) |
| Unrealized holding losses on investments arising during the period | $(33,091)$ | $(6,567)$ | $(177,560)$ | $(33,022)$ |
| Reclassification adjustment for losses included in net income |  | (64) |  | 285 |
| Unrealized net (losses) gains on cash flow hedges | $(3,496)$ | $(6,285)$ | 2,286 | $(12,612)$ |
| Reclassification adjustment for net (gains) losses included in net income | $(1,456)$ | 3,701 | $(4,652)$ | 9,677 |
| Other comprehensive loss before tax | $(33,888)$ | $(3,096)$ | $(165,362)$ | $(18,020)$ |
| Income tax benefit | 2,921 | 244 | 11,224 | 1,133 |
| Total other comprehensive loss, net of tax | $(30,967)$ | $(2,852)$ | $(154,138)$ | $(16,887)$ |
| Comprehensive income, net of tax | \$ 198,168 | \$44,336 | \$ 282,158 | \$ 144,448 |

Tax effect allocated to each component of other comprehensive loss:

| (In thousands) | Quarters ended September 30, |  | Nine months ended, September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Amortization of net losses of pension and postretirement benefit plans | \$ $(2,406)$ | \$ $(1,740)$ | \$ $(7,219)$ | \$ | $(5,220)$ |
| Amortization of prior service cost of pension and postretirement benefit plans |  | 15 |  |  | 45 |
| Unrealized holding losses on investments arising during the period | 3,588 | 1,193 | 17,479 |  | 5,428 |
| Unrealized net (losses) gains on cash flow hedges | 1,171 | 1,886 | (850) |  | 3,783 |
|  | 568 | $(1,110)$ | 1,814 |  | $(2,903)$ |

Reclassification adjustment for net (gains) losses included in net income

Income tax benefit $\quad \$ \quad 2,921 \quad \$ \quad 244 \quad \$ 11,224 \quad \$ \quad 1,133$
The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

## POPULAR, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

## (UNAUDITED)

| (In thousands) | Common stock | Preferred stock | Surplus | (Accumulated deficit) retained earnings | Treasury stock |  | umulated <br> other <br> rehensive <br> loss | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at December 31, 2011 | \$ 1,026 | \$ 50,160 | \$ 4,123,898 | $(212,726)$ | \$ $(1,057)$ | \$ | $(42,548)$ | \$3,918,753 |
| Net income |  |  |  | 161,335 |  |  |  | 161,335 |
| Issuance of stock | 5 |  | 7,783 |  |  |  |  | 7,788 |
| Dividends declared: |  |  |  |  |  |  |  |  |
| Preferred stock |  |  |  | $(2,792)$ |  |  |  | $(2,792)$ |
| Common stock purchases |  |  |  |  | (276) |  |  | (276) |
| Common stock reissuance |  |  |  |  | 1,063 |  |  | 1,063 |
| Other comprehensive loss, net of tax |  |  |  |  |  |  | $(16,887)$ | $(16,887)$ |
| Balance at September 30, 2012 | \$ 1,031 | \$ 50,160 | \$ 4,131,681 | \$ (54,183) | \$ (270) | \$ | $(59,435)$ | \$ 4,068,984 |

Balance at December 31,

| 2012 | $\$ 1,032$ | $\$ 50,160$ | $\$ 4,150,294$ | $\$$ | 11,826 | $\$$ | $(444)$ | $\$(102,868)$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Net income |  |  | $4,110,000$ |  |  |  |  |  |
| Issuance of stock | 2 | 4,950 |  |  |  | 436,296 |  |  |
| Dividends declared: |  |  |  | $(2,792)$ |  | 4,952 |  |  |
| Preferred stock |  |  |  | $(466)$ | $(2,792)$ |  |  |  |
| Common stock purchases |  |  |  |  | $(466)$ |  |  |  |

Common stock reissuance 33
Other comprehensive loss,
net of tax
$(154,138)$
$(154,138)$
Balance at September 30,


|  | September | September |
| :--- | :---: | :---: |
|  | 30, | 30, |
| Disclosure of changes in number of shares: | 2013 | 2012 |
| Preferred Stock: |  |  |


| Balance at beginning and end of period | $2,006,391$ | $2,006,391$ |
| :--- | ---: | ---: |
| Common Stock - Issued: | $103,193,303$ | $102,634,640$ |
| Balance at beginning of period | 171,972 | 477,665 |
| Issuance of stock | $103,365,275$ | $103,112,305$ |
| Balance at end of the period | $(38,129)$ | $(15,162)$ |
| Treasury stock | $103,327,146$ | $103,097,143$ |
| Common Stock - Outstanding |  |  |
| The accompanying notes are an integral part of these consolidated financial statements. |  |  |

Table of Contents

## POPULAR, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

## (UNAUDITED)

| (In thousands) | Nine months ended September 30,$2013 \quad 2012$ |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Cash flows from operating activities: |  |  |  |  |
| Net income | \$ | 436,296 | \$ | 161,335 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |  |
| Provision for loan losses |  | 545,927 |  | 326,130 |
| Amortization of intangibles |  | 7,403 |  | 7,605 |
| Depreciation and amortization of premises and equipment |  | 37,056 |  | 34,953 |
| Net accretion of discounts and amortization of premiums and deferred fees |  | $(48,195)$ |  | $(22,118)$ |
| Fair value adjustments on mortgage servicing rights |  | 6,862 |  | 7,217 |
| FDIC loss share expense |  | 44,887 |  | 19,387 |
| Amortization of prepaid FDIC assessment |  |  |  | 30,157 |
| Adjustments (expense) to indemnity reserves on loans sold |  | 30,162 |  | 17,990 |
| Earnings from investments under the equity method |  | $(42,740)$ |  | $(28,748)$ |
| Deferred income tax benefit |  | $(303,038)$ |  | $(150,201)$ |
| (Gain) loss on: |  |  |  |  |
| Disposition of premises and equipment |  | $(3,060)$ |  | $(8,253)$ |
| Sale and valuation adjustments of investment securities |  |  |  | 285 |
| Sale of loans, including valuation adjustments on loans held-for-sale and mortgage banking activities |  | 37,564 |  | $(18,569)$ |
| Sale of stock in equity method investee |  | $(312,589)$ |  |  |
| Sale of other assets |  |  |  | $(2,545)$ |
| Sale of foreclosed assets, including write-downs |  | 45,045 |  | 4,147 |
| Acquisitions of loans held-for-sale |  | $(15,335)$ |  | $(288,844)$ |
| Proceeds from sale of loans held-for-sale |  | 168,046 |  | 242,088 |
| Net disbursements on loans held-for-sale |  | $(1,169,094)$ |  | $(860,804)$ |
| Net (increase) decrease in: |  |  |  |  |
| Trading securities |  | 1,193,265 |  | 849,304 |
| Accrued income receivable |  | 2,847 |  | $(8,735)$ |
| Other assets |  | (610) |  | $(30,247)$ |
| Net increase (decrease) in: |  |  |  |  |
| Interest payable |  | $(9,480)$ |  | $(7,553)$ |
| Pension and other postretirement benefit obligation |  | 6,459 |  | 24,156 |
| Other liabilities |  | $(22,590)$ |  | $(23,112)$ |
| Total adjustments |  | 198,792 |  | 113,690 |
| Net cash provided by operating activities |  | 635,088 |  | 275,025 |


| Cash flows from investing activities: |  |  |
| :---: | :---: | :---: |
| Net decrease in money market investments | 123,792 | 450,511 |
| Purchases of investment securities: |  |  |
| Available-for-sale | $(1,661,080)$ | $(1,284,834)$ |
| Held-to-maturity | (250) | (250) |
| Other | $(145,691)$ | $(152,607)$ |
| Proceeds from calls, paydowns, maturities and redemptions of investment securities: |  |  |
| Available-for-sale | 1,576,112 | 1,166,618 |
| Held-to-maturity | 4,278 | 4,398 |
| Other | 132,270 | 119,098 |
| Proceeds from sale of investment securities: |  |  |
| Available-for-sale |  | 8,031 |
| Net repayments on loans | 1,014,907 | 687,582 |
| Proceeds from sale of loans | 310,767 | 51,677 |
| Acquisition of loan portfolios | $(1,727,454)$ | $(1,051,588)$ |
| Net payments from FDIC under loss sharing agreements | 52,758 | 327,739 |
| Return of capital from equity method investments | 438 | 130,580 |
| Proceeds from sale of stock in equity method investee | 363,492 |  |
| Mortgage servicing rights purchased | (45) | $(1,620)$ |
| Acquisition of premises and equipment | $(27,214)$ | $(34,336)$ |
| Proceeds from sale of: |  |  |
| Premises and equipment | 9,438 | 20,612 |
| Other productive assets |  | 1,026 |
| Foreclosed assets | 200,546 | 142,019 |
| Net cash provided by investing activities | 227,064 | 584,656 |
| Cash flows from financing activities: |  |  |
| Net increase (decrease) in: |  |  |
| Deposits | $(642,427)$ | $(1,624,634)$ |
| Federal funds purchased and assets sold under agreements to repurchase | $(223,544)$ | $(196,533)$ |
| Other short-term borrowings | 190,000 | 910,000 |
| Payments of notes payable | $(331,835)$ | $(72,815)$ |
| Proceeds from issuance of notes payable | 73,154 | 61,331 |
| Proceeds from issuance of common stock | 4,952 | 7,788 |
| Dividends paid | $(2,792)$ | $(2,482)$ |
| Net payments for repurchase of common stock | (433) | (276) |
| Net cash used in financing activities | $(932,925)$ | $(917,621)$ |
| Net decrease in cash and due from banks | $(70,773)$ | $(57,940)$ |
| Cash and due from banks at beginning of period | 439,363 | 535,282 |
| Cash and due from banks at end of period | \$ 368,590 | \$ 477,342 |

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

Edgar Filing: POPULAR INC - Form 10-Q

## Table of Contents

## Notes to Consolidated Financial

## Statements (Unaudited)

Note 1- Organization, consolidation and basis of presentation ..... 11
Note 2 - New accounting pronouncements ..... 12
Note 3 - Restrictions on cash and due from banks and certain securities ..... 14
Note 4 - Pledged assets ..... 15
Note 5- Investment securities available-for-sale ..... 16
Note 6 - Investment securities held-to-maturity ..... 20
Note 7 - Loans ..... 22
Note 8 - Allowance for loan losses ..... 32
Note 9 - FDIC loss share asset and true-up payment obligation ..... 58
Note 10 - Mortgage banking activities ..... 60
Note 11 - Transfers of financial assets and mortgage servicing assets ..... 61
Note 12 - Other assets ..... 65
Note 13- Goodwill and other intangible assets ..... 66
Note 14 - Deposits ..... 70
Note 15 - Borrowings ..... 71
Note 16 - Offsetting of financial assets and liabilities ..... 73
Note 17 - Trust preferred securities ..... 75
Note 18 - Stockholders equity ..... 77
Note 19 - Other comprehensive loss ..... 78
Note 20 - Guarantees ..... 80
Note 21 - Commitments and contingencies ..... 83
Note 22 - Non-consolidated variable interest entities ..... 86
Note 23 - Related party transactions with affiliated company / joint venture ..... 90
Note 24 - Fair value measurement ..... 96
Note 25 - Fair value of financial instruments ..... 103
Note 26 - Net income per common share ..... 110
Note 27 - Other service fees ..... 111
Note 28 - FDIC loss share (expense) income ..... 112
Note 29 - Pension and postretirement benefits ..... 113
Note 30 - Stock-based compensation ..... 114
Note 31 - Income taxes ..... 117
Note 32 - Supplemental disclosure on the consolidated statements of cash flows ..... 120
Note 33 - Segment reporting ..... 121
Note 34 - Subsequent events ..... 127
Note 35 - Condensed consolidating financial information of guarantor and issuers of registered guaranteed securities ..... 128

## Table of Contents

## Note 1 Organization, consolidation and basis of presentation

## Nature of Operations

Popular, Inc. (the Corporation ) is a diversified, publicly-owned financial holding company subject to the supervision and regulation of the Board of Governors of the Federal Reserve System. The Corporation has operations in Puerto Rico, the United States, the Caribbean and Latin America. In Puerto Rico, the Corporation provides mortgage, retail and commercial banking services through its principal banking subsidiary, Banco Popular de Puerto Rico ( BPPR ), as well as investment banking, broker-dealer, auto and equipment leasing and financing, and insurance services through specialized subsidiaries. In the U.S. mainland, the Corporation operates Banco Popular North America ( BPNA ), including its wholly-owned subsidiary E-LOAN. BPNA focuses efforts and resources on the core community banking business. BPNA operates branches in New York, California, Illinois, New Jersey and Florida. E-LOAN markets deposit accounts under its name for the benefit of BPNA. The BPNA branches operate under the name of Popular Community Bank. Note 33 to the consolidated financial statements presents information about the Corporation s business segments.

Effective December 31, 2012, Popular Mortgage, which was a wholly-owned subsidiary of BPPR prior to that date, was merged with and into BPPR as part of an internal reorganization. Popular Mortgage currently operates as a division of BPPR.

## Principles of Consolidation and Basis of Presentation

The consolidated interim financial statements have been prepared without audit. The consolidated statement of financial condition data at December 31, 2012 was derived from audited financial statements. The unaudited interim financial statements are, in the opinion of management, a fair statement of the results for the periods reported and include all necessary adjustments, all of a normal recurring nature, for a fair statement of such results.

Certain reclassifications have been made to the 2012 consolidated financial statements and notes to the financial statements to conform with the 2013 presentation. During the second quarter of 2013, the Corporation discontinued the elimination of its proportionate ownership share of intercompany transactions with EVERTEC from their respective revenue and expense categories to reflect them as an equity pick-up adjustment in other operating income. Refer to Note 23 Related party transactions with affiliated company / joint venture for additional information.

Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted from the unaudited financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, these financial statements should be read in conjunction with the audited consolidated financial statements of the Corporation for the year ended December 31, 2012, included in the Corporation s 2012 Annual Report (the 2012 Annual Report ). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

## Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Edgar Filing: POPULAR INC - Form 10-Q

11

## Table of Contents

## Note 2 New accounting pronouncements

FASB Accounting Standards Update 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ( ASU 2013-11 )

The FASB issued ASU 2013-11 in July 2013 which requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. When a net operating loss, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional taxes that would result from the disallowance of a tax position, or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purposes, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. Currently, there is no explicit guidance under U.S. GAAP on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendment of this guidance does not require new recurring disclosures.

ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments of this ASU should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted.

The Corporation does not anticipate that the adoption of this guidance will have a material effect on its consolidated statements of financial condition or results of operations.

FASB Accounting Standards Update 2013-10, Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes ( ASU 2013-10 )

The FASB issued ASU 2013-10 in July 2013 which permits the use of the Overnight Index Swap Rate (OIS), also referred to as the Fed Funds Effective Swap Rate as a U.S. GAAP benchmark interest rate for hedge accounting purposes under Topic 815. Currently, only the interest rates on direct Treasury obligations of the U.S. government (UST) and the London Interbank Offered Rate (LIBOR) swap rate are considered benchmark interest rates in the United States. This update also removes the restriction on using different benchmark rates for similar hedges. Including the Fed Funds Effective Swap Rate as an acceptable U.S. benchmark interest rate in addition to UST and LIBOR will provide risk managers with a more comprehensive spectrum of interest rate resets to utilize as the designated interest risk component under the hedge accounting guidance in Topic 815.

The amendments of this ASU are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013.

The adoption of this guidance has not had a material effect on its consolidated statements of financial condition or results of operations.

FASB Accounting Standards Update 2013-05, Foreign Currency Matters (Topic 830): Parent s Accounting for the Cumulative Translation Adjustment Upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity ( ASU 2013-05 )

Edgar Filing: POPULAR INC - Form 10-Q
The FASB issued ASU 2013-05 in March 2013 which clarifies the applicable guidance for the release of the cumulative translation adjustment. When a reporting entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity, the parent is required to apply the guidance in ASC 830-30 to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets has resided.

For an equity method investment that is a foreign entity, the partial sale guidance in ASC 830-30-40 still applies. As such, a pro rata portion of the cumulative translation adjustment should be released into net income upon a partial sale of such equity method investment. However, this treatment does not apply to an equity method investment that is not a foreign entity. In those instances, the cumulative translation adjustment is released into net income only if the partial sale represents a complete or substantially complete liquidation of the foreign entity that contains the equity method investment.

Additionally, the amendments in this ASU clarify that the sale of an investment in a foreign entity includes both: (1) events that result in the loss of a controlling financial interest in a foreign entity and (2) events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date. Accordingly, the cumulative translation adjustment should be released into net income upon the occurrence of those events.

## Table of Contents

ASU 2013-05 is effective for fiscal years and interim periods within those years, beginning on or after December 15, 2013. The amendments should be applied prospectively to derecognition events occurring after the effective date. Prior periods should not be adjusted. Early adoption is permitted. If an entity elects to early adopt the amendments of this ASU it should apply them as of the beginning of the entity s fiscal year of adoption.

The Corporation does not anticipate that the adoption of this guidance will have a material effect on its consolidated statements of financial condition or results of operations.

## Table of Contents

## Note 3 Restrictions on cash and due from banks and certain securities

The Corporation s banking subsidiaries, BPPR and BPNA, are required by federal and state regulatory agencies to maintain average reserve balances with the Federal Reserve Bank of New York (the Fed ) or other banks. Those required average reserve balances amounted to $\$ 963$ million at September 30, 2013 (December 31, 2012 - $\$ 952$ million). Cash and due from banks, as well as other short-term, highly liquid securities, are used to cover the required average reserve balances.

At September 30, 2013 the Corporation held $\$ 44$ million in restricted assets in the form of funds deposited in money market accounts, trading account securities and investment securities available for sale (December 31, 2012 - \$41 million). The amounts held in trading account securities and investment securities available for sale consist primarily of restricted assets held for the Corporation s non-qualified retirement plans and fund deposits guaranteeing possible liens or encumbrances over the title of insured properties.

## Table of Contents

## Note 4 Pledged assets

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

|  | September 30, <br> 2013 | December 31, <br> (In thousands) |  |
| :--- | ---: | ---: | ---: |
| Investment securities available-for-sale, at fair value | $\$ 1,421,432$ | $\$$ | $1,606,683$ |
| Investment securities held-to-maturity, at amortized <br> cost |  | 35,000 | 25,000 |
| Loans held-for-sale measured at lower of cost or fair <br> value | 1,108 | 132 |  |
| Loans held-in-portfolio covered under loss sharing <br> agreements with the FDIC | 441,933 | 452,631 |  |
| Loans held-in-portfolio not covered under loss <br> sharing agreements with the FDIC | $8,936,504$ | $8,358,456$ |  |
| Total pledged assets | $\$ 10,835,977$ | $\$ 10,442,902$ |  |

Pledged securities that the creditor has the right by custom or contract to repledge are presented separately on the consolidated statements of financial condition.

At September 30, 2013, the Corporation had $\$ 1.0$ billion in investment securities available-for-sale and $\$ 0.6$ billion in loans that served as collateral to secure public funds (December 31, 2012-\$ 1.2 billion and $\$ 0.3$ billion, respectively).

At September 30, 2013, the Corporation s banking subsidiaries had short-term and long-term credit facilities authorized with the Federal Home Loan Bank system (the FHLB ) aggregating to $\$ 2.8$ billion (December 31, 2012 $\$ 2.8$ billion). Refer to Note 15 to the consolidated financial statements for borrowings outstanding under these credit facilities. At September 30, 2013, the credit facilities authorized with the FHLB were collateralized by $\$ 3.8$ billion in loans held-in-portfolio (December 31, 2012 - $\$ 3.8$ billion). Also, at September 30, 2013, the Corporation s banking subsidiaries had a borrowing capacity at the Federal Reserve ( Fed ) discount window of $\$ 3.4$ billion, which remained unused as of such date ( December 31, 2012 - $\$ 3.1$ billion). The amount available under these credit facilities with the Fed is dependent upon the balance of loans and securities pledged as collateral. At September 30, 2013, the credit facilities with the Fed discount window were collateralized by $\$ 5.0$ billion in loans held-in-portfolio (December 31, 2012-\$ 4.7 billion). These pledged assets are included in the above table and were not reclassified and separately reported in the consolidated statements of financial condition.

In addition, at September 30, 2013 trades receivables from brokers and counterparties amounting to $\$ 62$ million were pledged to secure repurchase agreements (December 31, 2012 - $\$ 133$ million).

## Table of Contents

## Note 5 Investment securities available-for-sale

The following tables present the amortized cost, gross unrealized gains and losses, approximate fair value, weighted average yield and contractual maturities of investment securities available-for-sale.

At September 30, 2013

| (In thousands) | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value | Weighted average yield |
| :---: | :---: | :---: | :---: | :---: | :---: |
| U.S. Treasury securities |  |  |  |  |  |
| Within 1 year | \$ 15,000 | \$ | \$ | \$ 15,000 | 0.07\% |
| After 1 to 5 years | 26,669 | 2,259 |  | 28,928 | 3.85 |
| Total U.S. Treasury securities | 41,669 | 2,259 |  | 43,928 | 2.49 |
| Obligations of U.S. Government sponsored entities |  |  |  |  |  |
| Within 1 year | 43,130 | 182 |  | 43,312 | 1.47 |
| After 1 to 5 years | 506,739 | 1,951 | 4,661 | 504,029 | 1.38 |
| After 5 to 10 years | 736,292 | 157 | 19,785 | 716,664 | 1.53 |
| After 10 years | 23,000 |  | 1,606 | 21,394 | 3.11 |
| Total obligations of U.S. Government sponsored entities | 1,309,161 | 2,290 | 26,052 | 1,285,399 | 1.50 |
| Obligations of Puerto Rico, States and political subdivisions |  |  |  |  |  |
| After 1 to 5 years | 6,234 | 45 | 99 | 6,180 | 4.67 |
| After 5 to 10 years | 7,820 |  | 107 | 7,713 | 4.88 |
| After 10 years | 54,585 |  | 12,551 | 42,034 | 5.92 |
| Total obligations of Puerto Rico, States and political subdivisions | 68,639 | 45 | 12,757 | 55,927 | 5.69 |

Collateralized mortgage obligations - federal agencies

| After 1 to 5 years | 5,865 | 101 |  | 5,966 | 1.74 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| After 5 to 10 years | 22,433 | 638 |  | 23,071 | 2.93 |
| After 10 years | 2,535,653 | 25,049 | 55,995 | 2,504,707 | 2.05 |
| Total collateralized mortgage obligations - federal agencies | 2,563,951 | 25,788 | 55,995 | 2,533,744 | 2.06 |
| Collateralized mortgage obligations - private label |  |  |  |  |  |
| After 10 years | 877 | 10 |  | 887 | 3.76 |

Edgar Filing: POPULAR INC - Form 10-Q

| Total collateralized mortgage obligations - private label | 877 |  | 10 |  |  | 887 | 3.76 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Mortgage-backed securities |  |  |  |  |  |  |  |
| Within 1 year | 756 |  | 45 |  |  | 801 | 3.40 |
| After 1 to 5 years | 7,235 |  | 348 |  |  | 7,583 | 4.85 |
| After 5 to 10 years | 76,962 |  | 3,786 |  | 1,106 | 79,642 | 4.21 |
| After 10 years | 1,053,560 |  | 56,873 |  | 2,855 | 1,107,578 | 3.96 |
| Total mortgage-backed securities | 1,138,513 |  | 61,052 |  | 3,961 | 1,195,604 | 3.98 |
| Equity securities (without contractual maturity) | 6,506 |  | 2,466 |  | 186 | 8,786 | 3.35 |
| Other |  |  |  |  |  |  |  |
| After 1 to 5 years | 9,727 |  |  |  | 263 | 9,464 | 1.68 |
| After 10 years | 2,802 |  | 77 |  |  | 2,879 | 3.60 |
| Total other | 12,529 |  | 77 |  | 263 | 12,343 | 2.11 |
| Total investment securities available-for-sale | \$ 5,141,845 | \$ | 93,987 | \$ | 99,214 | \$ 5,136,618 | 2.40\% |

Table of Contents

| (In thousands) | At December 31, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Amortized cost | $\begin{gathered} \text { Gross } \\ \text { unrealized } \\ \text { gains } \end{gathered}$ | Gross unrealized losses | Fair value | Weighted average yield |
| U.S. Treasury securities |  |  |  |  |  |
| Within 1 year | 7,018 | 20 | \$ | 7,038 | 1.67\% |
| After 1 to 5 years | 27,236 | 2,964 |  | 30,200 | 3.83 |
| Total U.S. Treasury securities | 34,254 | 2,984 |  | 37,238 | 3.39 |
| Obligations of U.S. Government sponsored entities |  |  |  |  |  |
| Within 1 year | 460,319 | 7,614 |  | 467,933 | 3.82 |
| After 1 to 5 years | 167,177 | 2,057 |  | 169,234 | 1.59 |
| After 5 to 10 years | 456,480 | 3,263 | 592 | 459,151 | 1.74 |
| Total obligations of U.S. Government sponsored entities | 1,083,976 | 12,934 | 592 | 1,096,318 | 2.60 |

Obligations of Puerto Rico, States and political subdivisions

| Within 1 year | 5,220 | 26 |  | 5,246 | 3.08 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| After 1 to 5 years | 6,254 | 130 | 39 | 6,345 | 4.65 |
| After 5 to 10 years | 5,513 |  | 36 | 5,477 | 3.79 |
| After 10 years | 37,265 | 648 |  | 37,913 | 5.38 |


| Total obligations of Puerto Rico, States and <br> political subdivisions | 54,252 | 804 | 75 | 54,981 | 4.91 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Collateralized mortgage obligations - federal agencies

| After 1 to 5 years | 4,927 | 35 |  | 4,962 | 1.48 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| After 5 to 10 years | 39,897 | 1,794 |  | 41,691 | 2.94 |
| After 10 years | 2,270,184 | 50,740 | 512 | 2,320,412 | 2.21 |
| Total collateralized mortgage obligations - federal agencies | 2,315,008 | 52,569 | 512 | 2,367,065 | 2.22 |
| Collateralized mortgage obligations - private label |  |  |  |  |  |
| After 10 years | 2,414 | 59 |  | 2,473 | 4.59 |
| Total collateralized mortgage obligations - private label | 2,414 | 59 |  | 2,473 | 4.59 |
| Mortgage-backed securities |  |  |  |  |  |
| Within 1 year | 288 | 13 |  | 301 | 3.47 |
| After 1 to 5 years | 3,838 | 191 |  | 4,029 | 4.12 |
| After 5 to 10 years | 81,645 | 6,207 |  | 87,852 | 4.71 |

Table of Contents
$\left.\begin{array}{lrrrrr}\text { After } 10 \text { years } & 1,297,585 & 93,509 & 129 & 1,390,965 & 4.18 \\ \text { Total mortgage-backed securities } & 1,383,356 & 99,920 & 129 & 1,483,147 & 4.21 \\ \text { Equity securities (without contractual maturity) } & 6,507 & 909 & 10 & 7,406 & 3.46 \\ \text { Other } & & & & & \\ \text { After } 1 \text { to } 5 \text { years } & 9,992 & & 207 & 9,785 & 1.67 \\ \text { After 5 to 10 years } & 18,032 & 3,675 & & 21,707 & 11.00 \\ \text { After 10 years } & 3,945 & 136 & & 4,081 & 3.62 \\ \text { Total other } & 31,969 & 3,811 & 207 & 35,573 & 7.17 \\ \hline \text { Total investment securities available-for-sale } & \$ 4,911,736 & \$ 173,990 & \$ & 1,525 & \$ 5,084,201\end{array}\right) 2.94 \%$

The weighted average yield on investment securities available-for-sale is based on amortized cost; therefore, it does not give effect to changes in fair value.

Securities not due on a single contractual maturity date, such as mortgage-backed securities and collateralized mortgage obligations, are classified in the period of final contractual maturity. The expected maturities of collateralized mortgage obligations, mortgage-backed securities and certain other securities may differ from their contractual maturities because they may be subject to prepayments or may be called by the issuer.

There were no sales of investment securities available-for-sale during the nine months ended September 30, 2013. Proceeds from the sale of investments available-for-sale for the nine months ended September 30, 2012 were $\$ 8.0$ million.

Gross realized gains and losses on the sale of investment securities available-for-sale were as follows:

|  | For the quarter ended September $\operatorname{Bl}$ ne months ended September 30 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 | 2012 |  | 2013 | 2012 |  |
| Gross realized gains | \$ | \$ | 65 | \$ | \$ | 65 |
| Gross realized losses |  |  | (2) |  |  | (350) |
| Net realized gains (losses) on sale of investment securities available-for-sale | \$ | \$ | 63 | \$ | \$ | (285) |

## Table of Contents

The following tables present the Corporation s fair value and gross unrealized losses of investment securities available-for-sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.


Total investment securities available-for-sale in an unrealized loss position \$2,557,354 $\$ 96,243 \quad \$ 60,532 \quad \$ 2,971 \quad \$ 2,617,886 \quad \$ 99,214$

| (In thousands) | Less than <br> Fair value | Gross unrealized losses |  | 12 months or more <br> Gross <br> Fair unrealized <br> value losses |  |  | Fair value |  | Gross unrealized losses |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Obligations of U.S. Government sponsored entities | \$ 139,278 | \$ | 592 | \$ | \$ |  | \$ | 139,278 | \$ | 592 |
| Obligations of Puerto Rico, States and political subdivisions | 6,229 |  | 44 | 2,031 |  | 31 |  | 8,260 |  | 75 |
| Collateralized mortgage obligations federal agencies | 170,136 |  | 512 |  |  |  |  | 170,136 |  | 512 |
| Mortgage-backed securities | 7,411 |  | 90 | 983 |  | 39 |  | 8,394 |  | 129 |
| Equity securities |  |  |  | 51 |  | 10 |  | 51 |  | 10 |
| Other | 9,785 |  | 207 |  |  |  |  | 9,785 |  | 207 |

## Total investment securities

available-for-sale in an unrealized loss
position
$\begin{array}{llllllllll}\$ & 332,839 & \$ & 1,445 & \$ 3,065 & \$ & 80 & \$ & 335,904 & \$\end{array}$
As of September 30, 2013, the available-for-sale investment portfolio reflects gross unrealized losses of approximately $\$ 99$ million, driven by obligations from the U.S. Government sponsored entities, US Agency

Collateralized Mortgage Obligations, and Obligations of the Puerto Rico Government and its political subdivisions. As part of its analysis for all US Agencies securities, management considers the US Agency guarantee. The portfolio of Obligations of the Puerto Rico Government is comprised of securities with specific sources of income or revenues identified for repayments. The Corporation performs periodic credit quality review on these issuers.

Management evaluates investment securities for other-than-temporary ( OTTI ) declines in fair value on a quarterly basis. Once a decline in value is determined to be other-than-temporary, the value of a debt security is reduced and a corresponding charge to earnings is recognized for anticipated credit losses. Also, for equity securities that are considered other-than-temporarily impaired, the excess of the security $s$ carrying value over its fair value at the evaluation date is accounted for as a loss in the results of operations. The OTTI analysis requires management to consider various factors, which include, but are not limited to: (1) the length of time and the extent to which fair value has been less than the amortized cost basis, (2) the financial condition of the issuer or issuers, (3) actual collateral attributes, (4) the payment structure of the debt security and the likelihood of the issuer being able to

## Table of Contents

make payments, (5) any rating changes by a rating agency, (6) adverse conditions specifically related to the security, industry, or a geographic area, and (7) management s intent to sell the debt security or whether it is more likely than not that the Corporation would be required to sell the debt security before a forecasted recovery occurs.

At September 30, 2013, management performed its quarterly analysis of all debt securities in an unrealized loss position. Based on the analyses performed, management concluded that no individual debt security was other-than-temporarily impaired as of such date. At September 30, 2013, the Corporation did not have the intent to sell debt securities in an unrealized loss position and it is not more likely than not that the Corporation will have to sell the investment securities prior to recovery of their amortized cost basis. Also, management evaluated the Corporation s portfolio of equity securities at September 30, 2013. No other-than-temporary impairment losses on equity securities were recorded during the quarters ended September 30, 2013 and September 30, 2012. Management has the intent and ability to hold the investments in equity securities that are at a loss position at September 30, 2013, for a reasonable period of time for a forecasted recovery of fair value up to (or beyond) the cost of these investments.

The following table states the name of issuers, and the aggregate amortized cost and fair value of the securities of such issuer (includes available-for-sale and held-to-maturity securities), in which the aggregate amortized cost of such securities exceeds $10 \%$ of stockholders equity. This information excludes securities backed by the full faith and credit of the U.S. Government. Investments in obligations issued by a state of the U.S. and its political subdivisions and agencies, which are payable and secured by the same source of revenue or taxing authority, other than the U.S. Government, are considered securities of a single issuer.

September 30, 2013
Amortized
(In thousands)

| FNMA | $\$ 2,307,890$ | $\$ 2,277,592$ | $\$ 1,594,933$ | $\$ 1,634,927$ |
| :--- | ---: | ---: | ---: | ---: |
| FHLB | 339,910 | 331,972 | 520,127 | 528,287 |
| Freddie Mac | $1,178,266$ | $1,172,096$ | $1,198,969$ | $1,221,863$ |

## Table of Contents

## Note 6 Investment securities held-to-maturity

The following tables present the amortized cost, gross unrealized gains and losses, approximate fair value, weighted average yield and contractual maturities of investment securities held-to-maturity.

At September 30, 2013

| (In thousands) | Amortized cost |  | Gross unrealized gains |  | Gross unrealized losses |  | Fair value |  | Weighted average yield |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Obligations of Puerto Rico, States and political subdivisions |  |  |  |  |  |  |  |  |  |
| Within 1 year | \$ | 2,570 | \$ |  | \$ | 33 | \$ | 2,537 | 5.80\% |
| After 1 to 5 years |  | 22,060 |  |  |  | 1,143 |  | 20,917 | 3.73 |
| After 5 to 10 years |  | 20,015 |  |  |  | 5,354 |  | 14,661 | 6.06 |
| After 10 years |  | 69,088 |  | 54 |  | 13,721 |  | 55,421 | 2.43 |
| Total obligations of Puerto Rico, States and political subdivisions |  | 113,733 |  | 54 |  | 20,251 |  | 93,536 | 3.40 |
| Collateralized mortgage obligations - federal agencies |  |  |  |  |  |  |  |  |  |
| After 10 years |  | 122 |  | 7 |  |  |  | 129 | 5.45 |
| Total collateralized mortgage obligations - federal agencies |  | 122 |  | 7 |  |  |  | 129 | 5.45 |
| Other |  |  |  |  |  |  |  |  |  |
| Within 1 year |  | 26,000 |  |  |  | 913 |  | 25,087 | 3.41 |
| After 1 to 5 years |  | 500 |  |  |  | 3 |  | 497 | 1.39 |
| Total other |  | 26,500 |  |  |  | 916 |  | 25,584 | 3.37 |
| Total investment securities held-to-maturity |  | 140,355 | \$ | 61 | \$ | 21,167 |  | 19,249 | 3.40\% |

At December 31, 2012

|  | Amortized <br> cost | Gross <br> unealized <br> gains | Gross <br> unrealized <br> losses | Fair <br> value | Weighted <br> average <br> yield |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| (In thousands) | $\$ 2,420$ | $\$$ | 8 | $\$$ |  | $\$$ | 2,428 |
| Obligations of Puerto Rico, States and political <br> subdivisions | 21,335 | 520 | 19 | 21,836 | $5.74 \%$ |  |  |
| Within 1 year | 18,780 | 866 | 5 | 19,641 | 6.03 |  |  |
| After 1 to 5 years | 73,642 | 449 | 438 | 73,653 | 5.35 |  |  |
| After 5 to 10 years |  |  |  |  |  |  |  |
| After 10 years |  |  |  |  |  |  |  |

Table of Contents

| Total obligations of Puerto Rico, States and political subdivisions | 116,177 |  | 1,843 |  | 462 | 117,558 | 5.15 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Collateralized mortgage obligations - federal agencies |  |  |  |  |  |  |  |
| After 10 years | 140 |  | 4 |  |  | 144 | 5.00 |
| Total collateralized mortgage obligations - federal agencies | 140 |  | 4 |  |  | 144 | 5.00 |
| Other |  |  |  |  |  |  |  |
| Within 1 year | 250 |  |  |  |  | 250 | 0.86 |
| After 1 to 5 years | 26,250 |  | 31 |  |  | 26,281 | 3.40 |
| Total other | 26,500 |  | 31 |  |  | 26,531 | 3.38 |
| Total investment securities held-to-maturity | \$ 142,817 | \$ | 1,878 | \$ | 462 | \$ 144,233 | 4.82\% |

Securities not due on a single contractual maturity date, such as collateralized mortgage obligations, are classified in the period of final contractual maturity. The expected maturities of collateralized mortgage obligations and certain other securities may differ from their contractual maturities because they may be subject to prepayments or may be called by the issuer.

The following tables present the Corporation s fair value and gross unrealized losses of investment securities held-to-maturity, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2013 and December 31, 2012.

|  | At September 30, 2013 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Fair value | Gross unrealized losses | Fair value |  | ross <br> alized <br> sses | Fair value |  | Gross <br> ealized <br> osses |
| Obligations of Puerto Rico, States and political subdivisions | \$ 61,797 | \$ 13,515 | \$ 12,039 | \$ | 6,736 | \$ 73,836 | \$ | 20,251 |
| Other | 24,334 | 916 |  |  |  | 24,334 |  | 916 |
| Total investment securities held-to-maturity in an unrealized loss position | \$86,131 | \$ 14,431 | \$ 12,039 |  | 6,736 | \$ 98,170 |  | 1,167 |

Table of Contents

|  | At December 31, 2012 |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Fair value |  |  | Fair value |  | oss <br> lized <br> ses | Fair value |  | ss <br> lized <br> ses |
| Obligations of Puerto Rico, States and political subdivisions | \$ 2,365 | \$ | 35 | \$ 19,118 | \$ | 427 | \$ 21,483 | \$ | 462 |
| Total investment securities held-to-maturity in an unrealized loss position | \$ 2,365 | \$ | 35 | \$ 19,118 | \$ | 427 | \$ 21,483 | \$ | 462 |

As indicated in Note 5 to these consolidated financial statements, management evaluates investment securities for OTTI declines in fair value on a quarterly basis.

The Obligations of Puerto Rico, States and political subdivisions classified as held-to-maturity at September 30, 2013 are primarily associated with securities issued by municipalities of Puerto Rico and are generally not rated by a credit rating agency. This includes $\$ 64$ million of securities issued by three Municipalities of Puerto Rico that are payable from the real and personal property taxes collected within such municipalities. These bonds have seniority to the payment of operating cost and expenses of the municipality. The portfolio also includes approximately $\$ 40$ million in securities for which the underlying source of payment is not the central government, but in which it provides a guarantee in the event of default. The Corporation performs periodic credit quality reviews on these issuers. The Corporation does not have the intent to sell securities held-to-maturity and it is not more likely than not that the Corporation will have to sell these investment securities prior to recovery of their amortized cost basis.

## Table of Contents

## Note 7 Loans

Covered loans acquired in the Westernbank FDIC-assisted transaction, except for lines of credit with revolving privileges, are accounted for by the Corporation in accordance with ASC Subtopic 310-30. Under ASC Subtopic 310-30, the acquired loans were aggregated into pools based on similar characteristics. Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. The covered loans which are accounted for under ASC Subtopic 310-30 by the Corporation are not considered non-performing and will continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected. The Corporation measures additional losses for this portfolio when it is probable the Corporation will be unable to collect all cash flows expected at acquisition plus additional cash flows expected to be collected arising from changes in estimates after acquisition. Lines of credit with revolving privileges that were acquired as part of the Westernbank FDIC-assisted transaction are accounted for under the guidance of ASC Subtopic 310-20, which requires that any differences between the contractually required loan payment receivable in excess of the Corporation s initial investment in the loans be accreted into interest income. Loans accounted for under ASC Subtopic 310-20 are placed in non-accrual status when past due in accordance with the Corporation s non-accruing policy and any accretion of discount is discontinued.

The risks on loans acquired in the FDIC-assisted transaction are significantly different from the risks on loans not covered under the FDIC loss sharing agreements because of the loss protection provided by the FDIC. Accordingly, the Corporation presents loans subject to the loss sharing agreements as covered loans in the information below and loans that are not subject to the FDIC loss sharing agreements as non-covered loans .

For a summary of the accounting policy related to loans, interest recognition and allowance for loan losses refer to the summary of significant accounting policies included in Note 2 to the consolidated financial statements included in 2012 Annual Report.

The following table presents the composition of non-covered loans held-in-portfolio ( HIP ), net of unearned income, at September 30, 2013 and December 31, 2012.

| (In thousands) | September 30,2013 |  | December 31, 2012 |
| :--- | ---: | ---: | ---: |
| Commercial multi-family | $\$$ | $1,146,929$ | $\$ \mathrm{l}, 021,780$ |
| Commercial real estate non-owner |  |  |  |
| occupied | $2,881,959$ | $2,634,432$ |  |
| Commercial real estate owner occupied | $2,217,503$ | $2,608,450$ |  |
| Commercial and industrial | $3,599,086$ | $3,593,540$ |  |
| Construction | 293,220 | 252,857 |  |
| Mortgage | $6,613,133$ | $6,078,507$ |  |
| Leasing | 539,290 | 540,523 |  |
| Legacy ${ }^{[2]}$ | 235,645 | 384,217 |  |
| Consumer: |  |  |  |
| Credit cards | $1,174,330$ | $1,198,213$ |  |
| Home equity lines of credit | 485,614 | 491,035 |  |
| Personal | $1,361,340$ | $1,388,911$ |  |
| Auto | 658,826 | 561,084 |  |
| Other | 220,308 | 229,643 |  |

Edgar Filing: POPULAR INC - Form 10-Q
Total loans held-in-portfolio ${ }^{[1]}$ \$ 21,427,183
[1] Non-covered loans held-in-portfolio at September 30, 2013 are net of $\$ 93$ million in unearned income and exclude $\$ 125$ million in loans held-for-sale (December 31, 2012 - $\$ 97$ million in unearned income and $\$ 354$ million in loans held-for-sale).
[2] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

## Table of Contents

The following table presents the composition of covered loans at September 30, 2013 and December 31, 2012.

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :--- | ---: | ---: | ---: | ---: |
| Commercial real estate | $\$ 1,725,153$ | $\$$ | $2,077,411$ |  |
| Commercial and industrial |  | 128,698 |  | 167,236 |
| Construction |  | 201,437 |  | 361,396 |
| Mortgage | 965,779 |  | $1,076,730$ |  |
| Consumer |  | 54,942 |  | 73,199 |
| Total loans held-in-portfolio | $\$$ | $3,076,009$ | $\$$ | $3,755,972$ |

The following table provides a breakdown of loans held-for-sale ( LHFS ) at September 30, 2013 and December 31, 2012 by main categories.

|  | September 30,2013 |  | December 31, 2012 |  |
| :--- | :---: | ---: | :---: | ---: |
| (In thousands) | $\$$ |  | $\$$ | 16,047 |
| Commercial |  | 1,680 |  | 78,140 |
| Construction |  | 122,852 |  | 258,201 |
| Legacy |  |  |  |  |
| Mortgage | $\$$ | 124,532 | $\$$ | 354,468 |

During the quarter and nine months ended September 30, 2013, the Corporation recorded purchases (including repurchases) of mortgage loans amounting to $\$ 199$ million and $\$ 1.7$ billion, respectively (September 30, 2012 - $\$ 453$ million and $\$ 1.1$ billion, respectively). Also, the Corporation recorded purchases of $\$ 42$ million in consumer loans during the nine months ended September 30, 2013 (September 30, 2012 - $\$ 230$ million). In addition, during the quarter and nine months ended September 30, 2013, the Corporation recorded purchases of commercial loans amounting to $\$ 5$ million and $\$ 8$ million, respectively, and there were no purchases during the quarter and nine months ended September 30, 2012. There were no purchases of construction loans during the quarter and nine months ended September 30, 2013 (September 30, 2012 - $\$ 0.1$ million and $\$ 1$ million, respectively).

The Corporation performed whole-loan sales involving approximately $\$ 60$ million and $\$ 614$ million of residential mortgage loans during the quarter and nine months ended September 30, 2013, respectively (September 30, 2012 $\$ 94$ million and $\$ 238$ million, respectively). These sales included $\$ 435$ million from the bulk sale of non-performing mortgage loans, completed during the quarter ended June 30, 2013. Also, the Corporation securitized approximately $\$$ 200 million and $\$ 767$ million of mortgage loans into Government National Mortgage Association ( GNMA ) mortgage-backed securities during the quarter and nine months ended September 30, 2013, respectively (September 30, 2012 - $\$ 181$ million and $\$ 576$ million, respectively). Furthermore, the Corporation securitized approximately $\$$ 102 million and $\$ 354$ million of mortgage loans into Federal National Mortgage Association ( FNMA ) mortgage-backed securities during the quarter and nine months ended September 30, 2013, respectively (September 30, 2012-\$ 107 million and $\$ 238$ million, respectively). Also, the Corporation securitized approximately $\$ 1$ million and $\$ 28$ million of mortgage loans into Federal Home Loan Mortgage Corporation ( FHLMC ) mortgage-backed securities during the quarter and nine months ended September 30, 2013 (September 30, 2012 - \$ 20 million and \$ 20 million, respectively). The Corporation sold commercial and construction loans with a book value of
approximately $\$ 6$ million and $\$ 413$ million during the quarter and nine months ended September 30, 2013, respectively (September 30, 2012 - $\$ 9$ million and $\$ 48$ million, respectively). These sales included $\$ 401$ million from the bulk sale of non-performing commercial and construction loans during the quarter ended March 31, 2013.

## Non-covered loans

The following tables present non-covered loans held-in-portfolio by loan class that are in non-performing status or are accruing interest but are past due 90 days or more at September 30, 2013 and December 31, 2012. Accruing loans past due 90 days or more consist primarily of credit cards, FHA / VA and other insured mortgage loans, and delinquent mortgage loans which are included in the Corporation s financial statements pursuant to GNMA s 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. Also, accruing loans past due 90 days or more include

## Table of Contents

residential conventional loans purchased from another financial institution that, although delinquent, the Corporation has received timely payment from the seller / servicer, and, in some instances, have partial guarantees under recourse agreements. However, residential conventional loans purchased from another financial institution, which are in the process of foreclosure, are classified as non-performing mortgage loans.

At September 30, 2013

[1] For purposes of this table non-performing loans exclude $\$ 2$ million in non-performing loans held-for-sale.
[2] Non-covered loans accounted for under ASC Subtopic 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 analysis.
[3] It is the Corporation s policy to report delinquent residential mortgage loans insured by FHA or guaranteed by the VA as accruing loans past due 90 days or more as opposed to non-performing since the principal repayment is insured. These balances include $\$ 113$ million of residential mortgage loans in Puerto Rico insured by FHA or guaranteed by the VA that are no longer accruing interest as of September 30, 2013. Furthermore, the Corporation has approximately $\$ 25$ million in reverse mortgage loans in Puerto Rico which are guaranteed by FHA, but which are currently not accruing interest. Due to the guaranteed nature of the loans, it is the Corporation s policy to exclude these balances from non-performing assets.

At December 31, 2012
Puerto Rico
U.S. mainland

Popular, Inc.

| (In thousands) | Non-accrual loans | Accruing loans past-due 90 days or more | Accruing <br> Non-accrualoans past-due Non-accrual loans 90 days or more loans |  |  | Accruing loans past-due 90 days or mor |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial multi-family | \$ 15,816 | + | \$ 18,435 | \$ \$ | \$ 34,251 | \$ |
| Commercial real estate non-owner occupied | 66,665 |  | 78,140 |  | 144,805 |  |
| Commercial real estate owner occupied | 315,534 |  | 31,931 |  | 347,465 |  |
| Commercial and industrial | 124,717 | 529 | 14,051 |  | 138,768 | 529 |
| Construction | 37,390 |  | 5,960 |  | 43,350 |  |
| Mortgage | 596,105 | 364,387 | 34,025 |  | 630,130 | 364,387 |
| Leasing | 4,865 |  |  |  | 4,865 |  |
| Legacy |  |  | 40,741 |  | 40,741 |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards |  | 22,184 | 505 |  | 505 | 22,184 |
| Home equity lines of credit |  | 312 | 7,454 |  | 7,454 | 312 |
| Personal | 19,300 | 23 | 1,905 |  | 21,205 | 23 |
| Auto | 8,551 |  | 4 |  | 8,555 |  |
| Other | 3,036 | 469 | , |  | 3,039 | 469 |
| Total ${ }^{[1]}$ | \$ 1,191,979 | \$ 387,904 | \$ 233,154 | \$ \$ | \$ 1,425,133 | \$ 387,904 |

[1] For purposes of this table non-performing loans exclude $\$ 96$ million in non-performing loans held-for-sale.

## Table of Contents

The following tables present loans by past due status at September 30, 2013 and December 31, 2012 for non-covered loans held-in-portfolio (net of unearned income).

September 30, 2013
Puerto Rico
Past due Non covered

| (In thousands) | $\begin{gathered} 30-59 \\ \text { days } \end{gathered}$ | $\begin{gathered} 60-89 \\ \text { days } \end{gathered}$ | 90 days or more | Total past due | Current | loans HIP <br> Puerto Rico |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial multi-family | \$ | \$ 334 | \$ 9,394 | \$ 9,728 | \$ 75,552 | \$ 85,280 |
| Commercial real estate non-owner occupied | 1,485 | 3,815 | 41,860 | 47,160 | 1,664,650 | 1,711,810 |
| Commercial real estate owner occupied | 37,237 | 9,112 | 97,237 | 143,586 | 1,524,630 | 1,668,216 |
| Commercial and industrial | 19,991 | 16,809 | 56,884 | 93,684 | 2,696,034 | 2,789,718 |
| Construction | 640 | 1,580 | 23,019 | 25,239 | 226,631 | 251,870 |
| Mortgage | 302,671 | 143,631 | 606,332 | 1,052,634 | 4,291,048 | 5,343,682 |
| Leasing | 6,408 | 1,324 | 3,716 | 11,448 | 527,842 | 539,290 |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 13,223 | 8,803 | 19,785 | 41,811 | 1,117,504 | 1,159,315 |
| Home equity lines of credit | 381 |  | 43 | 424 | 15,094 | 15,518 |
| Personal | 13,266 | 6,528 | 17,518 | 37,312 | 1,185,051 | 1,222,363 |
| Auto | 30,407 | 8,597 | 9,464 | 48,468 | 609,810 | 658,278 |
| Other | 1,658 | 1,004 | 5,720 | 8,382 | 210,665 | 219,047 |

$\begin{array}{lllllll}\text { Total } & \$ 427,367 & \$ 201,537 & \$ 890,972 & \$ 1,519,876 & \$ 14,144,511 & \$ 15,664,387\end{array}$

September 30, 2013
U.S. mainland

Past due

| (In thousands) | $\begin{gathered} 30-59 \\ \text { days } \end{gathered}$ |  | $\begin{gathered} 60-89 \\ \text { days } \end{gathered}$ |  | 90 days or more | Total past due |  | Current |  | Loans HIP <br> U.S. mainland |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial multi-family | \$ | 1,381 | \$ | 1,862 | \$ 21,779 | \$ | 25,022 | \$ | 1,036,627 | \$ | 1,061,649 |
| Commercial real estate non-owner occupied |  | 3,270 |  |  | 54,707 |  | 57,977 |  | 1,112,172 |  | 1,170,149 |
| Commercial real estate owner occupied |  | 6,505 |  | 923 | 26,792 |  | 34,220 |  | 515,067 |  | 549,287 |
| Commercial and industrial |  | 5,408 |  | 2,206 | 8,193 |  | 15,807 |  | 793,561 |  | 809,368 |
| Construction |  |  |  |  | 5,763 |  | 5,763 |  | 35,587 |  | 41,350 |
| Mortgage |  | 9,448 |  | 6,936 | 25,373 |  | 41,757 |  | 1,227,694 |  | 1,269,451 |
| Legacy |  | 4,943 |  | 2,365 | 24,206 |  | 31,514 |  | 204,131 |  | 235,645 |
| Consumer: |  |  |  |  |  |  |  |  |  |  |  |
| Credit cards |  | 288 |  | 178 | 482 |  | 948 |  | 14,067 |  | 15,015 |
| Home equity lines of credit |  | 3,096 |  | 2,920 | 7,676 |  | 13,692 |  | 456,404 |  | 470,096 |

Table of Contents
42

Edgar Filing: POPULAR INC - Form 10-Q

| Personal | 836 | 834 | 1,340 | 3,010 | 135,967 | 138,977 |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Auto | 1 |  | 3 | 4 | 544 | 548 |  |
| Other | 6 | 20 | 6 | 32 | 1,229 | 1,261 |  |
|  |  |  |  |  |  |  |  |
| Total | $\$ 35,182$ | $\$ 18,244$ | $\$ 176,320$ | $\$$ | 229,746 | $\$ 5,533,050$ | $\$$ |

Table of Contents
September 30, 2013
Popular, Inc.

| (In thousands) | Past due |  |  |  |  | Non-covered |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} 30-59 \\ \text { days } \end{gathered}$ | 60-89 | 90 days or more | Total past due | Current | loans HIP <br> Popular, Inc. |
| Commercial multi-family | \$ 1,381 | \$ 2,196 | 31,173 | 34,750 | \$ 1,112,179 | \$ 1,146,929 |
| Commercial real estate non-owner occupied | 4,755 | 3,815 | 96,567 | 105,137 | 2,776,822 | 2,881,959 |
| Commercial real estate owner occupied | 43,742 | 10,035 | 124,029 | 177,806 | 2,039,697 | 2,217,503 |
| Commercial and industrial | 25,399 | 19,015 | 65,077 | 109,491 | 3,489,595 | 3,599,086 |
| Construction | 640 | 1,580 | 28,782 | 31,002 | 262,218 | 293,220 |
| Mortgage | 312,119 | 150,567 | 631,705 | 1,094,391 | 5,518,742 | 6,613,133 |
| Leasing | 6,408 | 1,324 | 3,716 | 11,448 | 527,842 | 539,290 |
| Legacy | 4,943 | 2,365 | 24,206 | 31,514 | 204,131 | 235,645 |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 13,511 | 8,981 | 20,267 | 42,759 | 1,131,571 | 1,174,330 |
| Home equity lines of credit | 3,477 | 2,920 | 7,719 | 14,116 | 471,498 | 485,614 |
| Personal | 14,102 | 7,362 | 18,858 | 40,322 | 1,321,018 | 1,361,340 |
| Auto | 30,408 | 8,597 | 9,467 | 48,472 | 610,354 | 658,826 |
| Other | 1,664 | 1,024 | 5,726 | 8,414 | 211,894 | 220,308 |
| Total | \$ 462,549 | \$ 219,781 | \$ 1,067,292 | \$ 1,749,622 | \$ 19,677,561 | \$ 21,427,183 |


| (In thousands) | Past due |  |  |  | Total past due |  | Current |  | Non-covered loans HIP Puerto Rico |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} 30-59 \\ \text { days } \end{gathered}$ | $\begin{gathered} 60-89 \\ \text { days } \end{gathered}$ | 90 days or more |  |  |  |  |  |  |  |
| Commercial multi-family | \$ 1,005 | \$ | \$ | 15,816 | \$ | 16,821 | \$ | 98,272 | \$ | 115,093 |
| Commercial real estate non-owner occupied | 10,580 | 4,454 |  | 66,665 |  | 81,699 |  | 1,268,734 |  | 1,350,433 |
| Commercial real estate owner occupied | 28,240 | 13,319 |  | 315,534 |  | 357,093 |  | 1,685,393 |  | 2,042,486 |
| Commercial and industrial | 27,977 | 5,922 |  | 125,246 |  | 159,145 |  | 2,629,127 |  | 2,788,272 |
| Construction | 1,243 |  |  | 37,390 |  | 38,633 |  | 173,634 |  | 212,267 |
| Mortgage | 241,930 | 121,175 |  | 960,492 |  | 1,323,597 |  | 3,625,327 |  | 4,948,924 |
| Leasing | 6,493 | 1,555 |  | 4,865 |  | 12,913 |  | 527,610 |  | 540,523 |
| Consumer: |  |  |  |  |  |  |  |  |  |  |
| Credit cards | 14,521 | 10,614 |  | 22,184 |  | 47,319 |  | 1,135,753 |  | 1,183,072 |
| Home equity lines of credit | 124 |  |  | 312 |  | 436 |  | 16,370 |  | 16,806 |
| Personal | 13,208 | 7,392 |  | 19,323 |  | 39,923 |  | 1,205,859 |  | 1,245,782 |
| Auto | 24,128 | 6,518 |  | 8,551 |  | 39,197 |  | 521,119 |  | 560,316 |
| Other | 2,120 | 536 |  | 3,505 |  | 6,161 |  | 222,192 |  | 228,353 |

Total
\$371,569 \$ 171,485 \$ 1,579,883 \$ 2,122,937 \$ 13,109,390 \$ 15,232,327

Edgar Filing: POPULAR INC - Form 10-Q

Table of Contents
December 31, 2012
U.S. mainland

Past due

| (In thousands) | $\begin{gathered} 30-59 \\ \text { days } \end{gathered}$ |  | $\begin{gathered} 60-89 \\ \text { days } \end{gathered}$ |  | 90 days or more |  | Total past due |  | Current |  | Loans HIP U.S. mainland |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial multi-family | \$ | 6,828 | \$ | 5,067 | \$ | 18,435 | \$ | 30,330 | \$ | 876,357 |  | 906,687 |
| Commercial real estate non-owner occupied |  | 19,032 |  | 1,309 |  | 78,140 |  | 98,481 |  | 1,185,518 |  | 1,283,999 |
| Commercial real estate owner occupied |  | 9,979 |  | 100 |  | 31,931 |  | 42,010 |  | 523,954 |  | 565,964 |
| Commercial and industrial |  | 12,885 |  | 1,975 |  | 14,051 |  | 28,911 |  | 776,357 |  | 805,268 |
| Construction |  | 5,268 |  |  |  | 5,960 |  | 11,228 |  | 29,362 |  | 40,590 |
| Mortgage |  | 29,909 |  | 10,267 |  | 34,025 |  | 74,201 |  | 1,055,382 |  | 1,129,583 |
| Legacy |  | 15,765 |  | 20,112 |  | 40,741 |  | 76,618 |  | 307,599 |  | 384,217 |
| Consumer: |  |  |  |  |  |  |  |  |  |  |  |  |
| Credit cards |  | 305 |  | 210 |  | 505 |  | 1,020 |  | 14,121 |  | 15,141 |
| Home equity lines of credit |  | 3,937 |  | 2,506 |  | 7,454 |  | 13,897 |  | 460,332 |  | 474,229 |
| Personal |  | 2,757 |  | 1,585 |  | 1,905 |  | 6,247 |  | 136,882 |  | 143,129 |
| Auto |  | 38 |  | 3 |  | 4 |  | 45 |  | 723 |  | 768 |
| Other |  | 41 |  | 9 |  | 3 |  | 53 |  | 1,237 |  | 1,290 |

Total $\$ 106,744 \quad \$ 43,143$ \$ $233,154 ~ \$ ~ 383,041 ~ \$ ~ 5,367,824 ~ \$ ~ 5,750,865$


The following table provides a breakdown of loans held-for-sale ( LHFS ) in non-performing status at September 30, 2013 and December 31, 2012 by main categories.

| (In thousands) | September 30, 2013 | December 31, 2012 |  |  |
| :--- | :---: | ---: | ---: | ---: |
| Commercial | $\$$ |  | $\$$ | 16,047 |
| Construction |  | 1,680 |  | 78,140 |
| Legacy |  | 419 |  | 2,080 |
| Mortgage | $\$$ | 2,099 | $\$$ | 96,320 |

The outstanding principal balance of non-covered loans accounted pursuant to ASC Subtopic 310-30, including amounts charged off by the Corporation, amounted to $\$ 175$ million at September 30, 2013. At September 30, 2013, none of the acquired non-covered loans accounted under ASC Subtopic 310-30 were considered non-performing loans. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, was recognized on all acquired loans.

## Table of Contents

Changes in the carrying amount and the accretable yield for the non-covered loans accounted pursuant to the ASC Subtopic 310-30, for the quarter and nine months ended September 30, 2013 were as follows:

Activity in the accretable discount - Non-covered loans ASC 310-30

|  | For the quarter ended <br> September 30, <br> 2013 | For the nine months ended <br> September 30, <br> 2013 |  |
| :--- | :---: | :---: | :---: |
| (In thousands) | $\$$ | 49,213 | $\$$ |
| Beginning balance | 6,732 |  | 54,074 |
| Additions |  | $(2,417)$ | $(5,029)$ |
| Accretion | $(6,247)$ |  | $(1,764)$ |
| Change in expected cash flows |  | 47,281 | $\$$ |
| Ending balance | $\$$ |  | 47,281 |

Carrying amount of non-covered loans accounted for pursuant to ASC 310-30 For the quarter ended For the nine months ended

September 30,
(In thousands)

| Beginning balance | $\$$ | 138,632 | $\$$ |
| :--- | ---: | ---: | ---: |
| Additions | 18,789 | 175,100 |  |
| Accretion | 2,417 | 5,029 |  |
| Collections and charge-offs | $(4,213)$ | $(24,504)$ |  |


| Ending balance | $\$$ | 155,625 | $\$$ | 155,625 |
| :--- | :--- | :--- | :--- | :--- |

Allowance for loan losses ASC
310-30 non-covered loans $(3,511)$
Ending balance, net of ALLL \$ 152,114 \$ 152,114

## Covered loans

The following table presents covered loans in non-performing status and accruing loans past-due 90 days or more by loan class at September 30, 2013 and December 31, 2012.

September 30, 2013
December 31, 2012
Accruing loans past
(In thousands)
Non-accrual Accruing loans past Non-accrual loans due 90 days or more loans due 90 days or more
\$ 12,877 \$ \$ 14,628

| Commercial and industrial | 8,283 | 132 | 48,743 | 504 |
| :--- | ---: | ---: | ---: | ---: |
| Construction | 5,642 | 69 | 8,363 |  |
| Mortgage | 1,260 |  | 2,133 |  |


| Consumer | 323 |  | 116 | 543 |  | 265 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Total $^{[1]}$ | $\$ 28,385$ | $\$$ | 317 | $\$ 74,410$ | $\$$ | 769 |

[1] Covered loans accounted for under ASC Subtopic 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.

## Table of Contents

The following tables present loans by past due status at September 30, 2013 and December 31, 2012 for covered loans held-in-portfolio. The information considers covered loans accounted for under ASC Subtopic 310-20 and ASC Subtopic 310-30.

September 30, 2013
Past due

| Past due |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | $\begin{gathered} 30-59 \\ \text { days } \end{gathered}$ | $\begin{gathered} 60-89 \\ \text { days } \end{gathered}$ |  | 90 days <br> or more |  | Total past due | Current | Covered loans HIP |
| Commercial real estate | \$ 18,765 | \$ 11,876 | \$ | 469,107 | \$ | 499,748 | \$ 1,225,405 | \$ 1,725,153 |
| Commercial and industrial | 1,516 | 800 |  | 16,718 |  | 19,034 | 109,664 | 128,698 |
| Construction |  | 160 |  | 189,612 |  | 189,772 | 11,665 | 201,437 |
| Mortgage | 32,205 | 19,268 |  | 109,373 |  | 160,846 | 804,933 | 965,779 |
| Consumer | 1,072 | 689 |  | 2,699 |  | 4,460 | 50,482 | 54,942 |
| Total covered loans | \$ 53,558 | \$ 32,793 | \$ | 787,509 | \$ | 873,860 | \$ 2,202,149 | \$ 3,076,009 |



The carrying amount of the covered loans consisted of loans determined to be impaired at the time of acquisition, which are accounted for in accordance with ASC Subtopic 310-30 ( credit impaired loans ), and loans that were considered to be performing at the acquisition date, accounted for by analogy to ASC Subtopic 310-30 ( non-credit impaired loans ), as detailed in the following table.

| (In thousands) | September 30, 2013 <br> Carrying amount <br> Non-credit Credit impaired |  |  |  | December 31, 2012 <br> Carrying amount <br> Non-credit Credit impaired |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial real estate | impaired loans | \$ | 153,590 | $\$ 1,638,699$ | \$ 1,778,594 | \$ | 185,386 | \$ 1,963,980 |
| Commercial and industrial | 53,977 |  | 4,183 | 58,160 | 55,396 |  | 4,379 | 59,775 |
| Construction | 78,818 |  | 114,543 | 193,361 | 174,054 |  | 174,093 | 348,147 |
| Mortgage | 895,054 |  | 59,862 | 954,916 | 988,158 |  | 69,654 | 1,057,812 |
| Consumer | 42,648 |  | 3,265 | 45,913 | 55,762 |  | 6,283 | 62,045 |


| Carrying amount | $2,555,606$ | 335,443 | $2,891,049$ | $3,051,964$ | 439,795 | $3,491,759$ |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | ---: |
| Allowance for loan losses | $(49,744)$ | $(59,130)$ | $(108,874)$ | $(48,365)$ | $(47,042)$ | $(95,407)$ |  |
| Carrying amount, net of |  |  |  |  |  |  |  |
| Cllowance <br> all | $\$ 2,505,862$ | $\$$ | 276,313 | $\$ 2,782,175$ | $\$ 3,003,599$ | $\$$ | 392,753 |

The outstanding principal balance of covered loans accounted pursuant to ASC Subtopic 310-30, including amounts charged off by the Corporation, amounted to $\$ 3.9$ billion at September 30, 2013 (December 31, 2012 - $\$ 4.8$ billion). At September 30, 2013, none of the acquired loans from the Westernbank FDIC-assisted transaction accounted for under ASC Subtopic 310-30 were considered non-performing loans. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, was recognized on all acquired loans.

## Table of Contents

Changes in the carrying amount and the accretable yield for the covered loans accounted pursuant to the ASC Subtopic 310-30, for the quarters and nine months ended September 30, 2013 and 2012, were as follows:

## Activity in the accretable discount

Covered loans ASC 310-30
For the quarters ended
September 30, 2013
September 30, 2012

| (In thousands) | Non-credit Credit impaired loansimpaired loans |  |  | Total | Non-credit Creditimpaired loans impaired loans |  |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Beginning balance | \$ 1,365,670 | \$ | 13,942 | \$ 1,379,612 | \$ 1,550,959 | \$ | 23,891 | \$ 1,574,850 |
| Accretion | $(69,146)$ |  | 617 | $(68,529)$ | $(61,540)$ |  | $(4,628)$ | $(66,168)$ |
| Change in expected cash flows | 4,879 |  | $(6,344)$ | $(1,465)$ | $(29,029)$ |  | $(8,771)$ | $(37,800)$ |
| Ending balance | \$ 1,301,403 | \$ | 8,215 | \$ 1,309,618 | \$ 1,460,390 | \$ | 10,492 | \$ 1,470,882 |

Activity in the accretable discount
Covered loans ASC 310-30
For the nine months ended
September 30, 2013 September 30, 2012

| (In thousands) | Non-credit Credit impaired loansimpaired loans |  |  | Total | Non-credit Creditimpaired loans impaired loans |  |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Beginning balance | \$ 1,446,381 | \$ | 5,288 | \$ 1,451,669 | \$ 1,428,764 | \$ | 41,495 | \$ 1,470,259 |
| Accretion | $(190,607)$ |  | $(5,448)$ | $(196,055)$ | $(191,989)$ |  | $(17,504)$ | $(209,493)$ |
| Change in expected cash flows | 45,629 |  | 8,375 | 54,004 | 223,615 |  | $(13,499)$ | 210,116 |
| Ending balance | \$ 1,301,403 | \$ | 8,215 | \$ 1,309,618 | \$ 1,460,390 | \$ | 10,492 | \$ 1,470,882 |

Carrying amount of covered loans accounted for pursuant to ASC 310-30
For the quarters ended
September 30, 2013
September 30, 2012

| (In thousands) | September 30, 2013 |  |  |  | 2 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Non-credit impaired loan |  | Credit <br> aired loans | Total | Non-credit impaired loans |  | Credit <br> red loans | Total |
| Beginning balance | \$ 2,653,071 | \$ | 359,795 | \$ 3,012,866 | \$ 3,244,957 | \$ | 484,532 | \$ 3,729,489 |
| Accretion | 69,146 |  | (617) | 68,529 | 61,540 |  | 4,628 | 66,168 |
| Collections and charge-offs | $(166,611)$ |  | $(23,735)$ | $(190,346)$ | $(149,583)$ |  | $(18,865)$ | $(168,448)$ |
| Ending balance | \$ 2,555,606 | \$ | 335,443 | \$ 2,891,049 | \$ 3,156,914 | \$ | 470,295 | \$ 3,627,209 |
| Allowance for loan losses |  |  |  |  |  |  |  |  |
| ASC 310-30 covered loans | $(49,744)$ |  | $(59,130)$ | $(108,874)$ | $(64,015)$ |  | $(39,532)$ | $(103,547)$ |

Ending balance, net of ALLL \$2,505,862 \$ 276,313 \$2,782,175 \$3,092,899 \$ 430,763 \$ 3,523,662

Carrying amount of loans accounted for pursuant to ASC 310-30
For the nine months ended
September 30, 2013
September 30, 2012
Non-credit Credit Non-credit Credit

| (In thousands) | impaired loansimpaired loans | Total |  |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | ---: | ---: |
| impaired loans impaired loans | Total |  |  |  |  |  |  |  |
| Beginning balance | $\$ 3,051,964$ | $\$$ | 439,795 | $\$ 3,491,759$ | $\$ 3,446,451$ | $\$$ | 590,020 | $\$ 4,036,471$ |
| Accretion | 190,607 | 5,448 | 196,055 | 191,989 | 17,504 | 209,493 |  |  |
| Collections and charge offs | $(686,965)$ | $(109,800)$ | $(796,765)$ | $(481,526)$ | $(137,229)$ | $(618,755)$ |  |  |


| Ending balance | $\$ 2,555,606$ | $\$$ | 335,443 | $\$ 2,891,049$ | $\$ 3,156,914$ | $\$$ | 470,295 | $\$ 3,627,209$ |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for loan losses |  | $(49,744)$ | $(59,130)$ | $(108,874)$ | $(64,015)$ | $(39,532)$ | $(103,547)$ |  |  |
| ASC 310-30 covered loans |  |  |  |  |  |  |  |  |  |
| Ending balance, net of |  | $\$ 2,505,862$ | $\$$ | 276,313 | $\$ 2,782,175$ | $\$ 3,092,899$ | $\$$ | 430,763 | $\$ 3,523,662$ |

## Table of Contents

The Corporation accounts for lines of credit with revolving privileges under the accounting guidance of ASC Subtopic 310-20, which requires that any differences between the contractually required loans payment receivable in excess of the initial investment in the loans be accreted into interest income over the life of the loans, if the loan is accruing interest. Covered loans accounted for under ASC Subtopic 310-20 amounted to $\$ 0.2$ billion at September 30, 2013 (September 30, 2012 - $\$ 0.3$ billion).

## Table of Contents

## Note 8 Allowance for loan losses

The Corporation s assessment of the allowance for loan losses is determined in accordance with accounting guidance, specifically loss contingencies guidance in ASC Subtopic 450-20 and loan impairment guidance in ASC Section 310-10-35.

The accounting guidance provides for the recognition of a loss allowance for groups of homogeneous loans. The determination for general reserves of the allowance for loan losses includes the following principal factors:

Base net loss rates, which are based on the moving average of annualized net loss rates computed over a 3 -year historical loss period for the commercial and construction loan portfolios, and an 18-month period for the consumer and mortgage loan portfolios. The base net loss rates are applied by loan type and by legal entity.

Recent loss trend adjustment, which replaces the base loss rate with a 12-month average loss rate for the commercial, construction and legacy loan portfolios and 6-month average loss rate for the consumer and mortgage loan portfolios, when these trends are higher than the respective base loss rates, up to a determined cap in the case of consumer and mortgage loan portfolios. The objective of this adjustment is to allow for a more recent loss trend to be captured and reflected in the ALLL estimation process, while limiting excessive pro-cyclicality on changing economic periods using caps for the consumer and mortgage portfolios given the shorter six month look back window. These caps are calibrated annually at the end of each year and consistently applied until the next annual review. As part of the periodic review of the adequacy of the ALLL models and related assumptions, management monitors and reviews the loan segments for which the caps are being utilized in order to assess the reasonability of the cap in light of current credit and loss trends. Management makes reserve adjustments if warranted upon the completion of these reviews. The caps are determined by measuring historic periods in which the recent loss trend adjustment rates were higher than the base loss rates and setting the cap at a percentile of the historic trend loss rates.

For the period ended September 30, 2013, 12\% of the ALLL for our BPPR non-covered loan portfolios utilized the recent loss trend adjustment instead of the base loss. The effect of replacing the base loss with the recent loss trend adjustment was mainly concentrated in the commercial multi-family, leasing, and auto loan portfolios. For the period ended September 30, 2013, $23 \%$ of the ALLL for our BPNA loan portfolios utilized the recent loss trend adjustment instead of the base loss. The effect of replacing the base loss with the recent loss trend adjustment was mainly concentrated in the commercial multi-family, commercial real estate non-owner occupied, commercial and industrial, and legacy loan portfolios.

For the period ended December 31, 2012, 32\% of the ALLL for our BPPR non-covered loan portfolios utilized the recent loss trend adjustment instead of the base loss. The effect of replacing the base loss with the recent loss trend adjustment was mainly concentrated in the commercial multi-family, commercial and industrial, construction, credit cards, and personal loan portfolios. For the period ended December 31, 2012, $8 \%$ of the ALLL for our BPNA loan portfolios utilized the recent loss trend adjustment instead of the base loss. The effect of replacing the base loss with the recent loss trend adjustment was mainly concentrated in the construction and legacy loan portfolios.

Environmental factors, which include credit and macroeconomic indicators such as unemployment rate, economic activity index and delinquency rates, were adopted to account for current market conditions that are likely to cause estimated credit losses to differ from historical losses. The Corporation reflects the effect of these environmental factors on each loan group as an adjustment that, as appropriate, increases or decreases the historical loss rate applied to each group. Environmental factors provide updated perspective on credit and economic conditions. Regression analysis was used to select these indicators and quantify the effect on the general reserve of the allowance for loan losses.
During the second quarter of 2013, management revised the estimation process for evaluating the adequacy of the general reserve component of the allowance for loan losses. The enhancements to the ALLL methodology, which is described in the paragraphs below, was implemented as of June 30, 2013 and resulted in a net increase to the allowance for loan losses of $\$ 11.8$ million for the non-covered portfolio and $\$ 7.5$ million for the covered portfolio.

Management made the following principal changes to the methodology during the second quarter of 2013:

Incorporated risk ratings to establish a more granular stratification of the commercial, construction and legacy loan portfolios to enhance the homogeneity of the loan classes. Prior to the second quarter enhancements, the Corporation s loan segmentation was based on product type, line of business and legal entity. During the second quarter

## Table of Contents

of 2013, lines of business were simplified and a regulatory classification level was added. These changes increase the homogeneity of each portfolio and capture the higher potential for loan loss in the criticized and substandard accruing categories.
These refinements resulted in a decrease to the allowance for loan losses of $\$ 42.9$ million at June 30, 2013, which consisted of a $\$ 35.7$ million decrease in the non-covered BPPR segment and a $\$ 7.2$ million reduction in the BPNA segment.

Recalibration and enhancements of the environmental factors adjustment. The environmental factor adjustments are developed by performing regression analyses on selected credit and economic indicators for each applicable loan segment. Prior to the second quarter enhancements, these adjustments were applied in the form of a set of multipliers and weights assigned to credit and economic indicators. During the second quarter of 2013, the environmental factor models used to account for changes in current credit and macroeconomic conditions, were enhanced and recalibrated based on the latest applicable trends. Also, as part of these enhancements, environmental factors are directly applied to the adjusted base loss rates using regression models based on particular credit data for the segment and relevant economic factors. These enhancements results in a more precise adjustment by having recalibrated models with improved statistical analysis and eliminating the multiplier concept that ensures that environmental factors are sufficiently sensitive to changing economic conditions.
The combined effect of the aforementioned changes to the environmental factors adjustment resulted in an increase to the allowance for loan losses of $\$ 52.5$ million at June 30, 2013, of which $\$ 56.1$ million relate to the non-covered BPPR segment, offset in part by a $\$ 3.6$ million reduction in the BPNA segment.

There were additional enhancements to the allowance for loan losses methodology which accounted for an increase of $\$ 9.7$ million at June 30, 2013 at the BPPR segment. These enhancements included the elimination of the use of a cap for the commercial recent loss adjustment (12-month average), the incorporation of a minimum general reserve assumption for the commercial, construction and legacy portfolios with minimal or zero loss history, and the application of the enhanced ALLL framework to the covered loan portfolio.

The following tables present the changes in the allowance for loan losses for the quarters and nine months ended September 30, 2013 and 2012.

| For the quarter ended September 30, 2013 <br> Puerto Rico - Non-covered loans |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) |  | mmercial | Con | truction | Mortgage |  | asing | Consumer | Total |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |
| Beginning balance | \$ | 112,152 | \$ | 9,072 | \$ 122,915 | \$ | 8,923 | \$ 140,514 | \$ 393,576 |
| Provision (reversal of provision) |  | 7,297 |  | $(4,672)$ | 20,373 |  | 2,238 | 25,239 | 50,475 |
| Charge-offs |  | $(21,431)$ |  | $(1,456)$ | $(11,504)$ |  | $(1,098)$ | $(28,796)$ | $(64,285)$ |
| Recoveries |  | 5,286 |  | 6,362 | 111 |  | 628 | 7,220 | 19,607 |
| Net write-down related to loans sold |  |  |  |  |  |  |  |  |  |
| Ending balance | \$ | 103,304 | \$ | 9,306 | \$ 131,895 |  | 0,691 | \$ 144,177 | \$ 399,373 |

For the quarter ended September 30, 2013
Puerto Rico - Covered loans

| (In thousands) | Commercial |  | Construction |  | Mortgage |  | Leasing | Consumer |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |
| Beginning balance | \$ | 65,557 | \$ | 7,353 | \$ | 27,001 | \$ | \$ | 6,546 | \$ 106,457 |
| Provision (reversal of provision) |  | $(4,528)$ |  | 14,158 |  | 6,753 |  |  | 1,050 | 17,433 |
| Charge-offs |  | $(3,186)$ |  | $(7,395)$ |  | $(1,632)$ |  |  | (65) | $(12,278)$ |
| Recoveries |  | 653 |  | 4,502 |  | 53 |  |  | 8 | 5,216 |
| Ending balance | \$ | 58,496 | \$ | 18,618 | \$ | 32,175 | \$ | \$ | 7,539 | \$ 116,828 |

Table of Contents

| (In thousands) | For the quarter ended September 30, 2013 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Commercial |  | Construction |  | Mortgage |  | Legacy |  | Consumer |  | Total |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |  |
| Beginning balance | \$ | 52,329 | \$ | 338 | \$ | 33,065 | \$ | 19,978 | \$ | 29,476 | \$ 135,186 |
| Provision (reversal of provision) |  | 6,222 |  | (24) |  | $(1,903)$ |  | (961) |  | 1,421 | 4,755 |
| Charge-offs |  | $(13,772)$ |  |  |  | $(1,778)$ |  | $(6,216)$ |  | $(5,991)$ | $(27,757)$ |
| Recoveries |  | 9,229 |  |  |  | 444 |  | 3,895 |  | 975 | 14,543 |
| Ending balance | \$ | 54,008 | \$ | 314 | \$ | 29,828 | \$ | 16,696 | \$ | 25,881 | \$ 126,727 |

For the quarter ended September 30, 2013 Popular, Inc.

| (In thousands) | Commercial | Construction | Mortgage | Legacy | Leasing | Consumer | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for credit losses: |  |  |  |  |  |  |  |
| Beginning balance | \$ 230,038 | \$ 16,763 | \$ 182,981 | 19,978 | \$ 8,923 | \$ 176,536 | \$ 635,219 |
| Provision (reversal of provision) | 8,991 | 9,462 | 25,223 | (961) | 2,238 | 27,710 | 72,663 |
| Charge-offs | $(38,389)$ | $(8,851)$ | $(14,914)$ | $(6,216)$ | $(1,098)$ | $(34,852)$ | $(104,320)$ |
| Recoveries | 15,168 | 10,864 | 608 | 3,895 | 628 | 8,203 | 39,366 |

Net write-down related to
loans sold
$\begin{array}{llllllllll}\text { Ending balance } & \$ 215,808 & \$ & 28,238 & \$ 193,898 & \$ 16,696 & \$ 10,691 & \$ 177,597 & \$ 642,928\end{array}$

| For the nine months ended September 30, 2013 <br> Puerto Rico - Non-covered loans |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Beginning balance | \$ | 217,615 | \$ | 5,862 | \$ | 119,027 | \$ | 2,894 | \$ 99,899 |  | 445,297 |
| Provision (reversal of provision) |  | 117,410 |  | $(1,555)$ |  | 253,125 |  | 10,465 | 105,783 |  | 485,228 |
| Charge-offs |  | $(89,146)$ |  | $(5,276)$ |  | $(42,013)$ |  | $(4,485)$ | $(83,403)$ |  | $(224,323)$ |
| Recoveries |  | 18,722 |  | 12,121 |  | 1,258 |  | 1,817 | 21,898 |  | 55,816 |
| Net write-downs related to loans sold |  | $(161,297)$ |  | $(1,846)$ |  | $(199,502)$ |  |  |  |  | $(362,645)$ |
| Ending balance | \$ | 103,304 | \$ | 9,306 | \$ | 131,895 | \$ | 10,691 | \$ 144,177 |  | 399,373 |

For the nine months ended September 30, 2013
Puerto Rico - Covered loans
(In thousands) Commercial Construction Mortgage Leasing Consumer Total

| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Beginning balance | \$ | 72,060 | \$ | 9,946 | \$ | 20,914 | \$ | \$ | 5,986 | \$ 108,906 |
| Provision |  | 612 |  | 36,712 |  | 17,146 |  |  | 6,019 | 60,489 |
| Charge-offs |  | $(14,901)$ |  | $(33,178)$ |  | $(5,949)$ |  |  | $(4,526)$ | $(58,554)$ |
| Recoveries |  | 725 |  | 5,138 |  | 64 |  |  | 60 | 5,987 |
| Ending balance | \$ | 58,496 | \$ | 18,618 | \$ | 32,175 | \$ | \$ | 7,539 | \$ 116,828 |

For the nine months ended September 30, 2013
U.S. Mainland

| (In thousands) | Commercial | Construction | Mortgage | Legacy | Consumer | Total |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |  |
| Beginning balance | $\$$ | 80,067 | $\$$ | 1,567 | $\$$ | 30,348 | $\$ 33,102$ | $\$$ | 31,320 | $\$ 176,404$ |  |
| Provision (reversal of provision) | $(2,849)$ |  | $(1,253)$ |  | 6,622 | $(13,872)$ | 11,562 | 210 |  |  |  |
| Charge-offs | $(44,308)$ |  |  | $(9,172)$ | $(18,500)$ | $(20,029)$ | $(92,009)$ |  |  |  |  |
| Recoveries | 21,098 |  |  | 2,030 | 15,966 | 3,028 | 42,122 |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Ending balance | $\$$ | 54,008 | $\$$ | 314 | $\$$ | 29,828 | $\$$ | 16,696 | $\$$ | 25,881 | $\$ 126,727$ |

Table of Contents

| For the nine months ended September 30, 2013 Popular, Inc. |  |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Commercial | Con | nstruction |  | Mortgage |  | Legacy |  | easing |  | onsumer |  | Total |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Beginning balance | \$ 369,742 | \$ | 17,375 | \$ | 170,289 | \$ | 33,102 | \$ | 2,894 | \$ | 137,205 | \$ | 730,607 |
| Provision (reversal of <br> provision) 115,173 33,904 276,893 $(13,872)$ 10,465 123,364 545,927 |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Charge-offs | $(148,355)$ |  | $(38,454)$ |  | $(57,134)$ |  | $(18,500)$ |  | $(4,485)$ |  | $(107,958)$ |  | $(374,886)$ |
| Recoveries | 40,545 |  | 17,259 |  | 3,352 |  | 15,966 |  | 1,817 |  | 24,986 |  | 103,925 |
| Net write-down related to loans sold | $(161,297)$ |  | $(1,846)$ |  | $(199,502)$ |  |  |  |  |  |  |  | $(362,645)$ |
| Ending balance | \$ 215,808 |  | 28,238 |  | 193,898 | \$ | 16,696 |  | 10,691 |  | 177,597 |  | 642,928 |


| For the quarter ended September 30, 2012 Puerto Rico - Non-covered loans |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Commercial | Con | struction |  | Mortgage |  | easing | Consumer | Total |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |
| Beginning balance | \$ 203,846 | \$ | 7,464 | \$ | 120,339 | \$ | 2,957 | \$ 111,951 | \$ 446,557 |
| Provision (reversal of provision) | 34,597 |  | (592) |  | 17,182 |  | (111) | 18,662 | 69,738 |
| Charge-offs | $(47,572)$ |  | $(1,733)$ |  | $(12,468)$ |  | $(1,292)$ | $(29,307)$ | $(92,372)$ |
| Recoveries | 10,553 |  | 2,260 |  | 37 |  | 1,027 | 7,454 | 21,331 |
| Ending balance | \$ 201,424 | \$ | 7,399 | \$ | 125,090 | \$ | 2,581 | \$ 108,760 | \$ 445,254 |

For the quarter ended September 30, 2012
Puerto Rico - Covered Loans

| (In thousands) | Commercial |  | Construction |  | Mortgage |  | Leasing | Consumer |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |
| Beginning balance | \$ | 75,592 | \$ | 23,628 | \$ | 11,617 | \$ | \$ | 6,658 | \$ 117,495 |
| Provision (reversal of provision) |  | 11,041 |  | 11,078 |  | 2,005 |  |  | $(1,505)$ | 22,619 |
| Charge-offs |  | $(7,013)$ |  | $(7,483)$ |  | (736) |  |  | (9) | $(15,241)$ |
| Recoveries |  |  |  |  |  |  |  |  |  |  |
| Ending balance | \$ | 79,620 | \$ | 27,223 | \$ | 12,886 | \$ | \$ | 5,144 | \$ 124,873 |

For the quarter ended September 30, 2012 U.S. Mainland

| (In thousands) | Commercial | Construction | Mortgage | Legacy | Consumer | Total |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |
| Beginning balance | $\$$ | 92,918 | $\$$ | 1,678 | $\$$ | 29,483 | $\$ 44,011$ | $\$$ | 33,888 |

Edgar Filing: POPULAR INC - Form 10-Q

| Provision (reversal of provision) |  | 1,311 |  | 59 |  | 3,800 |  | (188) |  | 8,869 | 13,851 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Charge-offs |  | $(15,809)$ |  |  |  | $(3,757)$ |  | $(8,502)$ |  | $(8,642)$ | $(36,710)$ |
| Recoveries |  | 6,198 |  |  |  | 216 |  | 4,550 |  | 996 | 11,960 |
| Net (write-down) recovery related to loans transferred to LHFS |  | (34) |  |  |  |  |  |  |  |  | (34) |
| Ending balance | \$ | 84,584 | \$ | 1,737 | \$ | 29,742 |  | 39,871 | \$ | 35,111 | \$ 191,045 |

Table of Contents

\left.| For the quarter ended September 30, 2012 |  |  |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Popular, Inc. |  |  |  |  |  |  |  |$\right)$

For the nine months ended September 30, 2012
Puerto Rico - Non-covered loans

| (In thousands) | Commercial | Construction | Mortgage | Leasing | Consumer | Total |  |
| :--- | :---: | ---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for credit losses: | $\$ 255,453$ | $\$$ | 5,850 | $\$ 72,322$ | $\$ 4,651$ | $\$ 115,126$ | $\$ 453,402$ |
| Beginning balance | 49,070 | 1,636 | 92,235 | $(1,643)$ | 62,673 | 203,971 |  |
| Provision (reversal of provision) | $(134,339)$ | $(3,046)$ | $(41,438)$ | $(3,418)$ | $(92,020)$ | $(274,261)$ |  |
| Charge-offs | 31,240 | 2,959 | 1,971 | 2,991 | 22,981 | 62,142 |  |
| Recoveries |  |  |  |  |  |  |  |
|  | $\$ 201,424$ | $\$$ | 7,399 | $\$ 125,090$ | $\$ 2,581$ | $\$ 108,760$ | $\$ 445,254$ |

For the nine months ended September 30, 2012
Puerto Rico - Covered Loans

| (In thousands) | Commercial | Construction | Mortgage | Leasing | Consumer | Total |  |  |  |  |
| :--- | :---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Allowance for credit losses: | $\$$ | 94,472 | $\$$ | 20,435 | $\$$ | 5,310 | $\$$ | $\$$ | 4,728 | $\$ 124,945$ |
| Beginning balance |  | 30,915 | 29,722 | 12,600 |  |  | 5,047 | 78,284 |  |  |
| Provision | $(45,767)$ | $(22,934)$ | $(5,024)$ |  | $(4,631)$ | $(78,356)$ |  |  |  |  |
| Charge-offs |  |  |  |  |  |  |  |  |  |  |
| Recoveries | $\$ 79,620$ | $\$$ | 27,223 | $\$ 12,886$ | $\$$ | $\$$ | 5,144 | $\$ 124,873$ |  |  |

For the nine months ended September 30, 2012
U.S. Mainland
(In thousands) Commercial Construction Mortgage Legacy Consumer Total
Allowance for credit losses:

Edgar Filing: POPULAR INC - Form 10-Q

| Beginning balance | $\$ 113,979$ | $\$$ | 2,631 | $\$ 29,939$ | $\$ 46,228$ | $\$ 44,184$ | $\$ 236,961$ |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | ---: | ---: |
| Provision (reversal of provision) | 8,249 | $(732)$ | 11,943 | 6,612 | 17,803 | 43,875 |  |
| Charge-offs | $(53,180)$ | $(1,396)$ | $(12,763)$ | $(28,168)$ | $(30,883)$ | $(126,390)$ |  |
| Recoveries | 15,570 | 1,234 | 623 | 15,199 | 4,007 | 36,633 |  |
| Net (write-down) recovery related to <br> loans transferred to LHFS | $(34)$ |  |  |  |  |  |  |
| Ending balance |  |  |  |  |  |  |  |
| (34) |  |  |  |  |  |  |  |

Table of Contents

| For the nine months ended September 30, 2012 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Commercial | Construction | Mortgage | Legacy | Leasing | Consumer | Total |
| Allowance for credit losses: |  |  |  |  |  |  |  |
| Beginning balance | \$ 463,904 | \$ 28,916 | \$ 107,571 | \$ 46,228 | \$ 4,651 | \$ 164,038 | \$ 815,308 |
| Provision (reversal of provision) | 88,234 | 30,626 | 116,778 | 6,612 | $(1,643)$ | 85,523 | 326,130 |
| Charge-offs | $(233,286)$ | $(27,376)$ | $(59,225)$ | $(28,168)$ | $(3,418)$ | $(127,534)$ | $(479,007)$ |
| Recoveries | 46,810 | 4,193 | 2,594 | 15,199 | 2,991 | 26,988 | 98,775 |
| Net (write-down) recovery related to loans transferred to LHFS | (34) |  |  |  |  |  | (34) |
| Ending balance | \$ 365,628 | \$ 36,359 | \$ 167,718 | \$ 39,871 | \$ 2,581 | \$ 149,015 | \$ 761,172 |

The following table provides the activity in the allowance for loan losses related to covered loans accounted for pursuant to ASC Subtopic 310-30.

ASC 310-30 Covered loans
For the quarters ended For the nine months ended

| (In thousands) | September 30, 2013September 30, 2012September 30, 2013September 30, 2012 |  |  |  |  |  |
| :--- | ---: | :---: | :---: | :---: | :---: | :---: |
| Balance at beginning of | $\$ 91,195$ | $\$$ | 93,971 | $\$ 95,407$ | $\$$ | 83,477 |
| period | 23,316 |  | 17,881 | 54,924 | 57,472 |  |
| Provision for loan losses | $(5,637)$ |  | $(8,305)$ | $(41,457)$ | $(37,402)$ |  |
| Net charge-offs | $\$ 108,874$ | $\$$ | 103,547 | $\$ 108,874$ | $\$$ | 103,547 |

The following tables present information at September 30, 2013 and December 31, 2012 regarding loan ending balances and the allowance for loan losses by portfolio segment and whether such loans and the allowance pertains to loans individually or collectively evaluated for impairment.

| At September 30, 2013 Puerto Rico |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Commercial |  | Construction |  | Mortgage |  | Leasing |  | Consumer |  | Total |  |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |  |  |
| Specific ALLL non-covered loans | \$ | 20,836 | \$ | 588 | \$ | 36,227 | \$ | 1,197 | \$ | 31,338 | \$ | 90,186 |
| General ALLL non-covered loans |  | 82,468 |  | 8,718 |  | 95,668 |  | 9,494 |  | 112,839 |  | 309,187 |
| ALLL-non-covered loans |  | 103,304 |  | 9,306 |  | 131,895 |  | 10,691 |  | 144,177 |  | 399,373 |

Edgar Filing: POPULAR INC - Form 10-Q

| Specific ALLL covered loans | 1,683 | 1,944 |  |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| General ALLL covered loans | 56,813 | 16,674 | 32,175 |  |  | 7,539 | 113,201 |  |  |
| ALLL - covered loans | 58,496 | 18,618 | 32,175 |  |  | 7,539 | 116,828 |  |  |
| Total ALLL | $\$$ | 161,800 | $\$$ | 27,924 | $\$$ | 164,070 | $\$$ | 10,691 | $\$$ |
| Loans held-in-portfolio: |  |  |  |  |  |  |  |  |  |

Table of Contents

| (In thousands) | At September 30, 2013 <br> U.S. Mainland |  |  |  |  |  | Legacy |  | Consumer |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |  |  |
| Specific ALLL | \$ |  | \$ |  | \$ | 17,555 | \$ |  | \$ | 324 | \$ | 17,879 |
| General ALLL |  | 54,008 |  | 314 |  | 12,273 |  | 16,696 |  | 25,557 |  | 108,848 |
| Total ALLL | \$ | 54,008 | \$ | 314 | \$ | 29,828 | \$ | 16,696 | \$ | 25,881 | \$ | 126,727 |
| Loans held-in-portfolio: |  |  |  |  |  |  |  |  |  |  |  |  |
| Impaired loans | \$ | 62,005 | \$ | 5,763 | \$ | 52,867 | \$ | 11,597 | \$ | 2,470 | \$ | 134,702 |
| Loans held-in-portfolio, excluding impaired loans |  | 3,528,448 |  | 35,587 |  | 1,216,584 |  | 224,048 |  | 623,427 |  | 5,628,094 |
| Total loans held-in-portfolio |  | 3,590,453 |  | 41,350 |  | ,269,451 |  | 235,645 |  | 625,897 |  | 5,762,796 |

At September 30, 2013
Popular, Inc.
(In thousands) Commercial Construction Mortgage Legacy Leasing Consumer Total Allowance for credit losses:
Specific ALLL

| non-covered loans | \$ | 20,836 | \$ | 588 | \$ | 53,782 | \$ |  | \$ | 1,197 | \$ | 31,662 | \$ | 108,065 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| General ALLL |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| non-covered loans |  | 136,476 |  | 9,032 |  | 107,941 |  | 16,696 |  | 9,494 |  | 138,396 |  | 418,035 |


| ALLL - non-covered |  |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| loans | 157,312 | 9,620 | 161,723 | 16,696 | 10,691 | 170,058 | 526,100 |


| Specific ALLL <br> covered loans <br> General ALLL <br> covered loans | 1,683 | 1,944 |  |  |  |  | 3,627 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| ALLL- covered loans | 56,813 | 16,674 | 32,175 |  |  |  |  |

## Loans

held-in-portfolio:
Impaired non-covered
loans $\quad \$ \quad 338,829 \quad \$ \quad 27,492 \quad \$ \quad 443,186$
$\begin{array}{lllllll}\text { Non-covered loans } & 9,506,648 & 265,728 & 6,169,947 & 224,048 & 536,131 & 3,770,559\end{array} 20,473,061$
held-in-portfolio
excluding impaired

Table of Contents

## loans

Non-covered loans

| held-in-portfolio | $9,845,477$ | 293,220 | $6,613,133$ | 235,645 | 539,290 | $3,900,418$ | $21,427,183$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |


| Impaired covered loans | 35,264 |  | 35,264 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Covered loans held-in-portfolio excluding impaired loans | 1,818,587 | 201,437 | 965,779 |  |  | 54,942 | 3,040,745 |
| Covered loans held-in-portfolio | 1,853,851 | 201,437 | 965,779 |  |  | 54,942 | 3,076,009 |
| Total loans held-in-portfolio | \$ 11,699,328 | \$ 494,657 | \$7,578,912 | \$ 235,645 | \$ 539,290 | \$3,955,360 | \$24,503,192 |

Table of Contents

| At December 31, 2012 Puerto Rico |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) |  | mmercial |  | onstruction |  | Mortgage |  | Leasing |  | Consumer |  | Total |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |  |  |
| Specific ALLL non-covered loans | \$ | 17,323 | \$ | 120 | \$ | 58,572 | \$ | 1,066 | \$ | 17,779 | \$ | 94,860 |
| General ALLL non-covered loans |  | 200,292 |  | 5,742 |  | 60,455 |  | 1,828 |  | 82,120 |  | 350,437 |
| ALLL - non-covered loans |  | 217,615 |  | 5,862 |  | 119,027 |  | 2,894 |  | 99,899 |  | 445,297 |
| Specific ALLL covered loans |  | 8,505 |  |  |  |  |  |  |  |  |  | 8,505 |
| General ALLL covered loans |  | 63,555 |  | 9,946 |  | 20,914 |  |  |  | 5,986 |  | 100,401 |
| ALLL - covered loans |  | 72,060 |  | 9,946 |  | 20,914 |  |  |  | 5,986 |  | 108,906 |
| Total ALLL | \$ | 289,675 | \$ | 15,808 | \$ | 139,941 |  | 2,894 | \$ | 105,885 | \$ | 554,203 |
| Loans held-in-portfolio: |  |  |  |  |  |  |  |  |  |  |  |  |
| Impaired non-covered loans Non-covered loans held-in-portfolio excluding impaired loans | \$ | 447,779 | \$ | 35,849 | \$ | 557,137 | \$ | 4,881 | \$ | 130,663 | \$ | 1,176,309 |
|  |  | 5,848,505 |  | 176,418 |  | 4,391,787 |  | 535,642 |  | 3,103,666 |  | 14,056,018 |
| Non-covered loans held-in-portfolio |  | 6,296,284 |  | 212,267 |  | 4,948,924 |  | 540,523 |  | 3,234,329 |  | 15,232,327 |
| Impaired covered loans Covered loans held-in-portfolio excluding impaired loans |  | 109,241 |  |  |  |  |  |  |  |  |  | 109,241 |
|  |  | 2,135,406 |  | 361,396 |  | 1,076,730 |  |  |  | 73,199 |  | 3,646,731 |
| Covered loans held-in-portfolio |  | 2,244,647 |  | 361,396 |  | 1,076,730 |  |  |  | 73,199 |  | 3,755,972 |
| Total loans held-in-portfolio |  | 8,540,931 | \$ | 573,663 |  | 6,025,654 |  | 540,523 |  | 3,307,528 |  | 18,988,299 |


| At December 31, 2012 U.S. Mainland |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Commercial |  | U.S. Mainland Construction |  | Mortgage |  | Legacy |  | Consumer |  | Total |  |
| Allowance for credit losses: |  |  |  |  |  |  |  |  |  |  |  |  |
| Specific ALLL | \$ | 25 | \$ |  | \$ | 16,095 | \$ |  | \$ | 107 | \$ | 16,227 |
| General ALLL |  | 80,042 |  | 1,567 |  | 14,253 |  | 33,102 |  | 31,213 |  | 160,177 |
| Total ALLL | \$ | 80,067 | \$ | 1,567 | \$ | 30,348 | \$ | 33,102 | \$ | 31,320 | \$ | 176,404 |

## Loans held-in-portfolio:

| Impaired loans | $\$$ | 79,885 | $\$$ | 5,960 | $\$$ | 54,093 | $\$$ | 18,744 | $\$$ | 2,714 | $\$$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Loans held-in-portfolio, excluding <br> impaired loans | $3,482,033$ |  | 34,630 | $1,075,490$ | 365,473 | 631,843 | $5,589,469$ |  |  |  |  |
| Total loans held-in-portfolio | $\$ 3,561,918$ | $\$$ | 40,590 | $\$ 1,129,583$ | $\$ 384,217$ | $\$ 634,557$ | $\$ 5,750,865$ |  |  |  |  |

At December 31, 2012
Popular, Inc.

| (In thousands) | Commercial Construction | Mortgage | Legacy | Leasing | Consumer | Total |  |  |  |  |
| :--- | ---: | ---: | ---: | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Allowance for credit <br> losses: |  |  |  |  |  |  |  |  |  |  |

ALLL - non-covered

| loans | 297,682 | 7,429 | 149,375 | 33,102 | 2,894 | 131,219 | 621,701 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |


| Specific ALLL covered loans |  | 8,505 |  |  |  |  |  |  |  |  |  |  |  | 8,505 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| General ALLL covered loans |  | 63,555 |  | 9,946 |  | 20,914 |  |  |  |  |  | 5,986 |  | 100,401 |
| ALLL - covered loans |  | 72,060 |  | 9,946 |  | 20,914 |  |  |  |  |  | 5,986 |  | 108,906 |
| Total ALLL | \$ | 369,742 | \$ | 17,375 | \$ | 170,289 | \$ | 33,102 | \$ | 2,894 | \$ | 137,205 | \$ | 730,607 |

## Loans

held-in-portfolio:
Impaired non-covered
loans $\quad \$ \quad 527,664 \quad \$ \quad 41,809$ \$ 611,230 \$ 18,744
Non-covered loans
held-in-portfolio
excluding impaired
$\begin{array}{llllllll}\text { loans } & 9,330,538 & 211,048 & 5,467,277 & 365,473 & 535,642 & 3,735,509 & 19,645,487\end{array}$
Non-covered loans

| held-in-portfolio | $9,858,202$ | 252,857 | $6,078,507$ | 384,217 | 540,523 | $3,868,886$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| $20,983,192$ |  |  |  |  |  |  |

Impaired covered
loans
109,241
109,241
Covered loans held-in-portfolio excluding impaired

| loans | $2,135,406$ | 361,396 | $1,076,730$ | 73,199 | $3,646,731$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
|  | $2,244,647$ | 361,396 | $1,076,730$ | 73,199 | $3,755,972$ |

## Covered loans

held-in-portfolio
Total loans
held-in-portfolio $\quad \$ 12,102,849 \quad \$ 614,253 \quad \$ 7,155,237 \quad \$ 384,217 \quad \$ 540,523 \quad \$ 3,942,085 \quad \$ 24,739,164$

Table of Contents

## Impaired loans

The following tables present loans individually evaluated for impairment at September 30, 2013 and December 31, 2012.

| (In thousands) | Recorded investment | Allowance Unpaid principal balance | Related allowance | With No <br> Recorded <br> investment | Allowance Unpaid principal balance | Recorded investment | ed Loans - <br> Unpaid principal balance | Total <br> Related allowance |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial multi-family | \$ 4,819 | \$ 4,819 | \$ 3,173 | \$ 3,312 | \$ 3,312 | \$ 8,131 | \$ 8,131 | \$ 3,173 |
| Commercial real estate non-owner occupied | 21,434 | 21,720 | 2,259 | 33,173 | 41,326 | 54,607 | 63,046 | 2,259 |
| Commercial real estate owner occupied | 62,282 | 78,180 | 5,806 | 53,655 | 77,680 | 115,937 | 155,860 | 5,806 |
| Commercial and industrial | 42,734 | 51,082 | 9,598 | 55,415 | 63,591 | 98,149 | 114,673 | 9,598 |
| Construction | 4,002 | 13,789 | 588 | 17,727 | 41,062 | 21,729 | 54,851 | 588 |
| Mortgage | 351,304 | 367,986 | 36,227 | 39,015 | 43,464 | 390,319 | 411,450 | 36,227 |
| Leasing | 3,159 | 3,159 | 1,197 |  |  | 3,159 | 3,159 | 1,197 |
| Consumer: |  |  |  |  |  |  |  |  |
| Credit cards | 44,652 | 44,652 | 9,072 |  |  | 44,652 | 44,652 | 9,072 |
| Personal | 81,016 | 81,016 | 22,012 |  |  | 81,016 | 81,016 | 22,012 |
| Auto | 1,173 | 1,173 | 142 |  |  | 1,173 | 1,173 | 142 |
| Other | 548 | 548 | 112 |  |  | 548 | 548 | 112 |
| Covered loans | 16,279 | 16,279 | 3,627 | 18,985 | 18,985 | 35,264 | 35,264 | 3,627 |
| Total Puerto Rico | \$ 633,402 | \$ 684,403 | \$ 93,813 | \$ 221,282 | \$ 289,420 | \$ 854,684 | \$ 973,823 | \$ 93,813 |

September 30, 2013
U.S. mainland

Impaired Loans - With an Impaired Loans

|  | Allowance |  |  | With No Allowance |  | Impaired Loans - Total |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Recorded investment | Unpaid principal balance | Related allowance | Recorded investment | Unpaid principal balance |  | corded <br> estment |  | Unpaid principal balance | Related allowance |
| Commercial multi-family | \$ | \$ | \$ | \$ 8,915 | \$ 13,511 | \$ | 8,915 |  | 13,511 | \$ |
|  |  |  |  | 33,591 | 48,758 |  | 33,591 |  | 48,758 |  |

Edgar Filing: POPULAR INC - Form 10-Q
Commercial real estate
non-owner occupied

| Commercial real estate owner occupied |  |  |  | 18,659 | 23,836 | 18,659 | 23,836 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial and industrial |  |  |  | 840 | 840 | 840 | 840 |  |
| Construction |  |  |  | 5,763 | 5,763 | 5,763 | 5,763 |  |
| Mortgage | 46,834 | 51,462 | 17,555 | 6,033 | 7,435 | 52,867 | 58,897 | 17,555 |
| Legacy |  |  |  | 11,597 | 17,023 | 11,597 | 17,023 |  |
| Consumer: |  |  |  |  |  |  |  |  |
| HELOCs |  |  |  | 199 | 199 | 199 | 199 |  |
| Auto |  |  |  | 89 | 89 | 89 | 89 |  |
| Other | 2,182 | 2,182 | 324 |  |  | 2,182 | 2,182 | 324 |



Table of Contents
September 30, 2013
Popular, Inc.
Impaired Loans - With an Impaired Loans

| (In thousands) | Recorded investment | Allowance Unpaid principal balance | Related allowance | With No <br> Recorded investment | Allowance <br> Unpaid principal balance | Impa <br> Recorded investment | red Loans - T <br> Unpaid principal balance | otal <br> Related allowance |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial multi-family | \$ 4,819 | \$ 4,819 | 3,173 | \$ 12,227 | \$ 16,823 | 17,046 | \$ 21,642 | 3,173 |
| Commercial real estate non-owner occupied | 21,434 | 21,720 | 2,259 | 66,764 | 90,084 | 88,198 | 111,804 | 2,259 |
| Commercial real estate owner occupied | 62,282 | 78,180 | 5,806 | 72,314 | 101,516 | 134,596 | 179,696 | 5,806 |
| Commercial and industrial | 42,734 | 51,082 | 9,598 | 56,255 | 64,431 | 98,989 | 115,513 | 9,598 |
| Construction | 4,002 | 13,789 | 588 | 23,490 | 46,825 | 27,492 | 60,614 | 588 |
| Mortgage | 398,138 | 419,448 | 53,782 | 45,048 | 50,899 | 443,186 | 470,347 | 53,782 |
| Legacy |  |  |  | 11,597 | 17,023 | 11,597 | 17,023 |  |
| Leasing | 3,159 | 3,159 | 1,197 |  |  | 3,159 | 3,159 | 1,197 |
| Consumer: |  |  |  |  |  |  |  |  |
| Credit cards | 44,652 | 44,652 | 9,072 |  |  | 44,652 | 44,652 | 9,072 |
| HELOCs |  |  |  | 199 | 199 | 199 | 199 |  |
| Personal | 81,016 | 81,016 | 22,012 |  |  | 81,016 | 81,016 | 22,012 |
| Auto | 1,173 | 1,173 | 142 | 89 | 89 | 1,262 | 1,262 | 142 |
| Other | 2,730 | 2,730 | 436 |  |  | 2,730 | 2,730 | 436 |
| Covered loans | 16,279 | 16,279 | 3,627 | 18,985 | 18,985 | 35,264 | 35,264 | 3,627 |

Total Popular,
Inc.

```
$ 682,418 $ 738,047 $ 111,692 $ 306,968 $406,874 $ 989,386 $ 1,144,921 $ 111,692
```

December 31, 2012
Puerto Rico
Impaired Loans - With an Impaired Loans

| (In thousands) | Recorded investment | Allowance Unpaid principal balance | Related allowance | With No Allowance |  | Impaired Loans - Total |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  | Recorded investment | Unpaid principal balance |  | corded stment |  | npaid <br> ncipal <br> lance |  |  |
| Commercial multi-family | \$ 271 | \$ 288 | \$ 6 | \$ 13,080 | \$ 19,969 | \$ | 13,351 | \$ | 20,257 | \$ | 6 |
|  | 22,332 | 25,671 | 1,354 | 55,320 | 63,041 |  | 77,652 |  | 88,712 |  |  |

Edgar Filing: POPULAR INC - Form 10-Q

| Commercial <br> real estate <br> non-owner <br> occupied |  |  |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial |  |  |  |  |  |  |  |  |
| real estate |  |  |  |  |  |  |  |  |

December 31, 2012
U.S. mainland

Impaired Loans - With an Impaired Loans

| (In thousands) | Recorded investment | Allowance Unpaid principal balance | Related allowance | With No Allowance  <br>  Unpaid <br> Recorded <br> principal <br> investment balance |  | Recorded investment | red Loans - T <br> Unpaid principal balance |  | Related allowance |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial multi-family | \$ 1,327 | \$ 1,479 | \$ 25 | \$ 6,316 | \$ 9,898 | 7,643 | \$ | 11,377 | \$ | 25 |
| Commercial real estate non-owner occupied |  |  |  | 45,815 | 64,783 | 45,815 |  | 64,783 |  |  |
| Commercial real estate owner occupied |  |  |  | 20,369 | 22,968 | 20,369 |  | 22,968 |  |  |
| Commercial and industrial |  |  |  | 6,058 | 8,026 | 6,058 |  | 8,026 |  |  |
| Construction |  |  |  | 5,960 | 5,960 | 5,960 |  | 5,960 |  |  |
| Mortgage | 45,319 | 46,484 | 16,095 | 8,774 | 10,328 | 54,093 |  | 56,812 |  | , 095 |
| Legacy |  |  |  | 18,744 | 29,972 | 18,744 |  | 29,972 |  |  |
| Consumer: |  |  |  |  |  |  |  |  |  |  |
| HELOCs | 201 | 201 | 11 |  |  | 201 |  | 201 |  | 11 |
| Auto | 91 | 91 | 2 |  |  | 91 |  | 91 |  | 2 |

Edgar Filing: POPULAR INC - Form 10-Q

| Other | 2,422 | 2,422 | 94 |  | 2,422 | 2,422 |  | 94 |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Total U.S. <br> mainland | $\$ 49,360$ | $\$$ | 50,677 | $\$$ | 16,227 | $\$ 112,036$ | $\$ 151,935$ | $\$$ | 161,396 | $\$$ | 202,612 |$\quad \$ 16,227$

Table of Contents
December 31, 2012
Popular, Inc.
Impaired Loans - With an Impaired Loans

| (In thousands) | Recorded investment | Allowance Unpaid principal balance | Related allowance | With No <br> Recorded investment | Allowance Unpaid principal balance | Recorded investment | red Loans - T <br> Unpaid principal balance | otal <br> Related allowance |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial multi-family | \$ 1,598 | \$ 1,767 | \$ 31 | \$ 19,396 | \$ 29,867 | \$ 20,994 | \$ 31,634 | \$ 31 |
| Commercial real estate non-owner occupied | 22,332 | 25,671 | 1,354 | 101,135 | 127,824 | 123,467 | 153,495 | 1,354 |
| Commercial real estate owner occupied | 100,685 | 149,342 | 12,614 | 141,845 | 190,607 | 242,530 | 339,949 | 12,614 |
| Commercial and industrial | 70,216 | 85,508 | 3,349 | 70,457 | 107,634 | 140,673 | 193,142 | 3,349 |
| Construction | 1,865 | 3,931 | 120 | 39,944 | 76,532 | 41,809 | 80,463 | 120 |
| Mortgage | 562,660 | 585,655 | 74,667 | 48,570 | 53,241 | 611,230 | 638,896 | 74,667 |
| Legacy |  |  |  | 18,744 | 29,972 | 18,744 | 29,972 |  |
| Leasing | 4,881 | 4,881 | 1,066 |  |  | 4,881 | 4,881 | 1,066 |
| Consumer: |  |  |  |  |  |  |  |  |
| Credit cards | 42,514 | 42,514 | 1,666 |  |  | 42,514 | 42,514 | 1,666 |
| HELOCs | 201 | 201 | 11 |  |  | 201 | 201 | 11 |
| Personal | 86,884 | 86,884 | 16,022 |  |  | 86,884 | 86,884 | 16,022 |
| Auto | 863 | 863 | 81 |  |  | 863 | 863 | 81 |
| Other | 2,915 | 2,915 | 106 |  |  | 2,915 | 2,915 | 106 |
| Covered loans | 64,762 | 64,762 | 8,505 | 44,479 | 44,479 | 109,241 | 109,241 | 8,505 |

Total Popular,
Inc. $\quad \$ 962,376 \$ 1,054,894 \quad \$ 119,592 \quad \$ 484,570 \quad \$ 660,156 \quad \$ 1,446,946 \quad \$ 1,715,050 \quad \$ 119,592$
The following tables present the average recorded investment and interest income recognized on impaired loans for the quarter and nine months ended September 30, 2013 and 2012.

For the quarter ended September 30, 2013

|  | Puerto Rico |  | U.S. Mainland |  | Popular, Inc. |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average recorded | Interest income | Average recorded | Interest income | Average recorded |  |  |
| (In thousands) | investment | recognized | investment | recognized | investment |  | nized |
| Commercial multi-family | \$ 8,262 | \$ 127 | \$ 7,540 | \$ 69 | 15,802 | \$ | 196 |
|  | 54,078 | 417 | 34,786 | 91 | 88,864 |  | 508 |

Edgar Filing: POPULAR INC - Form 10-Q


Table of Contents

For the quarter ended September 30, 2012

| (In thousands) | Puerto Rico |  | U.S. Mainland |  | Popular, Inc. |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized |
| Commercial multi-family | \$ 14,446 | \$ | \$ 8,522 | \$ | \$ 22,968 | \$ |
| Commercial real estate non-owner occupied | 64,968 | 240 | 59,932 | 151 | 124,900 | 391 |
| Commercial real estate owner occupied | 194,126 | 597 | 26,302 | 81 | 220,428 | 678 |
| Commercial and industrial | 117,979 | 499 | 9,855 |  | 127,834 | 499 |
| Construction | 42,380 | 98 | 12,072 |  | 54,452 | 98 |
| Mortgage | 482,041 | 6,911 | 53,509 | 515 | 535,550 | 7,426 |
| Legacy |  |  | 26,783 | 14 | 26,783 | 14 |
| Leasing | 5,231 |  |  |  | 5,231 |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 38,718 |  |  |  | 38,718 |  |
| Helocs |  |  | 101 |  | 101 |  |
| Personal | 91,030 |  |  |  | 91,030 |  |
| Auto | 252 |  | 92 |  | 344 |  |
| Other | 1,984 |  | 2,355 |  | 4,339 |  |
| Covered loans | 98,603 | 949 |  |  | 98,603 | 949 |
| Total Popular, Inc. | \$ 1,151,758 | \$ 9,294 | \$ 199,523 | \$ 761 | \$ 1,351,281 | \$ 10,055 |

For the nine months ended September 30, 2013

| (In thousands) | Puerto Rico |  | U.S. Mainland |  | Popular, Inc. |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized |
| Commercial multi-family | \$ 9,594 | \$ 259 | \$ 7,449 | \$ 107 | \$ 17,043 | \$ 366 |
| Commercial real estate non-owner occupied | 56,875 | 853 | 39,106 | 182 | 95,981 | 1,035 |
| Commercial real estate owner occupied | 133,970 | 1,194 | 19,875 | 99 | 153,845 | 1,293 |
| Commercial and industrial | 106,502 | 2,470 | 2,453 | 15 | 108,955 | 2,485 |
| Construction | 35,159 |  | 5,860 |  | 41,019 |  |
| Mortgage | 477,081 | 20,555 | 53,240 | 1,470 | 530,321 | 22,025 |
| Legacy |  |  | 14,685 |  | 14,685 |  |
| Leasing | 4,054 |  |  |  | 4,054 |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 38,801 |  |  |  | 38,801 |  |
| Helocs |  |  | 200 |  | 200 |  |
| Personal | 83,740 |  |  |  | 83,740 |  |
| Auto | 915 |  | 90 |  | 1,005 |  |
| Other | 397 |  | 2,306 |  | 2,703 |  |
| Covered loans | 48,252 | 914 |  |  | 48,252 | 914 |

Total Popular, Inc.
$\begin{array}{llllllll}\$ & 995,340 & \$ 26,245 & \$ 145,264 & \$ 1,873 & \$ 1,140,604 & \$ 28,118\end{array}$

For the nine months ended September 30, 2012

| (In thousands) | Puerto Rico |  | U.S. Mainland |  | Popular, Inc. |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized |
| Commercial multi-family | \$ 15,083 | \$ | \$ 9,354 | \$ 101 | \$ 24,437 | \$ 101 |
| Commercial real estate non-owner occupied | 60,972 | 597 | 61,907 | 965 | 122,879 | 1,562 |
| Commercial real estate owner occupied | 197,938 | 1,370 | 35,453 | 81 | 233,391 | 1,451 |
| Commercial and industrial | 123,062 | 1,119 | 21,416 | 37 | 144,478 | 1,156 |
| Construction | 46,383 | 205 | 19,808 |  | 66,191 | 205 |
| Mortgage | 423,571 | 18,751 | 52,613 | 1,492 | 476,184 | 20,243 |
| Legacy |  |  | 37,547 | 79 | 37,547 | 79 |
| Leasing | 5,494 |  |  |  | 5,494 |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 38,839 |  |  |  | 38,839 |  |
| Helocs |  |  | 51 |  | 51 |  |
| Personal | 91,966 |  |  |  | 91,966 |  |
| Auto | 126 |  | 69 |  | 195 |  |
| Other | 3,394 |  | 2,399 |  | 5,793 |  |
| Covered loans | 89,965 | 2,849 |  |  | 89,965 | 2,849 |
| Total Popular, Inc. | \$ 1,096,793 | \$ 24,891 | \$ 240,617 | \$ 2,755 | \$ 1,337,410 | \$ 27,646 |

Table of Contents
Modifications
Troubled debt restructurings related to non-covered loan portfolios amounted to $\$ 0.9$ billion at September 30, 2013 (December 31, 2012-\$ 1.2 billion). The amount of outstanding commitments to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructurings amounted $\$ 5$ million related to the commercial loan portfolio at September 30, 2013 (December 31, 2012 - $\$ 4$ million). There were no outstanding commitments to lend additional funds to debtors owing loans whose terms have been modified in troubled debt restructurings related to construction loan portfolio at September 30, 2013 (December 31, 2012 - \$120 thousand).

A modification of a loan constitutes a troubled debt restructuring (TDR ) when a borrower is experiencing financial difficulty and the modification constitutes a concession.

Commercial and industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting evergreen revolving credit lines to long-term loans. Commercial real estate ( CRE ), which includes multifamily, owner-occupied and non-owner occupied CRE, and construction loans modified in a TDR often involve reducing the interest rate for a limited period of time or the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or reductions in the payment plan. Construction loans modified in a TDR may also involve extending the interest-only payment period.

Residential mortgage loans modified in a TDR are primarily comprised of loans where monthly payments are lowered to accommodate the borrowers financial needs for a period of time, normally five years to ten years. After the lowered monthly payment period ends, the borrower reverts back to paying principal and interest per the original terms with the maturity date adjusted accordingly.

Home equity loans modifications are made infrequently and are not offered if the Corporation also holds the first mortgage. Home equity loans modifications are uniquely designed to meet the specific needs of each borrower. Automobile loans modified in a TDR are primarily comprised of loans where the Corporation has lowered monthly payments by extending the term. Credit cards modified in a TDR are primarily comprised of loans where monthly payments are lowered to accommodate the borrowers financial needs for a period of time, normally up to 24 months.

As part of its NPL reduction strategy and in order to expedite the resolution of delinquent construction and commercial loans, commencing in 2012, the Corporation routinely enters into liquidation agreements with borrowers and guarantors through the regular legal process, bankruptcy procedures and in certain occasions, out of Court transactions. These liquidation agreements, in general, contemplate the following conditions: (1) consent to judgment by the borrowers and guarantors; (2) acknowledgement by the borrower of the debt, its liquidity and maturity; (3) acknowledgment of the default in payments. The contractual interest rate is not reduced and continues to accrue during the term of the agreement. At the end of the period, borrower is obligated to remit all amounts due or be subject to the Corporation s exercise of its foreclosure rights and further collection efforts. Likewise, the borrower s failure to make stipulated payments will grant the Corporation the ability to exercise its foreclosure rights. This strategy procures to expedite the foreclosure process, resulting in a more effective and efficient collection process. Although in general, these liquidation agreements do not contemplate the forgiveness of principal or interest as debtor is required to cover all outstanding amounts when the agreement becomes due, it could be construed that the Corporation has granted a concession by temporarily accepting a payment schedule that is different from the contractual payment schedule. Accordingly, loans under these program agreements are considered TDRs.

Loans modified in a TDR that are not accounted pursuant to ASC 310-30 are typically already in non-accrual status at the time of the modification and partial charge-offs have in some cases already been taken against the outstanding
loan balance. The TDR loan continues in non-accrual status until the borrower has demonstrated a willingness and ability to make the restructured loan payments (generally at least six months of sustained performance after the modification (or one year for loans providing for quarterly or semi-annual payments)) and management has concluded that it is probable that the borrower would not be in payment default in the foreseeable future.

Loans modified in a TDR may have the financial effect to the Corporation of increasing the specific allowance for loan losses associated with the loan. Consumer and residential mortgage loans modified under the Corporation s loss mitigation programs that are determined to be TDRs are individually evaluated for impairment based on an analysis of discounted cash flows.

## Table of Contents

For consumer and mortgage loans that are modified with regard to payment terms and which constitute TDRs, the discounted cash flow value method is used as the impairment valuation is more appropriately calculated based on the ongoing cash flow from the individuals rather than the liquidation of the asset. The computations give consideration to probability of defaults and loss-given-foreclosure on the related estimated cash flows.

Commercial and construction loans that have been modified as part of loss mitigation efforts are evaluated individually for impairment. The vast majority of the Corporation s modified commercial loans are measured for impairment using the estimated fair value of the collateral, as these are normally considered as collateral dependent loans. In very few instances, the Corporation measures modified commercial loans at their estimated realizable values determined by discounting the expected future cash flows. Construction loans that have been modified are also accounted for as collateral dependent loans. The Corporation determines the fair value measurement dependent upon its exit strategy for the particular asset(s) acquired in foreclosure.

The following tables present the non-covered and covered loans classified as TDRs according to their accruing status at September 30, 2013 and December 31, 2012.

| (In thousands) | Popular, Inc. <br> Non-Covered Loans |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | September 30, 2013 |  |  |  | December 31, 2012 |  |  |  |  |
|  | Accruing | Non | Accruing | Total | Accruing | Non | -Accruing |  | Total |
| Commercial | \$ 111,645 |  | 77,558 | \$ 189,203 | \$ 105,648 | \$ | 208,119 | \$ | 313,767 |
| Construction | 449 |  | 11,542 | 11,991 | 2,969 |  | 10,310 |  | 13,279 |
| Legacy |  |  | 3,949 | 3,949 |  |  | 5,978 |  | 5,978 |
| Mortgage | 508,337 |  | 74,680 | 583,017 | 405,063 |  | 273,042 |  | 678,105 |
| Leases | 968 |  | 2,191 | 3,159 | 1,726 |  | 3,155 |  | 4,881 |
| Consumer | 119,204 |  | 10,333 | 129,537 | 125,955 |  | 8,981 |  | 134,936 |
| Total | \$ 740,603 | \$ | 180,253 | \$ 920,856 | \$ 641,361 | \$ | 509,585 |  | ,150,946 |

Popular, Inc.
Covered Loans

|  | September 30, 2013 |  |  |  | December 31, 2012 |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| (In thousands) | Accruing | Non-Accruing | Total | Accruing | Non-Accruing | Total |  |  |  |  |
| Commercial | $\$$ | 7,412 | $\$$ | 9,142 | $\$$ | 16,554 | $\$ 46,142$ | $\$$ | 4,071 | $\$$ |
| Construction |  |  | 5,241 |  | 5,241 |  |  |  | 7,435 | 7,435 |
| Mortgage | 147 | 189 | 336 |  | 149 |  | 220 | 369 |  |  |
| Consumer | 254 | 64 | 318 |  | 517 |  | 106 | 623 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Total | $\$$ | 7,813 | $\$$ | 14,636 | $\$$ | 22,449 | $\$ 46,808$ | $\$$ | 11,832 | $\$$ |

## Table of Contents

The following tables present the loan count by type of modification for those loans modified in a TDR during the quarters and nine months ended September 30, 2013 and 2012.

Puerto Rico

U.S. Mainland

For the quarter ended For the nine months ended
September 30, 2013
Combination of reduction in
interest rate and extension
Reduction in of Reduction in September 30, 2013

Combination of reduction
in
interest rate and extension of interEsttension ofmaturity intereltxtension of maturity ratenaturity date date Other ratematurity date date Other
Commercial real estate non-owner occupied 1
Commercial real estate owner occupied
2

Mortgage 11
1

Total
12
2
23


## Table of Contents

|  | Puerto Rico |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\left.\begin{array}{cc}\text { Combination of } \\ \text { reduction } \\ \text { in } \\ \text { interest rate and } \\ \text { extension }\end{array}\right\}$ ofReduction in <br> intereEtxension ofmaturity <br> ratematurity date date |  |  | of <br> nd <br> R <br> Other | F <br> uction nteres $\mathbb{E}$ rate $m$ | nine tembe C in <br> sion of ty dat | ths en , 2012 ination uction in trate ension of aturity date | Other |
| Commercial real estate non-owner occupied | 2 |  |  |  | 5 | 4 |  |  |
| Commercial real estate owner occupied | 1 | 5 |  |  | 7 | 20 |  |  |
| Commercial and industrial | 1 | 8 |  |  | 27 | 61 |  |  |
| Construction | 7 |  |  |  | 8 | 1 |  |  |
| Mortgage | 272 | 42 | 406 | 40 | 433 | 125 | 1,200 | 150 |
| Leasing |  | 16 |  |  |  | 49 | 28 |  |
| Consumer: |  |  |  |  |  |  |  |  |
| Credit cards | 311 |  |  | 268 | 1,268 |  |  | 942 |
| Personal | 231 | 4 |  |  | 901 | 25 |  |  |
| Auto |  | 2 | 1 |  |  | 3 | 3 |  |
| Other | 14 |  |  |  | 39 |  |  |  |
| Total | 839 | 77 | 407 | 308 | 2,688 | 288 | 1,231 | 1,092 |



Edgar Filing: POPULAR INC - Form 10-Q
Total
2
3
17
1
7
3
66

## Table of Contents



The following tables present by class, quantitative information related to loans modified as TDRs during the quarter and nine months ended September 30, 2013 and 2012.

Puerto Rico
For the quarter ended September 30, 2013
Increase (decrease) in the
Pre-modificatioRost-modification allowance for outstanding recoodexdanding recorded loan losses

| (Dollars in thousands) | Loan count |  | investment |  | investmeas a result of modification |  |
| :--- | ---: | ---: | ---: | ---: | :---: | :---: |
| Commercial real estate non-owner occupied | 4 | $\$$ | 3,433 | $\$$ | 1,373 | $\$$ |
| Commercial real estate owner occupied | 16 | 13,486 | 3,472 | 51 |  |  |
| Commercial and industrial | 8 | 4,906 | 4,896 | $(356)$ |  |  |
| Mortgage | 71 | 12,048 | 12,678 | 1,617 |  |  |
| Leasing | 9 | 184 | 178 | 58 |  |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 525 | 4,399 | 5,255 | 905 |  |  |
| Personal | 253 | 4,251 | 4,257 | 991 |  |  |
| Auto | 8 | 64 | 139 | 11 |  |  |


| Other | 14 | 52 | 52 | 10 |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Total | 908 | $\$$ | 42,823 | $\$$ | 32,300 | $\$$ |

U.S. Mainland

For the quarter ended September 30, 2013
Increase (decrease) in the
Pre-modificatidrost-modification allowance for outstanding recordethnding recorded loan losses

| (Dollars in thousands) | Loan count | investment | investmeas a result of modification |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial real estate non-owner occupied | 1 | $\$$ | 1,399 | $\$$ | 1,276 | $\$$ |

## Table of Contents

Popular, Inc.
For the quarter ended September 30, 2013
Increase (decrease) in the
Pre-modificatioRost-modification allowance for outstanding recoodexdanding recorded loan losses

| (Dollars in thousands) | Loan count | investment | investmeas a result of modification |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial real estate non-owner occupied | 5 | $\$$ | 4,832 | $\$$ | 2,649 | $\$$ |
| Commercial real estate owner occupied | 16 | 13,486 | 3,472 | 51 |  |  |
| Commercial and industrial | 8 | 4,906 | 4,896 | $(356)$ |  |  |
| Mortgage | 82 | 13,388 | 14,104 | 1,820 |  |  |
| Leasing | 9 | 184 | 178 | 58 |  |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 525 | 4,399 | 5,255 | 905 |  |  |
| Personal | 253 | 4,251 | 4,257 | 991 |  |  |
| Auto | 8 | 64 | 139 | 11 |  |  |
| Other | 14 | 52 | 52 | 10 |  |  |
|  |  |  |  |  |  |  |
| Total | 920 | $\$$ | 45,562 | $\$$ | 35,002 | $\$$ |

Puerto Rico
For the quarter ended September 30, 2012
Increase (decrease) in the
Pre-modificatioRost-modification allowance for outstanding recoodextanding recorded loan losses

| (Dollars in thousands) | Loan count | investment | investmeas a result of modificati |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial real estate non-owner occupied | 2 | $\$$ | 4,813 | $\$$ | 4,813 | $\$$ |
| Commercial real estate owner occupied | 6 | 1,626 | 1,619 | 368 |  |  |
| Commercial and industrial | 9 | 13,692 | 3,873 | $(6,596)$ |  |  |
| Construction | 7 | 5,025 | 4,230 | $(263)$ |  |  |
| Mortgage | 760 | 98,555 | 116,854 | 5,775 |  |  |
| Leasing | 16 | 256 | 241 | 29 |  |  |
| Consumer: | 579 | 5,100 | 6,000 |  |  |  |
| Credit cards | 235 | 4,054 | 4,083 | 60 |  |  |
| Personal | 2 | 20 | 23 | 2 |  |  |
| Auto | 14 | 54 | 54 | 2 |  |  |
| Other |  |  |  |  |  |  |
| Total | 1,630 | $\$$ | 133,195 | $\$$ | 141,790 | $\$$ |

## U.S. Mainland <br> For the quarter ended September 30, 2012

(Dollars in thousands)
Loan counPre-modificatioRost-modifichinimease (decrease) in the outstanding recordexdanding recordedillowance for investment investment loan losses

|  |  |  | as a result of modification |  |  |  |
| :--- | ---: | ---: | ---: | ---: | :---: | :---: |
| Commercial real estate non-owner occupied | 2 | $\$$ | 3,968 | $\$$ | 3,921 | $\$$ |
| Commercial real estate owner occupied | 1 | 2,246 | 1,750 | $(106)$ |  |  |
| Mortgage | 18 | 1,765 | 1,823 | 298 |  |  |
| Consumer: | 2 |  | 281 | 275 | 3 |  |
| HELOCs |  |  |  |  |  |  |
| Total | 23 | $\$$ | 8,260 | $\$$ | 7,769 | $\$$ |

## Table of Contents

Popular, Inc.
For the quarter ended September 30, 2012
Increase (decrease) in the
Pre-modificatioRost-modification allowance for outstanding recoodexdanding recorded loan losses

| (Dollars in thousands) | Loan count | investment | investmens a result of modification |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial real estate non-owner occupied | 4 | $\$$ | 8,781 | $\$$ | 8,734 | $\$$ |
| Commercial real estate owner occupied | 7 | 3,872 | 3,369 | $(112)$ |  |  |
| Commercial and industrial | 9 | 13,692 | 3,873 | $(6,596)$ |  |  |
| Construction | 7 | 5,025 | 4,230 | $(263)$ |  |  |
| Mortgage | 778 | 100,320 | 118,677 | 6,073 |  |  |
| Leasing | 16 | 256 | 241 | 29 |  |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 579 | 5,100 | 6,000 | 20 |  |  |
| HELOCs | 2 | 281 | 275 | 3 |  |  |
| Personal | 235 | 4,054 | 4,083 | 663 |  |  |
| Auto | 2 | 20 | 23 | 2 |  |  |
| Other | 14 | 54 | 54 |  |  |  |
|  |  |  |  |  |  |  |
| Total | 1,653 | $\$$ | 141,455 | $\$$ | 149,559 | $\$$ |

Puerto Rico
For the nine months ended September 30, 2013
Increase (decrease) in the
Pre-modificatioRost-modification allowance for outstanding recoodexdanding recorded loan losses

| (Dollars in thousands) | Loan count | investment |  | investmeas a result of modification |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial real estate non-owner occupied | 5 | $\$$ | 4,681 | $\$$ | 2,114 | $\$$ |
| Commercial real estate owner occupied | 52 | 28,698 | 16,686 | 41 |  |  |
| Commercial and industrial | 30 | 8,649 | 8,680 | $(857)$ |  |  |
| Mortgage | 335 | 54,992 | 58,659 | 5,922 |  |  |
| Leasing | 34 | 627 | 607 | 191 |  |  |
| Consumer: | 1,567 | 12,543 | 15,050 | 1,660 |  |  |
| Credit cards | 725 | 11,893 | 11,924 | 2,969 |  |  |
| Personal | 10 | 102 | 179 | 13 |  |  |
| Auto | 59 | 221 | 219 | 29 |  |  |
| Other |  |  |  |  |  |  |
|  | 2,817 | $\$$ | 122,406 | $\$$ | 114,118 | $\$$ |

U.S. mainland

For the nine months ended September 30, 2013
(Dollars in thousands)
Loan counPre-modificatioRost-modifichinimease (decrease) in the outstanding recordexdanding recordedillowance for

|  |  | investment | investment <br> as |  | loan losses |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | :---: |
|  |  | 5 | 4,221 | $\$$ | 3,989 | $\$$ | $(2)$ |
| Commercial real estate non-owner occupied | 1 |  | 381 | 287 | $(10)$ |  |  |
| Commercial real estate owner occupied | 19 |  | 2,268 | 2,385 | 275 |  |  |
| Mortgage |  |  |  |  |  |  |  |
| Total | 25 | $\$$ | 6,870 | $\$$ | 6,661 | $\$$ | 263 |

Table of Contents
Popular, Inc.
For the nine months ended September 30, 2013
Increase (decrease) in the
Pre-modificatioRost-modification allowance for outstanding recoodexdanding recorded loan losses

| (Dollars in thousands) | Loan count | investment | investmeas a result of modification |  |
| :--- | ---: | ---: | ---: | ---: |
| Commercial real estate non-owner occupied | 10 | 8,902 | 6,103 | 39 |
| Commercial real estate owner occupied | 53 | 29,079 | 16,973 | $(867)$ |
| Commercial and industrial | 30 | 8,649 | 8,680 | $(156)$ |
| Mortgage | 354 | 57,260 | 61,044 | 6,197 |
| Leasing | 34 | 627 | 607 | 191 |
| Consumer: | 1,567 | 12,543 | 15,050 | 1,660 |
| Credit cards | 725 | 11,893 | 11,924 | 2,969 |
| Personal | 10 | 102 | 179 | 13 |
| Auto | 59 | 221 | 219 | 29 |
| Other |  |  |  |  |
|  | 2,842 | $\$$ | 129,276 | $\$$ |
| Total |  |  | 120,779 | $\$$ |

Puerto Rico
For the nine months ended September 30, 2012
Increase (decrease) in the
Pre-modificatioRost-modification allowance for outstanding recoodexdanding recorded loan losses

| (Dollars in thousands) | Loan count | investment | investmeas a result of modification |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial real estate non-owner occupied | 8 | $\$$ | 8,754 | $\$$ | 7,810 | $\$$ |
| Commercial real estate owner occupied | 27 | 9,319 | 8,901 | $(42)$ |  |  |
| Commercial and industrial | 87 | 38,549 | 28,306 | $(6,352)$ |  |  |
| Construction | 9 | 6,122 | 5,327 | $(211)$ |  |  |
| Mortgage | 1,908 | 251,763 | 274,045 | 17,150 |  |  |
| Leasing | 78 | 1,265 | 1,208 | 132 |  |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 2,210 | 18,621 | 21,347 | 64 |  |  |
| Personal | 926 | 13,132 | 13,162 | 2,165 |  |  |
| Auto | 5 | 68 | 50 | 1 |  |  |
| Other | 39 | 129 | 128 |  |  |  |
|  |  |  |  |  |  |  |
| Total | 5,297 | $\$$ | 347,722 | $\$$ | 360,284 | $\$$ |

U.S. mainland

For the nine months ended September 30, 2012
(Dollars in thousands)
Loan counPre-modificatioRost-modifichinimease (decrease) in the outstanding recordexdanding recordedillowance for investment investment loan losses

|  |  |  | as a result of modification |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | :---: |
| Commercial real estate non-owner occupied | 4 | $\$$ | 9,765 | $\$$ | 9,457 | $\$$ |
| Commercial real estate owner occupied | 1 | 2,246 | 1,750 | $(106)$ |  |  |
| Construction | 1 | 1,573 | 1,573 |  |  |  |
| Mortgage | 69 | 7,168 | 7,248 | 1,133 |  |  |
| Legacy | 3 | 1,272 | 1,267 | $(3)$ |  |  |
| Consumer: |  |  |  |  |  |  |
| HELOCs |  |  | 431 | 409 | 3 |  |
| Total | 81 | $\$$ | 22,455 | $\$$ | 21,704 | $\$$ |

Table of Contents
Popular, Inc.
For the nine months ended September 30, 2012
Increase
(decrease) in
the
Pre-modificationPost-modificatiliowance for loan losses as outstanding recordedstanding recorded a result of

| (Dollars in thousands) | Loan count | investment | investment | modification |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial real estate non-owner | (422) |  |  |  |  |  |
| occupied | 12 | $\$$ | 18,519 | $\$$ | 17,267 | $\$$ |
| Commercial real estate owner occupied | 28 | 11,565 | 10,651 | $(148)$ |  |  |
| Commercial and industrial | 87 | 38,549 | 28,306 | $(6,352)$ |  |  |
| Construction | 10 | 7,695 | 6,900 | $(211)$ |  |  |
| Mortgage | 1,977 | 258,931 | 281,293 | 18,283 |  |  |
| Legacy | 3 | 1,272 | 1,267 | $(3)$ |  |  |
| Leasing | 78 | 1,265 | 1,208 | 132 |  |  |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 2,210 | 18,621 | 21,347 | 64 |  |  |
| HELOCs | 3 | 431 | 409 | 3 |  |  |
| Personal | 926 | 13,132 | 13,162 | 2,165 |  |  |
| Auto | 5 | 68 | 50 | 1 |  |  |
| Other | 39 | 129 | 128 |  |  |  |
| Total | 5,378 | $\$$ | 370,177 | $\$$ | 381,988 | $\$$ |

During the nine months ended September 30, 2013 and 2012, five loan comprising a recorded investment of approximately $\$ 14.3$ million and four loans of $\$ 27$ million, respectively, was restructured into multiple notes ( Note A / B split ). The Corporation recorded approximately $\$ 3.5$ million and $\$ 7.0$ million in loan charge-offs as part of the loan restructuring during the nine months ended September 30, 2013 and 2012, respectively. The renegotiations of this loan were made after analyzing the borrowers capacity to repay the debt, collateral and ability to perform under the modified terms. The recorded investment on these commercial TDRs amounted to approximately $\$ 1.9$ million at September 30, 2013 (September 30, 2012-\$21 million) with a related allowance for loan losses amounting to approximately $\$ 401$ thousand (September 30, 2012 - $\$ 357$ thousand).

The following tables present by class, TDRs that were subject to payment default and that had been modified as a TDR during the twelve months preceding the default date. Payment default is defined as a restructured loan becoming 90 days past due after being modified, foreclosed or charged-off, whichever occurs first. The recorded investment at September 30, 2013 is inclusive of all partial paydowns and charge-offs since the modification date. Loans modified as a TDR that were fully paid down, charged-off or foreclosed upon by period end are not reported.
(Dollars in thousands)
Commercial real estate owner occupied

## Puerto Rico

Defaulted during the quarter mpelfedulted during the nine months ended
September 30, 2013
September 30, 2013
Recorded investment as of first Recorded investment as of first
Loan count default date Loan count default date

Edgar Filing: POPULAR INC - Form 10-Q

| Commercial and industrial | 1 | 5 | 3 | 1,441 |
| :--- | ---: | ---: | ---: | ---: |
| Mortgage | 37 | 6,896 | 179 | 28,922 |
| Leasing | 6 | 176 | 16 | 241 |
| Consumer: | 148 | 1,320 | 448 | 4,247 |
| Credit cards | 35 | 450 | 106 | 1,442 |
| Personal | 4 | 91 | 4 | 91 |
| Auto | 2 | 21 | 2 | 21 |
| Other |  |  |  |  |
|  |  |  |  |  |
| Total | 234 | $\$$ | 9,344 | 761 |

## Table of Contents

| (Dollars in thousands) | U.S. Mainland <br> Defaulted during the quarter melfedulted during the nine months ended <br> September 30, 2013 September 30, 2013 <br> Recorded investment as of first Recorded investment as of first <br> Loan count default date Loan count default date |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |
| Commercial real estate non-owner occupied | 2 | \$ | 1,415 | 3 | \$ | 2,554 |
| Total |  | \$ | 1,415 | 3 | \$ | 2,554 |
|  | Popular, Inc. <br> Defaulted during the quarter đnelfedrlted during the nine months ended <br> September 30, 2013 September 30, 2013 <br> Recorded investment as of first Recorded investment as of first |  |  |  |  |  |
| (Dollars in thousands) | Loan count |  | date | Loan count |  | date |
| Commercial real estate non-owner occupied | - 2 | \$ | 1,415 | 3 | \$ | 2,554 |
| Commercial real estate owner occupied | 1 |  | 385 | 3 |  | 5,512 |
| Commercial and industrial | 1 |  | 5 | 3 |  | 1,441 |
| Mortgage | 37 |  | 6,896 | 179 |  | 28,922 |
| Legacy | 6 |  | 176 | 16 |  | 241 |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 148 |  | 1,320 | 448 |  | 4,247 |
| Personal | 35 |  | 450 | 106 |  | 1,442 |
| Auto | 4 |  | 91 | 4 |  | 91 |
| Other | 2 |  | 21 | 2 |  | 21 |
| Total | 236 | \$ | 10,759 | 764 | \$ | 44,471 |

## Puerto Rico

Defaulted during the quarter mederedlted during the nine months ended
September 30, $2012 \quad$ September 30, 2012
Recorded investment as of first Recorded investment as of first

| (Dollars in thousands) | Loan count |  | default date | Loan count | default date |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial real estate non-owner occupied |  | \$ |  | 2 | \$ | 1,897 |
| Commercial real estate owner occupied | 7 |  | 3,274 | 20 |  | 8,206 |
| Commercial and industrial | 5 |  | 2,310 | 15 |  | 7,202 |
| Mortgage | 203 |  | 26,780 | 542 |  | 77,707 |
| Leasing | 9 |  | 163 | 26 |  | 440 |
| Consumer: |  |  |  |  |  |  |
| Credit cards | 282 |  | 2,413 | 332 |  | 2,930 |
| Personal | 77 |  | 547 | 111 |  | 990 |
| Auto | 2 |  | 32 | 3 |  | 48 |
| Other |  |  |  | 1 |  | 1 |
| Total | 585 | \$ | 35,519 | 1,052 | \$ | 99,421 |

Edgar Filing: POPULAR INC - Form 10-Q

Table of Contents


Popular, Inc.
Defaulted during the quarter mederedulted during the nine months ended September 30, $2012 \quad$ September 30, 2012
Recorded investment as of first Recorded investment as of first

| (Dollars in thousands) | Loan count | default date | Loan count | default date |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Commercial real estate non-owner occupied |  | $\$$ | 3 | $\$$ | 3,832 |
| Commercial real estate owner occupied | 7 | 3,274 | 20 | 8,206 |  |
| Commercial and industrial | 5 | 2,310 | 15 | 7,202 |  |
| Mortgage | 206 | 27,116 | 548 | 78,122 |  |
| Leasing | 9 | 163 | 26 | 440 |  |
| Consumer: |  |  |  |  |  |
| Credit cards | 282 | 2,413 | 332 | 2,930 |  |
| Personal | 77 | 547 | 111 | 990 |  |
| Auto | 2 | 32 | 3 | 48 |  |
| Other |  |  | 1 | 1 |  |
|  |  |  |  |  |  |
| Total | 588 | $\$$ | 35,855 | 1,059 | $\$$ |

Commercial, consumer and mortgage loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Corporation evaluates the loan for possible further impairment. The allowance for loan losses may be increased or partial charge-offs may be taken to further write-down the carrying value of the loan.

Table of Contents

## Credit Quality

The following table presents the outstanding balance, net of unearned income, of non-covered loans held-in-portfolio based on the Corporation s assignment of obligor risk ratings as defined at September 30, 2013 and December 31, 2012.

September 30, 2013

| (In thousands) | Watch | Special <br> Mention | Substandard | Doubtful | Loss | Sub-total | Pass/ <br> Unrated |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Puerto Rico ${ }^{[1]}$ |  |  |  |  |  |  |  |  |  |
| Commercial multi-family | \$ 2,580 | \$ 1,118 | \$ 14,396 | \$ | \$ | \$ 18,094 | \$ 67,186 | \$ | 85,280 |
| Commercial real estate non-owner occupied | 228,678 | 120,551 | 137,382 |  |  | 486,611 | 1,225,199 |  | 1,711,810 |
| Commercial real estate owner occupied | 206,791 | 134,747 | 349,075 |  |  | 690,613 | 977,603 |  | 1,668,216 |
| Commercial and industrial | 698,622 | 184,520 | 237,566 | 81 | 484 | 1,121,273 | 1,668,445 |  | 2,789,718 |


| Total |  |  |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial | $1,136,671$ | 440,936 | 738,419 | 81 | 484 | $2,316,591$ | $3,938,433$ | $6,255,024$ |
| Construction | 8,001 | 3,255 | 21,577 | 3,762 |  | 36,595 | 215,275 | 251,870 |
| Mortgage |  |  | 151,050 |  |  | 151,050 | $5,192,632$ | $5,343,682$ |
| Leasing |  |  | 3,597 |  | 119 | 3,716 | 535,574 | 539,290 |
| Consumer: |  |  |  |  |  |  |  |  |
| Credit cards |  |  |  |  |  |  | 20,375 | $1,138,940$ |
| Home equity |  |  | 976 |  |  | $1,159,315$ |  |  |
| lines of credit |  |  | 7,511 |  | 154 | 3,645 | 11,873 | 15,518 |
| Personal |  | 9,166 | 7,665 | $1,214,698$ | $1,222,363$ |  |  |  |
| Auto |  | 1,941 | 285 | 9,451 | 648,827 | 658,278 |  |  |
| Other |  |  | 3,231 | 5,172 | 213,875 | 219,047 |  |  |

Total

| Consumer | 39,969 | 6,339 | 46,308 | $3,228,213$ | $3,274,521$ |
| :--- | :--- | :--- | :--- | :--- | :--- |

Total Puerto
Rico $\quad \$ 1,144,672 \quad \$ 444,191 \quad \$ \quad 954,612 \quad \$ 3,843 \quad \$ \quad 6,942 \quad \$ 2,554,260 \quad \$ 13,110,127 \quad \$ 15,664,387$
U.S.
mainland
Commercial
multi-family $\quad \$ \quad 82,960 \quad \$ 12,111 \quad \$ \quad 76,881 \quad \$ \quad \$ \quad \$ \quad \$ 171,952 \quad \$ 889,697 \quad \$ 1,061,649$

Edgar Filing: POPULAR INC - Form 10-Q
Commercial real estate

| non-owner <br> occupied | 92,892 | 33,598 | 165,435 | 291,925 | 878,224 | $1,170,149$ |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial <br> real estate <br> owner |  |  |  |  |  |  |
| occupied | 47,456 | 7,308 | 88,655 | 143,419 | 405,868 | 549,287 |
| Commercial <br> and industrial | 14,368 | 16,272 | 46,491 | 77,131 | 732,237 | 809,368 |


| Total |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial | 237,676 | 69,289 | 377,462 |  | 684,427 | 2,906,026 | 3,590,453 |
| Construction |  |  | 20,985 |  | 20,985 | 20,365 | 41,350 |
| Mortgage |  |  | 25,386 |  | 25,386 | 1,244,065 | 1,269,451 |
| Legacy | 15,255 | 10,632 | 61,441 |  | 87,328 | 148,317 | 235,645 |
| Consumer: |  |  |  |  |  |  |  |
| Credit cards |  |  | 458 | 24 | 482 | 14,533 | 15,015 |
| Home equity |  |  |  |  |  |  |  |
| lines of credit |  |  | 3,164 | 4,512 | 7,676 | 462,420 | 470,096 |
| Personal |  |  | 596 | 735 | 1,331 | 137,646 | 138,977 |
| Auto |  |  |  | 3 | 3 | 545 | 548 |
| Other |  |  | 6 |  | 6 | 1,255 | 1,261 |


| Total | 4,224 | 5,274 | 9,498 | 616,399 | 625,897 |
| :--- | :--- | :--- | :--- | :--- | :--- |

Total U.S.
mainland $\quad \$ 252,931 \quad \$ 79,921 \quad \$ 489,498 \quad \$ \quad \$ 2,274 \quad \$ 827,624 \quad \$ 4,935,172 \quad \$ 5,762,796$

## Popular, Inc.

Commercial


Commercial real estate
non-owner $\begin{array}{llllll}\text { occupied } & 321,570 & 154,149 & 302,817 & 778,536 & 2,103,423\end{array} 2,881,959$
Commercial real estate

| owner <br> occupied | 254,247 | 142,055 | 437,730 | 834,032 | $1,383,471$ | $2,217,503$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |


| Commercial <br> and industrial | 712,990 | 200,792 | 284,057 | 81 | 484 | $1,198,404$ | $2,400,682$ | $3,599,086$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Total

| Commercial | $1,374,347$ | 510,225 | $1,115,881$ | 81 | 484 | $3,001,018$ | $6,844,459$ | $9,845,477$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Construction | 8,001 | 3,255 | 42,562 | 3,762 |  | 57,580 | 235,640 | 293,220 |
| Mortgage |  |  | 176,436 |  |  | 176,436 | $6,436,697$ | $6,613,133$ |
| Legacy | 15,255 | 10,632 | 61,441 |  |  | 87,328 | 148,317 | 235,645 |
| Leasing |  |  | 3,597 |  | 119 | 3,716 | 535,574 | 539,290 |

Consumer:

Edgar Filing: POPULAR INC - Form 10-Q

| Credit cards | 20,833 | 24 | 20,857 | $1,153,473$ | $1,174,330$ |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Home equity |  | 4,140 | 7,181 | 11,321 | 474,293 | 485,614 | lines of credit |
| :--- |

## Table of Contents

The following table presents the weighted average obligor risk rating at September 30, 2013 for those classifications that consider a range of rating scales.
\(\left.$$
\begin{array}{lrcc}\text { Weighted average obligor risk rating } & \begin{array}{c}\text { (Scales 11 and 12) } \\
\text { Substandard }\end{array} & \begin{array}{c}\text { (Scales 1 through 8) } \\
\text { Puerto Rico: }{ }^{[1]}\end{array}
$$ \& 11.66 <br>

Pass\end{array}\right]\)|  |
| :--- |
| Commercial multi-family |


| U.S. mainland: | Substandard | Pass |
| :--- | :---: | :---: |
| Commercial multi-family | 11.28 | 7.10 |
| Commercial real estate non-owner occupied | 11.33 | 6.95 |
| Commercial real estate owner occupied | 11.30 | 7.02 |
| Commercial and industrial | 11.13 | 6.56 |
| Total Commercial | 11.29 | 6.91 |
| Construction | 11.27 | 7.78 |
| Legacy | 11.28 | 7.72 |

[1] Excludes covered loans acquired in the Westernbank FDIC-assisted transaction.

| December 31, 2012 |  |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Watch |  | Special <br> Mention | Substandard |  | Doubtful | Loss | Sub-total |  | Pass/ Unrated |  | Total |  |
| Puerto Rico ${ }^{[1]}$ |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Commercial multi-family | \$ | 978 | \$ 255 | \$ | 16,736 | \$ | \$ | \$ | 17,969 | \$ | 97,124 | \$ | 115,093 |
| Commercial real estate non-owner |  |  |  |  |  |  |  |  |  |  |  |  |  |
| occupied |  | 120,608 | 156,853 |  | 252,068 |  |  |  | 529,529 |  | 820,904 |  | 1,350,433 |
|  |  | 195,876 | 140,788 |  | 647,458 | 1,242 |  |  | 985,364 |  | 1,057,122 |  | 2,042,486 |

Edgar Filing: POPULAR INC - Form 10-Q
Commercial real estate
owner
occupied
$\begin{array}{lllllllll}\text { Commercial } \\ \text { and industrial } & 438,758 & 201,660 & 410,026 & 4,162 & 682 & 1,055,288 & 1,732,984 & 2,788,272\end{array}$

| Total |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial | 756,220 | 499,556 | 1,326,288 | 5,404 | 682 | 2,588,150 | 3,708,134 | 6,296,284 |
| Construction | 645 | 31,789 | 41,278 |  |  | 73,712 | 138,555 | 212,267 |
| Mortgage |  |  | 569,334 |  |  | 569,334 | 4,379,590 | 4,948,924 |
| Leasing |  |  | 4,742 |  | 123 | 4,865 | 535,658 | 540,523 |
| Consumer: |  |  |  |  |  |  |  |  |
| Credit cards |  |  | 22,965 |  |  | 22,965 | 1,160,107 | 1,183,072 |
| Home equity |  |  |  |  |  |  |  |  |
| lines of credit |  |  | 1,333 |  | 3,269 | 4,602 | 12,204 | 16,806 |
| Personal |  |  | 8,203 |  | 77 | 8,280 | 1,237,502 | 1,245,782 |
| Auto |  |  | 8,551 |  |  | 8,551 | 551,765 | 560,316 |
| Other |  |  | 3,036 |  |  | 3,036 | 225,317 | 228,353 |

Total

| Consumer | 44,088 | 3,346 | 47,434 | $3,186,895$ | $3,234,329$ |
| :--- | :--- | :--- | :--- | :--- | :--- |

## Total Puerto

Rico $\quad \$ 756,865 \quad \$ 531,345 \quad \$ 1,985,730 \quad \$ 5,404 \quad \$ 4,151 \quad \$ 3,283,495 \quad \$ 11,948,832 \quad \$ 15,232,327$

## U.S.

mainland
Commercial

Commercial real estate

| non-owner <br> occupied | 108,806 | 55,911 | 204,532 | 369,249 | 914,750 | $1,283,999$ |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial <br> real estate |  |  |  |  |  |  |
| owner <br> occupied | 22,423 | 6,747 | 113,161 | 142,331 | 423,633 | 565,964 |
| Commercial <br> and industrial | 24,489 | 8,889 | 65,562 | 98,940 | 706,328 | 805,268 |


| Total |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial | 234,208 | 93,597 | 454,913 |  | 782,718 | 2,779,200 | 3,561,918 |
| Construction | 5,268 |  | 21,182 |  | 26,450 | 14,140 | 40,590 |
| Mortgage |  |  | 34,077 |  | 34,077 | 1,095,506 | 1,129,583 |
| Legacy | 26,176 | 15,225 | 109,470 |  | 150,871 | 233,346 | 384,217 |
| Consumer: |  |  |  |  |  |  |  |
| Credit cards |  |  | 505 |  | 505 | 14,636 | 15,141 |
| Home equity |  |  |  |  |  |  |  |
| lines of credit |  |  | 3,150 | 4,304 | 7,454 | 466,775 | 474,229 |
| Personal |  |  | 785 | 941 | 1,726 | 141,403 | 143,129 |

Edgar Filing: POPULAR INC - Form 10-Q


## Popular, Inc.

Commercial
 Commercial
real estate non-owner

| occupied |  |  |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Commercial <br> real estate | 229,414 | 212,764 | 456,600 |  |  | 898,778 | $1,735,654$ | $2,634,432$ |
| owner <br> occupied | 218,299 | 147,535 | 760,619 | 1,242 |  | $1,127,695$ | $1,480,755$ | $2,608,450$ |
| Commercial <br> and industrial | 463,247 | 210,549 | 475,588 | 4,162 | 682 | $1,154,228$ | $2,439,312$ | $3,593,540$ |

Total

| Commercial | 990,428 | 593,153 | $1,781,201$ | 5,404 | 682 | $3,370,868$ | $6,487,334$ | $9,858,202$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Construction | 5,913 | 31,789 | 62,460 |  |  | 100,162 | 152,695 | 252,857 |
| Mortgage |  |  | 603,411 |  |  | 603,411 | $5,475,096$ | $6,078,507$ |
| Legacy | 26,176 | 15,225 | 109,470 |  | 150,871 | 233,346 | 384,217 |  |
| Leasing |  |  | 4,742 |  | 123 | 4,865 | 535,658 | 540,523 |
| Consumer: |  |  | 23,470 |  |  | 23,470 | $1,174,743$ | $1,198,213$ |
| Credit cards |  |  |  |  |  |  |  |  |
| Home equity |  |  | 4,483 | 7,573 | 12,056 | 478,979 | 491,035 |  |
| lines of credit |  |  | 8,988 | 1,018 | 10,006 | $1,378,905$ | $1,388,911$ |  |
| Personal |  | 8,551 | 4 | 8,555 | 552,529 | 561,084 |  |  |
| Auto |  | 3,039 |  |  | 3,039 | 226,604 | 229,643 |  |

Total

| Consumer | 48,531 | 8,595 | 57,126 | $3,811,760$ | $3,868,886$ |
| :--- | :--- | :--- | :--- | :--- | :--- |

Total Popular,
Inc.
$\begin{array}{lllllll}\$ 1,022,517 & \$ 640,167 & \$ 2,609,815 & \$ 5,404 & \$ 9,400 & \$ 4,287,303 & \$ 16,695,889\end{array} \$ 20,983,192$

## Table of Contents

The following table presents the weighted average obligor risk rating at December 31, 2012 for those classifications that consider a range of rating scales.
\(\left.$$
\begin{array}{lrcc}\text { Weighted average obligor risk rating } & \begin{array}{c}\text { (Scales 11 and 12) } \\
\text { Substandard }\end{array} & \begin{array}{c}\text { (Scales 1 through 8) } \\
\text { Puerto Rico: }{ }^{[1]}\end{array}
$$ \& 11.94 <br>

Pass\end{array}\right]\)|  |
| :--- |
| Commercial multi-family |


| U.S. mainland: | Substandard | Pass |
| :--- | :---: | :---: |
| Commercial multi-family | 11.26 | 7.12 |
| Commercial real estate non-owner occupied | 11.38 | 7.04 |
| Commercial real estate owner occupied | 11.28 | 6.64 |
| Commercial and industrial | 11.19 | 6.73 |
| Total Commercial | 11.31 | 6.81 |
| Construction | 11.28 | 7.21 |
| Legacy | 11.30 | 7.48 |

[1] Excludes covered loans acquired in the Westernbank FDIC-assisted transaction.

## Table of Contents

## Note 9 FDIC loss share asset and true-up payment obligation

In connection with the Westernbank FDIC-assisted transaction, BPPR entered into loss share agreements with the FDIC with respect to the covered loans and other real estate owned. Pursuant to the terms of the loss share agreements, the FDIC s obligation to reimburse BPPR for losses with respect to covered assets begins with the first dollar of loss incurred. The FDIC reimburses BPPR for $80 \%$ of losses with respect to covered assets, and BPPR reimburses the FDIC for $80 \%$ of recoveries with respect to losses for which the FDIC paid $80 \%$ reimbursement under loss share agreements. The loss share agreement applicable to single-family residential mortgage loans provides for FDIC loss and recoveries sharing for ten years expiring at the end of the quarter ending June 30, 2020. The loss share agreement applicable to commercial (including construction) and consumer loans provides for FDIC loss sharing for five years expiring at the end of the quarter ending June 30, 2015 and BPPR reimbursement to the FDIC for eight years expiring at the end of the quarter ending June 30, 2018, in each case, on the same terms and conditions as described above.

The following table sets forth the activity in the FDIC loss share asset for the periods presented.

|  | Quarters ended September 30, |  | Nine months ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 | 2012 |  | 2013 |  | 2012 |
| Balance at beginning of year | \$ 1,379,342 | \$ 1,631,594 | \$ | 1,399,098 | \$ | 1,915,128 |
| Amortization of loss share indemnification asset | $(37,681)$ | $(29,184)$ |  | $(116,442)$ |  | $(95,972)$ |
| Credit impairment losses to be covered under loss sharing agreements | 13,946 | 18,095 |  | 53,329 |  | 60,943 |
| Decrease due to reciprocal accounting on amortization of contingent liability on unfunded commitments | (87) | (248) |  | (473) |  | (744) |
| Reimbursable expenses | 25,641 | 7,577 |  | 45,555 |  | 20,619 |
| Net payments to (from) FDIC under loss sharing agreements | $(52,865)$ | $(64,932)$ |  | $(52,758)$ |  | $(327,739)$ |
| Other adjustments attributable to FDIC loss sharing agreements | $(3,585)$ | $(3,845)$ |  | $(3,598)$ |  | $(13,178)$ |
| Balance at end of period | \$ 1,324,711 | \$ 1,559,057 | \$ | 1,324,711 | \$ | 1,559,057 |

The following table presents the weighted average life of the loan portfolios subject to the FDIC loss sharing agreement for the quarters ended September 30, 2013 and December 31, 2012.

Quarters ended
September 30, 2013 December 31, 2012

| Commercial | 6.63 years | 7.40 years |
| :--- | ---: | ---: |
| Consumer | 3.18 | 2.91 |
| Construction | 1.52 | 2.72 |
| Mortgage | 7.06 | 6.97 |

As part of the loss share agreements, BPPR has agreed to make a true-up payment to the FDIC on the date that is 45 days following the last day (such day, the true-up measurement date ) of the final shared-loss month, or upon the final disposition of all covered assets under the loss share agreements, in the event losses on the loss share agreements fail to reach expected levels. The estimated fair value of such true-up payment obligation is recorded as contingent consideration, which is included in the caption of other liabilities in the consolidated statements of financial condition. Under the loss sharing agreements, BPPR will pay to the FDIC $50 \%$ of the excess, if any, of: (i) $20 \%$ of the intrinsic loss estimate of $\$ 4.6$ billion (or $\$ 925$ million) (as determined by the FDIC) less (ii) the sum of: (A) $25 \%$ of the asset discount (per bid) (or ( $\$ 1.1$ billion)); plus (B) $25 \%$ of the cumulative shared-loss payments (defined as the aggregate of all of the payments made or payable to BPPR minus the aggregate of all of the payments made or payable to the FDIC); plus (C) the sum of the period servicing amounts for every consecutive twelve-month period prior to and ending on the true-up measurement date in respect of each of the loss sharing agreements during which the loss sharing provisions of the applicable loss sharing agreement is in effect (defined as the product of the simple average of the principal amount of shared loss loans and shared loss assets at the beginning and end of such period times $1 \%$ ).

The following table provides the fair value and the undiscounted amount of the true-up payment obligation at September 30, 2013 and December 31, 2012.
(In thousands)
Carrying amount (fair value)
Undiscounted amount

September 30, 2013 December 31, 2012
\$ 124,092 \$ 111,519

| $\$$ | 183,015 | $\$$ | 178,522 |
| :--- | :--- | :--- | :--- |

## Table of Contents

The loss share agreements contain specific terms and conditions regarding the management of the covered assets that BPPR must follow in order to receive reimbursement on losses from the FDIC. Under the loss share agreements, BPPR must:
manage and administer the covered assets and collect and effect charge-offs and recoveries with respect to such covered assets in a manner consistent with its usual and prudent business and banking practices and, with respect to single family shared-loss loans, the procedures (including collection procedures) customarily employed by BPPR in servicing and administering mortgage loans for its own account and the servicing procedures established by FNMA or the Federal Home Loan Mortgage Corporation ( FHLMC ), as in effect from time to time, and in accordance with accepted mortgage servicing practices of prudent lending institutions;
exercise its best judgment in managing, administering and collecting amounts on covered assets and effecting charge-offs with respect to the covered assets;
use commercially reasonable efforts to maximize recoveries with respect to losses on single family shared-loss assets and best efforts to maximize collections with respect to commercial shared-loss assets;
retain sufficient staff to perform the duties under the loss share agreements;
adopt and implement accounting, reporting, record-keeping and similar systems with respect to the commercial shared-loss assets;
comply with the terms of the modification guidelines approved by the FDIC or another federal agency for any single-family shared-loss loan;
provide notice with respect to proposed transactions pursuant to which a third party or affiliate will manage, administer or collect any commercial shared-loss assets;
file monthly and quarterly certificates with the FDIC specifying the amount of losses, charge-offs and recoveries; and
maintain books and records sufficient to ensure and document compliance with the terms of the loss share agreements.

## Table of Contents

## Note 10 Mortgage Banking Activities

The caption of mortgage banking activities in the consolidated statements of operations consists of the following categories:

| (In thousands) | Quarters ended September 30,ine months ended September 30 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 |  | 2012 |  | 2013 |  | 2012 |  |
| Mortgage servicing fees, net of fair value adjustments: |  |  |  |  |  |  |  |  |
| Mortgage servicing fees | \$ | 11,547 | \$ | 12,282 | \$ | 34,110 | \$ | 36,339 |
| Mortgage servicing rights fair value adjustments |  | 3,879 |  | $(2,426)$ |  | $(6,862)$ |  | $(7,217)$ |
| Total mortgage servicing fees, net of fair value adjustments |  | 15,426 |  | 9,856 |  | 27,248 |  | 29,122 |
| Net gain on sale of loans, including valuation on loans |  | 3,559 |  | 19,700 |  | 16,968 |  | 49,028 |
| Trading account (loss) profit: |  |  |  |  |  |  |  |  |
| Unrealized losses on outstanding derivative positions |  | (865) |  | (58) |  | (265) |  | (154) |
| Realized gains (losses) on closed derivative positions |  | 776 |  | $(7,651)$ |  | 13,330 |  | $(17,578)$ |
| Total trading account (loss) profit |  | (89) |  | $(7,709)$ |  | 13,065 |  | $(17,732)$ |
| Total mortgage banking activities | \$ | 18,896 | \$ | 21,847 | \$ | 57,281 | \$ | 60,418 |

## Table of Contents

## Note 11 Transfers of financial assets and mortgage servicing assets

The Corporation typically transfers conforming residential mortgage loans in conjunction with GNMA, FNMA and FHLMC securitization transactions whereby the loans are exchanged for cash or securities and servicing rights. The securities issued through these transactions are guaranteed by the corresponding agency and, as such, under seller/service agreements the Corporation is required to service the loans in accordance with the agencies servicing guidelines and standards. Substantially all mortgage loans securitized by the Corporation in GNMA, FNMA and FHLMC securities have fixed rates and represent conforming loans. As seller, the Corporation has made certain representations and warranties with respect to the originally transferred loans and, in some instances, has sold loans with credit recourse to a government-sponsored entity, namely FNMA. Refer to Note 20 to the consolidated financial statements for a description of such arrangements.

No liabilities were incurred as a result of these securitizations during the quarters and nine months ended September 30, 2013 and 2012 because they did not contain any credit recourse arrangements. During the quarter ended September 30, 2013, the Corporation recorded a net gain $\$ 6.5$ million (September 30, 2012 - $\$ 18.0$ million) related to the residential mortgage loans securitized. During the nine months ended September 30, 2013, the Corporation recorded a net gain $\$ 33.0$ million (September 30, 2012 - $\$ 45.6$ million) related to the residential mortgage loans securitized.

The following tables present the initial fair value of the assets obtained as proceeds from residential mortgage loans securitized during the quarters and nine months ended September 30, 2013 and 2012:

| (In thousands) | Proceeds Obtained During the Quarter Ended September 30, 20 |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Level 1 |  | Level 2 | Level 3 |  | Initial Fair Value |  |
| Assets |  |  |  |  |  |  |  |
| Trading account securities: |  |  |  |  |  |  |  |
| Mortgage-backed securities - GNMA | \$ | \$ | 199,824 | \$ |  | \$ | 199,824 |
| Mortgage-backed securities - FNMA |  |  | 101,922 |  |  |  | 101,922 |
| Mortgage-backed securities - FHLMC |  |  | 1,127 |  |  |  | 1,127 |
| Total trading account securities | \$ | \$ | 302,873 | \$ |  | \$ | 302,873 |
| Mortgage servicing rights |  |  |  |  | 4,466 |  | 4,466 |
| Total | \$ | \$ | 302,873 | \$ | 4,466 | \$ | 307,339 |

Proceeds Obtained During the Nine Months Ended September 30, 2013 Level

| (In thousands) | 1 | Level 2 | Level 3 | Initial Fair Value |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Assets |  |  |  |  |  |
| Trading account securities: | $\$$ | $\$$ | 767,393 | $\$$ | $\$$ |
| Mortgage-backed securities - GNMA |  |  | 353,987 |  | 767,393 |
| Mortgage-backed securities - FNMA | 27,819 |  | 353,987 |  |  |
| Mortgage-backed securities - FHLMC |  |  | 27,819 |  |  |


| Total trading account securities | $\$$ | $\$$ | $1,149,199$ | $\$$ |  | $\$$ | $1,149,199$ |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Mortgage servicing rights |  |  |  | 13,846 | 13,846 |  |  |
| Total | $\$$ | $\$$ | $1,149,199$ | $\$$ | 13,846 | $\$$ | $1,163,045$ |

61

Table of Contents

| (In thousands) | Proceeds Obtained During the Quarter Ended September 30, |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Level 1 |  | Level 2 | Level 3 |  | Initial Fair Value |  |
| Assets |  |  |  |  |  |  |  |
| Trading account securities: |  |  |  |  |  |  |  |
| Mortgage-backed securities - GNMA | \$ | \$ | 180,827 | \$ |  | \$ | 180,827 |
| Mortgage-backed securities - FNMA |  |  | 107,301 |  |  |  | 107,301 |
| Mortgage-backed securities - FHLMC |  |  | 20,425 |  |  |  | 20,425 |
| Total trading account securities | \$ | \$ | 308,553 | \$ |  | \$ | 308,553 |
| Mortgage servicing rights |  |  |  |  | 3,777 |  | 3,777 |
| Total | \$ | \$ | 308,553 | \$ | 3,777 | \$ | 312,330 |

## Proceeds Obtained During the Nine Months Ended September 30, 2012 Level

| (In thousands) | 1 | Level 2 |  | Level 3 |  | Initial Fair Value |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Assets |  |  |  |  |  |  |  |
| Trading account securities: |  |  |  |  |  |  |  |
| Mortgage-backed securities - GNMA | \$ | \$ | 575,642 | \$ |  | \$ | 575,642 |
| Mortgage-backed securities - FNMA |  |  | 238,285 |  |  |  | 238,285 |
| Mortgage-backed securities - FHLMC |  |  | 20,425 |  |  |  | 20,425 |
| Total trading account securities | \$ | \$ | 834,352 | \$ |  | \$ | 834,352 |
| Mortgage servicing rights |  |  |  |  | 10,798 |  | 10,798 |
| Total | \$ | \$ | 834,352 | \$ | 10,798 | \$ | 845,150 |

During the nine months ended September 30, 2013, the Corporation retained servicing rights on whole loan sales involving approximately $\$ 116$ million in principal balance outstanding (September 30, 2012 - $\$ 196$ million), with realized gains of approximately $\$ 4.0$ million (September 30, 2012 - gains of $\$ 8.9$ million). All loan sales performed during the nine months ended September 30, 2013 and 2012 were without credit recourse agreements.

The Corporation recognizes as assets the rights to service loans for others, whether these rights are purchased or result from asset transfers such as sales and securitizations. These mortgage servicing rights ( MSRs ) are measured at fair value.

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

Edgar Filing: POPULAR INC - Form 10-Q

## Table of Contents

The following table presents the changes in MSRs measured using the fair value method for the nine months ended September 30, 2013 and 2012.

|  | Residential MSRs |  |  |  |
| :--- | ---: | :---: | ---: | ---: |
| (In thousands) | September 30, 2013 | September 30, 2012 |  |  |
| Fair value at beginning of period | $\$$ | 154,430 | $\$$ | 151,323 |
| Purchases |  | 45 |  | 1,620 |
| Servicing from securitizations or asset |  | 15,062 |  |  |
| transfers |  | 12,842 |  |  |
| Sale of servicing assets | $(17,351)$ | $(103)$ |  |  |
| Changes due to payments on loans ${ }^{[1]}$ | $(2,866)$ | $(14,262)$ |  |  |
| Reduction due to loan repurchases |  | $(3,961)$ |  |  |
| Changes in fair value due to changes in |  | 13,355 |  |  |
| valuation model inputs or assumptions |  | $(1,230)$ |  | 11,006 |
| Other disposals |  | $(98)$ |  |  |
| Fair value at end of period | $\$$ | 161,445 | $\$$ | 158,367 |

[1] Represents the change due to collection / realization of expected cash flow over time.
Residential mortgage loans serviced for others were $\$ 17.1$ billion at September 30, 2013 (December 31, 2012 - $\$ 16.7$ billion).

Net mortgage servicing fees, a component of mortgage banking activities in the consolidated statements of operations, include the changes from period to period in the fair value of the MSRs, including changes due to collection / realization of expected cash flows. Mortgage servicing fees, excluding fair value adjustments, for the quarter and nine months ended September 30, 2013 amounted to $\$ 11.5$ million and $\$ 34.1$ million, respectively (September 30, 2012 $\$ 12.2$ million and $\$ 36.3$ million, respectively). The banking subsidiaries receive servicing fees based on a percentage of the outstanding loan balance. At September 30, 2013, those weighted average mortgage servicing fees were $0.27 \%$ (September 30, 2012-0.28\%). Under these servicing agreements, the banking subsidiaries do not generally earn significant prepayment penalty fees on the underlying loans serviced.

The section below includes information on assumptions used in the valuation model of the MSRs, originated and purchased.

Key economic assumptions used in measuring the servicing rights derived from loans securitized or sold by the Corporation during the quarters and nine months ended September 30, 2013 and 2012 were as follows:

Quarter ended
Nine months ended
September 30, 20 Keptember 30, 20 K2eptember 30, 20 S̉eptember 30, 2012

| Prepayment speed | $5.6 \%$ | $6.4 \%$ | $7.0 \%$ | $6.2 \%$ |
| :--- | :---: | :---: | :---: | :---: |
| Weighted average life | 17.7 years | 15.6 years | 14.2 years | 16.2 years |
| Discount rate (annual rate) | $11.2 \%$ | $11.3 \%$ | $11.1 \%$ | $11.4 \%$ |

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

Originated MSRs

|  | September 30, 2013 |  | December 31, 2012 |  |
| :--- | :---: | :---: | :---: | :---: |
| (In thousands) | $\$$ | 115,057 | $\$$ | 102,727 |
| Fair value of servicing rights |  | 12.7 years |  | 10.2 years |
| Weighted average life |  |  |  |  |
| Weighted average prepayment speed <br> (annual rate) |  | $7.9 \%$ |  | $9.8 \%$ |
| Impact on fair value of $10 \%$ adverse <br> change | $\$$ | $(3,218)$ | $\$$ | $(3,226)$ |
| Impact on fair value of $20 \%$ adverse <br> change | $\$$ | $(6,868)$ | $\$$ | $(7,018)$ |
| Weighted average discount rate (annual <br> rate) |  | $11.7 \%$ |  | $12.3 \%$ |
| Impact on fair value of $10 \%$ adverse <br> change | $\$$ | $(4,473)$ | $\$$ | $(3,518)$ |
| Impact on fair value of $20 \%$ adverse <br> change | $\$$ | $(9,166)$ | $\$$ | $(7,505)$ |

## Table of Contents

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

## Purchased MSRs

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :--- | :---: | :---: | :---: | :---: |
| Fair value of servicing rights | $\$$ | 46,388 | $\$$ | 51,703 |
| Weighted average life |  | 10.8 years |  | 11.0 years |
| Weighted average prepayment speed <br> (annual rate) |  | $9.2 \%$ |  | $9.1 \%$ |
| Impact on fair value of $10 \%$ adverse <br> change | $\$$ | $(1,828)$ | $\$$ | $(2,350)$ |
| Impact on fair value of $20 \%$ adverse <br> change | $\$$ | $(3,383)$ | $\$$ | $(4,024)$ |
| Weighted average discount rate (annual <br> rate) |  | $10.8 \%$ |  | $11.4 \%$ |
| Impact on fair value of $10 \%$ adverse <br> change | $\$$ | $(1,934)$ | $\$$ | $(2,516)$ |
| Impact on fair value of $20 \%$ adverse <br> change | $\$$ | $(3,565)$ | $\$$ | $(4,317)$ |

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

At September 30, 2013, the Corporation serviced $\$ 2.6$ billion (December 31, 2012 - $\$ 2.9$ billion) in residential mortgage loans with credit recourse to the Corporation.

Under the GNMA securitizations, the Corporation, as servicer, has the right to repurchase (but not the obligation), at its option and without GNMA s prior authorization, any loan that is collateral for a GNMA guaranteed mortgage-backed security when certain delinquency criteria are met. At the time that individual loans meet GNMA s specified delinquency criteria and are eligible for repurchase, the Corporation is deemed to have regained effective control over these loans if the Corporation was the pool issuer. At September 30, 2013, the Corporation had recorded $\$ 51$ million in mortgage loans on its consolidated statements of financial condition related to this buy-back option program (December 31, 2012 - $\$ 56$ million). As long as the Corporation continues to service the loans that continue to be collateral in a GNMA guaranteed mortgage-backed security, the MSR is recognized by the Corporation. During the nine months ended September 30, 2013, the Corporation repurchased approximately $\$ 155$ million (December 31, 2012-\$255 million) of mortgage loans under the GNMA buy-back option program. The determination to repurchase these loans was based on the economic benefits of the transaction, which results in a reduction of the servicing costs for these severely delinquent loans, mostly related to principal and interest advances. Furthermore, due to their guaranteed nature, the risk associated with the loans is minimal. The Corporation places these loans under its loss mitigation programs and once brought back to current status, these may be either retained in portfolio or re-sold in the secondary market.

Edgar Filing: POPULAR INC - Form 10-Q

Table of Contents

## Note 12 Other assets

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

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :---: | :---: | :---: | :---: | :---: |
| Net deferred tax assets (net of valuation allowance) | \$ | 844,242 | \$ | 541,499 |
| Investments under the equity method |  | 213,614 |  | 246,776 |
| Bank-owned life insurance program |  | 227,916 |  | 233,475 |
| Prepaid FDIC insurance assessment |  |  |  | 27,533 |
| Prepaid taxes |  | 98,972 |  | 88,360 |
| Other prepaid expenses |  | 65,319 |  | 60,626 |
| Derivative assets |  | 32,732 |  | 41,925 |
| Trades receivables from brokers and counterparties |  | 85,746 |  | 137,542 |
| Others |  | 234,937 |  | 191,842 |
| Total other assets | \$ | 1,803,478 | \$ | 1,569,578 |

## Table of Contents

## Note 13 Goodwill and other intangible assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2013 and 2012, allocated by reportable segments, were as follows (refer to Note 33 for the definition of the Corporation s reportable segments):

2013

2012

|  |  | Purchase <br> Balance at |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Goodwill orcounting |  |  |  |$\quad$| Balance at |
| :---: |

Balance at Goodwill onccounting
Balance at

| (In thousands) | January 1, 201 2cquisitioradjustments |  |  |  |  | Other September 30, 2012 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Banco Popular de Puerto Rico | \$ | 246,272 | \$ | \$ | (439) | \$(154) | \$ | 245,679 |
| Banco Popular North America |  | 402,078 |  |  |  |  |  | 402,078 |
| Total Popular, Inc. | \$ | 648,350 | \$ | \$ | (439) | \$ (154) | \$ | 647,757 |

Purchase accounting adjustments consists of adjustments to the value of the assets acquired and liabilities assumed resulting from the completion of appraisals or other valuations, adjustments to initial estimates recorded for transaction costs, if any, and contingent consideration paid during a contractual contingency period.

The following table presents the gross amount of goodwill and accumulated impairment losses by reportable segments.

September 30, 2013
Balance at
January 1, Accumulated Balance at Balance at Accumulated Balance at 2013 impairmentJanuary 1, 2\&\&ptember 30, 20 lỉnpairmefieptember 30, 2013

| (In thousands) | (gross amounts) |  |  | losses | (net amounts)(gross amounts) |  |  |  | losses |  | (net amounts) |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Banco Popular de Puerto Rico | \$ | 245,679 | \$ |  | \$ | 245,679 | \$ | 245,679 | \$ |  | \$ | 245,679 |
| Banco Popular North America |  | 566,489 |  | 164,411 |  | 402,078 |  | 566,489 |  | 164,411 |  | 402,078 |
| Total Popular, Inc. | \$ | 812,168 | \$ | 164,411 | \$ | 647,757 | \$ | 812,168 | \$ | 164,411 | \$ | 647,757 |

December 31, 2012
Balance at
January 1, Accumulated Balance at Balance at Accumulated Balance at 2012 impairmentJanuary 1, 201ecember 31, 20 liznpairmenlecember 31, 2012

| (In thousands) | (gross amounts) |  |  | losses | (net amounts久gross amounts) |  |  |  | losses |  | (net amounts) |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Banco Popular de Puerto Rico | \$ | 246,272 | \$ |  | \$ | 246,272 | \$ | 245,679 | \$ |  | \$ | 245,679 |
| Banco Popular North America |  | 566,489 |  | 164,411 |  | 402,078 |  | 566,489 |  | 164,411 |  | 402,078 |
| Total Popular, Inc. | \$ | 812,761 | \$ | 164,411 | \$ | 648,350 | \$ | 812,168 | \$ | 164,411 | \$ | 647,757 |

At September 30, 2013 and December 31, 2012, the Corporation had $\$ 6$ million of identifiable intangible assets, with indefinite useful lives, mostly associated with E-LOAN s trademark.

## Table of Contents

The following table reflects the components of other intangible assets subject to amortization:

|  | Gross <br> Carrying <br> Amount | Accumulated <br> Amortization | Net <br> Carrying <br> Value |  |
| :--- | ---: | ---: | ---: | ---: |
| (In thousands) | $\$ 77,885$ | $\$$ | 49,710 | $\$ 28,175$ |
| September 30, 2013 | 16,835 |  | 4,268 | 12,567 |
| Core deposits | 135 |  | 99 | 36 |
| Other customer relationships <br> Other intangibles | $\$ 94,855$ | $\$$ | 54,077 | $\$ 40,778$ |
| Total other intangible assets | $\$ 77,885$ | $\$$ | 43,627 | $\$ 34,258$ |
|  | 16,835 |  | 2,974 | 13,861 |
| December 31, 2012 | 135 |  | 73 | 62 |
| Core deposits | $\$ 94,855$ | $\$$ | 46,674 | $\$ 48,181$ |

During the quarter ended September 30, 2013, the Corporation recognized $\$ 2.5$ million in amortization expense related to other intangible assets with definite useful lives (September 30, 2012-\$ 2.5 million). During the nine months ended September 30, 2013, the Corporation recognized $\$ 7.4$ million in amortization related to other intangible assets with definite useful lives (September 30, 2012 - $\$ 7.6$ million).

The following table presents the estimated amortization of the intangible assets with definite useful lives for each of the following periods:

| (In thousands) | $\$ 2,468$ |
| :---: | ---: |
| Remaining 2013 | 9,227 |
| Year 2014 | 7,084 |
| Year 2015 | 6,799 |
| Year 2016 | 4,050 |
| Year 2017 | 3,970 |
| Year 2018 |  |

The Corporation s goodwill and other identifiable intangible assets having an indefinite useful life are tested for impairment. Intangibles with indefinite lives are evaluated for impairment at least annually and on a more frequent basis if events or circumstances indicate impairment could have taken place. Such events could include, among others, a significant adverse change in the business climate, an adverse action by a regulator, an unanticipated change in the competitive environment and a decision to change the operations or dispose of a reporting unit.

Under applicable accounting standards, goodwill impairment analysis is a two-step test. The first step of the goodwill impairment test involves comparing the fair value of the reporting unit with its carrying amount, including goodwill. If

## Edgar Filing: POPULAR INC - Form 10-Q

the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired; however, if the carrying amount of the reporting unit exceeds its fair value, the second step must be performed. The second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated possible impairment. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination, which is the excess of the fair value of the reporting unit, as determined in the first step, over the aggregate fair values of the individual assets, liabilities and identifiable intangibles (including any unrecognized intangible assets, such as unrecognized core deposits and trademark) as if the reporting unit was being acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The Corporation estimates the fair values of the assets and liabilities of a reporting unit, consistent with the

## Table of Contents

requirements of the fair value measurements accounting standard, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of the assets and liabilities reflects market conditions, thus volatility in prices could have a material impact on the determination of the implied fair value of the reporting unit goodwill at the impairment test date. The adjustments to measure the assets, liabilities and intangibles at fair value are for the purpose of measuring the implied fair value of goodwill and such adjustments are not reflected in the consolidated statement of condition. If the implied fair value of goodwill exceeds the goodwill assigned to the reporting unit, there is no impairment. If the goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss recognized cannot exceed the amount of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted under applicable accounting standards.

The Corporation performed the annual goodwill impairment evaluation for the entire organization during the third quarter of 2013 using July 31, 2013 as the annual evaluation date. The reporting units utilized for this evaluation were those that are one level below the business segments, which are the legal entities within the reportable segment. The Corporation follows push-down accounting, as such all goodwill is assigned to the reporting units when carrying out a business combination.

In determining the fair value of a reporting unit, the Corporation generally uses a combination of methods, including market price multiples of comparable companies and transactions, as well as discounted cash flow analysis.
Management evaluates the particular circumstances of each reporting unit in order to determine the most appropriate valuation methodology. The Corporation evaluates the results obtained under each valuation methodology to identify and understand the key value drivers in order to ascertain that the results obtained are reasonable and appropriate under the circumstances. Elements considered include current market and economic conditions, developments in specific lines of business, and any particular features in the individual reporting units.

The computations require management to make estimates and assumptions. Critical assumptions that are used as part of these evaluations include:
a selection of comparable publicly traded companies, based on nature of business, location and size;
a selection of comparable acquisition and capital raising transactions;
the discount rate applied to future earnings, based on an estimate of the cost of equity;
the potential future earnings of the reporting unit; and
the market growth and new business assumptions.
For purposes of the market comparable approach, valuations were determined by calculating average price multiples of relevant value drivers from a group of companies that are comparable to the reporting unit being analyzed and applying those price multiples to the value drivers of the reporting unit. Multiples used are minority based multiples and thus, no control premium adjustment is made to the comparable companies market multiples. While the market
price multiple is not an assumption, a presumption that it provides an indicator of the value of the reporting unit is inherent in the valuation. The determination of the market comparables also involves a degree of judgment.

For purposes of the discounted cash flows ( DCF ) approach, the valuation is based on estimated future cash flows. The financial projections used in the DCF valuation analysis for each reporting unit are based on the most recent (as of the valuation date) financial projections presented to the Corporation s Asset / Liability Management Committee ( ALCO ). The growth assumptions included in these projections are based on management s expectations for each reporting unit s financial prospects considering economic and industry conditions as well as particular plans of each entity (i.e. restructuring plans, de-leveraging, etc.). The cost of equity used to discount the cash flows was calculated using the Ibbotson Build-Up Method and ranged from $13.5 \%$ to $17.34 \%$ for the 2013 analysis. The Ibbotson Build-Up Method builds up a cost of equity starting with the rate of return of a risk-free asset (20-year U.S. Treasury note) and adds to it additional risk elements such as equity risk premium, size premium and industry risk premium. The resulting discount rates were analyzed in terms of reasonability given the current market conditions and adjustments were made when necessary.

For BPNA, the only reporting unit that failed Step 1, the Corporation determined the fair value of Step 1 utilizing a DCF approach and a market value approach. The market value approach is based on a combination of price multiples from comparable companies and multiples from capital raising transactions of comparable companies. The market multiples used included price to book and

## Table of Contents

price to tangible book. The Step 1 fair value for BPNA under both valuation approaches (market and DCF) was below the carrying amount of its equity book value as of the valuation date (July 31), requiring the completion of Step 2. In accordance with accounting standards, the Corporation performed a valuation of all assets and liabilities of BPNA, including any recognized and unrecognized intangible assets, to determine the fair value of BPNA s net assets. To complete Step 2, the Corporation subtracted from BPNA s Step 1 fair value the determined fair value of the net assets to arrive at the implied fair value of goodwill. The results of the Step 2 indicated that the implied fair value of goodwill exceeded the goodwill carrying value of $\$ 402$ million at July 31, 2013, resulting in no goodwill impairment. The reduction in BPNA s Step 1 fair value was offset by a reduction in the fair value of its net assets, resulting in an implied fair value of goodwill that exceeds the recorded book value of goodwill.

The analysis of the results for Step 2 indicates that the reduction in the fair value of the reporting unit was mainly attributed to the deteriorated fair value of the loan portfolios and not to the fair value of the reporting unit as a going concern. The current negative performance of the reporting unit is principally related to deteriorated credit quality in its loan portfolio, which is consistent with the results of the Step 2 analysis. The fair value determined for BPNA s loan portfolio in the July 31, 2013 annual test represented a discount of $15.1 \%$, compared with $18.2 \%$ at July 31, 2012. The discount is mainly attributed to market participant $s$ expected rate of returns.

If the Step 1 fair value of BPNA declines further in the future without a corresponding decrease in the fair value of its net assets or if loan discounts improve without a corresponding increase in the Step 1 fair value, the Corporation may be required to record a goodwill impairment charge. The Corporation engaged a third-party valuator to assist management in the annual evaluation of BPNA s goodwill (including Step 1 and Step 2) as well as BPNA s loan portfolios as of the July 31, 2013 valuation date. Management discussed the methodologies, assumptions and results supporting the relevant values for conclusions and determined they were reasonable.

For the BPPR reporting unit, the average estimated fair value calculated in Step 1 using all valuation methodologies exceeded BPPR s equity value by approximately $\$ 387$ million in the July 31,2013 annual test as compared with approximately $\$ 222$ million at July 31, 2012. This result indicates there would be no indication of impairment on the goodwill recorded in BPPR at July 31, 2013. For the BPNA reporting unit, the estimated implied fair value of goodwill calculated in Step 2 exceeded BPNA s goodwill carrying value by approximately $\$ 557$ million as compared to approximately $\$ 338$ million at July 31, 2012. The increase in the excess of the implied fair value of goodwill over its carrying amount for BPNA is mainly due to an increase in the fair value of the equity of BPNA as calculated in Step 1, which is mainly attributed to improvement in BPNA financial performance and increases in market price multiples of comparable companies and transactions. The goodwill balance of BPPR and BPNA, as legal entities, represented approximately $97 \%$ of the Corporation s total goodwill balance as of the July 31, 2013 valuation date.

Furthermore, as part of the analyses, management performed a reconciliation of the aggregate fair values determined for the reporting units to the market capitalization of Popular, Inc. concluding that the fair value results determined for the reporting units in the July 31, 2013 annual assessment were reasonable.

The goodwill impairment evaluation process requires the Corporation to make estimates and assumptions with regard to the fair value of the reporting units. Actual values may differ significantly from these estimates. Such differences could result in future impairment of goodwill that would, in turn, negatively impact the Corporation s results of operations and the reporting units where the goodwill is recorded. Declines in the Corporation s market capitalization could increase the risk of goodwill impairment in the future.

Management monitors events or changes in circumstances between annual tests to determine if these events or changes in circumstances would more likely than not reduce the fair value of a reporting unit below its carrying amount.

Edgar Filing: POPULAR INC - Form 10-Q

## Table of Contents

## Note 14 Deposits

Total interest bearing deposits as of the end of the periods presented consisted of:

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :--- | :---: | :---: | :---: | :---: |
| Savings accounts <br> NOW, money market and other interest <br> bearing demand deposits | $\$$ | $6,898,351$ | $\$$ | $6,694,014$ |
| Total savings, NOW, money market and | $5,637,047$ |  | $5,601,261$ |  |
| other interest bearing demand deposits | $12,535,398$ |  | $12,295,275$ |  |
| Certificates of deposit: |  | $5,143,267$ | $5,666,973$ |  |
| Under $\$ 100,000$ | $2,953,835$ | $3,243,736$ |  |  |
| $\$ 100,000$ and over | $8,097,102$ | $8,910,709$ |  |  |
| Total certificates of deposit | $\$$ | $20,632,500$ | $\$$ | $21,205,984$ |

A summary of certificates of deposit by maturity at September 30, 2013 follows:

| (In thousands) |  |
| :--- | ---: |
| 2013 | $\$ 2,429,315$ |
| 2014 | $2,858,968$ |
| 2015 | $1,228,819$ |
| 2016 | 658,746 |
| 2017 | 444,686 |
| 2018 and thereafter | 476,568 |
|  |  |
| Total certificates of deposit | $\$ 8,097,102$ |

At September 30, 2013, the Corporation had brokered deposits amounting to $\$ 2.5$ billion (December 31, 2012 - $\$ 2.8$ billion).

The aggregate amount of overdrafts in demand deposit accounts that were reclassified to loans was $\$ 34$ million at September 30, 2013 (December 31, 2012-\$17 million).

## Table of Contents

## Note 15 Borrowings

Federal funds purchased and assets sold under agreements to repurchase as of the end of the periods presented were as follows:

| (In thousands) | September 30, 2013 | December 31, 2012 |  |  |
| :--- | :---: | :---: | :---: | :---: |
| Federal funds purchased | $\$$ | 14,062 | $\$$ |  |
| Assets sold under agreements to <br> repurchase |  | $1,779,146$ |  | $2,016,752$ |
| Total federal funds purchased and assets <br> sold under agreements to repurchase | $\$$ | $1,793,208$ | $\$$ | $2,016,752$ |

The repurchase agreements outstanding at September 30, 2013 were collateralized by $\$ 1.4$ billion (December 31, 2012 - \$ 1.6 billion) in investment securities available-for-sale, $\$ 312$ million (December 31, 2012 - $\$ 272$ million) in trading securities and $\$ 62$ million (December 31, 2012-\$ 133 million) in securities sold not yet delivered in other assets. It is the Corporation s policy to maintain effective control over assets sold under agreements to repurchase; accordingly, such securities continue to be carried on the consolidated statements of financial condition.

In addition, there were repurchase agreements outstanding collateralized by $\$ 237$ million in securities purchased under agreements to resell to which the Corporation has the right to repledge the securities (December 31, 2012 - $\$$ 227 million). It is the Corporation s policy to take possession of securities purchased under agreements to resell. However, the counterparties to such agreements maintain effective control over such securities; accordingly, these securities are not reflected in the Corporation s consolidated statements of financial condition.

Other short-term borrowings as of the end of the periods presented consisted of:

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :---: | :---: | :---: | :---: | :---: |
| Advances with the FHLB paying interest at maturity, at fixed rates ranging from $0.32 \%$ to $0.46 \%$ | \$ | 825,000 | \$ | 635,000 |
| Others |  | 1,200 |  | 1,200 |
| Total other short-term borrowings | \$ | 826,200 | \$ | 636,200 |

Note: Refer to the Corporation s 2012 Annual Report for rates information corresponding to the short-term borrowings outstanding at December 31, 2012.

## Table of Contents

Notes payable as of the end of the periods reported consisted of:

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :---: | :---: | :---: | :---: | :---: |
| Advances with the FHLB with maturities ranging from 2014 through 2021 paying interest at monthly fixed rates ranging from $0.57 \%$ to $4.19 \%$ | \$ | 555,644 | \$ | 577,490 |
| Term notes maturing in 2014 paying interest semiannually at a fixed rate of 7.47 \% |  | 675 |  | 236,620 |
| Term notes with maturities ranging from 2013 to 2014 paying interest monthly at a floating rate of $3.00 \%$ over the 10 -year U.S. Treasury note rate ${ }^{[1]}$ |  | 18 |  | 133 |
| Junior subordinated deferrable interest debentures (related to trust preferred securities) with maturities ranging from 2027 to 2034 with fixed interest rates ranging from $6.125 \%$ to $8.327 \%$ (Refer to Note 17) |  | 439,800 |  | 439,800 |
| Junior subordinated deferrable interest debentures (related to trust preferred securities) ( $\$ 936,000$ less discount of $\$ 411,129$ at September 30, 2013 and $\$ 436,530$ at December 31, 2012), with no stated maturity and a fixed interest rate of $5.00 \%$ until, but excluding December 5, 2013 and $9.00 \%$ thereafter (Refer to Note 17) ${ }^{[2]}$ |  | 524,871 |  | 499,470 |
| Others |  | 23,688 |  | 24,208 |
| Total notes payable | \$ | 1,544,696 | \$ | 1,777,721 |

Note: Refer to the Corporation s 2012 Annual Report for rates information corresponding to the long-term borrowings outstanding at December 31, 2012.
[1] The 10-year U.S. Treasury note key index rate at September 30, 2013 and December 31, 2012 was $2.61 \%$ and $1.76 \%$, respectively.
[2] The debentures are perpetual and may be redeemed by the Corporation at any time, subject to the consent of the Board of Governors of the Federal Reserve System. The discount on the debentures is being amortized over an estimated 30-year term that started in August 2009. The effective interest rate, including the discount accretion,
was approximately 16\% at September 30, 2013 and December 31, 2012.
A breakdown of borrowings by contractual maturities at September 30, 2013 is included in the table below.

| (In thousands) | Fed funds purchased and assets sold under agreements to repurchase |  | Short-term borrowings |  | Notes payable |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Year |  |  |  |  |  |  |  |
| 2013 | \$ | 1,051,011 | \$ | 826,200 | \$ | 205 | \$ 1,877,416 |
| 2014 |  |  |  |  |  | 111,503 | 111,503 |
| 2015 |  | 174,135 |  |  |  | 10,945 | 185,080 |
| 2016 |  | 453,062 |  |  |  | 215,201 | 668,263 |
| 2017 |  | 115,000 |  |  |  | 79,033 | 194,033 |
| Later years |  |  |  |  |  | 602,938 | 602,938 |
| No stated maturity |  |  |  |  |  | 936,000 | 936,000 |
| Subtotal |  | 1,793,208 |  | 826,200 |  | 1,955,825 | 4,575,233 |
| Less: Discount |  |  |  |  |  | 411,129 | 411,129 |
| Total borrowings | \$ | 1,793,208 | \$ | 826,200 | \$ | 1,544,696 | \$4,164,104 |

## Table of Contents

## Note 16 Offsetting of financial assets and liabilities

The following tables present the potential effect of rights of setoff associated with the Corporation s recognized financial assets and liabilities at September 30, 2013 and December 31, 2012.

As of September 30, 2013
Gross Amounts Not Offset in the Statement of Financial Position
Net Amounts of
Gross Amounts Assets
Offset in theresented in the
Gross AmounStatement of Statement of Securities Cash of Recognized Financial Financial Financial Collateral Collateral

| (In thousands) | Assets |  | Position | Position |  | Instruments |  | Received |  | Received Net Amount |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Derivatives | \$ | 32,742 | \$ | \$ | 32,742 | \$ | 1,092 | \$ |  | \$ | 126 | \$ | 31,524 |
| Reverse repurchase agreements |  | 222,396 |  |  | 222,396 |  | 240 |  | 222,156 |  |  |  |  |
| Total | \$ | 255,138 | \$ | \$ | 255,138 | \$ | 1,332 | \$ | 222,156 | \$ | 126 |  | 31,524 |

As of September 30, 2013
Gross Amounts Not Offset in the Statement of
Financial Position

| Gross Amounter Amounts of Offset in the Liabilities Statement Presented in the |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Gross Amount of Recognized Liabilities |  | of <br> Financial Position | Statement of Financial Position |  | Financial Instruments |  | Securities Collateral Pledged |  | Cash <br> Collateral Pledged Net Amount |  |  |
| Derivatives | \$ | 34,942 | \$ | \$ | 34,942 | \$ | 1,092 | \$ | 16,034 | \$ | \$ | 17,816 |
| Repurchase agreements |  | 1,779,146 |  |  | 1,779,146 |  | 240 |  | 1,778,906 |  |  |  |
| Total | \$ | 1,814,088 | \$ | \$ | 1,814,088 | \$ | 1,332 | \$ | 1,794,940 | \$ | \$ | 17,816 |

As of December 31, 2012
Gross Amounts Not Offset in the Statement of Financial Position
(In thousands) Gross AmouGross Amountst Amounts of Financial Securities Cash Net Amount of Recognized Offset Assets Instruments Collateral Collateral

Assets in the Presented in the Received Received Statement Statement of
of Financial

Edgar Filing: POPULAR INC - Form 10-Q

|  | Financial Position |  |  | Position |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Derivatives | \$ | 41,935 | \$ | 41,935 | \$ | 649 | \$ | 1,770 | \$ | \$ | 39,516 |
| Reverse repurchase agreements |  | 213,462 |  | 213,462 |  | 1,041 |  | 212,421 |  |  |  |
| Total | \$ | 255,397 | \$ | 255,397 | \$ | 1,690 | \$ | 214,191 | \$ | \$ | 39,516 |

73

Table of Contents
As of December 31, 2012

> Gross Amounts Not Offset in the Statement of Financial Position

| Gross Amoundet Amounts of Offset in the Liabilities Statement Presented in the |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Gross Amount of Recognized Liabilities |  | of Financial <br> Position | Statement of Financial Position |  | Financial Instruments |  | Securities <br> Collateral <br> Pledged |  | Cash <br> Collateral <br> ReceivedNet Amoun |  |  |
| Derivatives | \$ | 42,585 | \$ | \$ | 42,585 | \$ | 649 | \$ | 30,390 | \$ | \$ | 11,546 |
| Repurchase agreements |  | 2,016,752 |  |  | 2,016,752 |  | 1,041 |  | 2,015,711 |  |  |  |
| Total | \$ | 2,059,337 | \$ | \$ | 2,059,337 | \$ | 1,690 | \$ | 2,046,101 | \$ | \$ | 11,546 |

The Corporation s derivatives are subject to agreements which allow a right of set-off with each respective counterparty. In addition, the Corporation s Repurchase Agreements and Reverse Repurchase Agreements 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 agreement and any other amount or obligation owed in respect of any other agreement or transaction between them.

## Table of Contents

## Note 17 Trust preferred securities

At September 30, 2013 and December 31, 2012, four statutory trusts established by the Corporation (BanPonce Trust I, Popular Capital Trust I, Popular North America Capital Trust I and Popular Capital Trust II) had issued trust preferred securities (also referred to as capital securities ) to the public. The proceeds from such issuances, together with the proceeds of the related issuances of common securities of the trusts (the common securities ), were used by the trusts to purchase junior subordinated deferrable interest debentures (the junior subordinated debentures ) issued by the Corporation. In August 2009, the Corporation established the Popular Capital Trust III for the purpose of exchanging the shares of Series C preferred stock held by the U.S. Treasury at the time for trust preferred securities issued by this trust. In connection with this exchange, the trust used the Series C preferred stock, together with the proceeds of issuance and sale of common securities of the trust, to purchase junior subordinated debentures issued by the Corporation.

The sole assets of the five trusts consisted of the junior subordinated debentures of the Corporation and the related accrued interest receivable. These trusts are not consolidated by the Corporation pursuant to accounting principles generally accepted in the United States of America.

The junior subordinated debentures are included by the Corporation as notes payable in the consolidated statements of financial condition, while the common securities issued by the issuer trusts are included as other investment securities. The common securities of each trust are wholly-owned, or indirectly wholly-owned, by the Corporation.

The following table presents financial data pertaining to the different trusts at September 30, 2013 and December 31, 2012.
(Dollars in thousands)

| Issuer | BanPonce Trust I |  | Popular Capital Trust I |  | Popular North America Capital Trust I |  | Popular Capital Trust Il |  | Popular Capital Trust III |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Capital securities | \$ | 52,865 | \$ | 181,063 | \$ | 91,651 | \$ | 101,023 | \$ | 935,000 |
| Distribution rate |  | 8.327\% |  | 6.700\% |  | 6.564\% |  | 6.125\% |  | $00 \%$ until, excluding cember 5, 2013 and 9.000\% thereafter |
| Common securities | \$ | 1,637 | \$ | 5,601 | \$ | 2,835 | \$ | 3,125 | \$ | 1,000 |
| Junior subordinated debentures aggregate liquidation amount | \$ | 54,502 | \$ | 186,664 | \$ | 94,486 | \$ | 104,148 | \$ | 936,000 |
| Stated maturity date |  | February 2027 |  | November $2033$ |  | September $2034$ |  | December 2034 |  | Perpetual |
| Reference notes |  | 1],[3],[6] |  | [2],[4],[5] |  | [1],[3],[5] |  | [2],[4],[5] |  | [4],[7],[8] |

Statutory business trust that is wholly-owned by Popular North America and indirectly wholly-owned by the Corporation.
[2] Statutory business trust that is wholly-owned by the Corporation.
[3] The obligations of PNA under the junior subordinated debentures and its guarantees of the capital securities under the trust are fully and unconditionally guaranteed on a subordinated basis by the Corporation to the extent set forth in the applicable guarantee agreement.
[4] These capital securities are fully and unconditionally guaranteed on a subordinated basis by the Corporation to the extent set forth in the applicable guarantee agreement.
[5] The Corporation has the right, subject to any required prior approval from the Federal Reserve, to redeem after certain dates or upon the occurrence of certain events mentioned below, the junior subordinated debentures at a redemption price equal to $100 \%$ of the principal amount, plus accrued and unpaid interest to the date of redemption. The maturity of the junior subordinated debentures may be shortened at the option of the Corporation prior to their stated maturity dates (i) on or after the stated optional redemption dates stipulated in the agreements, in whole at any time or in part from time to time, or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of a tax event, an investment company event or a capital treatment event as set forth in the indentures relating to the capital securities, in each case subject to regulatory approval.
[6] Same as [5] above, except that the investment company event does not apply for early redemption.
[7] The debentures are perpetual and may be redeemed by Popular at any time, subject to the consent of the Board of Governors of the Federal Reserve System.
[8] Carrying value of junior subordinated debentures of \$ 525 million at September 30, 2013 (\$ 936 million aggregate liquidation amount, net of $\$ 411$ million discount) and $\$ 499$ million at December 31, 2012 (\$ 936 million aggregate liquidation amount, net of $\$ 437$ million discount).

## Table of Contents

In July 2013, the Board of Governors of the Federal Reserve System approved final rules ( New Capital Rules ) to establish a new comprehensive regulatory capital framework for all U.S. banking organizations. The New Capital Rules generally implement the Basel Committee on Banking Supervision s (the Basel Committee ) December 2010 final capital framework referred to as Basel III for strengthening international capital standards and several changes to the U.S. regulatory capital regime required by the Dodd-Frank Wall Street Reform and Consumer Protection on Act ( Dodd-Frank ). The New Capital Rules require that capital instruments such as trust preferred securities be phased-out of Tier 1 capital. The Corporation s Tier I capital level at September 30, 2013 included $\$ 427$ million of trust preferred securities that are subject to the phase-out provisions of the New Capital Rules. The Corporation would be allowed to include only $25 \%$ of such trust preferred securities in Tier I capital as of January 1, 2015 and $0 \%$ as of January 1, 2016 and thereafter. The New Capital Rules also permanently grandfathers as Tier 2 capital such trust preferred securities. The trust preferred securities issued to the U.S. Treasury pursuant to the Emergency Economic Stabilization Act of 2008 are exempt from the phase-out provision.

Table of Contents

## Note 18 Stockholders equity

## Reverse stock split

On May 29, 2012, the Corporation effected a 1-for-10 reverse split of its common stock previously approved by the Corporation s stockholders on April 27, 2012. Upon the effectiveness of the reverse split, each 10 shares of authorized and outstanding common stock were reclassified and combined into one new share of common stock. Popular, Inc. s common stock began trading on a split-adjusted basis on May 30, 2012. All share and per share information in the consolidated financial statements and accompanying notes were retroactively adjusted to reflect the 1 -for- 10 reverse stock split.

In connection with the reverse stock split, the Corporation amended its Restated Certificate of Incorporation to reduce the number of shares of its authorized common stock from $1,700,000,000$ to $170,000,000$.

The reverse stock split did not affect the par value of a share of the Corporation s common stock.

At the effective date of the reverse stock split, the stated capital attributable to common stock on the Corporation s consolidated statement of financial condition was reduced by dividing the amount of the stated capital prior to the reverse stock split by 10 , and the additional paid-in capital (surplus) was credited with the amount by which the stated capital was reduced. This was also reflected retroactively for prior periods presented in the financial statements.

## $B P P R$ statutory reserve

The Banking Act of the Commonwealth of Puerto Rico requires that a minimum of $10 \%$ of BPPR s net income for the year be transferred to a statutory reserve account until such statutory reserve equals the total of paid-in capital on common and preferred stock. Any losses incurred by a bank must first be charged to retained earnings and then to the reserve fund. Amounts credited to the reserve fund may not be used to pay dividends without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The failure to maintain sufficient statutory reserves would preclude BPPR from paying dividends. BPPR s statutory reserve fund amounted to $\$ 432$ million at September 30, 2013 (December 31, 2012 - $\$ 432$ million). There were no transfers between the statutory reserve account and the retained earnings account during the quarters and nine months ended September 30, 2013 and September 30, 2012.

## Table of Contents

## Note 19 Other comprehensive loss

The following table presents changes in accumulated other comprehensive loss by component during the quarters and nine months ended September 30, 2013 and 2012.

| (In thousands) | Changes in Accumulated Other Comprehensive Loss by Component[1] |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Quarters ended September 30, |  | Nine months ended September 30, |  |
| Foreign currency translation | Beginning Balance | \$ $(33,206)$ | \$ $(29,775)$ | \$ $(31,277)$ | \$ $(28,829)$ |
|  | Other comprehensive loss before reclassifications | $(2,013)$ | (120) | $(3,942)$ | $(1,066)$ |
|  | Net change | $(2,013)$ | (120) | $(3,942)$ | $(1,066)$ |
|  | Ending balance | \$ $(35,219)$ | \$ $(29,895)$ | \$ $(35,219)$ | \$ $(29,895)$ |

Adjustment of pension and postretirement benefit plans Beginning Balance $\quad \$(218,321) \quad \$(207,029) \quad \$(225,846) \quad \$(216,058)$

Amounts reclassified from accumulated other comprehensive $\begin{array}{lllll}\text { loss for amortization of net losses } & 3,762 & 4,549 & 11,287 & 13,648\end{array}$ Amounts reclassified from accumulated other comprehensive loss for amortization of prior service cost (35)

| Net change | 3,762 | 4,514 | 11,287 | 13,543 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Ending balance | $\$(214,559)$ | $\$(202,515)$ | $\$(214,559)$ | $\$(202,515)$ |

Unrealized net holding gains (losses) on investments $\quad$ Beginning Balance $\quad \$ 23,990 \quad \$ 181,207 \quad \$ 154,568 \quad \$ 203,078$

| Other comprehensive loss before <br> reclassifications | $(29,503)$ | $(5,374)$ | $(160,081)$ | $(27,594)$ |
| :--- | :--- | :--- | :--- | :--- |
| Amounts reclassified from <br> accumulated other comprehensive <br> income |  |  |  |  |

Net change
$(29,503) \quad(5,438) \quad(160,081)$
$(27,309)$
Ending balance
\$ $(5,513) \quad \$ 175,769 \quad \$(5,513) \quad \$ 175,769$

| Unrealized net gains (losses) on cash flow hedges | Beginning Balance | \$ | 1,498 | \$ | (986) | \$ | (313) | \$ | (739) |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Other comprehensive income (loss) before reclassifications |  | $(2,325)$ |  | $(4,399)$ |  | 1,436 |  | $(8,829)$ |
|  | Amounts reclassified from other accumulated other comprehensive loss |  | (888) |  | 2,591 |  | $(2,838)$ |  | 6,774 |
|  | Net change |  | $(3,213)$ |  | $(1,808)$ |  | $(1,402)$ |  | $(2,055)$ |
|  | Ending balance | \$ | $(1,715)$ | \$ | $(2,794)$ | \$ | $(1,715)$ | \$ | $(2,794)$ |
|  | Total | \$ | 57,006) | \$ | $(59,435)$ |  | 57,006) | \$ | 59,435) |

[1] All amounts presented are net of tax.

## Table of Contents

The following table presents the amounts reclassified out of each component of accumulated other comprehensive loss during the quarters and nine months ended September 30, 2013 and 2012.

| (In thousands) | Reclassifications Out of Accumulated Other Comprehensive Loss |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Affected Line Item in the Consolidated Statements of Operations | Quarters ended September 30, |  | Nine months ended <br> September 30, <br> 20132012 |  |
| Adjustment of pension and postretirement benefit plans |  |  |  |  |  |
| Amortization of net losses | Personnel costs | \$ $(6,168)$ | \$ $(6,289)$ | \$ $(18,506)$ | \$ $(18,868)$ |
| Amortization of prior service cost | Personnel costs |  | 50 |  | 150 |
|  | Total before tax | $(6,168)$ | $(6,239)$ | $(18,506)$ | $(18,718)$ |
|  | Income tax benefit | 2,406 | 1,725 | 7,219 | 5,175 |
|  | Total net of tax | \$ $(3,762)$ | \$ $(4,514)$ | \$ $(11,287)$ | \$ $(13,543)$ |


| Unrealized holding gains <br> (losses) on investments <br> Realized loss on sale of <br> securities | Net gain (loss) and valuation <br> adjustments on investment securities | $\$$ | $\$$ | 64 | $\$$ |  | $\$$ | $(285)$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  | Total before tax |  | 64 |  |  | $(285)$ |  |  |
|  | Total net of tax | $\$$ | $\$$ | 64 | $\$$ | $\$$ | $(285)$ |  |


| Unrealized net gains (losses) on cash flow hedges |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Forward contracts | Mortgage banking activities | \$ | 1,456 | \$ $(3,701)$ | \$ | 4,652 | \$ | $(9,677)$ |
|  | Total before tax |  | 1,456 | $(3,701)$ |  | 4,652 |  | $(9,677)$ |
|  | Income tax (expense) benefit |  | (568) | 1,110 |  | $(1,814)$ |  | 2,903 |
|  | Total net of tax | \$ | 888 | \$ $(2,591)$ | \$ | 2,838 | \$ | $(6,774)$ |
|  | Total reclassification adjustm of tax |  | $(2,874)$ | \$ $(7,041)$ | \$ | $(8,449)$ |  | 20,602) |

## Table of Contents

## Note 20 Guarantees

At September 30, 2013 the Corporation recorded a liability of $\$ 0.5$ million (December 31, 2012 - $\$ 0.6$ million), which represents the unamortized balance of the obligations undertaken in issuing the guarantees under the standby letters of credit. Management does not anticipate any material losses related to these instruments.

From time to time, the Corporation securitized mortgage loans into guaranteed mortgage-backed securities subject to limited, and in certain instances, lifetime credit recourse on the loans that serve as collateral for the mortgage-backed securities. The Corporation has not sold any mortgage loans subject to credit recourse since 2009. At September 30, 2013 the Corporation serviced $\$ 2.6$ billion (December 31, 2012 - $\$ 2.9$ billion) in residential mortgage loans subject to credit recourse provisions, principally loans associated with FNMA and FHLMC residential mortgage loan securitization programs. In the event of any customer default, pursuant to the credit recourse provided, the Corporation is required to repurchase the loan or reimburse the third party investor for the incurred loss. The maximum potential amount of future payments that the Corporation would be required to make under the recourse arrangements in the event of nonperformance by the borrowers is equivalent to the total outstanding balance of the residential mortgage loans serviced with recourse and interest, if applicable. During the quarter and nine months ended September 30, 2013, the Corporation repurchased approximately $\$ 29$ million and $\$ 95$ million, respectively, of unpaid principal balance in mortgage loans subject to the credit recourse provisions (September 30, 2012 - \$ 33 million and $\$ 115$ million, respectively). In the event of nonperformance by the borrower, the Corporation has rights to the underlying collateral securing the mortgage loan. The Corporation suffers ultimate losses on these loans when the proceeds from a foreclosure sale of the property underlying a defaulted mortgage loan are less than the outstanding principal balance of the loan plus any uncollected interest advanced and the costs of holding and disposing the related property. At September 30, 2013 the Corporation s liability established to cover the estimated credit loss exposure related to loans sold or serviced with credit recourse amounted to $\$ 44$ million (December 31, 2012-\$52 million).

The following table shows the changes in the Corporation s liability of estimated losses related to loans serviced with credit recourse provisions during the quarters and nine month periods ended September 30, 2013 and 2012.

Quarters ended September 30Nine months ended September 30,

| (In thousands) | 2013 |  | 2012 |  | 2013 |  | 2012 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance as of beginning of period | \$ | 45,892 | \$ | 55,783 | \$ | 51,673 | \$ | 58,659 |
| Additions for new sales |  |  |  |  |  |  |  |  |
| Provision for recourse liability |  | 5,180 |  | 5,576 |  | 15,965 |  | 15,138 |
| Net charge-offs / terminations |  | $(7,243)$ |  | $(5,068)$ |  | $(23,809)$ |  | $(17,506)$ |
| Balance as of end of period | \$ | 43,829 | \$ | 56,291 | \$ | 43,829 | \$ | 56,291 |

The estimated losses to be absorbed under the credit recourse arrangements are recorded as a liability when the loans are sold or credit recourse is assumed as part of acquired servicing rights, and are updated by accruing or reversing expense (categorized in the line item adjustments (expense) to indemnity reserves on loans sold in the consolidated statements of operations) throughout the life of the loan, as necessary, when additional relevant information becomes available. The methodology used to estimate the recourse liability is a function of the recourse arrangements given and considers a variety of factors, which include actual defaults and historical loss experience, foreclosure rate, estimated future defaults and the probability that a loan would be delinquent. Statistical methods are used to estimate the recourse liability. Expected loss rates are applied to different loan segmentations. The expected loss, which

## Edgar Filing: POPULAR INC - Form 10-Q

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 90 days delinquent within the following twelve-month period. Regression analysis quantifies the relationship between the default event and loan-specific characteristics, including credit scores, loan-to-value ratios, and loan aging, among others.

When the Corporation sells or securitizes mortgage loans, it generally makes customary representations and warranties regarding the characteristics of the loans sold. The Corporation s mortgage operations in Puerto Rico group conforming mortgage loans into pools which are exchanged for FNMA and GNMA mortgage-backed securities, which are generally sold to private investors, or are sold directly to FNMA or other private investors for cash. As required under the government agency programs, quality review procedures are performed by the Corporation to ensure that asset guideline qualifications are met. To the extent the loans do not meet specified characteristics, the Corporation may be required to repurchase such loans or indemnify for losses and bear any

## Table of Contents

subsequent loss related to the loans. Repurchases under BPPR s representation and warranty arrangements approximated $\$ 1.0$ million and $\$ 4.0$ million, in unpaid principal balance, respectively, with losses amounting to $\$$ 0.3 million and $\$ 0.8$ million, respectively, during the quarter and nine months period ended September 30, 2013 (September 30, 2012 - $\$ 0.5$ million and $\$ 3.1$ million, and $\$ 0.1$ million and $\$ 0.5$ million, respectively). A substantial amount of these loans reinstate to performing status or have mortgage insurance, and thus the ultimate losses on the loans are not deemed significant.

During the quarter ended June 30, 2013, the Corporation established a reserve for certain specific representation and warranties made in connection with BPPR s sale of non-performing mortgage loans. The purchaser s sole remedy under the indemnity clause is to seek monetary damages from BPPR, for a maximum of $\$ 16.3$ million. BPPR recognized a reserve of approximately $\$ 3.0$ million, representing its best estimate of the loss that would be incurred in connection with this indemnification. BPPR s obligations under this clause end one year after the closing except to any claim asserted prior to such termination date.

During the quarter ended March 31, 2013, the Corporation established a reserve for certain specific representation and warranties made in connection with BPPR s sale of commercial and construction loans, and commercial and single family real estate owned. The purchaser s sole remedy under the indemnity clause is to seek monetary damages from BPPR, for a maximum of $\$ 18.0$ million. BPPR is not required to repurchase any of the assets. BPPR recognized a reserve of approximately $\$ 10.7$ million, representing its best estimate of the loss that would be incurred in connection with this indemnification. BPPR s obligations under this clause end one year after the closing except to any claim asserted prior to such termination date.

Also, during the quarter ended June 30, 2011, the Corporation s banking subsidiary, BPPR, reached an agreement (the June 2011 agreement ) with the FDIC, as receiver for a local Puerto Rico institution, and the financial institution with respect to a loan servicing portfolio that BPPR services since 2008, related to FHLMC and GNMA pools. The loans were originated and sold by the financial institution and the servicing rights were transferred to BPPR in 2008. As part of the 2008 servicing agreement, the financial institution was required to repurchase from BPPR any loans that BPPR, as servicer, was required to repurchase from the investors under representation and warranty obligations. As part of the June 2011 agreement, the Corporation received cash to discharge the financial institution from any repurchase obligation and other claims over the serviced portfolio. At September 30, 2013, the related representation and warranty reserve amounted to $\$ 5.8$ million, and the related serviced portfolio approximated $\$ 2.5$ billion (December 31, 2012 - $\$ 7.6$ million and $\$ 2.9$ billion, respectively).

The following table presents the changes in the Corporation s liability for estimated losses associated with indemnifications and representations and warranties related to loans sold by BPPR for the quarters and nine months ended September 30, 2013 and 2012.

|  | Quarters ended September 30, ine months ended September 30 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 |  | 2012 |  | 2013 |  | 2012 |  |
| Balance as of beginning of period | \$ | 20,959 | \$ | 8,179 | \$ | 7,587 | \$ | 8,522 |
| Additions for new sales |  |  |  |  |  | 13,747 |  |  |
| Provision (reversal) for representation and warranties |  | $(1,100)$ |  | 110 |  | (975) |  | 356 |
| Net charge-offs / terminations |  | (945) |  | (327) |  | $(1,445)$ |  | (916) |
| Balance as of end of period | \$ | 18,914 | \$ | 7,962 | \$ | 18,914 | \$ | 7,962 |

In addition, at September 30, 2013, the Corporation has reserves for customary representation and warranties related to loans sold by its U.S. subsidiary E-LOAN prior to 2009. These loans were sold to investors on a servicing released basis subject to certain representation and warranties. Although the risk of loss or default was generally assumed by the investors, the Corporation made certain representations relating to borrower creditworthiness, loan documentation and collateral, which if not correct, may result in requiring the Corporation to repurchase the loans or indemnify investors for any related losses associated with these loans. At September 30, 2013, the Corporation s reserve for estimated losses from such representation and warranty arrangements amounted to $\$ 7$ million, which was included as part of other liabilities in the consolidated statement of financial condition (December 31, 2012 - $\$ 8$ million). E-LOAN is no longer originating and selling loans since the subsidiary ceased these activities in 2008 and most of the outstanding agreements with major counterparties were settled during 2010 and 2011. On a quarterly basis, the Corporation reassesses its estimate for expected losses associated with E-LOAN s customary representation and warranty arrangements. The analysis incorporates expectations on future disbursements based on quarterly repurchases and make-whole events. The analysis also considers factors such as the average length-time between the loan s funding date and the loan

## Table of Contents

repurchase date, as observed in the historical loan data. Make-whole events are typically defaulted cases in which the investor attempts to recover by collateral or guarantees, and the seller is obligated to cover any impaired or unrecovered portion of the loan. Claims have been predominantly for first mortgage agency loans and principally consist of underwriting errors related to undisclosed debt or missing documentation. The following table presents the changes in the Corporation s liability for estimated losses associated with customary representations and warranties related to loans sold by E-LOAN for the quarters and nine months periods ended September 30, 2013 and 2012.

| (In thousands) | Quarters ended September 30,Nine months ended September 30 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 |  | 2012 |  | 2013 |  | 2012 |  |
| Balance as of beginning of period | \$ | 8,760 | \$ | 10,131 | \$ | 7,740 | \$ | 10,625 |
| Additions for new sales |  |  |  |  |  |  |  |  |
| Provision (reversal) for representation and warranties |  | $(1,710)$ |  | $(1,841)$ |  | 314 |  | $(1,841)$ |
| Net charge-offs / terminations |  | (1) |  | (1) |  | $(1,005)$ |  | (495) |
| Balance as of end of period | \$ | 7,049 | \$ | 8,289 | \$ | 7,049 | \$ | 8,289 |

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 FHLMC, require the Corporation 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, 2013, the Corporation serviced $\$ 17.1$ billion in mortgage loans for third-parties, including the loans serviced with credit recourse (December 31, 2012 - $\$ 16.7$ billion). The Corporation generally recovers funds advanced pursuant to these arrangements from the mortgage owner, from liquidation proceeds when the mortgage loan is foreclosed or, in the case of FHA/VA loans, under the applicable FHA and VA insurance and guarantees programs. However, in the meantime, the Corporation must absorb the cost of the funds it advances during the time the advance is outstanding. The Corporation must also bear the costs of attempting to collect on delinquent and defaulted mortgage loans. In addition, if a defaulted loan is not cured, the mortgage loan would be canceled as part of the foreclosure proceedings and the Corporation would not receive any future servicing income with respect to that loan. At September 30, 2013, the outstanding balance of funds advanced by the Corporation under such mortgage loan servicing agreements was approximately $\$ 29$ million (December 31, 2012-\$19 million). To the extent the mortgage loans underlying the Corporation s servicing portfolio experience increased delinquencies, the Corporation 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.

Popular, Inc. Holding Company ( PIHC ) fully and unconditionally guarantees certain borrowing obligations issued by certain of its wholly-owned consolidated subsidiaries amounting to $\$ 0.2$ billion at September 30, 2013 (December 31, 2012 - $\$ 0.5$ billion). In addition, at September 30, 2013 and December 31, 2012, PIHC fully and unconditionally guaranteed on a subordinated basis $\$ 1.4$ billion of capital securities (trust preferred securities) issued by wholly-owned issuing trust entities to the extent set forth in the applicable guarantee agreement. Refer to Note 17 to the consolidated financial statements for further information on the trust preferred securities.

## Table of Contents

## Note 21 Commitments and contingencies

## Off-balance sheet risk

The Corporation is a party to financial instruments with off-balance sheet credit risk in the normal course of business to meet the financial needs of its customers. These financial instruments include loan commitments, letters of credit, and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition.

The Corporation $s$ exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit and financial guarantees written is represented by the contractual notional amounts of those instruments. The Corporation uses the same credit policies in making these commitments and conditional obligations as it does for those reflected on the consolidated statements of financial condition.

Financial instruments with off-balance sheet credit risk, whose contract amounts represent potential credit risk as of the end of the periods presented were as follows:

| (In thousands) | September 30,2013 | December 31, 2012 |  |
| :--- | ---: | ---: | ---: |
| Commitments to extend credit: | $\$$ | $4,599,350$ | $\$$ |
| Credit card lines | $2,342,231$ | $4,379,071$ |  |
| Commercial lines of credit | 345,755 | $2,044,382$ |  |
| Other unused credit commitments | 4,293 | 351,537 |  |
| Commercial letters of credit | 77,212 | 20,634 |  |
| Standby letters of credit |  | 127,519 |  |
| Commitments to originate or fund | 38,994 | 41,187 |  |

At September 30, 2013, the Corporation maintained a reserve of approximately $\$ 4$ million for potential losses associated with unfunded loan commitments related to commercial and consumer lines of credit (December 31, 2012 $\$ 5$ million).

## Other commitments

At September 30, 2013, the Corporation also maintained other non-credit commitments for $\$ 10$ million, primarily for the acquisition of other investments (December 31, 2012-\$10 million).

## Business concentration

Since the Corporation s business activities are currently concentrated primarily in Puerto Rico, its results of operations and financial condition are dependent upon the general trends of the Puerto Rico economy and, in particular, the residential and commercial real estate markets. The concentration of the Corporation s operations in Puerto Rico exposes it to greater risk than other banking companies with a wider geographic base. Its asset and revenue composition by geographical area is presented in Note 33 to the consolidated financial statements.

The Corporation s loan portfolio is diversified by loan category. However, approximately $\$ 14.2$ billion, or $67 \%$ of the Corporation s loan portfolio not covered under the FDIC loss sharing agreements, excluding loans held-for-sale, at

September 30, 2013, consisted of real estate related loans, including residential mortgage loans, construction loans and commercial loans secured by commercial real estate (December 31, 2012 - $\$ 13.3$ billion, or 64\%).

Except for the Corporation s exposure to the Puerto Rico Government sector, no individual or single group of related accounts is considered material in relation to our total assets or deposits, or in relation to our overall business. At September 30, 2013, the Corporation had approximately $\$ 0.9$ billion of credit facilities granted to the Puerto Rico Government, its municipalities and public corporations, of which $\$ 25$ million were uncommitted lines of credit (December 31, 2012 - $\$ 0.8$ billion and $\$ 75$ million, respectively). Of the total credit facilities granted, $\$ 681$ million was outstanding at September 30, 2013, of which none were uncommitted lines of credit (December 31, 2012 - \$681 billion and $\$ 61$ million respectively). As part of its investment securities portfolio, the Corporation had $\$ 204$ million in obligations issued or guaranteed by the Puerto Rico Government, its municipalities and public corporations (December 31, 2012-\$217 million).

Additionally, the Corporation holds consumer mortgage loans with an outstanding balance of $\$ 272$ million at September 30, 2013 that are guaranteed by the Puerto Rico Housing Finance Authority (December 31, 2012 - \$294 million). These mortgage loans are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default.

## Table of Contents

## Other contingencies

As indicated in Note 9 to the consolidated financial statements, as part of the loss sharing agreements related to the Westernbank FDIC-assisted transaction, the Corporation agreed to make a true-up payment to the FDIC on the date that is 45 days following the last day of the final shared loss month, or upon the final disposition of all covered assets under the loss sharing agreements in the event losses on the loss sharing agreements fail to reach expected levels. The fair value of the true-up payment obligation was estimated at $\$ 124$ million at September 30, 2013 (December 31, 2012 - $\$ 112$ million).

## Legal Proceedings

The nature of Popular s business ordinarily results in a certain number of claims, litigation, investigations, and legal and administrative cases and proceedings. When the Corporation determines it has meritorious defenses to the claims asserted, it vigorously defends itself. The Corporation will consider the settlement of cases (including cases where it has meritorious defenses) when, in management s judgment, it is in the best interest of both the Corporation and its shareholders to do so.

On at least a quarterly basis, Popular assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. For matters where it is probable that the Corporation will incur a material loss and the amount can be reasonably estimated, the Corporation establishes an accrual for the loss. Once established, the accrual is adjusted on at least a quarterly basis as appropriate to reflect any relevant developments. For matters where a material loss is not probable or the amount of the loss cannot be estimated, no accrual is established.

In certain cases, exposure to loss exists in excess of the accrual to the extent such loss is reasonably possible, but not probable. Management believes and estimates that the aggregate range of reasonably possible losses (with respect to those matters where such limits may be determined, in excess of amounts accrued), for current legal proceedings ranges from $\$ 0$ to approximately $\$ 15.4$ million as of September 30, 2013. For certain other cases, management cannot reasonably estimate the possible loss at this time. Any estimate involves significant judgment, given the varying stages of the proceedings (including the fact that many of them are currently in preliminary stages), the existence of multiple defendants in several of the current proceedings whose share of liability has yet to be determined, the numerous unresolved issues in many of the proceedings, and the inherent uncertainty of the various potential outcomes of such proceedings. Accordingly, management s estimate will change from time-to-time, and actual losses may be more or less than the current estimate.

While the final outcome of legal proceedings is inherently uncertain, based on information currently available, advice of counsel, and available insurance coverage, management believes that the amount it has already accrued is adequate and any incremental liability arising from the Corporation s legal proceedings will not have a material adverse effect on the Corporation s consolidated financial position as a whole. However, in the event of unexpected future developments, it is possible that the ultimate resolution of these matters, if unfavorable, may be material to the Corporation s consolidated financial position in a particular period.

## Ongoing Class Action Litigation

Banco Popular North America is currently a defendant in two class action lawsuits arising from its consumer and commercial banking activity:

On November 21, 2012, BPNA was served with a putative class action complaint captioned Valle v. Popular Community Bank filed in the New York State Supreme Court (New York County). Plaintiffs, existing BPNA
customers, allege among other things that BPNA has engaged in unfair and deceptive acts and trade practices relative to the assessment of overdraft fees and payment processing on consumer deposit accounts. The complaint further alleges that BPNA improperly disclosed its consumer overdraft policies and, additionally, that the overdraft rates and fees assessed by BPNA violate New York s usury laws. The complaint seeks unspecified damages, including punitive damages, interest, disbursements, and attorneys fees and costs.

BPNA removed the case to federal court (S.D.N.Y.), and plaintiffs subsequently filed a motion to remand the action to state court, which the Court has granted on August 6, 2013. A motion to dismiss was filed on September 9, 2013. On October 25, 2013, plaintiffs filed an amended complaint seeking to limit the putative class to New York account holders.

On August 22, 2013, BPNA was served with a putative class action complaint captioned Crissen v. Gupta, filed in the United States District Court for the Southern District of Indiana. The complaint alleges that BPNA, together with a BPNA commercial customer, purportedly engaged in a conspiracy to fraudulently inflate the amounts of money required to redeem property tax lien certificates in connection with certain Indiana real properties. Plaintiff is seeking actual damages against defendants in excess of $\$ 2$ million, in addition to treble and punitive damages, based on alleged violations of the Racketeer Influenced and Corrupt Organizations ( RICO ) Act and various other state law claims. A motion to dismiss the complaint was filed on October 21, 2013.

## Table of Contents

## Other Significant Proceedings

As described under Note 9 FDIC loss share asset and true-up payment obligation , in connection with the Westernbank FDIC-assisted transaction, on April 30, 2010, BPPR entered into loss share agreements with the FDIC with respect to the covered loans and other real estate owned that it acquired in the transaction. Pursuant to the terms of the loss share agreements, the FDIC s obligation to reimburse BPPR for losses with respect to covered assets begins with the first dollar of loss incurred. The FDIC reimburses BPPR for $80 \%$ of losses with respect to covered assets, and BPPR reimburses the FDIC for $80 \%$ of recoveries with respect to losses for which the FDIC paid $80 \%$ reimbursement under those loss share agreements. The loss share agreements contain specific terms and conditions regarding the management of the covered assets that BPPR must follow in order to receive reimbursement for losses from the FDIC. BPPR believes that it has complied with such terms and conditions. The loss share agreement applicable to the commercial late stage real-estate collateral-dependent loans described below provides for loss sharing by the FDIC through the quarter ending June 30, 2015 and for reimbursement to the FDIC through the quarter ending June 30, 2018.

For the quarters ended June 30, 2010 through March 31, 2012, BPPR received reimbursement for loss-share claims submitted to the FDIC, including charge-offs for certain commercial late stage real-estate-collateral-dependent loans calculated in accordance with BPPR s charge-off policy for non-covered assets. When BPPR submitted its shared-loss claim in connection with the June 30, 2012 quarter, however, the FDIC refused to reimburse BPPR for a portion of the claim because of a difference related to the methodology for the computation of charge-offs for certain commercial late stage real-estate-collateral-dependent loans. In accordance with the terms of the commercial loss share agreement, BPPR applied a methodology for charge-offs for late stage real-estate-collateral-dependent loans that conforms to its regulatory supervisory criteria and is calculated in accordance with BPPR s charge-off policy for non-covered assets. The FDIC has stated that it believes that BPPR should use a different methodology for those charge-offs. Notwithstanding the FDIC s refusal to reimburse BPPR for certain shared-loss claims, BPPR has continued to submit shared-loss claims for quarters subsequent to June 30, 2012. As of September 30, 2013, BPPR had unreimbursed shared-loss claims of $\$ 541.3$ million under the commercial loss share agreement with the FDIC. On October 21, 2013, BPPR received a payment of $\$ 143.1$ million related to reimbursable shared-loss claims from the FDIC. After giving effect to this payment, BPPR has unreimbursed shared-loss claims amounting to $\$ 398.2$ million, including $\$ 248.1$ million related to commercial late stage real-estate-collateral-dependent loans, determined in accordance with BPPR s regulatory supervisory criteria and BPPR s charge-off policy for non-covered assets. If the reimbursement amount for these claims were calculated in accordance with the FDIC s preferred methodology for late stage real-estate-collateral-dependent loans, the amount of such claims would be reduced by approximately $\$ 123.6$ million.

BPPR s loss share agreements with the FDIC specify that disputes can be submitted to arbitration before a review board under the commercial arbitration rules of the American Arbitration Association. On July 31, 2013, BPPR filed a statement of claim with the American Arbitration Association requesting that the review board determine certain matters relating to the loss-share claims under the commercial loss share agreement with the FDIC, including that the review board award BPPR the amounts owed under its unpaid quarterly certificates. The statement of claim also requests reimbursement of certain valuation adjustments for costs to sell troubled assets. The review board is comprised of one arbitrator appointed by BPPR, one arbitrator appointed by the FDIC and a third arbitrator selected either by those arbitrators or by the American Arbitration Association.

To the extent we are not able to successfully resolve this matter through the arbitration process described above, a material difference could result in the timing and amount of charge-offs recorded by us and the amount of charge-offs reimbursed by the FDIC under the commercial loss share agreement. No assurance can be given that we would be able to claim reimbursement from the FDIC for such difference prior to the expiration, in the quarter ending June 30, 2015, of the FDIC s obligation to reimburse BPPR under the commercial loss share agreement, which could require us to
make a material adjustment to the value of our loss share assets and the related true up payment obligation to the FDIC, and could have a material adverse effect on our financial results for the period in which such adjustment is taken.

## Table of Contents

## Note 22 Non-consolidated variable interest entities

The Corporation is involved with four statutory trusts which it established to issue trust preferred securities to the public. Also, it established Popular Capital Trust III for the purpose of exchanging Series C preferred stock shares held by the U.S. Treasury for trust preferred securities issued by this trust. These trusts are deemed to be variable interest entities ( VIEs ) since the equity investors at risk have no substantial decision-making rights. The Corporation does not hold any variable interest in the trusts, and therefore, cannot be the trusts primary beneficiary. Furthermore, the Corporation concluded that it did not hold a controlling financial interest in these trusts since the decisions of the trusts are predetermined through the trust documents and the guarantee of the trust preferred securities is irrelevant since in substance the sponsor is guaranteeing its own debt.

Also, the Corporation is involved with various special purpose entities mainly in guaranteed mortgage securitization transactions, including GNMA, FNMA and FHLMC. These special purpose entities are deemed to be VIEs since they lack equity investments at risk. The Corporation s continuing involvement in these guaranteed loan securitizations includes owning certain beneficial interests in the form of securities as well as the servicing rights retained. The Corporation is not required to provide additional financial support to any of the variable interest entities to which it has transferred the financial assets. The mortgage-backed securities, to the extent retained, are classified in the Corporation s consolidated statements of financial condition as available-for-sale or trading securities. The Corporation concluded that, essentially, these entities (FNMA, GNMA, and FHLMC) control the design of their respective VIEs, dictate the quality and nature of the collateral, require the underlying insurance, set the servicing standards via the servicing guides and can change them at will, and can remove a primary servicer with cause, and without cause in the case of FNMA and FHLMC. Moreover, through their guarantee obligations, agencies (FNMA, GNMA, and FHLMC) have the obligation to absorb losses that could be potentially significant to the VIE.

ASU 2009-17 requires that an ongoing primary beneficiary assessment should be made to determine whether the Corporation is the primary beneficiary of any of the VIEs it is involved with. The conclusion on the assessment of these trusts and guaranteed mortgage securitization transactions has not changed since their initial evaluation. The Corporation concluded that it is still not the primary beneficiary of these VIEs, and therefore, these VIEs are not required to be consolidated in the Corporation s financial statements at September 30, 2013.

The Corporation holds variable interests in these VIEs in the form of agency mortgage-backed securities and collateralized mortgage obligations, including those securities originated by the Corporation and those acquired from third parties. Additionally, the Corporation holds agency mortgage-backed securities, agency collateralized mortgage obligations and private label collateralized mortgage obligations issued by third party VIEs in which it has no other form of continuing involvement. Refer to Note 24 to the consolidated financial statements for additional information on the debt securities outstanding at September 30, 2013 and December 31, 2012, which are classified as available-for-sale and trading securities in the Corporation s consolidated statements of financial condition. In addition, the Corporation may retain the right to service the transferred loans in those government-sponsored special purpose entities ( SPEs ) and may also purchase the right to service loans in other government-sponsored SPEs that were transferred to those SPEs by a third-party. Pursuant to ASC Subtopic 810-10, the servicing fees that the Corporation receives for its servicing role are considered variable interests in the VIEs since the servicing fees are subordinated to the principal and interest that first needs to be paid to the mortgage-backed securities investors and to the guaranty fees that need to be paid to the federal agencies.

## Table of Contents

The following table presents the carrying amount and classification of the assets related to the Corporation s variable interests in non-consolidated VIEs and the maximum exposure to loss as a result of the Corporation s involvement as servicer with non-consolidated VIEs at September 30, 2013 and December 31, 2012.

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :--- | :---: | :---: | :---: | :---: |
| Assets | $\$$ | 113,839 | $\$$ | 105,246 |
| Servicing assets: <br> Mortgage servicing rights | $\$$ | 113,839 | $\$$ | 105,246 |
| Total servicing assets | $\$$ | 1,655 | $\$$ | 1,106 |
| Other assets: | $\$$ | 1,655 | $\$$ | 1,106 |
| Servicing advances | $\$$ | 115,494 | $\$$ | 106,352 |
| Total other assets | $\$$ | 115,494 | $\$$ | 106,352 |

The size of the non-consolidated VIEs, in which the Corporation has a variable interest in the form of servicing fees, measured as the total unpaid principal balance of the loans, amounted to $\$ 9.2$ billion at September 30, 2013 (December 31, 2012 - $\$ 9.2$ billion).

Maximum exposure to loss represents the maximum loss, under a worst case scenario, that would be incurred by the Corporation, as servicer for the VIEs, assuming all loans serviced are delinquent and that the value of the Corporation s interests and any associated collateral declines to zero, without any consideration of recovery. The Corporation determined that the maximum exposure to loss includes the fair value of the MSRs and the assumption that the servicing advances at September 30, 2013 and December 31, 2012, will not be recovered. The agency debt securities are not included as part of the maximum exposure to loss since they are guaranteed by the related agencies.

In September of 2011, BPPR sold construction and commercial real estate loans with a fair value of $\$ 148$ million, and most of which were non-performing, to a newly created joint venture, PRLP 2011 Holdings, LLC. The joint venture is majority owned by Caribbean Property Group ( CPG ), Goldman Sachs \& Co. and East Rock Capital LLC. The joint venture was created for the limited purpose of acquiring the loans from BPPR; servicing the loans through a third-party servicer; ultimately working out, resolving and/or foreclosing the loans; and indirectly owning, operating, constructing, developing, leasing and selling any real properties acquired by the joint venture through deed in lieu of foreclosure, foreclosure, or by resolution of any loan.

BPPR provided financing to the joint venture for the acquisition of the loans in an amount equal to the sum of $57 \%$ of the purchase price of the loans, or $\$ 84$ million, and $\$ 2$ million of closing costs, for a total acquisition loan of $\$ 86$ million (the acquisition loan ). The acquisition loan has a 5 -year maturity and bears a variable interest at 30 -day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity s assets. In addition, BPPR provided the joint venture with a non-revolving advance facility (the advance facility ) of $\$ 68.5$ million to cover unfunded commitments and costs-to-complete related to certain construction projects, and a revolving working capital line (the working capital line ) of $\$ 20$ million to fund certain operating expenses of the joint venture. Cash proceeds

## Edgar Filing: POPULAR INC - Form 10-Q

received by the joint venture are first used to cover debt service payments for the acquisition loan, advance facility, and the working capital line described above which must be paid in full before proceeds can be used for other purposes. The distributable cash proceeds are determined based on a pro-rata basis in accordance with the respective equity ownership percentages. BPPR s equity interest in the joint venture ranks pari-passu with those of other parties involved. As part of the transaction executed in September 2011, BPPR received $\$ 48$ million in cash and a $24.9 \%$ equity interest in the joint venture. The Corporation is not required to provide any other financial support to the joint venture.

BPPR accounted for this transaction as a true sale pursuant to ASC Subtopic 860-10 and thus recognized the cash received, its equity investment in the joint venture, and the acquisition loan provided to the joint venture and derecognized the loans sold.

The Corporation has determined that PRLP 2011 Holdings, LLC is a VIE but the Corporation is not the primary beneficiary. All decisions are made by CPG (or an affiliate thereof) (the Manager ), except for certain limited material decisions which would require the unanimous consent of all members. The Manager is authorized to execute and deliver on behalf of the joint venture any and all documents, contracts, certificates, agreements and instruments, and to take any action deemed necessary in the benefit of the joint venture. Also, the Manager delegates the day-to-day management and servicing of the loans to CPG Island Servicing, LLC, an affiliate of CPG, which contracted Archon, an affiliate of Goldman Sachs, to act as subservicer, but it has the responsibility to oversee such servicing responsibilities.

## Table of Contents

The Corporation holds variable interests in this VIE in the form of the $24.9 \%$ equity interest (the Investment in PRLP 2011 Holdings, LLC ) and the financing provided to the joint venture. The equity interest is accounted for under the equity method of accounting pursuant to ASC Subtopic 323-10.

The following table presents the carrying amount and classification of the assets and liabilities related to the Corporation s variable interests in the non-consolidated VIE, PRLP 2011 Holdings, LLC, and its maximum exposure to loss at September 30, 2013 and December 31, 2012.

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :---: | :---: | :---: | :---: | :---: |
| Assets |  |  |  |  |
| Loans held-in-portfolio: |  |  |  |  |
| Acquisition loan | \$ | 10,558 | \$ | 52,963 |
| Advances under the working capital line |  | 530 |  |  |
| Advances under the advance facility |  | 14,678 |  | 7,077 |
| Total loans held-in-portfolio | \$ | 25,766 | \$ | 60,040 |
| Accrued interest receivable | \$ | 70 | \$ | 163 |
| Other assets: |  |  |  |  |
| Investment in PRLP 2011 Holdings LLC | \$ | 25,971 | \$ | 22,747 |
| Total other assets | \$ | 25,971 | \$ | 22,747 |
| Total assets | \$ | 51,807 | \$ | 82,950 |
| Deposits | \$ | $(4,811)$ | \$ | $(7,103)$ |
| Total liabilities | \$ | $(4,811)$ | \$ | $(7,103)$ |
| Total net assets | \$ | 46,996 | \$ | 75,847 |
| Maximum exposure to loss | \$ | 46,996 | \$ | 75,847 |

The Corporation determined that the maximum exposure to loss under a worst case scenario at September 30, 2013 would be not recovering the carrying amount of the acquisition loan, the advances on the advance facility and working capital line, if any, and the equity interest held by the Corporation, net of the deposits.

On March 25, 2013, BPPR completed a sale of assets with a book value of $\$ 509.0$ million, of which $\$ 500.6$ million were in non-performing status, comprised of commercial and construction loans, and commercial and single family real estate owned, with a combined unpaid principal balance on loans and appraised value of other real estate owned of approximately $\$ 987.0$ million to a newly created joint venture, PR Asset Portfolio 2013-1 International, LLC. The joint venture is majority owned by Caribbean Property Group LLC ( CPG ) and certain affiliates of Perella Weinberg Partners Asset Based Value Strategy. The joint venture was created for the limited purpose of acquiring the loans from BPPR; servicing the loans through a third-party servicer; ultimately working out, resolving and/or foreclosing the loans; and indirectly owning, operating, constructing, developing, leasing and selling any real properties acquired by the joint venture through deed in lieu of foreclosure, foreclosure, or by resolution of any loan.

BPPR provided financing to the joint venture for the acquisition of the assets in an amount equal to the sum of $57 \%$ of the purchase price of the assets, and closing costs, for a total acquisition loan of $\$ 182.4$ million (the acquisition loan ). The acquisition loan has a 5 -year maturity and bears a variable interest at 30 -day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity $s$ assets. In addition, BPPR provided the joint venture with a non-revolving advance facility (the advance facility ) of $\$ 35.0$ million to cover unfunded commitments and costs-to-complete related to certain construction projects, and a revolving working capital line (the working capital line ) of $\$ 30.0$ million to fund certain operating expenses of the joint venture. Cash proceeds received by the joint venture are first used to cover debt service payments for the acquisition loan, advance facility, and the working capital line described above which must be paid in full before proceeds can be used for other purposes. The distributable cash proceeds are determined based on a pro-rata basis in accordance with the respective equity ownership percentages. BPPR s equity interest in the joint venture ranks pari-passu with those of other parties involved. As part of the transaction executed in March 2013, BPPR received $\$ 92.3$ million in cash and a $24.9 \%$ equity interest in the joint venture. The Corporation is not required to provide any other financial support to the joint venture.

## Table of Contents

BPPR accounted for this transaction as a true sale pursuant to ASC Subtopic 860-10 and thus recognized the cash received, its equity investment in the joint venture, and the acquisition loan provided to the joint venture and derecognized the loans and real estate owned sold.

The Corporation has determined that PR Asset Portfolio 2013-1 International, LLC is a VIE but the Corporation is not the primary beneficiary. All decisions are made by CPG (or an affiliate thereof) (the Manager ), except for certain limited material decisions which would require the unanimous consent of all members. The Manager is authorized to execute and deliver on behalf of the joint venture any and all documents, contracts, certificates, agreements and instruments, and to take any action deemed necessary in the benefit of the joint venture. Also, the Manager delegates the day-to-day management and servicing of the loans to PR Asset Portfolio Servicing International, LLC, an affiliate of CPG.

The initial fair value of the Corporation s equity interest in the joint venture was determined based on the fair value of the loans and real estate owned transferred to the joint venture of $\$ 306$ million which represented the purchase price of the loans agreed by the parties and was an arm s-length transaction between market participants in accordance with ASC Topic 820, reduced by the acquisition loan provided by BPPR to the joint venture, for a total net equity of $\$ 124$ million. Accordingly, the $24.9 \%$ equity interest held by the Corporation was valued at $\$ 31$ million. Thus, the fair value of the equity interest is considered a Level 2 fair value measurement since the inputs were based on observable market inputs.

The Corporation holds variable interests in this VIE in the form of the $24.9 \%$ equity interest (the Investment in PR Asset Portfolio 2013-1 International, LLC ) and the financing provided to the joint venture. The equity interest is accounted for under the equity method of accounting pursuant to ASC Subtopic 323-10.

The following table presents the carrying amount and classification of the assets and liabilities related to the Corporation s variable interests in the non-consolidated VIE, PR Asset Portfolio 2013-1 International, LLC, and its maximum exposure to loss at September 30, 2013.

| (In thousands) | September 30, 2013 |  |
| :---: | :---: | :---: |
| Assets |  |  |
| Loans held-in-portfolio: |  |  |
| Acquisition loan | \$ | 172,965 |
| Advances under the working capital line |  | 1,198 |
| Advances under the advance facility |  | 36 |
| Total loans held-in-portfolio | \$ | 174,199 |
| Accrued interest receivable | \$ | 468 |
| Other assets: |  |  |
| Investment in PR Asset Portfolio 2013-1 |  |  |
| International, LLC | \$ | 30,062 |
| Total other assets | \$ | 30,062 |
| Total assets | \$ | 204,729 |


| Deposits | $\$$ | $(25,567)$ |
| :--- | :---: | :---: |
| Total liabilities | $\$$ | $(25,567)$ |
| Total net assets | $\$$ | 179,162 |
| Maximum exposure to loss | $\$$ | 179,162 |

The Corporation determined that the maximum exposure to loss under a worst case scenario at September 30, 2013 would be not recovering the carrying amount of the acquisition loan, the advances on the advance facility and working capital line, if any, and the equity interest held by the Corporation, net of the deposits.

## Table of Contents

## Note 23 Related party transactions with affiliated company / joint venture

## EVERTEC

On September 30, 2010, the Corporation completed the sale of a $51 \%$ majority interest in EVERTEC, Inc. ( EVERTEC ) to an unrelated third-party, including the Corporation s merchant acquiring and processing and technology businesses (the EVERTEC transaction ), and retained a 49\% ownership interest in Carib Holdings, the holding company of EVERTEC. EVERTEC continues to provide various processing and information technology services to the Corporation and its subsidiaries and gives BPPR access to the ATH network owned and operated by EVERTEC. The investment in EVERTEC is accounted for under the equity method and is evaluated for impairment if events or circumstances indicate that a decrease in value of the investment has occurred that is other than temporary. Refer to Note 30 Related party transactions to the consolidated financial statements included in the Corporation s 2012 Annual Report for details on this sale to an unrelated third-party.

On April 12, 2013, EVERTEC completed an initial public offering ( IPO ) of 28.8 million shares of common stock, generating proceeds of approximately $\$ 575.8$ million. In connection with the IPO, EVERTEC sold 6.3 million shares of newly issued common stock and Apollo Global Management LLC ( Apollo ) and Popular sold 13.7 million and 8.8 million shares of EVERTEC retaining stakes of $29.1 \%$ and $33.5 \%$, respectively. As of June 30, 2013, Popular s stake in EVERTEC was reduced to $32.4 \%$ due to exercise by EVERTEC s management of certain stock options that became fully vested as a result of the IPO. A portion of the proceeds received by EVERTEC from the IPO was used to repay and refinance its outstanding debt. In connection with the refinancing, Popular received payment in full for its portion of the EVERTEC debt held by it at that time. As a result of these transactions, Popular recognized an after-tax gain of approximately $\$ 156.6$ million during the second quarter of 2013.

On September 18, 2013, EVERTEC completed a secondary public offering ( SPO ) of 20.0 million shares of common stock to the public at $\$ 22.50$ per share. Apollo sold $10,808,759$ shares and Popular sold $9,057,000$ shares of EVERTEC, retaining respective stakes after the sale of $14.9 \%$ and $21.3 \%$. As a result of this transaction, Popular recognized an after-tax gain of approximately $\$ 167.8$ million during the third quarter of 2013 and received proceeds of approximately $\$ 197$ million.

The Corporation received $\$ 2.7$ million in dividend distributions during the nine months ended September 30, 2013 from its investments in EVERTEC s holding company. During the nine months ended September 30, 2012, net capital distributions received from EVERTEC amounted to \$ 131 million, which included $\$ 1.4$ million in dividend distributions. The Corporation s equity in EVERTEC is presented in the table which follows and is included as part of other assets in the consolidated statements of financial condition.

| (In thousands) | September 30, 2013 | December 31, 2012 |  |
| :--- | :---: | :---: | :---: |
| Equity investment in EVERTEC | $\$$ | 42,369 | $\$$ |
| 73,916 |  |  |  |

The Corporation had the following financial condition balances outstanding with EVERTEC at September 30, 2013 and December 31, 2012. Items that represent liabilities to the Corporation are presented with parenthesis.

| (In thousands) | At September 30, 2013 | At December 31, 2012 |  |
| :--- | :---: | :---: | :---: |
| Investment securities | $\$$ | $\$$ | 35,000 |
| Loans |  |  | 53,589 |

Edgar Filing: POPULAR INC - Form 10-Q

| Accounts receivables (Other assets) | 5,494 | 4,085 |
| :--- | :---: | :---: |
| Deposits | $(23,877)$ | $(19,968)$ |
| Accounts payable (Other liabilities) | $(16,242)$ | $(16,582)$ |
| Net total | $\$$ | $(34,625)$ |

## Table of Contents

The Corporation s proportionate share of income or loss from EVERTEC is included in other operating income in the consolidated statements of operations since October 1, 2010. The following table presents the Corporation s proportionate share of EVERTEC s income (loss) and changes in stockholders equity for the quarters and nine months ended September 30, 2013 and 2012.

|  | Quarter ended <br> September 30, <br> 2013 | Nine months ended <br> September 30, <br> 2013 |  |
| :--- | :---: | ---: | :---: | :---: |
| (In thousands) |  |  |  |
| Share of income (loss) from the investment in <br> EVERTEC | $\$ 02,726$ | $\$$ | $(15,237)$ |
| Share of other changes in EVERTEC s <br> stockholders equity | 157 | 36,642 |  |
| Share of EVERTEC s changes in equity <br> recognized in income | $\$ 02,883$ | $\$$ | 21,405 |


|  | Quarter <br> ended <br> September 30, <br> 2012 | Nine months ended <br> September 30, <br> 2012 |
| :--- | :---: | :---: |
| (In thousands) <br> Share of income from the investment in <br> EVERTEC | 29 | 1,863 |
| Share of other changes in EVERTEC <br> stockholders equity |  |  |
| Share of EVERTEC s changes in equity <br> recognized in income | $\$ ~ 29$ | $\$$ |

The following tables present the transactions and service payments between the Corporation and EVERTEC (as an affiliate) and their impact on the results of operations for the quarters and nine months ended September 30, 2013 and 2012. Items that represent expenses to the Corporation are presented with parenthesis.

| Nine months ended |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Quarter ended September 30, 2013 | $\begin{gathered} \text { September } \\ 30, \\ 2013 \end{gathered}$ |  | Category |
| Interest income on loan to EVERTEC | \$ | \$ | 2,491 | Interest income |
| Interest income on investment securities issued by EVERTEC |  |  | 1,269 | Interest income |
|  | (29) |  | (86) | Interest expense |


| Interest expense on deposits |  |  |  |
| :---: | :---: | :---: | :---: |
| ATH and credit cards interchange income from services to EVERTEC | 6.585 | 18,974 | Other service fees |
| Debt prepayment penalty paid by EVERTEC |  | 5,856 | Net gain (loss) and valuation adjustments on investment securities |
| Consulting fee paid by EVERTEC |  | 9,854 | Other operating income |
| Rental income charged to EVERTEC | 1,690 | 5,054 | Net occupancy |
| Processing fees on services provided by EVERTEC | $(38,335)$ | $(114,610)$ | Professional fees |
| Other services provided to EVERTEC | 204 | 634 | Other operating expenses |
| Total | $(29,885)$ | $(70,564)$ |  |


|  | Quarter ended <br> September 30, <br> 2012 | Nine months ended <br> September 30, <br> 2012 | Category |  |
| :--- | :---: | :---: | :---: | :---: |
| (In thousands) | $\$$ | 854 | $\$$ | 2,502 |

## Table of Contents

At December 31, 2012, EVERTEC had certain performance bonds outstanding, which were guaranteed by the Corporation under a general indemnity agreement between the Corporation and the insurance companies issuing the bonds. EVERTEC s performance bonds guaranteed by the Corporation amounted to approximately $\$ 1.0$ million at December 31, 2012 and expired during the quarter ended June 30, 2013. Also, EVERTEC has a letter of credit issued by BPPR, for an amount of $\$ 3.6$ million at September 30, 2013 (December 31, 2012 - $\$ 2.9$ million). As part of the merger agreement, the Corporation also agreed to maintain outstanding this letter of credit for a 5 -year period.
EVERTEC and the Corporation entered into a Reimbursement Agreement, in which EVERTEC will reimburse the Corporation for any losses incurred by the Corporation in connection with the performance bonds and the letter of credit. Possible losses resulting from these agreements are considered insignificant.

During the second quarter of 2013, the Corporation discontinued the elimination of its proportionate ownership share of intercompany transactions with EVERTEC from their respective revenue and expense categories to reflect them as an equity pick-up adjustment in other operating income. The consolidated statements of operations for all periods presented have been adjusted to reflect this change. This change had no impact on the Corporation s net income and did not have a material effect on its consolidated financial statements. The following tables present the impact of the change in the Corporation $s$ results for all comparative prior period presented.

| (In thousands) | Quarter ended September 30, 2013 |  | Nine months ended September 30, 2013 |  |
| :---: | :---: | :---: | :---: | :---: |
| Share of EVERTEC $s$ changes in equity recognized in income | \$ | 2,883 | \$ | 21,405 |
| Intra-company eliminations considered in other operating income (detailed in next table) |  | $(1,858)$ |  | $(15,030)$ |
| Share of EVERTEC s changes in equity, net of eliminations | \$ | 1,025 | \$ | 6,375 |


| (In thousands) | Quarter ended September 30, 2013 Impact |  |  |  |  | $\begin{aligned} & \text { e mo } \\ & \text { In } \\ & \text { elemb } \end{aligned}$ | ths en r 30, 2 pact of A ations |  | ts net of nations | Category |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Interest income on loan to EVERTEC | \$ | \$ 276 | \$ | 276 | 2,491 | \$ | (531) | \$ | 1,960 | Interest income |
| Interest income on investment securities issued by EVERTEC |  | 141 |  | 141 | 1,269 |  | (270) |  | 999 | Interest income |
| Interest expense on deposits | (29) |  |  | (29) | (86) |  | 18 |  | (68) | Interest expense |

Edgar Filing: POPULAR INC - Form 10-Q
ATH and credit cards interchange income from
$\left.\begin{array}{lccccccr}\text { services to EVERTEC } & 6,585 & \text { (29) } & 6,556 & 18,974 & (4,041) & 14,933 & \begin{array}{r}\text { Other service fees }\end{array} \\ \begin{array}{l}\text { Debt prepayment penalty } \\ \text { paid by EVERTEC }\end{array} & & & & & \begin{array}{r}\text { Net gain (loss) } \\ \text { and valuation } \\ \text { adjustments on } \\ \text { investment }\end{array} \\ \text { securities }\end{array}\right\}$

Processing fees on services provided by EVERTEC (38,335) (286) (38,621) (114,610) 24,412 $\quad(90,198) \quad$ Professional fees

| Other services provided <br> to EVERTEC | 204 | 4 | 208 | 634 | $(135)$ | 499 | Other operating <br> expenses |
| :--- | ---: | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Total | $\$(29,885)$ | $\$ 1,858$ | $\$(28,027)$ | $\$(70,564)$ | $\$ 15,030$ | $\$(55,534)$ |  |

[1] The impact of eliminations for the quarter ended September 30, 2013 includes the effect of the reduction in Popular s stake in EVERTEC to $21.3 \%$ from $32.4 \%$ as of June 30, 2013.

Table of Contents

|  | Quarter <br> ended <br> September 30, <br> 2012 | Nine months ended <br> September 30, <br> 2012 |  |  |
| :--- | :---: | :---: | :---: | :---: |
| (In thousands) | $\$$ | 29 | $\$$ | 1,714 |
| Share of EVERTEC s changes in equity <br> recognized in income |  | $(12,793)$ |  | $(39,067)$ |
| Intra-company eliminations considered in <br> other operating income (detailed in next table) | $\$(12,764)$ | $\$$ | $(37,353)$ |  |



Interest income on investment

| securities issued by |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| EVERTEC | 963 | (467) | 496 | 2,888 | $(1,384)$ | 1,504 |
| Interest income |  |  |  |  |  |  |

Interest expense on
deposits $\quad(45) \quad 104 \quad$ (219) (115) Interest expense

ATH and credit
cards interchange
income from

| services to |  |  |  | Other service |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | ---: | ---: |
| EVERTEC | 6,240 | $(3,026)$ | 3,214 | 18,513 | $(8,854)$ | 9,659 | fees |


| Rental income <br> charged to <br> EVERTEC$\quad 1,636$ |
| :--- |

Processing fees on services provided by EVERTEC $\quad(36,173) \quad 17,540 \quad(18,633) \quad(110,687) \quad 53,048 \quad(57,639) \quad$ Professional fees

Other services provided to ,

| EVERTEC | 141 | 73 | 73 | 544 | $(258)$ | 286 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Total $\$(26,384) \quad \$ 12,793 \quad \$(13,591) \quad \$(81,468) \quad \$ 39,067 \quad \$(42,401)$

## PRLP 2011 Holdings LLC

As indicated in Note 22 to the consolidated financial statements, the Corporation holds a $24.9 \%$ equity interest in PRLP 2011 Holdings LLC and currently provides certain financing to the joint venture as well as holds certain deposits from the entity.

The Corporation s equity in PRLP 2011 Holdings, LLC is presented in the table which follows and is included as part of other assets in the consolidated statements of financial condition.

| (In thousands) | September 30, 2013 | December 31, 2012 |  |  |
| :--- | :---: | :---: | :---: | :---: |
| Equity investment in PRLP 2011 | $\$$ | 25,971 | $\$$ | 22,747 |
| Holdings, LLC | $\$$ |  |  |  |

The Corporation had the following financial condition balances outstanding with PRLP 2011 Holdings, LLC at September 30, 2013 and 2012.

| (In thousands) | At September 30, 2013 | At December 31, 2012 |  |  |
| :--- | :---: | :---: | :---: | :---: |
| Loans | $\$$ | 25,766 | $\$$ | 60,040 |
| Accrued interest receivable |  | 70 |  | 163 |
| Deposits (non-interest bearing) |  | $(4,811)$ |  | $(7,103)$ |
| Net total | $\$$ | 21,025 | $\$$ | 53,100 |

## Table of Contents

The Corporation s proportionate share of income or loss from PRLP 2011 Holdings, LLC is included in other operating income in the consolidated statements of operations. The following table presents the Corporation s proportionate share of income (loss) from PRLP 2011 Holdings, LLC for the quarters and nine months ended September 30, 2013 and 2012.

| (In thousands) | Quarter ended September 30, 2013 | Nine months ended September 30, 2013 |  |
| :---: | :---: | :---: | :---: |
| Share of (loss) income from the equity investment in PRLP 2011 Holdings, LLC | (9) | \$ | 2,721 |
| (In thousands) | $\begin{gathered} \text { Quarter } \\ \text { ended } \\ \text { September } 30, \\ 2012 \end{gathered}$ | Nine months ended September 30, 2012 |  |
| Share of income from the equity investment in PRLP 2011 Holdings, LLC | \$ 1,770 | \$ | 7,118 |

The following table presents transactions between the Corporation and PRLP 2011 Holdings, LLC and their impact on the Corporation s results of operations for the quarters and nine months ended September 30, 2013 and 2012.


| Quarter <br> ended |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: |
| (In thousands) | Nine months ended <br> September 30, 2012 September 30, 2012 | Category |  |  |
| Interest income on loan to PRLP | $\$$ | 619 | $\$$ | 2,130 | Interest income

## PR Asset Portfolio 2013-1 International, LLC

As indicated in Note 22 to the consolidated financial statements, effective March 2013 the Corporation holds a $24.9 \%$ equity interest in PR Asset Portfolio 2013-1 International, LLC and currently provides certain financing to the joint venture as well as holds certain deposits from the entity.

The Corporation s equity in PR Asset Portfolio 2013-1 International, LLC is presented in the table which follows and is included as part of other assets in the consolidated statements of financial condition.
(In thousands)
September 30, 2013
Equity investment in PR Asset Portfolio 2013-1
International, LLC
\$ 30,062
The Corporation had the following financial condition balances outstanding with PR Asset Portfolio 2013-1 International, LLC, at September 30, 2013.

| (In thousands) | At September 30, 2013 |  |
| :--- | :---: | :---: |
| Loans | $\$$ | 174,199 |
| Accrued interest receivable |  | 468 |
| Deposits (non-interest bearing) |  | $(25,567)$ |
| Net total | $\$$ | 149,100 |

## Table of Contents

The Corporation s proportionate share of income or loss from PR Asset Portfolio 2013-1 International, LLC is included in other operating income in the consolidated statements of operations. The following table presents the Corporation s proportionate share of income (loss) from PR Asset Portfolio 2013-1 International, LLC for the quarter and nine months ended September 30, 2013.

|  | Quarter ended <br> September 30, <br> 2013 | Nine months ended <br> September 30, <br> 2013 |
| :--- | :---: | :---: |
| (In thousands) |  |  |

The following table presents transactions between the Corporation and PR Asset Portfolio 2013-1 International, LLC and their impact on the Corporation s results of operations for the quarter and nine months ended September 30, 2013.

|  | Nine months ended <br> September <br> Quarter ended <br> September 30, <br> 30, |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 |  | 2013 | Category |  |
| Interest income on loan to PR Asset | $\$$ | 1,478 | $\$$ | 1,594 | Interest income |
| Portfolio 2013-1 International, LLC |  |  |  |  |  |
| Servicing fee paid by PR Asset <br> Portfolio 2013-1 International, LLC | 105 |  | 150 | Other service fees |  |
| Total | $\$$ | 1,583 | $\$$ | 1,744 |  |

Table of Contents

## Note 24 Fair value measurement

ASC Subtopic 820-10 Fair Value Measurements and Disclosures establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels in order to increase consistency and comparability in fair value measurements and disclosures. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

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

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

Level 3 - Inputs are unobservable and significant to the fair value measurement. Unobservable inputs reflect the Corporation s own assumptions about assumptions that market participants would use in pricing the asset or liability.
The Corporation maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available. Fair value is based upon quoted market prices when available. If listed prices or quotes are not available, the Corporation employs internally-developed models that primarily use market-based inputs including yield curves, interest rates, volatilities, and credit curves, among others. Valuation adjustments are limited to those necessary to ensure that the financial instrument s fair value is adequately representative of the price that would be received or paid in the marketplace. These adjustments include amounts that reflect counterparty credit quality, the Corporation s credit standing, constraints on liquidity and unobservable parameters that are applied consistently. There have been no changes in the Corporation s methodologies used to estimate the fair value of assets and liabilities since December 31, 2012. Refer to the Critical Accounting Policies / Estimates in the 2012 Annual Report for additional information on the accounting guidance and the Corporation s policies or procedures related to fair value measurements.

The estimated fair value may be subjective in nature and may involve uncertainties and matters of significant judgment for certain financial instruments. Changes in the underlying assumptions used in calculating fair value could significantly affect the results.

## Fair Value on a Recurring and Nonrecurring Basis

The following fair value hierarchy tables present information about the Corporation s assets and liabilities measured at fair value on a recurring basis at September 30, 2013 and December 31, 2012 and on a nonrecurring basis in periods subsequent to initial recognition for the nine months ended September 30, 2013 and 2012:

At September 30, 2013

|  | Level |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 1 | Level 2 | Level 3 | Total |

## RECURRING FAIR VALUE MEASUREMENTS

Assets
Investment securities available-for-sale:

| U.S. Treasury securities | $\$$ | $\$ 43,928$ | $\$$ | $\$ 43,928$ |
| :--- | ---: | ---: | ---: | ---: |
| Obligations of U.S. Government sponsored entities |  | $1,285,399$ |  | $1,285,399$ |
| Obligations of Puerto Rico, States and political |  | 55,927 |  | 55,927 |
| subdivisions |  |  |  |  |
| Collateralized mortgage obligations - federal |  | $2,533,744$ | 887 | $2,533,744$ |
| agencies |  | $1,188,906$ | 6,698 | $1,195,604$ |
| Collateralized mortgage obligations - private label |  | 3,598 | 8,786 |  |
| Mortgage-backed securities | 5,188 | 12,343 |  | 12,343 |

Total investment securities available-for-sale $\quad \$ 5,188 \quad \$ 5,124,732 \quad \$ \quad 6,698 \quad \$ 5,136,618$

Trading account securities, excluding derivatives:
Obligations of Puerto Rico, States and political

| subdivisions | \$ | \$ | 9,464 | \$ |  | \$ | 9,464 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Collateralized mortgage obligations |  |  | 462 |  | 1,479 |  | 1,941 |
| Mortgage-backed securities - federal agencies |  |  | 299,952 |  | 10,036 |  | 309,988 |
| Other |  |  | 15,471 |  | 1,973 |  | 17,444 |
| Total trading account securities | \$ | \$ | 325,349 | \$ | 13,488 | \$ | 338,837 |
| Mortgage servicing rights | \$ | \$ |  | \$ | 161,445 | \$ | 161,445 |


| Total assets measured at fair value on a recurring <br> basis |
| :--- |
| $\$ 5,188$ |$\quad \$ 5,482,823 \quad \$ 181,631 \quad \$ 5,669,642$

Liabilities

| Derivatives | $\$$ | $\$(34,942)$ | $\$$ | $\$(34,942)$ |
| :--- | :--- | :--- | :--- | :--- |
| Contingent consideration |  |  | $(124,575)$ | $(124,575)$ |

Total liabilities measured at fair value on a
recurring basis $\quad \$ \quad \$(34,942) \quad \$(124,575) \quad \$(159,517)$

Table of Contents

At December 31, 2012
Level
(In thousands) $1 \quad$ Level 2 Level 3 Total

## RECURRING FAIR VALUE MEASUREMENTS

Assets

| U.S. Treasury securities | \$ | \$ 37,238 | \$ |  | \$ 37,238 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Obligations of U.S. Government sponsored entities |  | 1,096,318 |  |  | 1,096,318 |
| Obligations of Puerto Rico, States and political subdivisions |  | 54,981 |  |  | 54,981 |
| Collateralized mortgage obligations - federal agencies |  | 2,367,065 |  |  | 2,367,065 |
| Collateralized mortgage obligations - private label |  | 2,473 |  |  | 2,473 |
| Mortgage-backed securities |  | 1,476,077 |  | 7,070 | 1,483,147 |
| Equity securities | 3,827 | 3,579 |  |  | 7,406 |
| Other |  | 35,573 |  |  | 35,573 |
| Total investment securities available-for-sale | \$ 3,827 | \$ 5,073,304 | \$ | 7,070 | \$ 5,084,201 |

$\left.\begin{array}{lrrrrrr}\text { Trading account securities, excluding derivatives: } & & & & & \\ \hline \begin{array}{ll}\text { Obligations of Puerto Rico, States and political } \\ \text { subdivisions }\end{array} & \$ & \$ & 24,801 & \$ & 618 & 2,499\end{array}\right)$

| Total assets measured at fair value on a recurring |
| :--- |
| basis |$\quad \$ 3,827 \quad \$ 5,413,198 \quad \$ 178,056 \quad \$ 5,595,081$.

Liabilities

| Derivatives | $\$$ | $\$(42,585)$ | $\$$ | $\$ \quad(42,585)$ |
| :--- | :--- | :--- | :--- | :--- |
| Contingent consideration |  | $(112,002)$ | $(112,002)$ |  |

Total liabilities measured at fair value on a recurring basis $\quad \$ \quad \$(42,585) \quad \$(112,002) \quad \$(154,587)$

Table of Contents
Nine months ended September 30, 2013
(In thousands) Level 1 Level 2 Level 3 Total
NONRECURRING FAIR VALUE MEASUREMENTS

[1] Relates mostly to certain impaired collateral dependent loans. The impairment was measured based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations, in accordance with the provisions of ASC Section 310-10-35.
[2] Relates to lower of cost or fair value adjustments on loans held-for-sale and loans transferred from loans held-in-portfolio to loans held-for-sale.
[3] Represents the fair value of foreclosed real estate and other collateral owned that were written down to their fair value. Costs to sell excluded from the reported fair value amount were $\$ 5$ million at September 30, 2013.

Nine months ended September 30, 2012
(In thousands) Level ILevel 2 Level 3 Total

NONRECURRING FAIR VALUE MEASUREMENTS

| Assets |  |  | Write-downs |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans ${ }^{[1]}$ | \$ | \$ | \$ 11,887 | \$ 11,887 | \$ | $(12,206)$ |
| Loans held-for-sale ${ }^{[2]}$ |  |  | 102,092 | 102,092 |  | $(41,706)$ |
| Other real estate owned ${ }^{[3]}$ |  |  | 93,560 | 93,560 |  | $(25,795)$ |
| Other foreclosed assets ${ }^{[3]}$ |  |  | 120 | 120 |  | (303) |
| Long-lived assets held-for-sale ${ }^{[4]}$ |  |  |  |  |  | (123) |
| Total assets measured at fair value on a nonrecurring basis | \$ | \$ | \$ 207,659 | \$ 207,659 | \$ | $(80,133)$ |

[1] Relates mostly to certain impaired collateral dependent loans. The impairment was measured based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations, in accordance with the provisions of ASC Section 310-10-35.
[2] Relates to lower of cost or fair value adjustments on loans held-for-sale and loans transferred from loans held-in-portfolio to loans held-for-sale.
[3] Represents the fair value of foreclosed real estate and other collateral owned that were written down to their fair value. Costs to sell excluded from the reported fair value amount were $\$ 6$ million at September 30, 2012.
[4] Represents the fair value of long-lived assets held-for-sale that were written down to their fair value.

Edgar Filing: POPULAR INC - Form 10-Q

## Table of Contents

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the quarters and nine months ended September 30, 2013 and 2012.

Quarter ended September 30, 2013

| (In thousands) | MBS <br> classified as investmen securities available-for-sale |  | CMOs <br> classified as trading accounttra securities |  | MBS <br> sified as g accoun curities | Other securities classified as trading taccount securities | Mortgage servicing rights | Total assets | Contingent consideration | Total liabilities |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| $\begin{aligned} & \text { Balance at June 30, } \\ & 2013 \end{aligned}$ | \$ | 6,756 | \$ 1,653 | \$ | 10,335 | \$ 2,042 | \$ 153,444 | \$ 174,230 | \$ $(119,253)$ | \$ $(119,253)$ |
| Gains (losses) included in earnings |  | (2) | (4) |  | 83 | (69) | 3,879 | 3,887 | $(5,322)$ | $(5,322)$ |
| Gains (losses) included in OCl |  | 44 |  |  |  |  |  | 44 |  |  |
| Purchases |  |  |  |  | 343 |  | 4,910 | 5,253 |  |  |
| Sales |  |  | (103) |  | (100) |  |  | (203) |  |  |
| Settlements |  | (100) | (67) |  | (625) |  | (788) | $(1,580)$ |  |  |
| Balance at <br> September 30, 2013 | \$ |  | \$ 1,479 | \$ | 10,036 | \$ 1,973 | \$ 161,445 | \$ 181,631 | \$ $(124,575)$ | \$ $(124,575)$ |
| Changes in unrealized gains (losses) included in earnings relating to assets still held at |  |  |  |  |  |  |  |  |  |  |
|  | \$ |  | \$ 1 | \$ | 135 | \$ | \$ 9,342 | \$ 9,478 | \$ (5,322) | \$ $(5,322)$ |


| Nine months ended September 30, 2013 |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | MBSclassified <br> as investmentlassifiedOther <br> securities <br> classifiedsecurities as trading classified as as trading |  |  |  |  | Mortgage servicing rights | Total assets | Contingent consideration | Total liabilities |
| Balance at January 1, 2013 | \$ 7,070 | \$ 2,499 | \$ | 11,818 | \$ 2,240 | \$ 154,430 | \$ 178,057 | \$ $(112,002)$ | \$(112,002) |
| Gains (losses) included in earnings | (5) | (3) |  | (91) | (267) | $(6,862)$ | $(7,228)$ | $(12,573)$ | $(12,573)$ |
|  | (42) |  |  |  |  |  | (42) |  |  |

Edgar Filing: POPULAR INC - Form 10-Q
Gains (losses)
included in OCI

| Purchases |  | 25 | 601 | 15,107 | 15,733 |
| :--- | :---: | :---: | :---: | :---: | :---: |
| Sales |  | $(802)$ | $(100)$ | $(902)$ |  |
| Settlements | $(325)$ | $(240)$ | $(2,192)$ | $(1,230)$ | $(3,987)$ |

## Balance at

September 30, 2013 \$ 6,698 \$ 1,479 \$ 10,036 \$ 1,973 \$ 161,445 \$ 181,631 \$ (124,575) \$ $(124,575)$
Changes in unrealized gains (losses) included in earnings relating to assets still held at September 30, 2013 \$ $\quad \$ \quad 4 \quad \$ \quad 90 \quad \$ \quad(7) \$ 13,355 \quad \$ 13,442 \quad \$(12,573) \$(12,573)$

Quarter ended September 30, 2012


## Balance at

September 30, 2012 \$ 7,143 \$ 2,634 \$ 12,569 \$ 2, 390 $\quad \$ 158,367$ \$ 183,103 $\quad \$(103,688) \quad \$(103,688)$
Changes in unrealized gains (losses) included in earnings relating to assets still held at


Table of Contents
Nine months ended September 30, 2012
MBS
classified CMOs
as investmentlassified MBS classified securities as trading classified as as trading Mortgage

| (In thousands) | available- accounttrading account account for-sale securities securities securities |  |  |  | servicing rights | Total assets |  | ontingent <br> sideration | Total liabilities |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at <br> January 1, 2012 | \$ 7,435 | \$ 2,808 | \$ 21,777 | \$ 4,036 | \$ 151,323 | \$ 187,379 | \$ | $(99,762)$ | $(99,762)$ |
| Gains (losses) included in earnings | (5) | 54 | 747 | 27 | $(7,217)$ | $(6,394)$ |  | $(4,237)$ | $(4,237)$ |
| Gains (losses) included in OCI | 63 |  |  |  |  | 63 |  |  |  |
| Purchases |  | 607 | 6,393 | 2,116 | 14,462 | 23,578 |  |  |  |
| Sales |  | (251) | $(9,741)$ | $(1,834)$ | (103) | $(11,929)$ |  |  |  |
| Settlements | (350) | (584) | $(1,396)$ | $(1,955)$ | (98) | $(4,383)$ |  | 311 | 311 |
| Transfers into Level 3 |  |  | 2,405 |  |  | 2,405 |  |  |  |
| Transfers out of Level 3 |  |  | $(7,616)$ |  |  | $(7,616)$ |  |  |  |

Balance at
September 30,
2012 \$ 7,143 \$ 2,634 $\$ 12,569 \quad \$ 2,390 \quad \$ 158,367$ \$ 183,103 $\quad \$(103,688) \quad \$(103,688)$
Changes in unrealized gains (losses) included in earnings relating to assets still held at September 30,


There were no transfers in and / or out of Level 1, Level 2, or Level 3 for financial instruments measured at fair value on a recurring basis during the quarters ended September 30, 2013 and 2012, and nine months ended September 30, 2013. There were no transfers in and / or out of Level 1 for financial instruments measured at fair value on a recurring basis during the nine months ended September 30, 2012. There were $\$ 2$ million in transfers from Level 2 to Level 3 and $\$ 8$ million in transfers from Level 3 to Level 2 for financial instruments measured at fair value on a recurring basis during the nine months ended September 30, 2012. The transfers from Level 2 to Level 3 of trading mortgage-backed securities were the result of a change in valuation technique to a matrix pricing model, based on indicative prices provided by brokers. The transfers from Level 3 to Level 2 of trading mortgage-backed securities resulted from observable market data becoming available for these securities. The Corporation s policy is to recognize transfers as of the end of the reporting period.

Gains and losses (realized and unrealized) included in earnings for the quarter and nine months ended September 30, 2013 and 2012 for Level 3 assets and liabilities included in the previous tables are reported in the consolidated statement of operations as follows:


Table of Contents

|  | Quarter ended September 30, 2012 |  | Nine months ended September 30, 2012 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Total gains (losses) included in earnings | Changes in unrealized gains (losses) relating to d assets still held at reporting date | Total gains (losses) included in earnings |  | ges in <br> lized <br> ) relating to till held <br> ng date |
| Interest income | \$ (2) | \$ | \$ (5) | \$ |  |
| FDIC loss share (expense) income | $(2,991)$ | $(2,991)$ | $(4,849)$ |  | $(4,849)$ |
| Mortgage banking activities | $(2,426)$ | 5,548 | $(7,217)$ |  | 11,067 |
| Trading account profit (loss) | (255) | (50) | 828 |  | (466) |
| Other operating income | 5 |  | 612 |  | 96 |
| Total | \$ $(5,669)$ | \$ 2,507 | \$ $(10,631)$ | \$ | 5,848 |

The following table includes quantitative information about significant unobservable inputs used to derive the fair value of Level 3 instruments, excluding those instruments for which the unobservable inputs were not developed by the Corporation such as prices of prior transactions and/or unadjusted third-party pricing sources.

Weighted

| (In thousands) | Fair Value <br> at <br> September 30, 2013 | Valuation Technique | Unobservable Inputs | Average <br> (Range) |
| :---: | :---: | :---: | :---: | :---: |
| Collateralized mortgage obligations trading | \$ 1,479 | Discounted cash flow model | Weighted average life Yield <br> Constant prepayment rate | $\begin{gathered} 2.6 \text { years (0.7-4.6 years) } \\ 4.3 \%(1.5 \%-4.7 \%) \\ 23.9 \%(21.7 \%-25.2 \%) \end{gathered}$ |
| Other - trading | \$ 959 | Discounted cash flow model | Weighted average life Yield <br> Constant prepayment rate | $\begin{gathered} 5.1 \text { years } \\ 10.1 \% \\ 12.6 \% \end{gathered}$ |
| Mortgage servicing rights | \$ 161,445 | Discounted cash flow model | Prepayment speed Weighted average life Discount rate | $\begin{gathered} 8.4 \%(5.3 \%-21.1 \%) \\ 12.0 \text { years }(4.7-19.0 \text { years }) \\ 11.4 \%(9.5 \%-16.8 \%) \end{gathered}$ |
| Contingent consideration | \$ $(124,575)$ | Discounted cash flow model | Credit loss rate on covered loans Risk premium component of discount rate | $17.1 \%(0.0 \%-103.4 \%)$ $3.8 \%$ |
| Loans <br> held-in-portfolio | \$ 25,488[1] | External Appraisal | Haircut applied on external appraisals | 15.1\% (5.0\%-30.0\%) |
| Other real estate owned | \$ 14,328[2] | External Appraisal | Haircut applied on external appraisals | 26.3\% (10.0\%-40.0\%) |

[1] Loans held-in-portfolio in which haircuts were not applied to external appraisals were excluded from this table.
[2] Other real estate owned in which haircuts were not applied to external appraisals were excluded from this table. The significant unobservable inputs used in the fair value measurement of the Corporation s collateralized mortgage obligations and interest-only collateralized mortgage obligation (reported as other ), which are classified in the trading category, are yield, constant prepayment rate, and weighted average life. Significant increases (decreases) in any of those inputs in isolation would result in significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the constant prepayment rate will generate a directionally opposite change in the weighted average life. For example, as the average life is reduced by a higher constant prepayment rate, a lower yield will be realized, and when there is a reduction in the constant prepayment rate, the average life of these collateralized mortgage obligations will extend, thus resulting in a higher yield. These particular financial instruments are valued internally by the Corporation s investment banking and broker-dealer unit utilizing internal valuation techniques. The unobservable inputs incorporated into the internal discounted cash flow models used to derive the fair value of collateralized mortgage obligations and interest-only collateralized mortgage obligation (reported as other ), which are classified in the trading category, are reviewed by the Corporation s Corporate Treasury unit on a quarterly basis. In the case of Level 3 financial instruments which fair value is based on broker quotes, the Corporation s Corporate Treasury unit reviews the inputs used by the broker-dealers for reasonableness utilizing information available from other published sources and validates that the fair value measurements were developed in accordance with ASC Topic 820. The Corporate Treasury unit also substantiates the inputs used by validating the prices with other broker-dealers, whenever possible.

## Table of Contents

The significant unobservable inputs used in the fair value measurement of the Corporation s mortgage servicing rights are constant prepayment rates and discount rates. Increases in interest rates may result in lower prepayments. Discount rates vary according to products and / or portfolios depending on the perceived risk. Increases in discount rates result in a lower fair value measurement. The Corporation s Corporate Comptroller s unit is responsible for determining the fair value of MSRs, which is based on discounted cash flow methods based on assumptions developed by an external service provider, except for prepayment speeds, which are adjusted internally for the local market based on historical experience. The Corporation s Corporate Treasury unit validates the economic assumptions developed by the external service provider on a quarterly basis. In addition, an analytical review of prepayment speeds is performed quarterly by the Corporate Comptroller s unit. Significant variances in prepayment speeds are investigated by the Corporate Treasury unit. The Corporation s MSR Committee analyzes changes in fair value measurements of MSRs and approves the valuation assumptions at each reporting period. Changes in valuation assumptions must also be approved by the MSR Committee. The fair value of MSRs are compared with those of the external service provider on a quarterly basis in order to validate if the fair values are within the materiality thresholds established by management to monitor and investigate material deviations. Back-testing is performed to compare projected cash flows with actual historical data to ascertain the reasonability of the projected net cash flow results.

## Table of Contents

## Note 25 Fair value of financial instruments

The fair value of financial instruments is the amount at which an asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on the type of financial instrument and relevant market information. Many of these estimates involve various assumptions and may vary significantly from amounts that could be realized in actual transactions.

The information about the estimated fair values of financial instruments presented hereunder excludes all nonfinancial instruments and certain other specific items.

For those financial instruments with no quoted market prices available, fair values have been estimated using present value calculations or other valuation techniques, as well as management $s$ best judgment with respect to current economic conditions, including discount rates, estimates of future cash flows, and prepayment assumptions.

The fair values reflected herein have been determined based on the prevailing interest rate environment at September 30, 2013 and December 31, 2012, as applicable. In different interest rate environments, fair value estimates can differ significantly, especially for certain fixed rate financial instruments. In addition, the fair values presented do not attempt to estimate the value of the Corporation s fee generating businesses and anticipated future business activities, that is, they do not represent the Corporation s value as a going concern. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Corporation.

Following is a description of the Corporation s valuation methodologies and inputs used to estimate the fair values for each class of financial assets and liabilities not measured at fair value, but for which the fair value is disclosed. The disclosure requirements exclude certain financial instruments and all non-financial instruments. Accordingly, the aggregate fair value amounts of the financial instruments disclosed do not represent management sestimate of the underlying value of the Corporation. For a description of the valuation methodologies and inputs used to estimate the fair value for each class of financial assets and liabilities measured at fair value, refer to the Critical Accounting Policies / Estimates in the 2012 Annual Report.

## Cash and due from banks

Cash and due from banks include cash on hand, cash items in process of collection, and non-interest bearing deposits due from other financial institutions. The carrying amount of cash and due from banks is a reasonable estimate of its fair value. Cash and due from banks are classified as Level 1.

## Money market investments

Investments in money market instruments include highly liquid instruments with an average maturity of three months or less. For this reason, they carry a low risk of changes in value as a result of changes in interest rates, and the carrying amount approximates their fair value. Money market investments include federal funds sold, securities purchased under agreements to resell, time deposits with other banks, and cash balances, including those held at the Federal Reserve. These money market investments are classified as Level 2, except for cash balances which generate interest, including those held at the Federal Reserve, which are classified as Level 1.

Obligations of Puerto Rico, States and political subdivisions: Municipal bonds include Puerto Rico public municipalities debt and bonds collateralized by second mortgages under the Home Purchase Stimulus Program. Puerto Rico public municipalities debt was valued internally based on benchmark treasury notes and a credit spread derived from comparable Puerto Rico government trades and recent issuances. Puerto Rico public municipalities debt is classified as Level 3. Given that the fair value of municipal bonds collateralized by second mortgages was based on internal yield and prepayment speed assumptions, these municipal bonds are classified as Level 3.

Agency collateralized mortgage obligation: The fair value of the agency collateralized mortgage obligation ( CMO ), which is guaranteed by GNMA, was based on internal yield and prepayment speed assumptions. This agency CMO is classified as Level 3.

Other: Other securities include foreign and corporate debt. Given that the fair value was based on quoted prices for similar instruments, foreign debt is classified as Level 2 . The fair value of corporate debt, which is collateralized by municipal bonds of Puerto Rico, was internally derived from benchmark treasury notes and a credit spread based on comparable Puerto Rico government trades, similar securities, and/or recent issuances. Corporate debt is classified as Level 3.

## Other investment securities

Federal Home Loan Bank capital stock: Federal Home Loan Bank (FHLB) capital stock represents an equity interest in the FHLB of New York. It does not have a readily determinable fair value because its ownership is restricted and it lacks a market. Since the excess stock is repurchased by the FHLB at its par value, the carrying amount of FHLB capital stock approximates fair value. Thus, these stocks are classified as Level 2.

Federal Reserve Bank capital stock: Federal Reserve Bank (FRB) capital stock represents an equity interest in the FRB of New York. It does not have a readily determinable fair value because its ownership is restricted and it lacks a market. Since the canceled stock is repurchased by the FRB for the amount of the cash subscription paid, the carrying amount of FRB capital stock approximates fair value. Thus, these stocks are classified as Level 2.

Trust preferred securities: These securities represent the equity-method investment in the common stock of these trusts. Book value is the same as fair value for these securities since the fair value of the junior subordinated debentures is the same amount as the fair value of the trust preferred securities issued to the public. The equity-method investment in the common stock of these trusts is classified as Level 2, except for that of Popular Capital Trust III (Troubled Asset Relief Program) which is classified as Level 3. Refer to Note 17 for additional information on these trust preferred securities.

Other investments: Other investments include private equity method investments and Visa Class B common stock held by the Corporation. Since there are no observable market values, private equity method investments are classified as Level 3. The Visa Class B common stock was priced by applying the quoted price of Visa Class A common stock, net of a liquidity adjustment, to the as converted number of Class A common shares since these Class B common shares are restricted and not convertible to Class A common shares until pending litigation is resolved. Thus, these stocks are classified as Level 3.

## Loans held-for-sale

The fair value of certain impaired loans held-for-sale was based on a discounted cash flow model that assumes that no principal payments are received prior to the effective average maturity date, that the outstanding unpaid principal balance is reduced by a monthly net loss rate, and that the remaining unpaid principal balance is received as a lump sum principal payment at the effective average maturity date. The remaining unpaid principal balance expected to be received, which is based on the prior 12-month cash payment experience of these loans and their expected collateral recovery, was discounted using the interest rate currently offered to clients for the origination of comparable loans. These loans were classified as Level 3. As of September 30, 2013, no loans were valued under this methodology. For loans held-for-sale originated with the intent to sell in the secondary market, its fair value was determined using similar characteristics of loans and secondary market prices assuming the conversion to mortgage-backed securities. Given that the valuation methodology uses internal assumptions based on loan level data, these loans are classified as Level 3. The fair value of certain other loans held-for-sale is based on bids received from potential buyers; binding offers; or external appraisals, net of internal adjustments and estimated costs to sell. Loans held-for-sale based on binding offers are classified as Level 2. Loans held-for-sale based on indicative offers and/or external appraisals are classified as Level 3.

## Loans held-in-portfolio

The fair values of the loans held-in-portfolio have been determined for groups of loans with similar characteristics. Loans were segregated by type such as commercial, construction, residential mortgage, consumer, and credit cards. Each loan category was further segmented based on loan characteristics, including interest rate terms, credit quality and vintage. Generally, fair values were estimated based on an exit price by discounting expected cash flows for the segmented groups of loans using a discount rate that considers interest, credit and expected return by market participant under current market conditions. Additionally, prepayment, default and recovery assumptions have been applied in the mortgage loan portfolio valuations. Generally accepted accounting principles do not require a fair valuation of the lease financing portfolio, therefore it is included in the loans total at its carrying amount. Loans held-in-portfolio are classified as Level 3.

## Table of Contents

## FDIC loss share asset

Fair value of the FDIC loss share asset was estimated using projected net losses related to the loss sharing agreements, which are expected to be reimbursed by the FDIC. The projected net losses were discounted using the U.S. Government agency curve. The loss share asset is classified as Level 3.

## Deposits

Demand deposits: The fair value of demand deposits, which have no stated maturity, was calculated based on the amount payable on demand as of the respective dates. These demand deposits include non-interest bearing demand deposits, savings, NOW, and money market accounts. Thus, these deposits are classified as Level 2.

Time deposits: The fair value of time deposits was calculated based on the discounted value of contractual cash flows using interest rates being offered on time deposits with similar maturities. The non-performance risk was determined using internally-developed models that consider, where applicable, the collateral held, amounts insured, the remaining term, and the credit premium of the institution. For certain 5 -year certificates of deposit in which customers may withdraw their money anytime with no penalties or charges, the fair value of these certificates of deposit incorporate an early cancellation estimate based on historical experience. Time deposits are classified as Level 2.
Assets sold under agreements to repurchase

Securities sold under agreements to repurchase (structured and non-structured): Securities sold under agreements to repurchase with short-term maturities approximate fair value because of the short-term nature of those instruments. Resell and repurchase agreements with long-term maturities were valued using discounted cash flows based on the three-month LIBOR. In determining the non-performance credit risk valuation adjustment, the collateralization levels of these long-term securities sold under agreements to repurchase were considered. In the case of callable structured repurchase agreements, the callable feature is not considered when determining the fair value of those repurchase agreements, since there is a remote possibility, based on forward rates, that the investor will call back these agreements before maturity since it is not expected that the interest rates would rise more than the specified interest rate of these agreements. Securities sold under agreements to repurchase (structured and non-structured) are classified as Level 2.
Other short-term borrowings
The carrying amount of other short-term borrowings approximate fair value because of the short-term maturity of those instruments or because they carry interest rates which approximate market. Thus, these other short-term borrowings are classified as Level 2.

## Notes payable

FHLB advances: The fair value of FHLB advances was based on the discounted value of contractual cash flows over their contractual term. In determining the non-performance credit risk valuation adjustment, the collateralization levels of these advances were considered. These advances are classified as Level 2.

Medium-term notes: The fair value of publicly-traded medium-term notes was determined using recent trades of similar transactions. Publicly-traded medium-term notes are classified as Level 2. The fair value of non-publicly traded debt was based on remaining contractual cash outflows, discounted at a rate commensurate with the non-performance credit risk of the Corporation, which is subjective in nature. Non-publicly traded debt is classified as Level 3.

Junior subordinated deferrable interest debentures (related to trust preferred securities): The fair value of junior subordinated interest debentures was determined using recent trades of similar transactions. Thus, these junior subordinated deferrable interest debentures are classified as Level 2.

Junior subordinated deferrable interest debentures (Troubled Asset Relief Program): The fair value of junior subordinated deferrable interest debentures was based on the discounted value of contractual cash flows over their contractual term. The discount rate was based on the rate at which a similar security was priced in the open market. Thus, these junior subordinated deferrable interest debentures are classified as Level 3.

Others: The other category includes capital lease obligations. Generally accepted accounting principles do not require a fair valuation of capital lease obligations, therefore; it is included at its carrying amount. Capital lease obligations are classified as Level 3.

## Table of Contents

## Commitments to extend credit and letters of credit

Commitments to extend credit were valued using the fees currently charged to enter into similar agreements. For those commitments where a future stream of fees is charged, the fair value was estimated by discounting the projected cash flows of fees on commitments. Since the fair value of commitments to extend credit varies depending on the undrawn amount of the credit facility, fees are subject to constant change, and cash flows are dependent on the creditworthiness of borrowers, commitments to extend credit are classified as Level 3. The fair value of letters of credit was based on fees currently charged on similar agreements. Given that the fair value of letters of credit constantly vary due to fees being subject to constant change and whether the fees are received depends on the creditworthiness of the account parties, letters of credit are classified as Level 3.

The following tables present the carrying or notional amounts, as applicable, and estimated fair values for financial instruments with their corresponding level in the fair value hierarchy.

September 30, 2013

| (In thousands) |  | amount | Level 1 |  | Level 2 |  | Level 3 |  | Fair value |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Financial Assets: |  |  |  |  |  |  |  |  |  |
| Cash and due from banks | \$ | 368,590 | \$ 368,590 | \$ |  | \$ |  | \$ | 368,590 |
| Money market investments |  | 961,788 | 738,993 |  | 222,795 |  |  |  | 961,788 |
| Trading account securities, excluding derivatives ${ }^{[1]}$ |  | 338,837 |  |  | 325,349 |  | 13,488 |  | 338,837 |
| Investment securities available-for-sale ${ }^{[1]}$ |  | 5,136,618 | 5,188 |  | 5,124,732 |  | 6,698 |  | 5,136,618 |
| Investment securities held-to-maturity: |  |  |  |  |  |  |  |  |  |
| Obligations of Puerto Rico, States and political subdivisions |  | 113,733 |  |  |  |  | 93,536 |  | 93,536 |
| Collateralized mortgage obligation-federal agency |  | 122 |  |  |  |  | 129 |  | 129 |
| Other |  | 26,500 |  |  | 1,500 |  | 24,084 |  | 25,584 |
| Total investment securities held-to-maturity | \$ | 140,355 | \$ | \$ | 1,500 | \$ | 117,749 | \$ | 119,249 |
| Other investment securities: |  |  |  |  |  |  |  |  |  |
| FHLB stock | \$ | 102,858 | \$ | \$ | 102,858 | \$ |  | \$ | 102,858 |
| FRB stock |  | 79,883 |  |  | 79,883 |  |  |  | 79,883 |
| Trust preferred securities |  | 14,197 |  |  | 13,197 |  | 1,000 |  | 14,197 |
| Other investments |  | 1,926 |  |  |  |  | 4,411 |  | 4,411 |
| Total other investment securities | \$ | 198,864 | \$ | \$ | 195,938 | \$ | 5,411 | \$ | 201,349 |
| Loans held-for-sale | \$ | 124,532 | \$ | \$ | 4,540 | \$ | 125,543 | \$ | 130,083 |
| Loans not covered under loss sharing agreement with the FDIC |  | 20,901,083 |  |  |  |  | 8,591,073 |  | 18,591,073 |
| Loans covered under loss sharing agreements with the FDIC |  | 2,959,181 |  |  |  |  | 3,349,983 |  | 3,349,983 |

Edgar Filing: POPULAR INC - Form 10-Q

| FDIC loss share asset | $1,324,711$ |  | $1,189,678$ | $1,189,678$ |
| :--- | ---: | ---: | ---: | ---: |
| Mortgage servicing rights | 161,445 | 161,445 | 161,445 |  |
| Derivatives | 32,742 | 32,742 |  | 32,742 |

Table of Contents

September 30, 2013

| (In thousands) |  | Carrying amount |  | evel 1 |  | Level 2 |  | Level 3 |  | Fair value |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Financial Liabilities: |  |  |  |  |  |  |  |  |  |  |
| Deposits: |  |  |  |  |  |  |  |  |  |  |
| Demand deposits |  | 18,297,952 | \$ |  |  | 18,297,952 | \$ | \$ |  | 18,297,952 |
| Time deposits |  | 8,097,102 |  |  |  | 8,157,281 |  |  |  | 8,157,281 |
| Total deposits |  | 26,395,054 | \$ |  |  | 26,455,233 | \$ | \$ |  | 26,455,233 |
| Assets sold under agreements to repurchase: |  |  |  |  |  |  |  |  |  |  |
| Securities sold under agreements to repurchase | \$ | 1,124,058 | \$ |  | \$ | 1,128,952 | \$ | \$ | \$ | 1,128,952 |
| Structured repurchase agreements |  | 669,150 |  |  |  | 731,210 |  |  |  | 731,210 |
| Total assets sold under agreements to repurchase | \$ | 1,793,208 | \$ |  | \$ | 1,860,162 | \$ | \$ | \$ | 1,860,162 |
| Other short-term borrowings ${ }^{[2]}$ | \$ | 826,200 | \$ |  | \$ | 826,200 | \$ | \$ | \$ | 826,200 |
| Notes payable: |  |  |  |  |  |  |  |  |  |  |
| FHLB advances | \$ | 555,644 | \$ |  | \$ | 574,316 | \$ | \$ | \$ | 574,316 |
| Medium-term notes |  | 693 |  |  |  |  |  | 720 |  | 720 |
| Junior subordinated deferrable interest debentures (related to trust preferred securities) |  | 439,800 |  |  |  | 378,192 |  |  |  | 378,192 |
| Junior subordinated deferrable interest debentures (Troubled Asset Relief Program) |  | 524,871 |  |  |  |  |  | 1,024,590 |  | 1,024,590 |
| Others |  | 23,688 |  |  |  |  |  | 23,688 |  | 23,688 |
| Total notes payable | \$ | 1,544,696 | \$ |  | \$ | 952,508 |  | 1,048,998 | \$ | 2,001,506 |
| Derivatives | \$ | 34,942 | \$ |  | \$ | 34,942 | \$ | \$ | \$ | 34,942 |
| Contingent consideration | \$ | 124,575 | \$ |  | \$ |  |  | \$ 124,575 | \$ | 124,575 |


|  | Notional |  | Level |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | amount | Level 1 | Level 2 | 3 | Fair value |  |
| Commitments to extend credit | $\$ 7,287,336$ | $\$$ | $\$$ | $\$ 3,375$ | $\$$ | 3,375 |
| Letters of credit | 81,505 |  |  |  | 986 | 986 |

[1] Refer to Note 24 to the consolidated financial statements for the fair value by class of financial asset and its hierarchy level.
[2] Refer to Note 15 to the consolidated financial statements for the composition of short-term borrowings.

Table of Contents
December 31, 2012

| (In thousands) |  | Carrying amount | Level 1 |  | Level 2 |  | Level 3 |  | Fair value |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Financial Assets: |  |  |  |  |  |  |  |  |  |
| Cash and due from banks | \$ | 439,363 | \$ 439,363 | \$ |  | \$ |  | \$ | 439,363 |
| Money market investments |  | 1,085,580 | 839,007 |  | 246,573 |  |  |  | 1,085,580 |
| Trading account securities, excluding derivatives ${ }^{[1]}$ |  | 314,515 |  |  | 297,959 |  | 16,556 |  | 314,515 |
| Investment securities available-for-sale ${ }^{[1]}$ |  | 5,084,201 | 3,827 |  | 5,073,304 |  | 7,070 |  | 5,084,201 |
| Investment securities held-to-maturity: |  |  |  |  |  |  |  |  |  |
| Obligations of Puerto Rico, States and political subdivisions |  | 116,177 |  |  |  |  | 117,558 |  | 117,558 |
| Collateralized mortgage obligation-federal agency |  | 140 |  |  |  |  | 144 |  | 144 |
| Other |  | 26,500 |  |  | 1,500 |  | 25,031 |  | 26,531 |
| Total investment securities held-to-maturity | \$ | 142,817 | \$ | \$ | 1,500 | \$ | 142,733 | \$ | 144,233 |
| Other investment securities: |  |  |  |  |  |  |  |  |  |
| FHLB stock | \$ | 89,451 | \$ | \$ | 89,451 | \$ |  | \$ | 89,451 |
| FRB stock |  | 79,878 |  |  | 79,878 |  |  |  | 79,878 |
| Trust preferred securities |  | 14,197 |  |  | 13,197 |  | 1,000 |  | 14,197 |
| Other investments |  | 1,917 |  |  |  |  | 3,975 |  | 3,975 |
| Total other investment securities | \$ | 185,443 | \$ | \$ | 182,526 | \$ | 4,975 | \$ | 187,501 |
| Loans held-for-sale | \$ | 354,468 | \$ | \$ | 4,779 | \$ | 376,582 | \$ | 381,361 |
| Loans not covered under loss sharing agreement with the FDIC |  | 20,361,491 |  |  |  |  | 17,424,038 |  | 17,424,038 |
| Loans covered under loss sharing agreements with the FDIC |  | 3,647,066 |  |  |  |  | 3,925,440 |  | 3,925,440 |
| FDIC loss share asset |  | 1,399,098 |  |  |  |  | 1,241,579 |  | 1,241,579 |
| Mortgage servicing rights |  | 154,430 |  |  |  |  | 154,430 |  | 154,430 |
| Derivatives |  | 41,935 |  |  | 41,935 |  |  |  | 41,935 |

Table of Contents

|  | Carrying <br> amount | Level 1 | Level 2 | Level 3 | Fair value |
| :--- | ---: | :---: | ---: | ---: | ---: | ---: |
| (In thousands) |  |  |  |  |  |
| Financial Liabilities: | $\$ 18,089,904$ | $\$$ | $\$ 18,089,904$ | $\$$ | $\$ 18,089,904$ |
| Deposits: | $8,910,709$ |  | $8,994,363$ |  | $8,994,363$ |
| Demand deposits |  |  | $\$ 27,084,267$ | $\$$ | $\$ 27,084,267$ |

Assets sold under agreements to repurchase:

| Securities sold under agreements to |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| repurchase | $\$ 1,378,562$ | $\$$ | $\$$ | $1,385,237$ | $\$$ | 720,620 |


| Total assets sold under agreements to repurchase | \$ | 2,016,752 | \$ | \$ | 2,105,857 | \$ |  | \$ | ,105,857 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Other short-term borrowings ${ }^{[2]}$ | \$ | 636,200 | \$ | \$ | 636,200 | \$ |  | \$ | 636,200 |
| Notes payable: |  |  |  |  |  |  |  |  |  |
| FHLB advances | \$ | 577,490 | \$ | \$ | 608,313 | \$ |  | \$ | 608,313 |
| Medium-term notes |  | 236,753 |  |  | 243,351 |  | 3,843 |  | 247,194 |
| Junior subordinated deferrable interest <br> debentures (related to trust preferred securities) <br> 439,800 <br> 363,659 <br> 363,659 |  |  |  |  |  |  |  |  |  |
| Junior subordinated deferrable interest debentures (Troubled Asset Relief Program) |  | 499,470 |  |  |  |  | 824,458 |  | 824,458 |
| Others |  | 24,208 |  |  |  |  | 24,208 |  | 24,208 |


| Total notes payable | $\$ 1,777,721$ | $\$$ | $\$$ | $1,215,323$ | $\$$ | 852,509 | $\$$ | $2,067,832$ |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Derivatives | $\$$ | 42,585 | $\$$ | $\$$ | 42,585 | $\$$ |  | $\$$ | 42,585 |
| Contingent consideration | $\$$ | 112,002 | $\$$ | $\$$ |  | $\$ 112,002$ | $\$$ | 112,002 |  |


|  | Notional |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | amount | Level 1 | Level 2 | Level 3 | Fair value |
| Commitments to extend credit | $\$ 6,774,990$ | $\$$ | $\$$ | $\$ 2,858$ | $\$ 2,858$ |
| Letters of credit | 148,153 |  |  | 1,544 | 1,544 |

[1] Refer to Note 24 to the consolidated financial statements for the fair value by class of financial asset and its hierarchy level.
[2] Refer to Note 15 to the consolidated financial statements for the composition of short-term borrowings.

## Table of Contents

## Note 26 Net income per common share

The following table sets forth the computation of net income per common share ( EPS ), basic and diluted, for the quarters and nine months ended September 30, 2013 and 2012:

|  | Quarter ended September 30, |  |  |  | Nine months ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands, except per share information) |  | 2013 |  | 2012 |  | 2013 |  | 2012 |
| Net income | \$ | 229,135 | \$ | 47,188 | \$ | 436,296 | \$ | 161,335 |
| Preferred stock dividends |  | (931) |  | (931) |  | $(2,792)$ |  | $(2,792)$ |
| Net income applicable to common stock | \$ | 228,204 | \$ | 46,257 | \$ | 433,504 | \$ | 158,543 |
| Average common shares outstanding |  | 2,714,262 |  | 102,451,410 |  | 102,666,570 |  | 2,363,099 |
| Average potential dilutive common shares |  | 303,181 |  | 33,550 |  | 348,104 |  | 182,375 |
| Average common shares outstanding assuming dilution |  | 3,017,443 |  | 102,484,960 |  | 103,014,674 |  | 2,545,474 |
| Basic EPS | \$ | 2.22 | \$ | 0.45 | \$ | 4.22 | \$ | 1.55 |
| Diluted EPS | \$ | 2.22 | \$ | 0.45 | \$ | 4.21 | \$ | 1.55 |

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

For the quarter and nine months ended September 30, 2013, there were 101,755 and 103,047 weighted average antidilutive stock options outstanding, respectively (September 30, 2012 -164,195 and 166,810). Additionally, the Corporation has outstanding a warrant issued to the U.S. Treasury to purchase $2,093,284$ shares of common stock, which had an antidilutive effect at September 30, 2013.

Table of Contents

## Note 27 Other service fees

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

Quarter ended September 30, ine months ended September 30,

| (In thousands) | 2013 |  | 2012 |  | 2013 |  | 2012 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Debit card fees | \$ | 11,005 | \$ | 10,752 | \$ | 32,138 | \$ | 33,223 |
| Insurance fees |  | 13,255 |  | 12,322 |  | 37,793 |  | 36,775 |
| Credit card fees |  | 16,890 |  | 15,623 |  | 48,981 |  | 44,383 |
| Sale and administration of investment products |  | 8,981 |  | 9,511 |  | 27,941 |  | 28,045 |
| Trust fees |  | 4,148 |  | 3,977 |  | 12,760 |  | 12,127 |
| Processing fees |  |  |  | 1,406 |  |  |  | 4,819 |
| Other fees |  | 4,305 |  | 4,363 |  | 13,946 |  | 13,210 |
| Total other services fees | \$ | 58,584 | \$ | 57,954 | \$ | 173,559 | \$ | 172,582 |

## Table of Contents

## Note 28 FDIC loss share (expense) income

The caption of FDIC loss share (expense) income in the consolidated statements of operations consists of the following major categories:

Quarters ended September 30Nine months ended September 30,

| (In thousands) |  | 2013 |  | 2012 |  | 2013 |  | 2012 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Amortization of loss share indemnification asset | \$ | $(37,681)$ | \$ | $(29,184)$ | \$ | $(116,442)$ | \$ | $(95,972)$ |
| $80 \%$ mirror accounting on credit impairment losses ${ }^{[1]}$ |  | 13,946 |  | 18,095 |  | 53,329 |  | 60,943 |
| $80 \%$ mirror accounting on reimbursable expenses |  | 25,641 |  | 7,577 |  | 45,555 |  | 20,619 |
| $80 \%$ mirror accounting on recoveries on covered assets, including rental income on OREOs, subject to reimbursement to the FDIC |  | $(11,533)$ |  | (199) |  | $(14,802)$ |  | (774) |
| 80\% mirror accounting on amortization of contingent liability on unfunded commitments |  | (87) |  | (248) |  | (473) |  | (744) |
| Change in true-up payment obligation |  | $(5,322)$ |  | $(2,991)$ |  | $(12,573)$ |  | $(4,849)$ |
| Other |  | 170 |  | 243 |  | 519 |  | 1,390 |
| Total FDIC loss share (expense) income | \$ | $(14,866)$ | \$ | $(6,707)$ | \$ | $(44,887)$ | \$ | $(19,387)$ |

[1] Reductions in expected cash flows for ASC 310-30 loans, which may impact the provision for loan losses, may consider reductions in both principal and interest cash flow expectations. The amount covered under the FDIC loss sharing agreements for interest not collected from borrowers is limited under the agreements (approximately 90 days); accordingly, these amounts are not subject fully to the $80 \%$ mirror accounting.

## Table of Contents

## Note 29 Pension and postretirement benefits

The Corporation has a non-contributory defined benefit pension plan and supplementary pension benefit restoration plans for regular employees of certain of its subsidiaries. The accrual of benefits under the plans is frozen to all participants.

The components of net periodic pension cost for the periods presented were as follows:

|  | $\begin{gathered} \text { Pension Plan } \\ \text { Quarters ended September 30, } \end{gathered}$ |  |  | Benefit Restoration Plans Quarters ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) |  | 2013 | 2012 |  | 013 |  | 12 |
| Interest Cost | \$ | 6,966 | \$ 7,495 | \$ | 373 | \$ | 393 |
| Expected return on plan assets |  | $(10,804)$ | $(9,810)$ |  | (542) |  | (526) |
| Amortization of net loss |  | 5,363 | 5,426 |  | 332 |  | 323 |
| Total net periodic pension cost (benefit) | \$ | 1,525 | \$ 3,111 | \$ | 163 | \$ | 190 |


|  | $\begin{array}{cc}\text { Pension Plans } & \text { Benefit Restoration Plans } \\ \text { Nine months ended September 30,ine months ended September 30 }\end{array}$ |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 |  | 2012 |  | 2013 |  | 2012 |  |
| Interest Cost | \$ | 20,897 | \$ | 22,486 | \$ | 1,120 | \$ | 1,179 |
| Expected return on plan assets |  | $(32,412)$ |  | $(29,430)$ |  | $(1,625)$ |  | $(1,578)$ |
| Amortization of net loss |  | 16,089 |  | 16,277 |  | 998 |  | 969 |
| Total net periodic pension cost (benefit) | \$ | 4,574 | \$ | 9,333 | \$ | 493 | \$ | 570 |

The Corporation did not make any contributions to the pension and benefit restoration plans during the quarter ended September 30, 2013. The total contributions expected to be paid during the year 2013 for the pension and benefit restoration plans amount to approximately $\$ 51$ thousand.

The Corporation also provides certain postretirement health care benefits for retired employees of certain subsidiaries. The table that follows presents the components of net periodic postretirement benefit cost.

Postretirement Benefit Plan
Quarters ended September Bine months ended September 30,

| (In thousands) | 2013 | 2012 | 2013 | 2012 |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| Service cost | $\$ 564$ | $\$ 548$ | $\$$ | 1,693 | $\$$ |
| Interest cost | 1,712 | 1,950 |  | 5,136 |  |
| Amortization of prior service cost |  | $(50)$ |  | 520 |  |
| Amortization of net loss | 473 | 540 |  | 1,419 |  |
|  |  |  |  |  | 1,621 |
| Total net periodic postretirement benefit cost | $\$ 2,749$ | $\$ 2,988$ | $\$$ | 8,248 | $\$$ |

Contributions made to the postretirement benefit plan for the quarter ended September 30, 2013 amounted to approximately $\$ 1.7$ million. The total contributions expected to be paid during the year 2013 for the postretirement benefit plan amount to approximately $\$ 6.8$ million.

## Table of Contents

## Note 30 Stock-based compensation

The Corporation maintained a Stock Option Plan (the Stock Option Plan ), which permitted the granting of incentive awards in the form of qualified stock options, incentive stock options, or non-statutory stock options of the Corporation. In April 2004, the Corporation s shareholders adopted the Popular, Inc. 2004 Omnibus Incentive Plan (the Incentive Plan ), which replaced and superseded the Stock Option Plan. The adoption of the Incentive Plan did not alter the original terms of the grants made under the Stock Option Plan prior to the adoption of the Incentive Plan.

## Stock Option Plan

Employees and directors of the Corporation or any of its subsidiaries were eligible to participate in the Stock Option Plan. The Board of Directors or the Compensation Committee of the Board had the absolute discretion to determine the individuals that were eligible to participate in the Stock Option Plan. This plan provided for the issuance of Popular, Inc. s common stock at a price equal to its fair market value at the grant date, subject to certain plan provisions. The shares are to be made available from authorized but unissued shares of common stock or treasury stock. The Corporation s policy has been to use authorized but unissued shares of common stock to cover each grant. The maximum option term is ten years from the date of grant. Unless an option agreement provides otherwise, all options granted are $20 \%$ exercisable after the first year and an additional $20 \%$ is exercisable after each subsequent year, subject to an acceleration clause at termination of employment due to retirement.
(Not in thousands)


There was no intrinsic value of options outstanding and exercisable at September 30, 2013 and 2012.
The following table summarizes the stock option activity and related information:

| (Not in thousands) | Options Outstanding | Weighted-Average Exercise Price |  |
| :---: | :---: | :---: | :---: |
| Outstanding at December 31, 2011 | 206,946 | \$ | 207.83 |
| Granted |  |  |  |
| Exercised |  |  |  |
| Forfeited |  |  |  |
| Expired | $(45,960)$ |  | 155.68 |
| Outstanding at December 31, 2012 | 160,986 | \$ | 222.71 |
| Granted |  |  |  |
| Exercised |  |  |  |
| Forfeited |  |  |  |
| Expired | $(59,231)$ |  | 170.10 |


| Edgar Filing: POPULAR INC - Form 10-Q |  |  |  |
| :--- | :---: | :---: | :---: |
| Outstanding at September 30, 2013 | 101,755 | $\$ \quad 253.34$ |  |

There was no stock option expense recognized for the quarters and nine months ended September 30, 2013 and 2012.

## Incentive Plan

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

Under the Incentive Plan, the Corporation has issued restricted shares, which become vested based on the employees continued service with Popular. Unless otherwise stated in an agreement, the compensation cost associated with the shares of restricted stock

## Table of Contents

is determined based on a two-prong vesting schedule. The first part is vested ratably over five years commencing at the date of grant and the second part is vested at termination of employment after attainment of 55 years of age and 10 years of service. The five-year vesting part is accelerated at termination of employment after attaining 55 years of age and 10 years of service. The restricted shares granted consistent with the requirements of the Troubled Asset Relief Program ( TARP ) Interim Final Rule vest in two years from grant date.

The following table summarizes the restricted stock activity under the Incentive Plan for members of management.

|  |  | Weighted-Average <br> Grant Date |  |
| :--- | ---: | :---: | ---: |
|  |  | Fair <br> Value |  |
| (Not in thousands) | Restricted Stock | Valu |  |
| Non-vested at December 31, 2011 | 241,934 | $\$$ | 31.98 |
| Granted | 359,427 |  | 17.72 |
| Vested | $(96,353)$ | 37.61 |  |
| Forfeited | $(13,785)$ |  | 26.59 |
|  |  |  |  |
| Non-vested at December 31, 2012 | 491,223 | $\$$ | 20.59 |
| Granted | 229,131 |  | 28.20 |
| Vested | $(130,574)$ |  | 31.21 |
| Forfeited | $(3,783)$ |  | 24.63 |
|  |  |  |  |
| Non-vested at September 30, 2013 | 585,997 | $\$$ | 21.18 |

During the quarter ended September 30, 2013 and 2012, no shares of restricted stock were awarded to management under the Incentive Plan. For the nine-month period ended September 30, 2013, 229,131 shares of restricted stock (September 30, 2012-359,427) were awarded to management under the Incentive Plan, from which 165,304 shares (September 30, 2012-253,170) were awarded to management consistent with the requirements of the TARP Interim Final Rule.

During the quarter ended September 30, 2013, the Corporation recognized \$ 1.4 million of restricted stock expense related to management incentive awards, with a tax benefit of $\$ 0.4$ million (September 30, 2012 - $\$ 1.1$ million, with a tax benefit of $\$ 0.3$ million). For the nine-month period ended September 30, 2013, the Corporation recognized $\$$ 3.9 million of restricted stock expense related to management incentive awards, with a tax benefit of $\$ 1.2$ million (September 30, 2012 - $\$ 3.2$ million, with a tax benefit of $\$ 0.8$ million). During the quarter ended September 30, 2013, there was no vesting of restricted stock. For the nine-month period ended September 30, 2013, the fair market value of the restricted stock vested was $\$ 4.0$ million at grant date and $\$ 3.6$ million at vesting date. This triggers a shortfall, net of windfalls, of $\$ 0.1$ million that was recorded as an additional income tax expense at the applicable income tax rate. No income tax expense was recorded for the U.S. employees due to the valuation allowance of the deferred tax asset. The total unrecognized compensation cost related to non-vested restricted stock awards and performance shares to members of management at September 30, 2013 was $\$ 7.8$ million and is expected to be recognized over a weighted-average period of 2 years.

The following table summarizes the restricted stock activity under the Incentive Plan for members of the Board of Directors:

|  | Restricted Stock | Weighted-Average <br> Grant Date Fair <br> Value |  |
| :--- | :---: | :---: | :---: |
| (Not in thousands) | 41,174 | $\$$ | 16.37 |
| Non-vested at December 31, 2011 | $(41,174)$ |  | 16.37 |
| Granted |  |  |  |
| Vested |  |  |  |
| Forfeited |  |  |  |
|  |  | 18,885 | $\$$ |
| Non-vested at December 31, 2012 | $(18,885)$ |  | 29.70 |
| Granted |  |  |  |
| Vested |  |  |  |

Non-vested at September 30, 2013

## Table of Contents

During the quarter ended September 30, 2013, the Corporation granted 1,669 shares of restricted stock to members of the Board of Directors of Popular, Inc., which became vested at grant date (September 30, 2012-3,322). During this period, the Corporation recognized $\$ 0.1$ million of restricted stock expense related to these restricted stock grants, with a tax benefit of $\$ 46$ thousand (September 30, 2012 - $\$ 0.1$ million, with a tax benefit of $\$ 32$ thousand). For the nine-month period ended September 30, 2013, the Corporation granted 18,885 shares of restricted stock to members of the Board of Directors of Popular, Inc., which became vested at grant date (September 30, 2012 -37,800). During this period, the Corporation recognized $\$ 0.4$ million of restricted stock expense related to these restricted stock grants, with a tax benefit of $\$ 0.1$ million (September 30, 2012 - $\$ 0.3$ million, with a tax benefit of $\$ 0.1$ million). The fair value at vesting date of the restricted stock vested during the nine months ended September 30, 2013 for directors was $\$ 0.6$ million.

## Table of Contents

## Note 31 Income taxes

The reason for the difference between the income tax (benefit) expense applicable to income before provision for income taxes and the amount computed by applying the statutory tax rate in Puerto Rico, were as follows:


Nine months ended

| (In thousands) | September 30, 2013 |  |  | September 30, 2012 |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Amount | $\%$ of pre-tax income | Amount | \% of pre-tax income |
| Computed income tax at statutory rates | \$ | 62,325 | 39\% | \$ 34,505 | 30\% |
| Net benefit of net tax exempt interest income |  | $(27,484)$ | (17) | $(18,378)$ | (16) |
| Deferred tax asset valuation allowance |  | $(15,404)$ | (10) | 2,730 | 2 |
| Non-deductible expenses |  | 23,844 | 15 | 17,182 | 15 |
| Difference in tax rates due to multiple jurisdictions |  | $(9,442)$ | (6) | $(4,606)$ | (4) |
| Adjustment in deferred tax due to change in tax rate |  | $(197,467)$ | (124) |  |  |
| Effect of income subject to preferential tax rate ${ }^{[1]}$ |  | $(102,878)$ | (64) | $(66,607)$ | (58) |
| Unrecognized tax benefits |  | $(7,727)$ | (5) | $(8,985)$ | (8) |
| Others |  | $(2,256)$ | (1) | $(2,158)$ | (1) |
| Income tax (benefit) expense | \$ | $(276,489)$ | (173)\% | \$ $(46,317)$ | (40)\% |

[1] For 2012, includes the impact of the Closing Agreement with the P.R. Treasury signed in June 2012. Income tax expense amounted to $\$ 17.8$ million for the quarter ended September 30, 2013, compared with an income tax expense of $\$ 15.4$ million for the same quarter of 2012 . The increase in income tax expense was primarily due to the gain recognized during the third quarter of 2013 on the sale of a portion of Evertec s shares which was taxable at a preferential tax rate according to Act Number 73 of May 28, 2008, known as Economic Incentives Act for the Development of Puerto Rico .

The increase in income tax benefit for the nine months ended September 30, 2013, compared to the same period of 2012 was mainly due to the recognition during the year 2013 of a tax benefit and a corresponding increase in the net deferred tax assets of the Puerto Rico operations as a result of the increase in the marginal tax rate from $30 \%$ to $39 \%$. On June 30, 2013, the Governor of Puerto Rico signed Act Number 40 which includes among the most significant changes to the Puerto Rico Internal Revenue Code an increase in the marginal tax rate from $30 \%$ to $39 \%$ effective for taxable years beginning after December 31, 2012. In addition, income tax benefit increased due to the loss generated in the Puerto Rico operations by the sale of non-performing assets that took place during the first and second quarter of 2013, net of the gain realized on the sale of Evertec s shares that took place during the second and third quarter of 2013.

## Table of Contents

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

| (In thousands) | $\begin{gathered} \text { September 30, } \\ 2013 \end{gathered}$ |  | $\begin{gathered} \text { December 31, } \\ 2012 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: |
| Deferred tax assets: |  |  |  |  |
| Tax credits available for carryforward | \$ | 8,057 | \$ | 2,666 |
| Net operating loss and other carryforward available |  | 1,269,805 |  | ,201,174 |
| Postretirement and pension benefits |  | 132,101 |  | 97,276 |
| Deferred loan origination fees |  | 7,751 |  | 6,579 |
| Allowance for loan losses |  | 775,353 |  | 592,664 |
| Deferred gains |  | 9,601 |  | 10,528 |
| Accelerated depreciation |  | 6,931 |  | 6,699 |
| Intercompany deferred gains |  | 3,040 |  | 3,891 |
| Other temporary differences |  | 36,220 |  | 31,864 |
| Total gross deferred tax assets |  | 2,248,859 |  | ,953,341 |
| Deferred tax liabilities: |  |  |  |  |
| Differences between the assigned values and the tax basis of assets and liabilities recognized in purchase business combinations |  | 38,101 |  | 37,281 |
| Difference in outside basis between financial and tax reporting on sale of a business |  | 740 |  | 6,400 |
| FDIC-assisted transaction |  | 77,287 |  | 53,351 |
| Unrealized net gain on trading and available-for-sale securities |  | 14,024 |  | 51,002 |
| Deferred loan origination costs |  |  |  | 3,459 |
| Other temporary differences |  | 9,769 |  | 10,142 |
| Total gross deferred tax liabilities |  | 139,921 |  | 161,635 |
| Valuation allowance |  | 1,267,116 |  | 1,260,542 |
| Net deferred tax asset | \$ | 841,822 | \$ | 531,164 |

The net deferred tax asset shown in the table above at September 30, 2013 is reflected in the consolidated statements of financial condition as $\$ 844$ million in net deferred tax assets in the Other assets caption (December 31, 2012-\$541 million) and $\$ 2$ million in deferred tax liabilities in the Other liabilities caption (December 31, 2012-\$10 million), reflecting the aggregate deferred tax assets or liabilities of individual tax-paying subsidiaries of the Corporation.

A deferred tax asset should be reduced by a valuation allowance if based on the weight of all available evidence, it is more likely than not (a likelihood of more than $50 \%$ ) that some portion or the entire deferred tax asset will not be realized. The valuation allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. The determination of whether a deferred tax asset is realizable is based on weighting all available evidence, including both positive and negative evidence. The realization of deferred tax assets, including carryforwards and deductible temporary differences, depends upon the existence of sufficient taxable income of the

## Edgar Filing: POPULAR INC - Form 10-Q

same character during the carryback or carryforward period. The analysis considers all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, taxable income in prior carryback years and tax-planning strategies.

At September 30, 2013, the Corporation s net deferred tax assets related to its Puerto Rico operations amounted to $\$ 871$ million. The Corporation s Puerto Rico banking operation is in a cumulative loss position for the three-year period ended September 30, 2013 taking into account taxable income exclusive of reversing temporary differences (adjusted taxable income). This cumulative loss position was mainly due to the sale of assets, most of which were in non-performing status, comprised of commercial and construction loans and commercial and single family real estate owned, completed during the first quarter of 2013 and mortgage loans, completed during the second quarter of 2013. The Corporation weights all available positive and negative evidence to assess

## Table of Contents

the realization of the deferred tax asset. Positive evidence assessed included (i) the Corporation s Puerto Rico banking operations very strong earnings history; (ii) consideration that the event causing the cumulative loss position is not a continuing condition of the operations; (iii) new legislation extending the period of carryover of net operating losses to twelve years for losses incurred during taxable years 2005 thru 2012 and ten years for losses incurred after 2012. Accordingly, there is enough positive evidence to outweigh the negative evidence of the cumulative loss. Based on this evidence, the Corporation has concluded that it is more-likely-than-not that such net deferred tax asset will be realized.

The Corporation s U.S. mainland operations are in a cumulative loss position for the three-year period ended September 30, 2013. For purposes of assessing the realization of the deferred tax assets in the U.S. mainland, this cumulative taxable loss position is considered significant negative evidence and has caused management to conclude that it is more likely than not that the Corporation will not be able to realize the associated deferred tax assets in the future. At September 30, 2013, the Corporation recorded a valuation allowance of approximately $\$ 1.3$ billion on the deferred tax assets of its U.S. operations (December 31, 2012 - $\$ 1.3$ billion).

The reconciliation of unrecognized tax benefits was as follows:

| (In millions) | 2013 | 2012 |
| :---: | :---: | :---: |
| Balance at January 1 | \$ 13.4 | \$ 19.5 |
| Additions for tax positions - January through March | 0.2 | 0.7 |
| Balance at March 31 | \$ 13.6 | \$ 20.2 |
| Additions for tax positions - April through June | 0.3 |  |
| Reduction for tax positions - April through June |  | (0.2) |
| Reduction for tax positions taken in prior years - April through June |  | (0.7) |
| Balance at June 30 | \$ 13.9 | \$ 19.3 |
| Additions for tax positions - July through September | 0.3 | 0.2 |
| Reduction as a result of lapse of statute of limitations - July through September | (5.7) | (6.3) |
| Balance at September 30 | \$ 8.5 | \$ 13.2 |

The accrued interest related to uncertain tax positions approximated $\$ 2.8$ million at September 30, 2013 (December 31, 2012 - $\$ 4.3$ million). Management determined that at September 30, 2013 and December 31, 2012, there was no need to accrue for the payment of penalties.

After consideration of the effect on U.S. federal tax of unrecognized U.S. state tax benefits, the total amount of unrecognized tax benefits, including U.S. and Puerto Rico, that if recognized, would affect the Corporation s effective tax rate, was approximately $\$ 10.4$ million at September 30, 2013 (December 31, 2012 - $\$ 16.9$ million).

The amount of unrecognized tax benefits may increase or decrease in the future for various reasons including adding amounts for current tax year positions, expiration of open income tax returns due to the statutes of limitation, changes in management s judgment about the level of uncertainty, status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions.

The Corporation and its subsidiaries file income tax returns in Puerto Rico, the U.S. federal jurisdiction, various U.S. states and political subdivisions, and foreign jurisdictions. At September 30, 2013, the following years remain subject to examination in the U.S. Federal jurisdiction: 2010 and thereafter; and in the Puerto Rico jurisdiction, 2009 and thereafter. The Corporation anticipates a reduction in the total amount of unrecognized tax benefits within the next 12 months, which could amount to approximately $\$ 6$ million.

## Table of Contents

## Note 32 Supplemental disclosure on the consolidated statements of cash flows

Additional disclosures on cash flow information and non-cash activities for the nine months ended September 30, 2013 and September 30, 2012 are listed in the following table:

| (In thousands) | September 30, 2013 |  | September 30, 2012 |  |
| :---: | :---: | :---: | :---: | :---: |
| Non-cash activities: |  |  |  |  |
| Loans transferred to other real estate | \$ | 188,275 | \$ | 218,798 |
| Loans transferred to other property |  | 24,974 |  | 18,970 |
| Total loans transferred to foreclosed assets |  | 213,249 |  | 237,768 |
| Transfers from loans held-in-portfolio to loans held-for-sale |  | 442,003 |  | 55,826 |
| Transfers from loans held-for-sale to loans held-in-portfolio |  | 25,245 |  | 10,325 |
| Loans securitized into investment securities ${ }^{[1]}$ |  | 1,149,199 |  | 834,352 |
| Trades receivables from brokers and counterparties |  | 85,746 |  | 287,322 |
| Trades payables to brokers and counterparties |  | 161,452 |  | 71,698 |
| Recognition of mortgage servicing rights on securitizations or asset transfers |  | 15,062 |  | 12,842 |
| Loans sold to a joint venture in exchange for an acquisition loan and an equity interest in the joint venture |  | 194,514 |  |  |

[1] Includes loans securitized into trading securities and subsequently sold before quarter end.

## Table of Contents

## Note 33 Segment reporting

The Corporation s corporate structure consists of two reportable segments - Banco Popular de Puerto Rico and Banco Popular North America.

Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. The segments were determined based on the organizational structure, which focuses primarily on the markets the segments serve, as well as on the products and services offered by the segments.

## Banco Popular de Puerto Rico:

Given that Banco Popular de Puerto Rico constitutes a significant portion of the Corporation s results of operations and total assets at September 30, 2013, additional disclosures are provided for the business areas included in this reportable segment, as described below:

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

Consumer and retail banking represents the branch banking operations of BPPR which focus on retail clients. It includes the consumer lending business operations of BPPR, as well as the lending operations of Popular Auto and Popular Mortgage. Popular Auto focuses on auto and lease financing, while Popular Mortgage focuses principally on residential mortgage loan originations. The consumer and retail banking area also incorporates income related with the investment of excess funds from the branch network, as well as a proportionate share of the investment function of BPPR.

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

## Banco Popular North America:

Banco Popular North America s reportable segment consists of the banking operations of BPNA, E-LOAN, Popular Equipment Finance, Inc. and Popular Insurance Agency, U.S.A. BPNA operates through a retail branch network in the U.S. mainland, while E-LOAN supports BPNA s deposit gathering through its online platform. All direct lending activities at E-LOAN were ceased during the fourth quarter of 2008. Popular Equipment Finance, Inc. also holds a running-off loan portfolio as this subsidiary ceased originating loans during 2009. Popular Insurance Agency, U.S.A. offers investment and insurance services across the BPNA branch network.

The Corporate group consists primarily of the holding companies: Popular, Inc., Popular North America, Popular International Bank and certain of the Corporation s investments accounted for under the equity method, including EVERTEC and Centro Financiero BHD, S.A. The Corporate group also includes the expenses of certain corporate
areas that are identified as critical to the organization: Finance, Risk Management and Legal.
The accounting policies of the individual operating segments are the same as those of the Corporation. Transactions between reportable segments are primarily conducted at market rates, resulting in profits that are eliminated for reporting consolidated results of operations.

## Table of Contents

The tables that follow present the results of operations and total assets by reportable segments:

## 2013

For the quarter ended September 30, 2013

| (In thousands) | Banco Popular de Puerto Rico |  | Banco Popular North America |  | Intersegment Eliminations |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 309,946 | \$ | 73,179 | \$ |
| Provision for loan losses |  | 67,856 |  | 4,755 |  |
| Non-interest income |  | 90,995 |  | 16,433 |  |
| Amortization of intangibles |  | 1,788 |  | 680 |  |
| Depreciation expense |  | 9,630 |  | 2,258 |  |
| Other operating expenses |  | 232,612 |  | 55,800 |  |
| Income tax expense |  | 26,407 |  | 937 |  |
| Net income | \$ | 62,648 | \$ | 25,182 | \$ |
| Segment assets |  | 7,090,255 | \$ | 8,782,020 | \$ $(11,904)$ |

For the quarter ended September 30, 2013
Reportable

| (In thousands) | Segments | Corporate | Eliminations | Total Popular, Inc. |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Net interest income (expense) | $\$ 383,125$ | $\$$ | $(28,919)$ | $\$$ |  |
| Provision for loan losses | 72,611 | 52 |  | 354,206 |  |
| Non-interest income | 107,428 | 184,583 |  | 72,663 |  |
| Amortization of intangibles | 2,468 |  |  | 291,959 |  |
| Depreciation expense | 11,888 | 159 |  | 2,468 |  |
| Loss on early extinguishment of debt |  | 3,388 |  | 12,047 |  |
| Other operating expenses | 288,412 | 20,983 | $(699)$ | 3,388 |  |
| Income tax expense (benefit) | 27,344 | $(9,799)$ | 223 | 17,768 |  |


| Net income | $\$$ | 87,830 | $\$ 140,881$ | $\$$ | 424 | $\$$ | 229,135 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Segment assets | $\$ 35,860,371$ | $\$ 5,361,877$ | $\$(5,170,132)$ | $\$$ | $36,052,116$ |  |  |

For the nine months ended September 30, 2013

| (In thousands) | Banco Popular <br> de Puerto Rico | Banco Popular <br> North America | Intersegment <br> Eliminations |  |
| :--- | :---: | :---: | :---: | :---: |
| Net interest income | $\$ 9929,722$ | $\$$ | 209,032 | $\$$ |
| Provision for loan losses |  | 545,685 |  | 210 |

Edgar Filing: POPULAR INC - Form 10-Q

| Non-interest income | 210,703 | 39,257 |  |  |
| :--- | ---: | ---: | ---: | :--- |
| Amortization of intangibles | 5,363 | 2,040 |  |  |
| Depreciation expense | 29,702 | 6,870 |  |  |
| Other operating expenses | 707,973 | 163,145 |  |  |
| Income tax (benefit) expense | $(262,224)$ |  | 2,809 |  |
|  |  |  |  |  |
| Net income | $\$ 113,926$ | $\$$ | 73,215 | $\$$ |

For the nine months ended September 30, 2013
Reportable

| (In thousands) | Segments | Corporate | Eliminations | Total Popular, Inc. |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Net interest income (expense) | $\$ 1,138,754$ | $\$(82,516)$ | $\$$ |  | $\$ 0$ |
| Provision for loan losses | 545,895 | 32 |  | 545,927 |  |
| Non-interest income | 249,960 | 370,869 | $(1,450)$ | 619,379 |  |
| Amortization of intangibles | 7,403 |  |  | 7,403 |  |
| Depreciation expense | 36,572 | 484 |  | 37,056 |  |
| Loss on early extinguishment of debt |  | 3,388 |  | 3,388 |  |
| Other operating expenses | 871,118 | 52,985 | $(2,067)$ | 922,036 |  |
| Income tax benefit | $(259,415)$ | $(17,190)$ | 116 | $(276,489)$ |  |
|  |  |  |  |  |  |
| Net income | $\$ 187,141$ | $\$ 248,654$ | $\$$ | 501 | $\$$ |

## Table of Contents

## 2012

For the quarter ended September 30, 2012

| (In thousands) | Banco Popular de Puerto Rico |  | Banco Popular North America |  | Intersegment Eliminations |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 301,016 | \$ | 69,598 | \$ |
| Provision for loan losses |  | 92,439 |  | 13,851 |  |
| Non-interest income |  | 113,378 |  | 11,481 |  |
| Amortization of intangibles |  | 1,801 |  | 680 |  |
| Depreciation expense |  | 9,368 |  | 2,000 |  |
| Loss on early extinguishment of debt |  | 43 |  |  |  |
| Other operating expenses |  | 220,430 |  | 54,942 |  |
| Income tax expense |  | 17,090 |  | 937 |  |
| Net income | \$ | 73,223 | \$ | 8,669 | \$ |

For the quarter ended September 30, 2012
Reportable

| (In thousands) | Segments | Corporate | Eliminations | Total Popular, Inc. |  |  |
| :--- | ---: | :---: | ---: | ---: | ---: | ---: |
| Net interest income (expense) | $\$ 370,614$ | $\$(26,337)$ | $\$$ | 162 | $\$$ | 344,439 |
| Provision (reversal of provision) for loan |  |  |  |  |  |  |
| losses | 106,290 | $(82)$ |  | 106,208 |  |  |
| Non-interest income | 124,859 | 7,089 | $(574)$ | 131,374 |  |  |
| Amortization of intangibles | 2,481 |  |  | 2,481 |  |  |
| Depreciation expense | 11,368 | 303 |  | 11,671 |  |  |
| Loss on early extinguishment of debt | 43 |  |  | 43 |  |  |
| Other operating expenses | 275,372 | 18,653 | $(1,187)$ | 292,838 |  |  |
| Income tax expense (benefit) | 18,027 | $(2,851)$ | 208 | 15,384 |  |  |
|  |  |  |  |  |  |  |
| Net income (loss) | $\$ 81,892$ | $\$(35,271)$ | $\$$ | 567 | $\$$ | 47,188 |

For the nine months ended September 30, 2012

| (In thousands) | Banco Popular <br> de Puerto Rico | Banco Popular <br> North America | Intersegment <br> Eliminations |  |
| :--- | ---: | ---: | ---: | ---: |
| Net interest income | $\$ 889,954$ | $\$$ | 213,228 | $\$$ |
| Provision for loan losses | 281,986 | 43,877 |  |  |
| Non-interest income | 311,333 | 42,187 |  |  |
| Amortization of intangibles | 5,565 | 2,040 |  |  |
| Depreciation expense | 27,992 | 6,017 |  |  |
| Loss on early extinguishment of debt | 25,184 |  |  |  |
| Other operating expenses | 673,747 | 172,127 |  |  |

Income tax (benefit) expense $\quad(39,281) \quad 2,809$
Net income \$ $226,094 \quad \$ \quad 28,545$ \$

For the nine months ended September 30, 2012
Reportable

| (In thousands) | Segments | Corporate | Eliminations |  | Total Popular, Inc. |
| :--- | ---: | :---: | :---: | :---: | ---: |
| Net interest income (expense) | $\$ 1,103,182$ | $\$(78,453)$ | $\$$ | 487 | $\$$ |
| Provision for loan losses | 325,863 | 267 |  | $1,025,216$ |  |
| Non-interest income | 353,520 | 29,079 |  | $(1,867)$ | 326,130 |
| Amortization of intangibles | 7,605 |  |  | 380,732 |  |
| Depreciation expense | 34,009 | 944 |  | 7,605 |  |
| Loss on early extinguishment of debt | 25,184 |  |  | 34,953 |  |
| Other operating expenses | 845,874 | 53,684 | $(2,500)$ | 25,184 |  |
| Income tax benefit | $(36,472)$ | $(10,108)$ | 263 | 897,058 |  |
|  |  |  |  | $(46,317)$ |  |
| Net income (loss) | $\$ 254,639$ | $\$(94,161)$ | $\$$ | 857 | $\$$ |

## Table of Contents

Additional disclosures with respect to the Banco Popular de Puerto Rico reportable segment are as follows:

## 2013

For the quarter ended September 30, 2013
Banco Popular de Puerto Rico

| (In thousands) | Commercial Banking |  | Consumer and Retail Banking |  | Other <br> Financial Services |  | Eliminations |  | Total Banco Popular de Puerto Rico |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 122,706 | \$ | 184,522 | \$ | 2,718 | \$ |  | \$ | 309,946 |
| Provision for loan losses |  | 6,898 |  | 60,958 |  |  |  |  |  | 67,856 |
| Non-interest income |  | 10,231 |  | 61,736 |  | 19,044 |  | (16) |  | 90,995 |
| Amortization of intangibles |  | 1 |  | 1,708 |  | 79 |  |  |  | 1,788 |
| Depreciation expense |  | 4,066 |  | 5,260 |  | 304 |  |  |  | 9,630 |
| Other operating expenses |  | 75,088 |  | 140,933 |  | 16,607 |  | (16) |  | 232,612 |
| Income tax expense |  | 19,411 |  | 5,701 |  | 1,295 |  |  |  | 26,407 |
| Net income | \$ | 27,473 | \$ | 31,698 | \$ | 3,477 | \$ |  | \$ | 62,648 |
| Segment assets |  | ,168,478 |  | ,089,472 |  | 52,664 |  | 359) |  | ,090,255 |

For the nine months ended September 30, 2013
Banco Popular de Puerto Rico

| Consumer and Retail Banking | Other <br> Financial Services | Eliminations | Total Banco Popular de Puerto Rico |
| :---: | :---: | :---: | :---: |
| 567,223 | \$ 7,274 | \$ | \$ 929,722 |
| 399,175 |  |  | 545,685 |
| 176,172 | 69,835 | (51) | 210,703 |
| 5,127 | 233 |  | 5,363 |
| 15,874 | 922 |  | 29,702 |
| 434,810 | 50,830 | (51) | 707,973 |
| $(196,194)$ | 7,093 |  | $(262,224)$ |

Net income
$\begin{array}{lllllllll}\$ & 11,292 & \$ & 84,603 & \$ 18,031 & \$ & \$ 113,926\end{array}$
2012

For the quarter ended September 30, 2012
Banco Popular de Puerto Rico

Edgar Filing: POPULAR INC - Form 10-Q

| (In thousands) | Commercial Banking |  | Consumer and Retail Banking |  | Other <br> Financial ervices | Eliminations | Total Banco Popular de Puerto Rico |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 102,548 | \$ 195,952 | \$ | 2,516 | \$ | \$ 301,016 |
| Provision for loan losses |  | 55,300 | 37,139 |  |  |  | 92,439 |
| Non-interest income |  | 13,496 | 74,111 |  | 25,809 | (38) | 113,378 |
| Amortization of intangibles |  | 2 | 1,708 |  | 91 |  | 1,801 |
| Depreciation expense |  | 4,238 | 4,886 |  | 244 |  | 9,368 |
| Loss on early extinguishment of debt |  | 43 |  |  |  |  | 43 |
| Other operating expenses |  | 69,040 | 135,179 |  | 16,249 | (38) | 220,430 |
| Income tax (benefit) expense |  | $(6,007)$ | 20,119 |  | 2,978 |  | 17,090 |
| Net (loss) income | \$ | $(6,572)$ | \$ 71,032 |  | 8,763 | \$ | \$ 73,223 |

Table of Contents

| For the nine months ended September 30, 2012 Banco Popular de Puerto Rico |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) |  | ommercial <br> Banking | Consumer and Retail Banking | Other <br> Financial Services | Elim | ations |  | al Banco pular de rto Rico |
| Net interest income | \$ | 312,201 | \$ 568,154 | \$ 9,595 | \$ | 4 | \$ | 889,954 |
| Provision for loan losses |  | 111,723 | 170,263 |  |  |  |  | 281,986 |
| Non-interest income |  | 32,130 | 196,228 | 83,079 |  | (104) |  | 311,333 |
| Amortization of intangibles |  | 12 | 5,126 | 427 |  |  |  | 5,565 |
| Depreciation expense |  | 12,610 | 14,662 | 720 |  |  |  | 27,992 |
| Loss on early extinguishment of debt |  | 7,905 | 17,279 |  |  |  |  | 25,184 |
| Other operating expenses |  | 204,289 | 418,323 | 51,239 |  | (104) |  | 673,747 |
| Income tax (benefit) expense |  | $(26,397)$ | $(23,240)$ | 10,354 |  | 2 |  | $(39,281)$ |
| Net income | \$ | 34,189 | \$ 161,969 | \$ 29,934 | \$ | 2 | \$ | 226,094 |

Additional disclosures with respect to the Banco Popular North America reportable segments are as follows:

## 2013

For the quarter ended September 30, 2013
Banco Popular North America
Total Banco

| (In thousands) | North America | E-LOAN | Eliminations | America |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Net interest income | $\$$ | 72,459 | $\$$ | 720 | $\$$ |
| Provision (reversal of provision) for loan losses | 6,486 | $(1,731)$ | $\$ 3,179$ |  |  |
| Non-interest income | 14,576 | 1,857 | 4,755 |  |  |
| Amortization of intangibles | 680 |  | 16,433 |  |  |
| Depreciation expense | 2,258 |  | 680 |  |  |
| Other operating expenses | 55,191 | 609 | 2,258 |  |  |
| Income tax expense | 937 |  | 55,800 |  |  |

Popular North
America

| Net income | $\$$ | 21,483 | $\$$ | 3,699 | $\$$ | $\$$ | 25,182 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Segment assets | $\$ 9,513,077$ | $\$ 327,231$ | $\$(1,058,288)$ | $\$ 8,782,020$ |  |  |  |

For the nine months ended September 30, 2013
Banco Popular North America
Total Banco
Popular North
(In thousands)

| Banco Popular | Popular North |  |
| :---: | :---: | :---: |
| North America | E-LOAN | Eliminations America |

Edgar Filing: POPULAR INC - Form 10-Q

| Net interest income | $\$$ | 206,664 | $\$$ | 2,368 | $\$$ |
| :--- | ---: | ---: | ---: | ---: | ---: |
| (Reversal of provision) provision for loan losses | $(2,561)$ | 2,771 | $\$ 209,032$ |  |  |
| Non-interest income | 39,098 | 159 | 210 |  |  |
| Amortization of intangibles | 2,040 |  | 39,257 |  |  |
| Depreciation expense | 6,870 |  | 2,040 |  |  |
| Other operating expenses | 161,268 | 1,877 | 6,870 |  |  |
| Income tax expense | 2,809 |  | 163,145 |  |  |
|  |  |  | 2,809 |  |  |
| Net income (loss) | $\$ 75,336$ | $\$(2,121) \$$ | $\$$ | 73,215 |  |

## Table of Contents

## 2012

For the quarter ended September 30, 2012
Banco Popular North America

| (In thousands) | Banco Popular North America |  | E-LOAN |  | Eliminations | Total Banco Popular North America |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 68,639 | \$ | 959 | \$ | \$ | 69,598 |
| Provision for loan losses |  | 8,294 |  | 5,557 |  |  | 13,851 |
| Non-interest income |  | 9,470 |  | 2,011 |  |  | 11,481 |
| Amortization of intangibles |  | 680 |  |  |  |  | 680 |
| Depreciation expense |  | 2,000 |  |  |  |  | 2,000 |
| Other operating expenses |  | 54,430 |  | 512 |  |  | 54,942 |
| Income tax expense |  | 937 |  |  |  |  | 937 |
| Net income (loss) | \$ | 11,768 | \$ | $(3,099)$ | \$ | \$ | 8,669 |

For the nine months ended September 30, 2012
Banco Popular North America

| (In thousands) | Banco Popular North America |  | E-LOAN |  | Eliminations | Total Banco Popular North America |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 210,705 | \$ | 2,523 | \$ | \$ | 213,228 |
| Provision for loan losses |  | 31,180 |  | 12,697 |  |  | 43,877 |
| Non-interest income |  | 39,207 |  | 2,980 |  |  | 42,187 |
| Amortization of intangibles |  | 2,040 |  |  |  |  | 2,040 |
| Depreciation expense |  | 6,017 |  |  |  |  | 6,017 |
| Other operating expenses |  | 169,976 |  | 2,151 |  |  | 172,127 |
| Income tax expense |  | 2,809 |  |  |  |  | 2,809 |
| Net income (loss) | \$ | 37,890 | \$ | $(9,345)$ | \$ | \$ | 28,545 |

## Geographic Information

|  | Quarter ended |  | Nine months ended |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
|  | September 30, September 30, | September 30, | September 30, |  |  |
| (In thousands) | 2013 | 2012 | 2013 | 2012 |  |
| Revenues:[1] |  |  |  |  |  |
| Puerto Rico | $\$ 540,721$ | $\$$ | 377,032 | $\$ 1,378,361$ | $\$$ |
| United States | 85,948 | 74,248 | 237,768 | 238,076 |  |
| Other | 19,496 | 24,533 | 59,488 | 73,382 |  |

$\begin{array}{llllll}\text { Total consolidated revenues } & \$ 646,165 & \$ & 475,813 & \$ 1,675,617 & \$ 1,405,948\end{array}$
[1] Total revenues include net interest income, service charges on deposit accounts, other service fees, mortgage banking activities, net gain (loss) and valuation adjustments of investment securities, trading account profit (loss), net gain (loss) on sale of loans and valuation adjustments on loans held-for-sale, adjustments to indemnity reserves on loans sold, FDIC loss share expense (income) and other operating income.

## Table of Contents

## Selected Balance Sheet Information:

| (In thousands) | September 30, 2013 | December 31, 2012 |  |  |
| :--- | ---: | ---: | ---: | ---: |
| Puerto Rico | $\$$ | $25,912,067$ | $\$$ | $26,582,248$ |
| Total assets |  | $17,948,824$ |  | $18,484,977$ |
| Loans | $19,406,949$ |  | $19,984,830$ |  |
| Deposits | $\$$ | $9,013,477$ | $\$$ | $8,816,143$ |
| United States |  | $5,924,406$ |  | $5,852,705$ |
| Total assets |  | $6,036,980$ |  | $6,049,168$ |
| Loans | $\$$ |  |  |  |
| Deposits | $1,126,572$ | $\$$ | $1,109,144$ |  |
| Other |  | 754,494 |  | 755,950 |
| Total assets |  | 951,125 |  | 966,615 |

[1] Represents deposits from BPPR operations located in the U.S. and British Virgin Islands.

## Note 34 Subsequent events

Subsequent events are events and transactions that occur after the balance sheet date but before the financial statements are issued. The effects of subsequent events and transactions are recognized in the financial statements when they provide additional evidence about conditions that existed at the balance sheet date. The Corporation has evaluated events and transactions occurring subsequent to September 30, 2013.

On October 18, 2013, the Corporation submitted a formal application to the Federal Reserve of New York to redeem the $\$ 935$ million in trust preferred securities due under the Troubled Assets Relief Program ( TARP ), discussed in Note 17. While there can be no assurance that the Corporation will be approved to repay TARP, nor on the timing of this event, if the Corporation is approved and repays TARP in full, a non-cash charge to earnings would be recorded for the unamortized portion of the discount associated with this debt, which at September 30, 2013 had a balance of $\$ 411$ million.

Table of Contents

## Note 35 Condensed consolidating financial information of guarantor and issuers of registered guaranteed securities

The following condensed consolidating financial information presents the financial position of Popular, Inc. Holding Company ( PIHC ) (parent only), Popular North America, Inc. ( PNA ) and all other subsidiaries of the Corporation at September 30, 2013 and December 31, 2012, and the results of their operations and cash flows for periods ended September 30, 2013 and 2012.

PNA is an operating, wholly-owned subsidiary of PIHC and is the holding company of its wholly-owned subsidiaries: Equity One, Inc. and Banco Popular North America ( BPNA ), including BPNA s wholly-owned subsidiaries Popular Equipment Finance, Inc., Popular Insurance Agency, U.S.A., and E-LOAN, Inc.

PIHC fully and unconditionally guarantees all registered debt securities issued by PNA.
Popular International Bank, Inc. ( PIBI ) is a wholly-owned subsidiary of PIHC and is the holding company of its wholly-owned subsidiaries Popular Insurance V.I., Inc. In July 2013, the Corporation completed the sale of Tarjetas y Transacciones en Red Tranred, C.A., which was a wholly owned subsidiary of PIBI. Effective January 1, 2012, PNA, which was a wholly-owned subsidiary of PIBI prior to that date, became a direct wholly-owned subsidiary of PIHC after an internal reorganization. Since the internal reorganization, PIBI is no longer a bank holding company and is no longer a potential issuer of the Corporation s debt securities. PIBI has no outstanding registered debt securities that would also be guaranteed by PIHC.

A potential source of income for PIHC consists of dividends from BPPR and BPNA. Under existing federal banking regulations any dividend from BPPR or BPNA to the PIHC could be made if the total of all dividends declared by each entity during the calendar year would not exceed the total of its net income for that year, as defined by the Federal Reserve Board, combined with its retained net income for the preceding two years, less any required transfers to surplus or to a fund for the retirement of any preferred stock. At September 30, 2013, BPPR could have declared a dividend of approximately $\$ 471$ million (December 31, 2012 - $\$ 404$ million). However, on July 25, 2011, PIHC and BPPR entered into a Memorandum of Understanding with the Federal Reserve Bank of New York and the Office of the Commissioner of Financial Institutions of Puerto Rico that requires the approval of these entities prior to the payment of any dividends by BPPR to PIHC. BPNA could not declare any dividends without the approval of the Federal Reserve Board.

Table of Contents

## Condensed Consolidating Statement of Financial Condition (Unaudited)

At September 30, 2013
All other

| (In thousands) | Popular Inc. Holding Co. | PNA <br> Holding Co. | subsidiaries and eliminations | Elimination entries | Popular, Inc. Consolidated |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Assets: |  |  |  |  |  |
| Cash and due from banks | 5,744 | 618 | 368,258 | $(6,030)$ | \$ 368,590 |
| Money market investments | 23,722 | 360 | 942,966 | $(5,260)$ | 961,788 |
| Trading account securities, at fair value | 1,378 |  | 337,470 |  | 338,848 |
| Investment securities available-for-sale, at fair value | 5,005 |  | 5,131,613 |  | 5,136,618 |
| Investment securities held-to-maturity, at amortized cost | 185,000 |  | 140,355 | $(185,000)$ | 140,355 |
| Other investment securities, at lower of cost or realizable value | 10,850 | 4,492 | 183,522 |  | 198,864 |
| Investment in subsidiaries | 4,308,536 | 1,656,798 |  | $(5,965,334)$ |  |
| Loans held-for-sale, at lower of cost or fair value |  |  | 124,532 |  | 124,532 |

Loans held-in-portfolio:

| Loans not covered under loss sharing agreements with the FDIC | 615,416 | 21,518,299 | $(613,661)$ | 21,520,054 |
| :---: | :---: | :---: | :---: | :---: |
| Loans covered under loss sharing agreements with the FDIC |  | 3,076,009 |  | 3,076,009 |
| Less - Unearned income |  | 92,871 |  | 92,871 |
| Allowance for loan losses | 98 | 642,830 |  | 642,928 |
| Total loans held-in-portfolio, net | 615,318 | 23,858,607 | $(613,661)$ | 23,860,264 |


| FDIC loss share asset |  | 1,324,711 |  |  | 1,324,711 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Premises and equipment, net | 2,259 | 50 | 517,314 |  | 519,623 |
| Other real estate not covered under |  |  |  |  |  |
| loss sharing agreements with the FDIC |  |  | 135,502 |  | 135,502 |
| Other real estate covered under loss sharing agreements with the FDIC |  |  | 159,968 |  | 159,968 |
| Accrued income receivable | 128 | 31 | 122,796 | (74) | 122,881 |
| Mortgage servicing assets, at fair value |  |  | 161,445 |  | 161,445 |
| Other assets | 89,072 | 15,167 | 1,736,282 | $(37,043)$ | 1,803,478 |
| Goodwill |  |  | 647,757 |  | 647,757 |
| Other intangible assets | 554 |  | 46,338 |  | 46,892 |

Total assets \$5,247,566 \$ 1,677,516 \$ 35,939,436 \$ (6,812,402) \$ 36,052,116

Liabilities and Stockholders Equity
Liabilities:
Deposits:

| Non-interest bearing | $\$$ | $\$$ | $5,768,584$ | $\$$ | $(6,030)$ | $\$ 5,762,554$ |
| :--- | :--- | ---: | ---: | ---: | ---: | ---: |
| Interest bearing | $20,632,860$ | $(360)$ | $20,632,500$ |  |  |  |
| Total deposits |  | $26,401,444$ |  | $(6,390)$ | $26,395,054$ |  |


| Federal funds purchased and assets sold under agreements to repurchase |  |  | 1,798,108 | $(4,900)$ | 1,793,208 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Other short-term borrowings |  | 233,561 | 1,206,300 | $(613,661)$ | 826,200 |
| Notes payable | 815,683 | 149,663 | 579,350 |  | 1,544,696 |
| Subordinated notes |  |  | 185,000 | $(185,000)$ |  |
| Other liabilities | 37,998 | 36,633 | 1,061,995 | $(37,553)$ | 1,099,073 |
| Total liabilities | 853,681 | 419,857 | 31,232,197 | $(847,504)$ | 31,658,231 |

Stockholders equity:

| Preferred stock | 50,160 |  |  |  | 50,160 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Common stock | 1,034 | 2 | 55,628 | $(55,630)$ | 1,034 |
| Surplus | $4,146,717$ | $4,238,208$ | $5,859,225$ | $(10,088,906)$ | $4,155,244$ |
| Retained earnings (accumulated <br> deficit) | 453,857 | $(2,974,381)$ | $(949,069)$ | $3,914,923$ | 445,330 |
| Treasury stock, at cost <br> Accumulated other comprehensive <br> loss, net of tax | $(877)$ |  |  |  | $(877)$ |
| Total stockholders equity | $(257,006)$ | $(6,170)$ | $(258,545)$ | 264,715 | $(257,006)$ |
|  | $4,393,885$ | $1,257,659$ | $4,707,239$ | $(5,964,898)$ | $4,393,885$ |

Total liabilities and stockholders equity
\$5,247,566 \$ 1,677,516 \$ 35,939,436 \$ (6,812,402) \$ 36,052, 116

Table of Contents

## Condensed Consolidating Statement of Financial Condition



Loans held-in-portfolio:

| Loans not covered under loss |  |  |  |  |
| :--- | :---: | ---: | ---: | ---: |
| sharing agreements with the FDIC | 286,080 | $21,050,205$ | $(256,280)$ | $21,080,005$ |
| Loans covered under loss sharing   <br> agreements with the FDIC 241 $3,755,972$ | $3,755,972$ |  |  |  |
| Less - Unearned income | 96,813 | 96,813 |  |  |
| Allowance for loan losses | 730,366 | 730,607 |  |  |
| Total loans held-in-portfolio, net | 285,839 | $23,978,998$ | $(256,280)$ | $24,008,557$ |



Total assets
$\$ 4,948,464 \quad \$ 1,672,460 \quad \$ 36,301,223 \quad \$(6,414,612) \quad \$ 36,507,535$

Table of Contents

Liabilities and Stockholders Equity
Liabilities:
Deposits:

| Non-interest bearing | $\$$ | $\$$ | $5,796,992$ | $\$$ | $(2,363)$ | $\$ 5,794,629$ |
| :--- | :--- | :--- | ---: | ---: | ---: | ---: |
| Interest bearing | $21,216,085$ | $(10,101)$ | $21,205,984$ |  |  |  |
| Total deposits |  |  |  |  |  |  |

Assets sold under agreements to

| repurchase |  |  | $2,016,752$ |  | $2,016,752$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Other short-term borrowings | 790,282 | 385,609 | 660,500 | $(230,300)$ | 636,200 |
| Notes payable | 48,182 | 42,120 | 901,830 |  | $1,777,721$ |
| Subordinated notes |  |  | 923,138 | $(185,000)$ |  |
| Other liabilities | 838,464 | 427,729 | $31,606,297$ | $(474,955)$ | $32,397,535$ |
| Total liabilities |  |  |  |  | 966,249 |

Stockholders equity:

| Preferred stock | 50,160 |  |  |  | 50,160 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Common stock | 1,032 | 2 | 55,628 | $(55,630)$ | 1,032 |
| Surplus | $4,141,767$ | $4,206,708$ | $5,859,926$ | $(10,058,107)$ | $4,150,294$ |
| Retained earnings (accumulated <br> deficit) | 20,353 | $(3,012,365)$ | $(1,114,802)$ | $4,118,640$ | 11,826 |
| Treasury stock, at cost | $(444)$ |  |  |  |  |
| Accumulated other comprehensive <br> (loss) income, net of tax | $(102,868)$ | 50,386 | $(105,826)$ | 55,440 | $(102,868)$ |
| Total stockholders equity | $4,110,000$ | $1,244,731$ | $4,694,926$ | $(5,939,657)$ | $4,110,000$ |

Total liabilities and stockholders equity
$\$ 4,948,464 \quad \$ 1,672,460 \quad \$ 36,301,223 \quad \$(6,414,612) \quad \$ 36,507,535$

Table of Contents

## Condensed Consolidating Statement of Operations (Unaudited)



[^0]Edgar Filing: POPULAR INC - Form 10-Q

| Equipment expenses | 1,049 |  |  |  | 10,719 |  |  |  | 11,768 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Other taxes | 113 |  |  |  | 17,636 |  |  |  | 17,749 |
| Professional fees | 4,120 |  | 23 |  | 67,948 |  | (52) |  | 72,039 |
| Communications | 120 |  |  |  | 6,438 |  |  |  | 6,558 |
| Business promotion | 385 |  |  |  | 14,597 |  |  |  | 14,982 |
| FDIC deposit insurance |  |  |  |  | 16,100 |  |  |  | 16,100 |
| Loss on early extinguishment of debt |  |  | 3,388 |  |  |  |  |  | 3,388 |
| Other real estate owned (OREO) expenses |  |  |  |  | 17,175 |  |  |  | 17,175 |
| Other operating expenses | $(15,305)$ |  | 108 |  | 38,666 |  | (647) |  | 22,822 |
| Amortization of intangibles |  |  |  |  | 2,468 |  |  |  | 2,468 |
| Total operating expenses | (603) |  | 3,519 |  | 324,382 |  | (699) |  | 326,599 |
| Income (loss) before income tax and equity in earnings of subsidiaries | 157,640 |  | $(9,968)$ |  | 98,584 |  | 647 |  | 246,903 |
| Income tax (benefit) expense | $(4,797)$ |  |  |  | 22,342 |  | 223 |  | 17,768 |
| Income (loss) before equity in earnings of subsidiaries | 162,437 |  | $(9,968)$ |  | 76,242 |  | 424 |  | 229,135 |
| Equity in undistributed earnings of subsidiaries | 66,698 |  | 18,316 |  |  |  | $(85,014)$ |  |  |
| Net income | \$ 229,135 | \$ | 8,348 | \$ | 76,242 | \$ | $(84,590)$ | \$ | 229,135 |
| Comprehensive income (loss), net of tax | \$ 198,168 | \$ | 3,393 | \$ | 45,299 | \$ | $(48,692)$ | \$ | 198,168 |

Table of Contents

## Condensed Consolidating Statement of Operations (Unaudited)

| (In thousands) | Nine months ended September 30, 2013 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Popular, Inc. Holding Co. | $\begin{gathered} \text { PNA } \\ \text { Holding Co. } \end{gathered}$ | All other subsidiaries and eliminations | Elimination entries | Popular, Inc. Consolidated |
| Interest income: |  |  |  |  |  |
| Loans | \$ 3,342 | \$ | \$ 1,170,488 | \$ (784) | \$ 1,173,046 |
| Money market investments | 113 | 3 | 2,630 | (114) | 2,632 |
| Investment securities | 10,634 | 242 | 105,350 | $(8,736)$ | 107,490 |
| Trading account securities |  |  | 16,212 |  | 16,212 |
| Total interest income | 14,089 | 245 | 1,294,680 | $(9,634)$ | 1,299,380 |
| Interest expense: |  |  |  |  |  |
| Deposits |  |  | 105,971 | (3) | 105,968 |
| Short-term borrowings |  | 81 | 29,927 | (895) | 29,113 |
| Long-term debt | 75,312 | 21,542 | 19,943 | $(8,736)$ | 108,061 |
| Total interest expense | 75,312 | 21,623 | 155,841 | $(9,634)$ | 243,142 |
| Net interest (expense) income | $(61,223)$ | $(21,378)$ | 1,138,839 |  | 1,056,238 |
| Provision for loan losses- non-covered loans | 32 |  | 485,406 |  | 485,438 |
| Provision for loan losses- covered loans |  |  | 60,489 |  | 60,489 |
| Net interest (expense) income after provision for loan losses | $(61,255)$ | $(21,378)$ | 592,944 |  | 510,311 |
| Service charges on deposit accounts |  |  | 130,755 |  | 130,755 |
| Other service fees |  |  | 175,010 | $(1,451)$ | 173,559 |
| Mortgage banking activities |  |  | 57,281 |  | 57,281 |
| Net gain and valuation adjustments on investment securities | 5,856 |  |  |  | 5,856 |
| Trading account profit (loss) | 134 |  | $(12,070)$ |  | $(11,936)$ |
| Net loss on sale of loans, including valuation adjustments on loans held-for-sale |  |  | $(54,532)$ |  | $(54,532)$ |
| Adjustments (expense) to indemnity reserves on loans sold |  |  | $(30,162)$ |  | $(30,162)$ |
| FDIC loss share (expense) income |  |  | $(44,887)$ |  | $(44,887)$ |
| Other operating income | 345,818 | 3,427 | 44,200 |  | 393,445 |
| Total non-interest income | 351,808 | 3,427 | 265,595 | $(1,451)$ | 619,379 |

Operating expenses:
Table of Contents 233

Edgar Filing: POPULAR INC - Form 10-Q

| Personnel costs | 23,152 |  |  |  | 324,355 |  |  |  | 347,507 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net occupancy expenses | 2,649 |  | 2 |  | 69,641 |  |  |  | 72,292 |
| Equipment expenses | 3,113 |  |  |  | 32,448 |  |  |  | 35,561 |
| Other taxes | 280 |  |  |  | 44,343 |  |  |  | 44,623 |
| Professional fees | 9,814 |  | 68 |  | 202,785 |  | (167) |  | 212,500 |
| Communications | 323 |  |  |  | 19,711 |  |  |  | 20,034 |
| Business promotion | 1,254 |  |  |  | 42,207 |  |  |  | 43,461 |
| FDIC deposit insurance |  |  |  |  | 44,883 |  |  |  | 44,883 |
| Loss on early extinguishment of debt |  |  | 3,388 |  |  |  |  |  | 3,388 |
| Other real estate owned (OREO) expenses |  |  |  |  | 69,678 |  |  |  | 69,678 |
| Other operating expenses | $(40,654)$ |  | 325 |  | 110,782 |  | $(1,900)$ |  | 68,553 |
| Amortization of intangibles |  |  |  |  | 7,403 |  |  |  | 7,403 |
| Total operating expenses | (69) |  | 3,783 |  | 968,236 |  | $(2,067)$ |  | 969,883 |
| Income (loss) before income tax and equity in earnings of subsidiaries | 290,622 |  | $(21,734)$ |  | $(109,697)$ |  | 616 |  | 159,807 |
| Income tax (benefit) expense | $(1,176)$ |  |  |  | $(275,429)$ |  | 116 |  | $(276,489)$ |
| Income (loss) before equity in earnings of subsidiaries | 291,798 |  | $(21,734)$ |  | 165,732 |  | 500 |  | 436,296 |
| Equity in undistributed earnings of subsidiaries | 144,498 |  | 59,718 |  |  |  | $(204,216)$ |  |  |
| Net Income | \$ 436,296 | \$ | 37,984 | \$ | 165,732 | \$ | $(203,716)$ | \$ | 436,296 |
| Comprehensive income (loss), net of tax | \$ 282,158 | \$ | $(18,572)$ | \$ | 13,013 | \$ | 5,559 | \$ | 282,158 |

Table of Contents

## Condensed Consolidating Statement of Operations (Unaudited)

| (In thousands) | Quarter ended September 30, 2012 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Popular, Inc. Holding Co. | PNA <br> Holding Co. | All other subsidiaries and eliminations |  | Elimination entries |  | Popular, Inc. Consolidated |  |
| Interest income: |  |  |  |  |  |  |  |  |
| Loans | \$ 1,759 | \$ | \$ | 387,076 | \$ | (886) | \$ | 387,949 |
| Money market investments |  | 3 |  | 862 |  | (3) |  | 862 |
| Investment securities | 4,052 | 81 |  | 39,028 |  | $(2,749)$ |  | 40,412 |
| Trading account securities |  |  |  | 5,815 |  |  |  | 5,815 |
| Total interest income | 5,811 | 84 |  | 432,781 |  | $(3,638)$ |  | 435,038 |
| Interest expense: |  |  |  |  |  |  |  |  |
| Deposits |  |  |  | 43,025 |  | (3) |  | 43,022 |
| Short-term borrowings |  | 2 |  | 10,761 |  | (887) |  | 9,876 |
| Long-term debt | 24,118 | 8,067 |  | 8,427 |  | $(2,911)$ |  | 37,701 |
| Total interest expense | 24,118 | 8,069 |  | 62,213 |  | $(3,801)$ |  | 90,599 |
| Net interest (expense) income | $(18,307)$ | $(7,985)$ |  | 370,568 |  | 163 |  | 344,439 |
| Provision for loan losses- non-covered loans | (82) |  |  | 83,671 |  |  |  | 83,589 |
| Provision for loan losses- covered loans |  |  |  | 22,619 |  |  |  | 22,619 |
| Net interest (expense) income after provision for loan losses | $(18,225)$ | $(7,985)$ |  | 264,278 |  | 163 |  | 238,231 |
| Service charges on deposit accounts |  |  |  | 45,858 |  |  |  | 45,858 |
| Other service fees |  |  |  | 58,529 |  | (575) |  | 57,954 |
| Mortgage banking activities |  |  |  | 21,847 |  |  |  | 21,847 |
| Net gain and valuation adjustments on investment securities |  |  |  | 64 |  |  |  | 64 |
| Trading account profit |  |  |  | 5,443 |  |  |  | 5,443 |
| Net gain on sale of loans, including valuation adjustments on loans held-for-sale |  |  |  | $(1,205)$ |  |  |  | $(1,205)$ |
| Adjustments (expense) to indemnity reserves on loans sold |  |  |  | $(8,717)$ |  |  |  | $(8,717)$ |
| FDIC loss share (expense) income |  |  |  | $(6,707)$ |  |  |  | $(6,707)$ |
| Other operating income | 103 | $(1,149)$ |  | 17,882 |  | 1 |  | 16,837 |
| Total non-interest income | 103 | $(1,149)$ |  | 132,994 |  | (574) |  | 131,374 |

Operating expenses:
Table of Contents 235

Edgar Filing: POPULAR INC - Form 10-Q

| Personnel costs | 6,675 |  |  |  | 104,875 |  |  |  | 111,550 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net occupancy expenses | 844 |  |  |  | 22,772 |  | (1) |  | 23,615 |
| Equipment expenses | 1,021 |  |  |  | 10,426 |  |  |  | 11,447 |
| Other taxes | 368 |  |  |  | 12,298 |  |  |  | 12,666 |
| Professional fees | 3,647 |  | 3 |  | 67,875 |  | (573) |  | 70,952 |
| Communications | 114 |  |  |  | 6,386 |  |  |  | 6,500 |
| Business promotion | 425 |  |  |  | 14,499 |  |  |  | 14,924 |
| FDIC deposit insurance |  |  |  |  | 24,173 |  |  |  | 24,173 |
| Loss on early extinguishment of debt |  |  |  |  | 43 |  |  |  | 43 |
| Other real estate owned (OREO) expenses |  |  |  |  | 5,896 |  |  |  | 5,896 |
| Other operating expenses | $(12,468)$ |  | 110 |  | 35,755 |  | (611) |  | 22,786 |
| Amortization of intangibles |  |  |  |  | 2,481 |  |  |  | 2,481 |
| Total operating expenses | 626 |  | 113 |  | 307,479 |  | $(1,185)$ |  | 307,033 |
| (Loss) income before income tax and equity in earnings of subsidiaries | $(18,748)$ |  | $(9,247)$ |  | 89,793 |  | 774 |  | 62,572 |
| Income tax expense | 72 |  |  |  | 15,103 |  | 209 |  | 15,384 |
| (Loss) income before equity in earnings of subsidiaries | $(18,820)$ |  | $(9,247)$ |  | 74,690 |  | 565 |  | 47,188 |
| Equity in undistributed earnings of subsidiaries | 66,008 |  | 5,203 |  |  |  | $(71,211)$ |  |  |
| Net Income (loss) | \$ 47,188 | \$ | $(4,044)$ | \$ | 74,690 | \$ | $(70,646)$ | \$ | 47,188 |
| Comprehensive income (loss), net of tax | \$ 44,336 | \$ | $(4,082)$ | \$ | 71,037 | \$ | $(66,955)$ | \$ | 44,336 |

Table of Contents

## Condensed Consolidating Statement of Operations (Unaudited)

| (In thousands) | Nine months ended September 30, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Popular, Inc. Holding Co. | PNA <br> Holding Co. | All other subsidiaries and eliminations | Elimination entries | Popular, Inc. <br> Consolidated |
| Interest and dividend income: |  |  |  |  |  |
| Dividend income from subsidiaries | \$ 5,000 | \$ | \$ | \$ (5,000) | \$ |
| Loans | 4,966 |  | 1,163,939 | $(2,512)$ | 1,166,393 |
| Money market investments | 13 | 25 | 2,773 | (37) | 2,774 |
| Investment securities | 12,240 | 242 | 125,978 | $(8,248)$ | 130,212 |
| Trading account securities |  |  | 17,669 |  | 17,669 |
| Total interest and dividend income | 22,219 | 267 | 1,310,359 | $(15,797)$ | 1,317,048 |

Interest expense:

| Deposits |  |  | 143,321 | $(24)$ | 143,297 |
| :--- | :---: | ---: | ---: | ---: | ---: |
| Short-term borrowings | 71,462 | 24,223 | 38,883 | $(2,524)$ | 36,503 |
| Long-term debt |  | 25,083 | $(8,736)$ | 112,032 |  |
| Total interest expense | 71,462 | 24,367 | 207,287 | $(11,284)$ | 291,832 |
|  |  |  |  |  |  |
| Net interest (expense) income | $(49,243)$ | $(24,100)$ | $1,103,072$ | $(4,513)$ | $1,025,216$ |
| Provision for loan losses- non-covered <br> loans <br> Provision for loan losses- covered loans | 267 |  |  |  | 247,579 |
|  |  |  | 78,284 |  | 78,846 |

Net interest (expense) income after

| provision for loan losses | $(49,510)$ | $(24,100)$ | 777,209 | $(4,513)$ | 699,086 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Service charges on deposit accounts |  |  | 138,577 |  | 138,577 |
| Other service fees |  |  | 174,449 | $(1,867)$ | 172,582 |
| Mortgage banking activities |  |  | 60,418 |  | 60,418 |
| Net loss and valuation adjustments on investment securities |  |  | (285) |  | (285) |
| Trading account profit |  |  | 6,040 |  | 6,040 |
| Net loss on sale of loans, including valuation adjustments on loans held-for-sale |  |  | $(30,459)$ |  | $(30,459)$ |
| Adjustments (expense) to indemnity reserves on loans sold |  |  | $(17,990)$ |  | $(17,990)$ |
| FDIC loss share (expense) income |  |  | $(19,387)$ |  | $(19,387)$ |
| Other operating income | 4,540 | 380 | 66,316 |  | 71,236 |
| Total non-interest income | 4,540 | 380 | 377,679 | $(1,867)$ | 380,732 |

Edgar Filing: POPULAR INC - Form 10-Q

| Operating expenses: |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Personnel costs | 22,028 |  |  |  | 327,349 |  |  | 349,377 |
| Net occupancy expenses | 2,577 |  | 2 |  | 68,564 |  |  | 71,143 |
| Equipment expenses | 2,802 |  |  |  | 30,886 |  |  | 33,688 |
| Other taxes | 1,796 |  |  |  | 36,382 |  |  | 38,178 |
| Professional fees | 8,519 |  | 9 |  | 198,867 | (703) |  | 206,692 |
| Communications | 340 |  |  |  | 19,936 |  |  | 20,276 |
| Business promotion | 1,326 |  |  |  | 43,428 |  |  | 44,754 |
| FDIC deposit insurance |  |  |  |  | 72,006 |  |  | 72,006 |
| Loss on early extinguishment of debt |  |  |  |  | 25,184 |  |  | 25,184 |
| Other real estate owned (OREO) expenses |  |  |  |  | 22,441 |  |  | 22,441 |
| Other operating expenses | $(37,138)$ |  | 331 |  | 112,059 | $(1,796)$ |  | 73,456 |
| Amortization of intangibles |  |  |  |  | 7,605 |  |  | 7,605 |
| Total operating expenses | 2,250 |  | 342 |  | 964,707 | $(2,499)$ |  | 964,800 |
| (Loss) income before income tax and equity in earnings of subsidiaries | $(47,220)$ |  | $(24,062)$ |  | 190,181 | $(3,881)$ |  | 115,018 |
| Income tax benefit | $(1,185)$ |  |  |  | $(45,395)$ | 263 |  | $(46,317)$ |
| (Loss) income before equity in earnings of subsidiaries | $(46,035)$ |  | $(24,062)$ |  | 235,576 | $(4,144)$ |  | 161,335 |
| Equity in undistributed earnings of subsidiaries | 207,370 |  | 18,417 |  |  | $(225,787)$ |  |  |
| Net Income (loss) | \$ 161,335 | \$ | $(5,645)$ | \$ | 235,576 | \$ $(229,931)$ | \$ | 161,335 |
| Comprehensive income (loss), net of tax | \$ 144,448 | \$ | $(7,555)$ | \$ | 216,930 | \$ $(209,375)$ | \$ | 144,448 |

Table of Contents

## Condensed Consolidating Statement of Cash Flows (Unaudited)



Edgar Filing: POPULAR INC - Form 10-Q

| Accrued income receivable | 1,548 | 81 | 1,468 | (250) | 2,847 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Other assets | 2,996 | 130 | $(1,562)$ | $(2,174)$ | (610) |
| Net increase (decrease) in: |  |  |  |  |  |
| Interest payable |  | $(3,158)$ | $(6,257)$ | (65) | $(9,480)$ |
| Pension and other postretirement benefits obligations |  |  | 6,459 |  | 6,459 |
| Other liabilities | $(5,090)$ | $(2,330)$ | $(17,043)$ | 1,873 | $(22,590)$ |
| Total adjustments | $(467,065)$ | $(67,976)$ | 530,117 | 203,716 | 198,792 |
| Net cash (used in) provided by operating activities | $(30,769)$ | $(29,992)$ | 695,849 |  | 635,088 |

Cash flows from investing activities:
$\left.\begin{array}{lrrrr}\text { Net (increase) decrease in money } & & & & \\ \text { market investments } & (5,147) & 508 & 124,039 & 4,392\end{array}\right) 123,792$

Proceeds from calls, paydowns, maturities and redemptions of

| Available-for-sale | 35,000 | 1,541,112 |  | 1,576,112 |
| :---: | :---: | :---: | :---: | :---: |
| Held-to-maturity |  | 4,278 |  | 4,278 |
| Other |  | 132,270 |  | 132,270 |
| Net (disbursements) repayments on loans | $(327,910)$ | 959,455 | 383,362 | 1,014,907 |
| Proceeds from sale of loans |  | 310,767 |  | 310,767 |
| Acquisition of loan portfolios |  | $(1,727,454)$ |  | (1,727,454) |
| Net payments from FDIC under loss sharing agreements |  | 52,758 |  | 52,758 |

Return of capital from equity method
investments 438 438

| Proceeds from sale of stock in equity |  |  |  | 363,492 |
| :--- | ---: | ---: | ---: | ---: |
| method investee | 363,492 |  | 31,500 | $(45)$ |
| Capital contribution to subsidiary | $(31,500)$ | $(45)$ | $(27,214)$ |  |
| Mortgage servicing rights purchased | $(285)$ |  | $(26,929)$ | 9,438 |
| Acquisition of premises and equipment |  | 180 | 9,225 | 200,546 |

Net cash provided by (used in)
investing activities
33,683
$(226,999) \quad 419,254$
227,064

Cash flows from financing activities:
Net increase (decrease) in:

| Deposits | $(638,820)$ | $(3,607)$ | $(642,427)$ |
| :--- | :--- | :--- | :--- |
| $(218,644)$ | $(4,900)$ | $(223,544)$ |  |


| Federal funds purchased and assets sold under agreements to repurchase |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Other short-term borrowings |  |  |  |  |  | 573,361 |  | $(383,361)$ |  | 190,000 |
| Payments of notes payable |  |  |  | $(236,200)$ |  | $(95,635)$ |  |  |  | $(331,835)$ |
| Proceeds from issuance of notes payable |  |  |  | 233,560 |  | $(160,406)$ |  |  |  | 73,154 |
| Proceeds from issuance of common stock |  | 4,952 |  |  |  |  |  |  |  | 4,952 |
| Dividends paid |  | $(2,792)$ |  |  |  |  |  |  |  | $(2,792)$ |
| Net payments for repurchase of common stock |  | (433) |  |  |  |  |  |  |  | (433) |
| Capital contribution from parent |  |  |  | 31,500 |  |  |  | $(31,500)$ |  |  |
| Net cash provided by (used in) financing activities |  | 1,727 |  | 28,860 |  | $(540,144)$ |  | $(423,368)$ |  | $(932,925)$ |
| Net increase (decrease) in cash and due from banks |  | 4,641 |  | (6) |  | $(71,294)$ |  | $(4,114)$ |  | $(70,773)$ |
| Cash and due from banks at beginning of period |  | 1,103 |  | 624 |  | 439,552 |  | $(1,916)$ |  | 439,363 |
| Cash and due from banks at end of period | \$ | 5,744 | \$ | 618 | \$ | 368,258 | \$ | $(6,030)$ | \$ | 368,590 |

Table of Contents

## Condensed Consolidating Statement of Cash Flows (Unaudited)

|  | Nine months ended September 30, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Popular, Inc. | All other |  |  |  |
| (In thousands) | Holding | PNA | subsidiaries | Elimination | Popular, Inc. |
|  | Co. | Holding Co. | and eliminations | entries | Consolidated |

Cash flows from operating activities:
Net income (loss) $\quad \$ 161,335 \quad \$ \quad(5,645) \quad \$ \quad 235,576 \quad \$(229,931) \quad \$ 161,335$

Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:

| Equity in undistributed earnings of subsidiaries | $(207,370)$ | $(18,417)$ | 225,787 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for loan losses | 267 |  | 325,863 |  | 326,130 |
| Amortization of intangibles |  |  | 7,605 |  | 7,605 |
| Depreciation and amortization of premises and equipment | 484 | 2 | 34,467 |  | 34,953 |
| Net accretion of discounts and amortization of premiums and deferred fees | 21,624 | 84 | $(43,339)$ | (487) | $(22,118)$ |
| Fair value adjustments on mortgage servicing rights |  |  | 7,217 |  | 7,217 |
| FDIC loss share expense |  |  | 19,387 |  | 19,387 |
| Amortization of prepaid FDIC assessment |  |  | 30,157 |  | 30,157 |


| Adjustments (expense) to indemnity    <br> reserves on loans sold  17,990  <br> Earnings from investments under the    <br> equity method    | $(3,079)$ | $(379)$ | $(25,290)$ |  |
| :--- | ---: | ---: | ---: | ---: |
| Deferred income tax benefit | $(14,755)$ |  | $(135,709)$ | 263 |

Loss (gain) on:
Disposition of premises and equipment $1 \quad(8,254)$

Sale and valuation adjustments of investment securities 285 285
Sale of loans, including valuation adjustments on loans held for sale and mortgage banking activities $(18,569)$ $(18,569)$
Sale of other assets $(2,545)$
Sale of foreclosed assets, including
write-downs 4,147
Acquisitions of loans held-for-sale
$(288,844)$
$(288,844)$
Proceeds from sale of loans
held-for-sale
242,088
242,088

| Net disbursements on loans held-for-sale |  |  | $(860,804)$ |  | $(860,804)$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Net (increase) decrease in: |  |  |  |  |  |
| Trading securities |  |  | 849,304 |  | 849,304 |
| Accrued income receivable | $(1,168)$ | 81 | $(7,728)$ | 80 | $(8,735)$ |
| Other assets | 4,693 | 213 | $(28,508)$ | $(6,645)$ | $(30,247)$ |
| Net increase (decrease) in: |  |  |  |  |  |
| Interest payable |  | 2,527 | $(10,114)$ | 34 | $(7,553)$ |
| Pension and other postretirement benefits obligations |  |  | 24,156 |  | 24,156 |
| Other liabilities | $(1,347)$ | (20) | $(22,837)$ | 1,092 | $(23,112)$ |
| Total adjustments | $(200,650)$ | $(15,909)$ | 110,125 | 220,124 | 113,690 |
| Net cash (used in) provided by operating activities | $(39,315)$ | $(21,554)$ | 345,701 | $(9,807)$ | 275,025 |

Cash flows from investing activities:

| Net decrease (increase) in money market investments | 24,008 | (88) | 450,564 | $(23,973)$ | 450,511 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Purchases of investment securities: |  |  |  |  |  |
| Available-for-sale |  |  | $(1,284,834)$ |  | $(1,284,834)$ |
| Held-to-maturity |  |  | (250) |  | (250) |
| Other |  |  | $(152,607)$ |  | $(152,607)$ |
| Proceeds from calls, paydowns, maturities and redemptions of investment securities: |  |  |  |  |  |
| Available-for-sale |  |  | 1,166,618 |  | 1,166,618 |
| Held-to-maturity |  |  | 4,398 |  | 4,398 |
| Other |  |  | 119,098 |  | 119,098 |
| Proceeds from sale of investment securities: |  |  |  |  |  |
| Available for sale |  |  | 8,031 |  | 8,031 |
| Net (disbursements) repayments on |  |  |  |  |  |
| Proceeds from sale of loans |  |  | 51,677 |  | 51,677 |
| Acquisition of loan portfolios |  |  | $(1,051,588)$ |  | $(1,051,588)$ |
| Net payments from FDIC under loss sharing agreements |  |  | 327,739 |  | 327,739 |
| Return of capital from equity method investments | 129,744 | 836 |  |  | 130,580 |
| Capital contribution to subsidiary | $(50,000)$ |  |  | 50,000 |  |
| Mortgage servicing rights purchased |  |  | $(1,620)$ |  | $(1,620)$ |
| Acquisition of premises and equipment | (637) |  | $(33,699)$ |  | $(34,336)$ |
| Proceeds from sale of: |  |  |  |  |  |
| Premises and equipment | 24 |  | 20,588 |  | 20,612 |
| Other productive assets |  |  | 1,026 |  | 1,026 |
| Foreclosed assets |  |  | 142,019 |  | 142,019 |
|  | 32,097 | 748 | 455,026 | 96,785 | 584,656 |

Net cash provided by investing activities

## Cash flows from financing activities:

Net increase (decrease) in:

| Deposits |  | $(1,631,309)$ | 6,675 | $(1,624,634)$ |
| :---: | :---: | :---: | :---: | :---: |
| Assets sold under agreements to repurchase |  | $(220,593)$ | 24,060 | $(196,533)$ |
| Other short-term borrowings | $(29,500)$ | 1,010,400 | $(70,900)$ | 910,000 |
| Payments of notes payable |  | $(72,815)$ |  | $(72,815)$ |
| Proceeds from issuance of notes payable |  | 61,331 |  | 61,331 |
| Proceeds from issuance of common stock | 7,788 |  |  | 7,788 |
| Dividends paid to parent company |  | $(5,000)$ | 5,000 |  |
| Dividends paid | $(2,482)$ |  |  | $(2,482)$ |

Payments for repurchase of common
stock
Capital contribution from parent $\quad 50,000 \quad(50,000)$

| Net cash provided by (used in) |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
| financing activities | 5,030 | 20,500 | $(857,986)$ | $(85,165)$ |


| Net decrease in cash and due from <br> banks | $(2,188)$ | $(306)$ | $(57,259)$ | 1,813 | $(57,940)$ |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Cash and due from banks at beginning <br> of period | 6,365 | 932 | 534,796 | $(6,811)$ | 535,282 |  |
| Cash and due from banks at end of <br> period | $\$ 4,177$ | $\$$ | 626 | $\$$ | 477,537 | $\$$ |

Table of Contents

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

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

The Corporation is a diversified, publicly-owned financial holding company subject to the supervision and regulation of the Board of Governors of the Federal Reserve System. The Corporation has operations in Puerto Rico, the United States ( U.S. ) mainland, and the U.S. and British Virgin Islands. In Puerto Rico, the Corporation provides mortgage, retail and commercial banking services through its principal banking subsidiary, Banco Popular de Puerto Rico ( BPPR ), as well as investment banking, broker-dealer, auto and equipment leasing and financing, and insurance services through specialized subsidiaries. In the U.S. mainland, the Corporation operates Banco Popular North America ( BPNA ), including its wholly-owned subsidiary E-LOAN. BPNA focuses efforts and resources on the core community banking business. BPNA, under the name Popular Community Bank, operates branches in New York, California, Illinois, New Jersey and Florida. E-LOAN markets deposit accounts under its name for the benefit of BPNA. Note 33 to the consolidated financial statements presents information about the Corporation s business segments. As of September 30, 2013, the Corporation had a $21.3 \%$ interest in the holding company of EVERTEC, which provides transaction processing services throughout the Caribbean and Latin America, including servicing many of the Corporation s system infrastructures and transaction processing businesses. During the nine months ended September 30, 2013, the Corporation recorded $\$ 21.4$ million in earnings from its investment in EVERTEC (including $\$ 36.6$ million from increases in EVERTEC s capital as a result of their issuance of shares during the second and third quarter of 2013), which had a carrying amount of $\$ 42.4$ million as of the end of the third quarter. Also, the Corporation had a $19.99 \%$ stake in BHD Financial Group ( BHD ), one of the largest banking and financial services groups in the Dominican Republic. During the nine months ended September 30, 2013, the Corporation recorded $\$ 15.6$ million in earnings from its investment in BHD, which had a carrying amount of $\$ 79.7$ million, as of the end of the third quarter.

Effective December 31, 2012, Popular Mortgage, which was a wholly-owned subsidiary of BPPR prior to that date, was merged with and into BPPR as part of an internal reorganization. Popular Mortgage currently operates as a division of BPPR.

## Table of Contents

## OVERVIEW

For the quarter ended September 30, 2013, the Corporation recorded net income of $\$ 229.1$ million, compared with net income of $\$ 47.2$ million for the same quarter of the previous year. The results for the third quarter of 2013 reflected an after-tax gain of $\$ 167.8$ million resulting from the sale of EVERTEC s shares in connection with their secondary public offering ( SPO ).

## Recent significant events

On September 18, 2013, EVERTEC, Inc. ( EVERTEC ) completed a secondary public offering of 20.0 million shares of common stock to the public at $\$ 22.50$ per share. Apollo Global Management LLC ( Apollo ) sold 10.8 million shares and Popular sold 9.1 million shares of EVERTEC, retaining respective stakes after the sale of $14.9 \%$ and $21.3 \%$.
As a result of this transaction, Popular recognized an after-tax gain of $\$ 167.8$ million during the third quarter of 2013 and received proceeds of $\$ 197$ million. As of September 30, 2013, Popular s investment in EVERTEC had a remaining book value of $\$ 42.4$ million.

## Financial highlights for the quarter ended September 30, 2013

Taxable equivalent net interest income was $\$ 367.0$ million for the third quarter of 2013, an increase of $\$ 12.1$ million, or $3.4 \%$, from the same quarter of the prior year. Net interest margin increased by 14 basis points from $4.51 \%$ to $4.65 \%$ mainly resulting from a reduction in the average cost of funds by 17 basis points primarily from time deposits, short-term borrowings and medium and long-term debt as a result of the Corporation s strategy to continue to reduce its funding costs. The net interest margin also benefited from a higher yield on covered loans by 201 basis points as a result of reductions in expected losses, which are recognized as part of the accretable yield over the average life of the loans. The yield from commercial and construction loans increased by 11 basis points and 228 basis points, respectively, due to lower level of non-performing loans and the partial prepayment of a large commercial relationship at BPNA. These positive variances were partially offset by the yield from the investment securities that decreased by 61 basis points due to reinvestments at lower prevailing rates and the yield in mortgage loans that decreased by 61 basis points due to strategic acquisition of loans at lower yielding rates and the reversal of interest income of $\$ 5.9$ million from reverse mortgages which had been accrued in excess of the amounts insured by FHA. Refer to the Net Interest Income section of this MD\&A for a discussion of the major variances in net interest income, including yields and costs.

The Corporation continued to make progress in credit quality during the quarter, reflective of key strategies executed to reduce non-performing loans and improvements in the underlying quality of the loan portfolios. Credit metrics showed improvements with reduced levels of non-performing assets and non-performing loans held-in portfolio, when compared to December 31, 2012. Non-covered, non-performing loans were down by $\$ 901.8$ million, or $59 \%$, when compared to December 31, 2012. These improvements were accelerated by the bulk sales of non-performing assets completed during the first two quarters of 2013. Excluding the impact of the bulk asset sales, total non-performing loans and non-performing assets declined by $\$ 121.0$ million and $\$ 123.0$ million, respectively, from December 31, 2012. The ratio of

## Edgar Filing: POPULAR INC - Form 10-Q

annualized net charge-offs to average non-covered loans held-in-portfolio decreased to $1.08 \%$ for the quarter. Also, non-covered OREO decreased by $\$ 131.3$ million from December 31, 2012, primarily as a result of the bulk sale of assets during the quarter ended March 31, 2013.

The provision for loan losses for the quarter ended September 30, 2013 totaled $\$ 72.7$ million, compared with $\$ 106.2$ million for the same period of 2012 , a decline of $\$ 33.5$ million. The provision for the non-covered loan portfolio amounted to $\$ 55.2$ million, compared to $\$ 83.6$ million for the same period of 2012 , a decrease of $\$ 28.4$ million, reflecting improved credit quality at both BPPR and BPNA. The provision for loan losses for the covered loan portfolio amounted to $\$ 17.4$ million, compared to $\$ 22.6$ million for the quarter ended September 30, 2012, a decline of $\$ 5.2$ million, reflecting lower impairment losses.
Refer to the Credit Risk Management and Loan Quality section of this MD\&A for an explanation of the main factors impacting the provision for loan losses and a detailed analysis of net charge-offs, non-performing assets, the allowance for loan losses and selected loan losses statistics.

## Table of Contents

Non-interest income increased by $\$ 160.6$ million to $\$ 292.0$ million for the quarter ended September 30, 2013, compared with $\$ 131.4$ million for the same quarter in the previous year. This increase was mainly attributed to:

Higher other operating income by $\$ 175.0$ million due to the gain of $\$ 175.9$ million recognized in connection with EVERTEC s SPO

An increase of $\$ 4.7$ million in net gain (loss) on sale of loans, driven by unfavorable valuation adjustments recorded at the BPPR segment during the third quarter of 2012 as a result of revised appraisals and market indicators and higher net gain on sale of loans at BPNA during the third quarter of 2013

Lower adjustments for indemnity reserves on loans sold by $\$ 6.3$ million due to reserve releases at BPPR and BPNA

These favorable variances were partially offset by an increase of $\$ 12.1$ million in trading losses, primarily at BPPR, an unfavorable variance of $\$ 8.2$ million in FDIC loss share income (expense), lower service charges on deposits and lower income from mortgage banking activities
Refer to the Non-Interest Income section of this MD\&A for additional information on the main variances that affected the non-interest income categories.

Operating expenses increased by $\$ 19.6$ million when compared to the third quarter of 2012 due to the following main factors:

Higher personnel costs by $\$ 5.3$ million due to higher headcount and incentive payments and the restoration of the Corporation s matching contribution to the 401 k savings plan in April 2013

Higher other taxes by $\$ 5.1$ million due to the impact of the gross receipts tax enacted earlier in the year in Puerto Rico

Higher loss on early extinguishment of debt due $\$ 3.4$ million paid in connection with the repayment of $\$ 233.2$ million in senior notes

Higher OREO expenses by $\$ 11.3$ million due to fair value adjustments on commercial properties, consisting primarily of covered assets

The above variances were partially offset by a decrease of $\$ 8.1$ million in the FDIC deposit premium insurance due to reduced level of higher risk assets as well as revisions to the calculation and the efficiencies from the merger of Popular Mortgage into BPPR, both completed during the fourth quarter of 2012.

Income tax expense amounted to $\$ 17.8$ million for the quarter ended September 30, 2013, compared with an income tax expense of $\$ 15.4$ million for the same quarter of 2012. The increase in income tax expense was primarily due to higher income before tax, driven by the gain on the sale of EVERTEC s shares, which is subject to a preferential tax rate and the increase in the statutory tax rate from $30 \%$ to $39 \%$ during the year 2013. The higher income tax provision was offset by a favorable adjustment of $\$ 7.7$ million in connection with filing the tax returns for the year 2012 during this quarter, the reclassification of $\$ 3.3$ million of income tax credit related to the gross receipts tax from the operating expenses line to income taxes and the reversal of $\$ 7.7$ million of reserves for uncertain tax positions due to the expiration of the statute of limitations in the Puerto Rico operations.

Total assets amounted to $\$ 36.1$ billion at September 30, 2013, compared with $\$ 36.5$ billion at December 31, 2012. The decrease in total assets was attributed to:
a decrease of $\$ 229.9$ million in loans held for sale, due to the bulk sale of non-performing loans completed during the first quarter of 2013 and decreased activity in origination of mortgage loans for sale in the secondary market
a decrease in covered loans held-in-portfolio of $\$ 680.0$ million due to resolutions and the run-off of the portfolio
a decrease in other real estate owned of $\$ 110.4$ million due mainly to the bulk sale of non-performing assets completed during the first quarter and continued resolutions
a decrease in the FDIC loss share asset of $\$ 74.4$ million due to amortization and collections

## Table of Contents

The above decreases were offset by:

An increase in securities available-for-sale and held-to-maturity of $\$ 50.0$ million due mainly to purchases of CMOs and agency securities at BPNA, offset by portfolio declines in market value, agency maturities, MBS prepayments and the prepayment of $\$ 22.8$ million of EVERTEC s debentures held by the Corporation in connection with their IPO

An increase in non-covered loans-held-in-portfolio of $\$ 436.1$ million driven by mortgage loan originations and purchases at BPPR and BPNA

An increase in the deferred tax asset, included within the other assets category, of \$302.7 million, due mainly to the $\$ 215.6$ million benefit related to the increase in corporate tax rate from $30 \%$ to $39 \%$ and the loss generated by the bulk sales of non performing assets completed during the first and second quarter of 2013

The Corporation s total deposits amounted to $\$ 26.4$ billion compared to $\$ 27.0$ billion at December 31, 2012. The decrease was mainly due to decreases in brokered and non-brokered time deposits due to the execution of funding strategies

The Corporation s borrowings amounted to $\$ 4.2$ billion at September 30, 2013, compared with $\$ 4.4$ billion at December 31, 2012. The decrease in borrowings was mainly driven by the prepayment of $\$ 233.2$ million in senior notes and lower balance of repurchase agreements, offset by an increase in advances from the Federal Home Loan Bank of New York, as part of the Corporation s funding strategies. Refer to the Liquidity section in this MD\&A for additional information on the Corporation $s$ funding sources

Stockholders equity totalled $\$ 4.4$ billion at September 30, 2013, compared with $\$ 4.1$ billion at December 31, 2012. This increase mainly resulted from the Corporation s net income of $\$ 436.3$ million for the first nine months of 2013, partially offset by unrealized holding losses of $\$ 160.1$ million in the portfolio of investment securities, reflected net of tax in accumulated other comprehensive loss. Capital ratios continued to be strong. The Corporation s Tier 1 risk-based capital ratio stood at $18.54 \%$ at September 30, 2013, while the tangible common equity ratio at September 30, 2013 was $10.32 \%$. Refer to Table 20 for capital ratios and Tables 21 and 22 for Non-GAAP reconciliations.
Table 1 provides selected financial data and performance indicators for the quarters and nine months ended September 30, 2013 and 2012.

As a financial services company, the Corporation s earnings are significantly affected by general business and economic conditions. Lending and deposit activities and fee income generation are influenced by the level of business spending and investment, consumer income, spending and savings, capital market activities, competition, customer preferences, interest rate conditions and prevailing market rates on competing products.

The Corporation continuously monitors general business and economic conditions, industry-related indicators and trends, competition, interest rate volatility, credit quality indicators, loan and deposit demand, operational and systems efficiencies, revenue enhancements and changes in the regulation of financial services companies.

The Corporation operates in a highly regulated environment and may be adversely affected by changes in federal and local laws and regulations. Also, competition with other financial institutions could adversely affect its profitability.

The description of the Corporation s business contained in Item 1 of the Corporation s 2012 Annual Report, while not all inclusive, discusses additional information about the business of the Corporation and risk factors, many beyond the Corporation s control that, in addition to the other information in this Form 10-Q, readers should consider.

The Corporation s common stock is traded on the NASDAQ Global Select Market under the symbol BPOP.

Table of Contents

## Table 1 Financial Highlights

Financial Condition Highlights

|  |  |  |  | Average for the nine months ended <br> September |  |  |  |  |  |  | September |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |

* Average deposits exclude average derivatives.

| Operating Highlights | Quarter ended September 30, |  |  | Nine months ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ 354,206 | \$ 344,439 | \$ 9,767 | \$ 1,056,238 | \$ 1,025,216 | \$ 31,022 |
| Provision for loan losses - non-covered loans | 55,230 | 83,589 | $(28,359)$ | 485,438 | 247,846 | 237,592 |
| Provision for loan losses - covered loans | 17,433 | 22,619 | $(5,186)$ | 60,489 | 78,284 | $(17,795)$ |
| Non-interest income | 291,959 | 131,374 | 160,585 | 619,379 | 380,732 | 238,647 |
| Operating expenses | 326,599 | 307,033 | 19,566 | 969,883 | 964,800 | 5,083 |
| Income before income tax | 246,903 | 62,572 | 184,331 | 159,807 | 115,018 | 44,789 |
| Income tax expense (benefit) | 17,768 | 15,384 | 2,384 | $(276,489)$ | $(46,317)$ | $(230,172)$ |
| Net income | \$ 229,135 | \$ 47,188 | \$ 181,947 | \$ 436,296 | \$ 161,335 | \$ 274,961 |
| Net income applicable to common stock | \$ 228,204 | \$ 46,257 | \$ 181,947 | \$ 433,504 | \$ 158,543 | \$ 274,961 |
| Net income per common share - Basic | \$ 2.22 | \$ 0.45 | \$ 1.77 | \$ 4.22 | \$ 1.55 | \$ 2.67 |
| Net income per common share - Diluted | \$ 2.22 | \$ 0.45 | \$ 1.77 | \$ 4.21 | \$ 1.55 | \$ 2.66 |


|  | Quarter ended September Nome months ended September 30 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Selected Statistical Information | 2013 | 2012 | 2013 | 2012 |  |
| Common Stock Data |  |  |  |  |  |
| Market price |  |  |  |  |  |  |
| High | \$ 34.20 | \$ 18.74 | \$ 34.20 |  | 23.00 |


| Low | 26.25 | 13.55 | 21.70 | 13.55 |
| :--- | :---: | :---: | :---: | :---: |
| End | 26.25 | 17.45 | 26.25 | 17.45 |
| Book value per common share at period end | 42.04 | 38.98 | 42.04 | 38.98 |
| Profitability Ratios | $2.51 \%$ | $0.52 \%$ | $1.60 \%$ | $0.59 \%$ |
| Return on assets | 21.64 | 4.81 | 14.38 | 5.63 |
| Return on common equity | 4.40 | 4.25 | 4.40 | 4.19 |
| Net interest spread (taxable equivalent) | 4.65 | 4.51 | 4.65 | 4.45 |
| Net interest margin (taxable equivalent) |  |  |  |  |
| Capitalization Ratios | $11.71 \%$ | $10.77 \%$ | $11.23 \%$ | $10.52 \%$ |
| Average equity to average assets | 18.54 | 16.81 | 18.54 | 16.81 |
| Tier I capital to risk-weighted assets | 19.82 | 18.09 | 19.82 | 18.09 |
| Total capital to risk-weighted assets | 12.26 | 11.40 | 12.26 | 11.40 |
| Leverage ratio |  |  |  |  |

## Table of Contents

## CRITICAL ACCOUNTING POLICIES / ESTIMATES

The accounting and reporting policies followed by the Corporation and its subsidiaries conform to generally accepted accounting principles in the United States of America and general practices within the financial services industry. Various elements of the Corporation s accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. These estimates are made under facts and circumstances at a point in time and changes in those facts and circumstances could produce actual results that differ from those estimates.

Management has discussed the development and selection of the critical accounting policies and estimates with the Corporation s Audit Committee. The Corporation has identified as critical accounting policies those related to: (i) Fair Value Measurement of Financial Instruments; (ii) Loans and Allowance for Loan Losses; (iii) Acquisition Accounting for Loans and Related Indemnification Asset; (iv) Income Taxes; (v) Goodwill, and (vi) Pension and Postretirement Benefit Obligations. For a summary of these critical accounting policies and estimates, refer to that particular section in the MD\&A included in Popular, Inc. s 2012 Financial Review and Supplementary Information to Stockholders, incorporated by reference in Popular, Inc. s Annual Report on Form 10-K for the year ended December 31, 2012 (the 2012 Annual Report ). Also, refer to Note 2 to the consolidated financial statements included in the 2012 Annual Report for a summary of the Corporation s significant accounting policies.

During the second quarter of 2013, management enhanced the estimation process for evaluating the adequacy of the general reserve component of the allowance for loan losses. The enhancements to the ALLL methodology, which are described in the paragraphs below, were implemented as of June 30, 2013 and resulted in a net increase to the allowance for loan losses of $\$ 11.8$ million for the non-covered portfolio and $\$ 7.5$ million for the covered portfolio.

Management made the following principal changes to the methodology during the second quarter of 2013:

> Incorporated risk ratings to establish a more granular stratification of the commercial, construction and legacy loan portfolios to enhance the homogeneity of the loan classes. Prior to the second quarter enhancements, the Corporation s loan segmentation was based on product type, line of business and legal entity. During the second quarter of 2013, lines of business were simplified and a regulatory risk classification level was added. These changes increase the homogeneity of each portfolio and capture the higher potential for loan loss in the criticized and substandard accruing categories.
> These enhancements resulted in a decrease to the allowance for loan losses of $\$ 42.9$ million at June 30,2013 , which consisted of a $\$ 35.7$ million decrease in the non-covered BPPR segment and a $\$ 7.2$ million reduction in the BPNA segment.

Recalibration and enhancements of the environmental factors adjustment. The environmental factor adjustments are developed by performing regression analyses on selected credit and economic indicators for each applicable loan segment. Prior to the second quarter enhancements, these adjustments were applied in the form of a set of multipliers and weights assigned to credit and economic indicators. During the second quarter of 2013, the environmental factor models used to account for changes in current credit and macroeconomic conditions, were enhanced and recalibrated based on the latest applicable trends. Also, as part of these enhancements, environmental factors are directly applied to the adjusted base loss rates using regression models based on particular credit data for the segment and relevant economic factors. These
enhancements result in a more precise adjustment by having recalibrated models with improved statistical analysis and eliminating the multiplier concept that ensures that environmental factors are sufficiently sensitive to changing economic conditions.
The combined effect of the aforementioned changes to the environmental factors adjustment resulted in an increase to the allowance for loan losses of $\$ 52.5$ million at June 30, 2013, of which $\$ 56.1$ million related to the non-covered BPPR segment, offset in part by a $\$ 3.6$ million reduction in the BPNA segment.

There were additional enhancements to the allowance for loan losses methodology which accounted for an increase of $\$ 9.7$ million at June 30, 2013 at the BPPR segment. These enhancements included the elimination of the use of a cap for the commercial recent loss adjustment (12-month average), the incorporation of a minimum general reserve assumption for the commercial, construction and legacy portfolios with minimal or zero loss history, and the application of the enhanced ALLL framework to the covered loan portfolio.

## Table of Contents

## NET INTEREST INCOME

Net interest income, on a taxable equivalent basis, is presented with its different components on Tables 2 and 3 for the quarter and nine months ended September 30, 2013 as compared with the same periods in 2012, segregated by major categories of interest earning assets and interest bearing liabilities.

The interest earning assets include the investment securities and loans that are exempt from income tax, principally in Puerto Rico. The main sources of tax-exempt interest income are certain investments in obligations of the U.S. Government, its agencies and sponsored entities, and certain obligations of the Commonwealth of Puerto Rico and its agencies. To facilitate the comparison of all interest related to these assets, the interest income has been converted to a taxable equivalent basis, using the applicable statutory income tax rates for each quarter. The taxable equivalent computation considers the interest expense disallowance required by the Puerto Rico tax law. The increase in the taxable equivalent adjustment in Tables 2 and 3 can be explained by three main items:

During the quarter ended June 30, 2013 the Puerto Rico Government amended the Commonwealth s Internal Revenue Code. The changes that were implemented included an increase in the corporate income tax rate from $30 \%$ to $39 \%$. The effect of this change represented an increase of $\$ 4.2$ million and $\$ 15.1$ million in the taxable equivalent adjustment for the quarter and nine months ended September 30, 2013.

Additional exempt loan volume resulting from consumer loans purchased during 2012 resulted in an increase in the taxable equivalent adjustment of $\$ 0.7$ million and $\$ 6.9$ million, for the quarter and nine months ended September 30, 2013. This increase excludes the effect of the change in corporate income tax rate for this portfolio included in the previous explanation.

On the negative side a decrease in exempt income from mortgage loans related to the reversal of $\$ 5.9$ million in interests from reverse mortgages at BPPR which had been accrued in excess of the amount insured by FHA.
Average outstanding securities balances are based upon amortized cost excluding any unrealized gains or losses on securities available-for-sale. Non-accrual loans have been included in the respective average loans and leases categories. Loan fees collected and costs incurred in the origination of loans are deferred and amortized over the term of the loan as an adjustment to interest yield. Prepayment penalties, late fees collected and the amortization of premiums / discounts on purchased loans are also included as part of the loan yield. Interest income for the quarter and nine months ended September 30, 2013 included a favorable impact, excluding the discount accretion on covered loans accounted for under ASC 310-30, of $\$ 3.4$ million and $\$ 9.4$ million, related to those items, compared with a favorable impact of $\$ 4.3$ million and $\$ 14.9$ million for the same period in 2012.

The increase in the net interest margin of 14 basis points for the quarter ended September 30, 2013 as compared to the same quarter in 2012, on a taxable equivalent basis is mainly related to:

The above mentioned change in Corporate tax rate during the second quarter of 2013 resulted in an increase of $\$ 4.2$ million in the exempt income adjustment for the quarter.

Higher interest income from commercial and construction loans due to both an increase in yield related to the partial prepayment of a large commercial relationship at BPNA and to the sale of non performing loans during the first quarter of 2013.

A higher yield of consumer loans. The increase experienced in this category is in part attributed to the exempt loan purchases made at the end of the second and fourth quarters of 2012.

A higher yield for covered loans. Although the portfolio continues running off, due to its nature, the quarterly loss reassessment process has increased the accretable yield to be recognized over the average life of the loans.

## Table of Contents

Lower cost of interest bearing deposits by 19 basis points, mainly individual certificates of deposits, IRAs and brokered cds related to renewal of maturities in a low interest rate environment.

A lower cost of borrowed money due to maturity of $\$ 405$ million in FHLB notes with an average cost of approximately $3.98 \%$.
The positive impacts in net interest margin detailed above were partially offset by the following:

The reversal of interest from reverse mortgages, as mentioned above and lower yield from strategic acquisitions in the US and PR.

Lower interest income from investment securities due to reinvestment of cash flows received from mortgage backed securities in lower yielding collateralized mortgage obligations as well as the acquisition of lower yielding agency securities.

Table of Contents

## Table 2 Analysis of Levels \& Yields on a Taxable Equivalent Basis

Quarters ended September 30,

| Average Volume |  |  |  |  | Average Yields / Costs |  |  |  | Interest |  |  |  |  |  | Variance Attributable to |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 <br> (\$ in mil | $\begin{array}{r} 2012 \\ \text { illions) } \end{array}$ |  | riance | 2013 | 2012 | Variance |  |  | 2013 | 2012 Variance <br> (In thousands) |  |  |  |  | Rate | Volume |  |
|  | 1,006 | \$ 954 | \$ |  | 0.33\% | 0.36\% | (0.03)\% | Money market investments | \$ | \$ 848 | \$ | 862 | \$ | (14) | \$ | (28) | \$ | 14 |
|  | 5,411 | 5,205 |  | 206 | 2.79 | 3.40 | (0.61) | Investment securities |  | 37,735 |  | 44,209 |  | $(6,474)$ |  | $(6,541)$ |  | 67 |
|  | 396 | 466 |  | (70) | 6.39 | 5.62 | 0.77 | Trading securities |  | 6,384 |  | 6,582 |  | (198) |  | 856 |  | $(1,054)$ |
|  | 6,813 | 6,625 |  | 188 | 2.64 | 3.12 | (0.48) | Total money market, investment and trading securities |  | 44,967 |  | 51,653 |  | $(6,686)$ |  | $(5,713)$ |  | (973) |
|  |  |  |  |  |  |  |  | Loans: |  |  |  |  |  |  |  |  |  |  |
|  | 10,107 | 10,024 |  | 83 | 5.09 | 4.98 | 0.11 | Commercial |  | 129,733 |  | 125,429 |  | 4,304 |  | 3,257 |  | 1,047 |
|  | 319 | 435 |  | (116) | 5.30 | 3.02 | 2.28 | Construction |  | 4,255 |  | 3,300 |  | 955 |  | 2,011 |  | $(1,056)$ |
|  | 537 | 540 |  | (3) | 8.08 | 8.67 | (0.59) | Leasing |  | 10,851 |  | 11,696 |  | (845) |  | (787) |  | (58) |
|  | 6,633 | 5,915 |  | 718 | 4.99 | 5.60 | (0.61) | Mortgage |  | 82,749 |  | 82,773 |  | (24) |  | $(9,494)$ |  | 9,470 |
|  | 3,906 | 3,855 |  | 51 | 10.20 | 10.32 | (0.12) | Consumer |  | 100,474 |  | 100,055 |  | 419 |  | (431) |  | 850 |
|  | 21,502 | 20,769 |  | 733 | 6.07 | 6.20 | (0.13) | Sub-total loans |  | 328,062 |  | 323,253 |  | 4,809 |  | $(5,444)$ |  | 10,253 |
|  | 3,119 | 3,952 |  | (833) | 9.13 | 7.12 | 2.01 | Covered loans |  | 71,631 |  | 70,584 |  | 1,047 |  | 15,871 |  | $(14,824)$ |
|  | 24,621 | 24,721 |  | (100) | 6.46 | 6.35 | 0.11 | Total loans |  | 399,693 |  | 393,837 |  | 5,856 |  | 10,427 |  | $(4,571)$ |
|  | 31,434 | \$ 31,346 | \$ |  | 5.63\% | 5.66\% | (0.03)\% | Total earning assets |  | \$ 444,660 |  | 445,490 | \$ | (830) | \$ | 4,714 | \$ | $(5,544)$ |
|  |  |  |  |  |  |  |  | Interest bearing deposits: |  |  |  |  |  |  |  |  |  |  |
|  | 5,766 | \$ 5,709 | \$ |  | 0.29\% | 0.43\% | (0.14)\% | NOW and money |  | \$ 4,159 | \$ | 6,198 | \$ | $(2,039)$ | \$ | $(2,148)$ | \$ | 109 |
|  | Table of Contents |  |  |  |  |  |  |  |  |  |  |  |  |  | 259 |  |  |  |

Edgar Filing: POPULAR INC - Form 10-Q
$\left.\begin{array}{rccccccccccccc} \\ 6,828 & 6,561 & 267 & 0.21 & 0.27 & (0.06) & \begin{array}{l}\text { market[1] } \\ \text { Savings }\end{array} & 3,650 & 4,480 & (830) & (975) & 145 \\ 8,231 & 9,003 & (772) & 1.16 & 1.43 & (0.27) & \begin{array}{l}\text { Time } \\ \text { deposits }\end{array} & 24,039 & 32,344 & (8,305) & (5,529) & (2,776) \\ 20,825 & 21,273 & (448) & 0.61 & 0.80 & (0.19) & \begin{array}{l}\text { Total } \\ \text { deposits }\end{array} & 31,848 & 43,022 & (11,174) & (8,652) & (2,522) \\ 2,617 & 2,529 & 88 & 1.45 & 1.55 & (0.10) & \begin{array}{l}\text { Short-term } \\ \text { borrowings }\end{array} & 9,564 & 9,876 & (312) & (560) & 248 \\ 520 & 487 & 33 & 15.96 & 15.93 & 0.03 & \begin{array}{l}\text { TARP } \\ \text { funds[2] }\end{array} & 20,731 & 19,390 & 1,341 & 40 & 1,301\end{array}\right)$

| Non-interest |
| :--- |
| bearing |
| demand |
| deposits |


| Other |
| :--- |
| sources of |
| funds |


| Total source |
| :--- |
| of funds |


| $\$ 31,434$ | $\$ 31,346$ | $\$ 88$ | $0.98 \%$ | $1.15 \%$ | $(0.17) \%$ | of funds $\quad 77,640$ | 90,599 | $(12,959)$ | $(9,968)$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |$(2,991)$



Net interest
$4.40 \% \quad 4.25 \% \quad 0.15 \%$ spread

| Taxable <br> equivalent <br> adjustment | 12,814 | 10,452 | 2,362 |
| :--- | :--- | :--- | :--- |

Net interest
income $\$ 354,206$ \$344,439 \$ 9,767

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

## Table of Contents

[1] Includes interest bearing demand deposits corresponding to certain government entities in Puerto Rico.
[2] Junior subordinated deferrable interest debentures held by the U.S. Treasury.
The results for the nine-month period ended September 30, 2013 were mainly impacted by the same factors described in the quarterly results. A lower average cost of sources of funds combined with a higher yield in covered loans and consumer loans contributed to a higher net interest margin. These positive effects were partially offset by a lower volume of covered loans by $\$ 825$ million and lower yield of investments and mortgage loans.

## Table 3 Analysis of Levels \& Yields on a Taxable Equivalent Basis

Nine months ended September 30,


Edgar Filing: POPULAR INC - Form 10-Q
assets


Edgar Filing: POPULAR INC - Form 10-Q
Net interest
spread
Taxable
equivalent
adjustment $\quad 45,785 \quad 28,014 \quad 17,771$
Net interest
income $\$ 1,056,238$ \$ 1,025,216 \$ 31,022

## Table of Contents

Note: The changes that are not due solely to volume or rate are allocated to volume and rate based on the proportion of the change in each category.
[1] Includes interest bearing demand deposits corresponding to certain government entities in Puerto Rico.
[2] Junior subordinated deferrable interest debentures held by the U.S. Treasury.

## PROVISION FOR LOAN LOSSES

The Corporation stotal provision for loan losses totaled $\$ 72.7$ million for the quarter ended September 30, 2013 compared with $\$ 106.2$ million for the same period in 2012 , declining by $\$ 33.5$ million from the third quarter of 2012.

The provision for loan losses for the non-covered loan portfolio amounted to $\$ 55.2$ million for the quarter ended September 30, 2013, decreasing by $\$ 28.4$ million when compared to the third quarter of 2012. The decrease in the provision reflects overall improvements in credit quality at both the BPPR and the BPNA segments.

The provision for loan losses for the covered loan portfolio amounted to $\$ 17.4$ million, compared to $\$ 22.6$ million at September 30, 2012, a decline of $\$ 5.2$ million, reflecting lower impairment losses.

For the nine months ended September 30, 2013, the Corporation s total provision for loan losses totaled $\$ 545.9$ million, compared with $\$ 326.1$ million for the same period in 2012 , reflecting an increase of $\$ 219.8$ million mostly due to the impact of $\$ 318.1$ million related to the bulk loan sales completed during 2013. Excluding the impact of the sales, the provision for the nine months ended was $\$ 227.8$ million, declining by $\$ 98.3$ million from the nine months ended September 30, 2012. The results for the nine months ended September 30, 2013 were impacted by the enhancements made to the allowance for loan losses implemented during the second quarter of 2013, which resulted in a reserve increase of $\$ 11.8$ million for the non-covered portfolio. Furthermore, the results for the same period of 2012 reflect the impact of a reduction in the reserve of $\$ 24.8$ million of certain enhancements to the methodology implemented during the first quarter of 2012. Refer to the Critical Accounting Policies section of the Corporation s Annual Report for the year ended December 31, 2012 for additional details of these changes.

For the nine months ended September 30, 2013 the provision for loan losses for the non-covered loan portfolio increased by $\$ 237.6$ million when compared to the same period of 2012 , mainly due to the $\$ 318.1$ million impact of the loan sales during 2013. Excluding the impact of the sales, the provision would have declined by $\$ 80.5$ million.

The provision for the covered portfolio was $\$ 60.5$ million for the nine month period ended September 30, 2013, compared to $\$ 78.3$ million for same period of last year, which also reflect lower impairment losses.

Refer to the Overview, Reportable Segments and Credit Risk Management and Loan Quality sections of this MD\&A for an explanation of the main factors impacting the provision for loan losses and a detailed analysis of net charge-offs, non-performing assets, the allowance for loan losses and selected loan losses statistics.

Table of Contents

## NON-INTEREST INCOME

Refer to Table 4 for a breakdown on non-interest income by major categories for the quarters and nine months ended September 30, 2013 and 2012.

## Table 4 Non-Interest Income

|  | Quarter ended September 30, |  |  | Nine months ended September 30, |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 | 2012 | Variance | 2013 | 2012 | Variance |  |  |
| Service charges on deposit accounts | $\$ 43,096$ | $\$ 45,858$ | $\$$ | $(2,762)$ | $\$ 130,755$ | $\$ 138,577$ | $\$$ | $(7,822)$ |

Other service fees:

| Debit card fees | 11,005 | 10,752 | 253 | 32,138 | 33,223 | $(1,085)$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Insurance fees | 13,255 | 12,322 | 933 | 37,793 | 36,775 | 1,018 |
| Credit card fees | 16,890 | 15,623 | 1,267 | 48,981 | 44,383 | 4,598 |
| Sale and administration of investment <br> products | 8,981 | 9,511 | $(530)$ | 27,941 | 28,045 | $(104)$ |
| Trust fees | 4,148 | 3,977 | 171 | 12,760 | 12,127 | 633 |
| Processing fees | 4,305 | 1,406 | $(1,406)$ |  | 4,819 | $(4,819)$ |
| Other fees |  |  | $(58)$ | 13,946 | 13,210 | 736 |
| Total other service fees | 58,584 | 57,954 | 630 | 173,559 | 172,582 | 977 |
|  |  |  |  |  |  |  |
| Mortgage banking activities | 18,896 | 21,847 | $(2,951)$ | 57,281 | 60,418 | $(3,137)$ |


| Net gain (loss) and valuation adjustments |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| rad | (6,6) | 5,443 | 2,05 | 1,93 | ,040 | 7,976) |

Net gain (loss) on sale of loans, including valuation adjustment on loans

| held-for-sale | 3,454 | $(1,205)$ | 4,659 | $(54,532)$ | $(30,459)$ | $(24,073)$ |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Adjustment (expense) to indemnity |  |  |  |  |  |  |
| reserves on loans sold | $(2,387)$ | $(8,717)$ | 6,330 | $(30,162)$ | $(17,990)$ | $(12,172)$ |
| FDIC loss share (expense) income | $(14,866)$ | $(6,707)$ | $(8,159)$ | $(44,887)$ | $(19,387)$ | $(25,500)$ |
| Other operating income | 191,789 | 16,837 | 174,952 | 393,445 | 71,236 | 322,209 |

$\begin{array}{lllllll}\text { Total non-interest income } & \$ 291,959 & \$ 131,374 & \$ 160,585 & \$ 619,379 & \$ 380,732 & \$ 238,647\end{array}$

## Table 5 Mortgage Banking Activities



Edgar Filing: POPULAR INC - Form 10-Q

| Mortgage servicing fees | $\$ 11,547$ | $\$ 12,282$ | $\$$ | $(735)$ | $\$ 34,110$ | $\$ 36,339$ | $\$(2,229)$ |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Mortgage servicing rights fair value <br> adjustments | 3,879 | $(2,426)$ | 6,305 | $(6,862)$ | $(7,217)$ | 355 |  |
| Total mortgage servicing fees, net of fair <br> value adjustments | 15,426 | 9,856 | 5,570 | 27,248 | 29,122 | $(1,874)$ |  |
| Net gain on sale of loans, including <br> valuation on loans | 3,559 | 19,700 | $(16,141)$ | 16,968 | 49,028 | $(32,060)$ |  |

Trading account (loss) profit:
Unrealized losses on outstanding derivative

| positions | $(865)$ | $(58)$ | $(807)$ | $(265)$ | $(154)$ | $(111)$ |
| :--- | :---: | :---: | :---: | :---: | ---: | :---: |
| Realized gains (losses) on closed derivative <br> positions | 776 | $(7,651)$ | 8,427 | 13,330 | $(17,578)$ | 30,908 |
| Total trading account (loss) profit | $(89)$ | $(7,709)$ | 7,620 | 13,065 | $(17,732)$ | 30,797 |
| Total mortgage banking activities | $\$ 18,896$ | $\$ 21,847$ | $\$(2,951)$ | $\$ 57,281$ | $\$ 60,418$ | $\$(3,137)$ |

Non-interest income increased by $\$ 160.6$ million during the quarter ended September 30, 2013, compared with the same quarter of the previous year. Excluding the impact of EVERTEC s SPO during the third quarter of 2013, non-interest income decreased by $\$ 15.3$ million from the quarter ended September 30, 2012.

## Table of Contents

The increase in non-interest income for the quarterly results was attributed to the following factors:

Higher other operating income by $\$ 175.0$ million principally due to the gain of $\$ 175.9$ million recognized in connection with EVERTEC s SPO;

Favorable variance of $\$ 4.7$ million in net gain (loss) on sale of loans, net of valuation adjustment on loans held-for-sale. This increase was principally driven by unfavorable adjustments recorded during the third quarter of 2012 in the BPPR segment as a result of revised appraisals and market indicators and higher net gains on sale of loans in the BPNA reportable segment during the third quarter of 2013; and

Lower adjustments (expenses) to indemnity reserves on loans sold by $\$ 6.3$ million mainly due to reserves released at BPNA and BPPR segments resulting from the portfolio amortization and revisions to the loss assumptions in the reserve models.
These favorable variances were partially offset by:

A decrease of $\$ 2.8$ million in service charges on deposit accounts mostly related to lower commercial account analysis fees, and nonsufficient funds and overdraft fees;

A decrease of $\$ 3.0$ million in mortgage banking activities mainly due to a decrease of $\$ 16.1$ million on gain on sale of loans driven by valuation adjustments, partially offset by lower trading account losses by $\$ 7.6$ million related to derivative positions, and an increase of $\$ 5.6$ million on mortgage servicing fees mainly due to fair value adjustments. Refer to Table 5 for details of Mortgage banking activities;

Unfavorable variance of $\$ 12.1$ million in trading account profit (loss) mainly at the BPPR segment due to higher unrealized losses on outstanding mortgage-backed securities and higher losses on Puerto Rico government obligations and closed-end funds; and

Unfavorable variance in FDIC loss share (expense) income of $\$ 8.2$ million, principally due to lower mirror accounting on credit impairment losses and recoveries on covered assets, including rental income on OREOs, and higher amortization of the loss share indemnification asset, partially offset by higher mirror accounting on reimbursable expenses. Refer to Table 6 for a breakdown of FDIC loss share (expense) income by major categories.
Non-interest income increased by $\$ 238.6$ million during the nine months ended September 30, 2013, compared with the same period of the previous year. Excluding the impact of the EVERTEC s SPO during the third quarter of 2013, the bulk sale of non-performing residential mortgage loans and EVERTEC s IPO during the second quarter of 2013 and the bulk sale of non-performing assets during the first quarter of 2013, non-interest income decreased by $\$ 26.3$ million during the nine months ended September 30, 2013.

The increase in non-interest income for the year-to-date results was principally driven by the following factors:

Higher other operating income by $\$ 322.2$ million principally due to the gains of $\$ 162.1$ million and $\$ 175.9$ million recognized in connection with EVERTEC s IPO and SPO during the second and third quarters of 2013, respectively; partially offset by an unfavorable impact resulting from a $\$ 4.6$ million gain on the sale of a real estate property previously owned and used by BPPR during the first quarter of 2012 , lower net earnings on the portfolio of investments accounted under the equity method by $\$ 3.2$ million, and a $\$ 2.5$ million gain on the sale of the wholesale indirect general agency property and casualty business of Popular Insurance during the second quarter of 2012; and

Favorable variance in net gain (loss) and valuation adjustments of investment securities of $\$ 6.1$ million principally attributed to the prepayment penalty fee of $\$ 5.9$ million received from EVERTEC for the repayment of a $\$ 22.8$ million debt security during the second quarter of 2013.
These favorable variances were partially offset by:

Unfavorable variance of $\$ 18.0$ million in trading account (loss) profit mainly resulting from the abovementioned unrealized losses on mortgage-backed securities and losses on Puerto Rico government obligations and closed end funds;

Unfavorable variance of $\$ 24.1$ million in net gain (loss) on sale of loans, net of valuation adjustment on loans held-for-sale. This decrease was driven by the loss of $\$ 61.4$ million recorded during the first quarter of 2013 in connection with the bulk sale of non-performing assets and the loss of $\$ 3.9$ million recorded during the second quarter of 2013 in connection with the bulk sale of non-performing residential mortgage loans, as previously mentioned. This decrease was partially offset by lower valuation adjustments of $\$ 36.1$ million on commercial and construction loans held-for-sale of the BPPR reportable segment recorded during the second quarter of the previous year as a result of updated appraisals and market indicators;

## Table of Contents

An increase of $\$ 12.2$ million in adjustments to indemnity reserves on loans sold, which includes $\$ 10.7$ million recorded in connection with the bulk sale of non-performing assets during the first quarter of 2013 and $\$ 3.0$ million recorded in connection with the bulk sale of non-performing residential mortgage loans during the second quarter of 2013; and

Unfavorable variance in FDIC loss share (expense) income of $\$ 25.5$ million, principally due to higher amortization of the FDIC loss share asset due to a decrease in expected losses, lower mirror accounting on credit impairment losses, higher mirror accounting on recoveries on covered assets, including rental income on OREOs, and the impact of fair value adjustments in the true-up payment obligation, partially offset by higher mirror accounting on reimbursable loan-related expenses on covered loans. Refer to Table 6 for information on FDIC loss share (expense) income.
The following table provides a summary of the gross revenues derived from the assets acquired in the FDIC-assisted transaction during the quarters and nine months ended September 30, 2013 and 2012:

## Table 6 Financial Information Westernbank FDIC-Assisted Transaction

|  | Quarters ended September 30, |  |  | Nine months ended September 30, |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 | 2012 | Variance | 2013 | 2012 | Variance |  |
| Interest income on covered loans | $\$ 71,631$ | $\$ 70,584$ | $\$$ | 1,047 | $\$ 213,952$ | $\$ 224,443$ | $\$(10,491)$ |

FDIC loss share (expense) income:
Amortization of loss share
indemnification asset $\quad(37,681) \quad(29,184) \quad(8,497) \quad(116,442) \quad(95,972) \quad(20,470)$
$80 \%$ mirror accounting on credit

| impairment losses $^{[1]}$ | 13,946 | 18,095 | $(4,149)$ | 53,329 | 60,943 | $(7,614)$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| $80 \%$ mirror accounting on reimbursable    <br> expenses 25,641 7,577 18,064 |  |  |  |  |  |  |

$80 \%$ mirror accounting on recoveries on covered assets, including rental income on OREOs, subject to reimbursement to the FDIC
$80 \%$ mirror accounting on amortization of contingent liability on unfunded

|  | $(87)$ | $(248)$ | 161 | $(473)$ | $(744)$ | 271 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| commitments | $(5,322)$ | $(2,991)$ | $(2,331)$ | $(12,573)$ | $(4,849)$ | $(7,724)$ |
| Change in true-up payment obligation | 170 | 243 | $(73)$ | 519 | 1,390 | $(871)$ |
| Other |  |  |  |  |  |  |
|  | $(14,866)$ | $(6,707)$ | $(8,159)$ | $(44,887)$ | $(19,387)$ | $(25,500)$ |

Amortization of contingent liability on unfunded commitments (included in $\begin{array}{lllll}\text { other operating income) } & 109 & 310 & \text { (201) } & 593\end{array}$

Total revenues
$56,874 \quad 64,187 \quad(7,313) \quad 169,658 \quad 205,986$
(337)

| Provision for loan losses | 17,433 | 22,619 | $(5,186)$ | 60,489 | 78,284 | $(17,795)$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Total revenues less provision for loan <br> losses | $\$ 39,441$ | $\$ 41,568$ | $\$(2,127)$ | $\$ 109,169$ | $\$ 127,702$ | $\$(18,533)$ |

[1] Reductions in expected cash flows for ASC 310-30 loans, which may impact the provision for loan losses, may consider reductions in both principal and interest cash flow expectations. The amount covered under the FDIC loss sharing agreements for interest not collected from borrowers is limited under the agreements (approximately 90 days); accordingly, these amounts are not subject fully to the $80 \%$ mirror accounting.

Average balances

|  | Quarters ended |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |
| September 30, | Nine months ended September 30, |  |  |  |  |  |
| (In millions) | 2013 | 2012 | Variance | 2013 | 2012 | Variance |
| Covered loans | $\$ 3,119$ | $\$ 3,952$ | $\$(833)$ | $\$ 3,299$ | $\$ 4,124$ | $\$(825)$ |
| FDIC loss share asset | 1,348 | 1,578 | $(230)$ | 1,373 | 1,726 | $(353)$ |

Table of Contents

## Operating Expenses

Table 7 provides a breakdown of operating expenses by major categories.
Table 7 Operating Expenses

| (In thousands) | Quarters ended September 30, |  |  | Nine months ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 | 2012 | Variance | 2013 | 2012 | Variance |
| Personnel costs: |  |  |  |  |  |  |
| Salaries | \$ 76,735 | \$ 74,339 | \$ 2,396 | \$ 224,472 | \$ 227,119 | \$ (2,647) |
| Commissions, incentives and other bonuses | 14,457 | 12,800 | 1,657 | 45,472 | 39,885 | 5,587 |
| Pension, postretirement and medical insurance | 14,724 | 15,984 | $(1,260)$ | 44,710 | 50,523 | $(5,813)$ |
| Other personnel costs, including payroll taxes | 10,923 | 8,427 | 2,496 | 32,853 | 31,850 | 1,003 |
| Total personnel costs | 116,839 | 111,550 | 5,289 | 347,507 | 349,377 | $(1,870)$ |
| Net occupancy expenses | 24,711 | 23,615 | 1,096 | 72,292 | 71,143 | 1,149 |
| Equipment expenses | 11,768 | 11,447 | 321 | 35,561 | 33,688 | 1,873 |
| Other taxes | 17,749 | 12,666 | 5,083 | 44,623 | 38,178 | 6,445 |

Professional fees:

| Collections, appraisals and other credit | 8,042 | 12,197 | $(4,155)$ | 27,518 | 33,596 | $(6,078)$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| related fees |  |  |  |  |  |  |
| Programming, processing and other | 44,603 | 42,247 | 2,356 | 132,743 | 128,675 | 4,068 |
| technology services | 19,394 | 16,508 | 2,886 | 52,239 | 44,421 | 7,818 |
| Other professional fees | 72,039 | 70,952 | 1,087 | 212,500 | 206,692 | 5,808 |


| Communications | 6,558 | 6,500 | 58 | 20,034 | 20,276 | $(242)$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Business promotion | 14,982 | 14,924 | 58 | 43,461 | 44,754 | $(1,293)$ |
| FDIC deposit insurance | 16,100 | 24,173 | $(8,073)$ | 44,883 | 72,006 | $(27,123)$ |
| Loss on early extinguishment of debt | 3,388 | 43 | 3,345 | 3,388 | 25,184 | $(21,796)$ |
| Other real estate owned (OREO) expenses | 17,175 | 5,896 | 11,279 | 69,678 | 22,441 | 47,237 |

Other operating expenses:

| Credit and debit card processing, volume |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| and interchange expenses | 5,076 | 5,442 | $(366)$ | 15,403 | 15,083 | 320 |
| Transportation and travel | 2,020 | 1,641 | 379 | 5,349 | 5,002 | 347 |
| Printing and supplies | 995 | 1,017 | $(22)$ | 3,052 | 3,507 | $(455)$ |
| Operational losses | 5,039 | 2,474 | 2,565 | 12,584 | 16,141 | $(3,557)$ |
| All other | 9,692 | 12,212 | $(2,520)$ | 32,165 | 33,723 | $(1,558)$ |
| Total other operating expenses | 22,822 | 22,786 | 36 | 68,553 | 73,456 | $(4,903)$ |


| Amortization of intangibles | 2,468 | 2,481 | $(13)$ | 7,403 | 7,605 |  | (202) |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total operating expenses | $\$ 326,599$ | $\$ 307,033$ | $\$ 19,566$ | $\$ 969,883$ | $\$ 964,800$ | $\$$ | 5,083 |

Operating expenses increased by $\$ 19.6$ million when compared to the third quarter of 2012 due to the following main factors:

Higher personnel cost by $\$ 5.3$ million due to higher salary expense by $\$ 2.4$ million due to an increase in employee salaries resulting from headcount increases and salary revisions, accompanied by an increase in commissions, incentives and other bonuses and an increase in 401 k savings plan expenses of $\$ 1.2$ million due to the restoration of the Corporation s matching contribution, beginning in April 2013. These variances were partially offset by a decrease in pension and other benefits related to actuarial revisions. The Corporation s full time equivalent employees ( FTEs ) were 8,094 at September 30, 2013 vs. 8,074 at September 30, 2012;

Higher other taxes by $\$ 5.1$ million principally as a result of the gross receipts tax enacted earlier in the year in Puerto Rico, imposed as one percent of gross revenues, as defined, with a corresponding income tax credit of half percent. During the third quarter of 2013 the Corporation reclassified the year to date income tax credit of $\$ 3.3$ million from the operating expenses line into income taxes;

Higher loss on early extinguishment of debt by $\$ 3.3$ million as a result of an early cancellation of $\$ 233.2$ million in senior notes which resulted in a $\$ 3.4$ million loss on extinguishment of debt during the third quarter of 2013; and

Higher other real estate owned (OREO) expenses by $\$ 11.3$ million due mainly to higher fair value adjustments of $\$ 11.8$ million of commercial and construction OREO, consisting primarily of covered assets which are subject to $80 \%$ reimbursement from the FDIC, partially offset by higher net gains on sale of commercial and construction properties.

## Table of Contents

The above variances were partially offset by a decrease in FDIC deposit insurance expense of $\$ 8.1$ million, driven by a reduced volume of higher risk assets, and revisions in the deposit insurance premium calculation and efficiencies achieved from the internal reorganization of Popular Mortgage into BPPR, both completed during the fourth quarter of 2012.

Operating expenses increased by $\$ 5.1$ million for the nine months ended September 30, 2013 when compared to the same period in 2012, due to the following main factors:

Higher other taxes by $\$ 6.4$ million as a result of the gross receipts tax discussed above;

Higher professional fees by $\$ 5.8$ million due to legal fees at BPPR and higher consulting service fees at the Corporate segment related to regulatory compliance matters; and

Higher OREO expenses by $\$ 47.2$ million that mainly resulted from the loss of $\$ 37.0$ million on the bulk sale of commercial and single-family real estate owned completed during the first quarter of 2013.
These variances were partially offset by:

Lower FDIC deposit insurance by $\$ 27.1$ million primarily driven by the recognition of a credit assessment of $\$ 11.3$ million during the first quarter of 2013, and, as discussed above, as a result of revisions in the deposit insurance premium calculation, accompanied by the reduction in higher risk assets, and efficiencies achieved from the internal reorganization of Popular Mortgage into BPPR during the fourth quarter of 2012; and

Lower loss on early extinguishment of debt by $\$ 21.8$ million resulting from the prepayment expense of $\$ 25.0$ million on the early cancellation of repurchase agreements during the nine months ended September 30, 2012, partially offset by the previously mentioned $\$ 3.4$ million loss on early extinguishment of debt for the cancellation of senior notes during the third quarter of 2013.

## INCOME TAXES

Income tax expense amounted to $\$ 17.8$ million for the quarter ended September 30, 2013, compared with an income tax expense of $\$ 15.4$ million for the same quarter of 2012. The increase in income tax expense was primarily due to the gain recognized during the third quarter of 2013 on the sale of a portion of EVERTEC s shares which was taxable at a preferential tax rate according to Act Number 73 of May 28, 2008, known as Economic Incentives Act for the Development of Puerto Rico . The higher income tax provision was offset by a favorable true up adjustment of approximately $\$ 7.7$ million in connection with filing the tax returns for the year 2012 during the third quarter of 2013, mainly related to distributions received from EVERTEC, the reclassification of $\$ 3.3$ million of income tax credit related to the gross receipt tax from the operating expenses line to income taxes and the reversal of approximately $\$ 7.7$ million of reserves for uncertain tax positions due to the expiration of the statute of limitations in the Puerto Rico operations.

On June 30, 2013 the Governor of Puerto Rico signed Act Number 40 which includes several amendments to the Puerto Rico Internal Revenue Code. Among the most significant changes applicable to corporations was the increase
in the marginal tax rate from $30 \%$ to $39 \%$ effective for taxable years beginning after December 31, 2012 and the imposition of a tax for financial institutions of $1 \%$ of gross revenues, as defined, with a corresponding $.5 \%$ credit on the income tax payable and for non financial institutions up to $.85 \%$ of the gross revenues as part of the alternative minimum tax, the gross receipt tax .

## Table of Contents

The components of income tax expense for the quarters ended September 30, 2013 and 2012 are included in Table 8.
Table 8 Components of Income Tax (Benefit) Expense Quarter

| (In thousands) | Quarters ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | September 30, 2013 |  | September 30, 2012 |  |
|  | Amount | $\%$ of pre-tax <br> income | Amount | $\%$ of pre-tax income |
| Computed income tax at statutory rates | \$ 96,292 | 39\% | \$ 18,772 | 30\% |
| Net benefit of net tax exempt interest income | $(7,608)$ | (3) | $(7,625)$ | (12) |
| Deferred tax asset valuation allowance | $(3,667)$ | (2) | 1,611 | 3 |
| Non-deductible expenses | 8,085 | 3 | 5,817 | 9 |
| Difference in tax rates due to multiple jurisdictions | $(2,492)$ | (1) | (250) |  |
| Effect of income subject to preferential tax rate | $(57,565)$ | (23) | 7,662 | 12 |
| Unrecognized tax benefits | $(7,727)$ | (3) | $(8,985)$ | (14) |
| Others | $(7,550)$ | (3) | $(1,618)$ | (3) |
| Income tax expense | \$ 17,768 | 7\% | \$ 15,384 | 25\% |

Income tax benefit amounted to $\$ 276.5$ million for the nine months ended September 30, 2013, compared with an income tax benefit of $\$ 46.3$ million for the same period of 2012 . The increase in income tax benefit was primarily due to the recognition during the year 2013 of a tax benefit of $\$ 215.6$ million and a corresponding increase in the net deferred tax assets of the Puerto Rico operations as a result of the increase in the marginal tax rate from $30 \%$ to $39 \%$ as mentioned above. In addition, the income tax benefit increased due to the loss generated on the Puerto Rico operations by the sale of non-performing assets that took place during the first and second quarter of 2013, net of the gain realized on the sale of EVERTEC s common stock that took place during the second and third quarter of 2013. The income tax benefit for the nine-month period ended September 30, 2013 was also impacted by the adjustments recorded during the third quarter, discussed above.

Table 9 Components of Income Tax (Benefit) Expense Year-to-Date


| Unrecognized tax benefits | $(7,727)$ | $(5)$ | $(8,985)$ |  |
| :--- | ---: | ---: | ---: | ---: |
| Others | $(2,256)$ | $(1)$ | $(2,158)$ | $(8)$ |
| Income tax (benefit) expense | $\$(276,489)$ | $(173) \%$ | $\$(46,317)$ | $(40) \%$ |

[1] For 2012, includes the impact of the Closing Agreement with the P.R. Treasury signed in June 2012.
Refer to Note 31 to the consolidated financial statements for a breakdown of the Corporation s deferred tax assets as of September 30, 2013.

## Table of Contents

## REPORTABLE SEGMENT RESULTS

The Corporation s reportable segments for managerial reporting purposes consist of Banco Popular de Puerto Rico and Banco Popular North America. A Corporate group has been defined to support the reportable segments. For managerial reporting purposes, the costs incurred by the Corporate group are not allocated to the reportable segments.

For a description of the Corporation s reportable segments, including additional financial information and the underlying management accounting process, refer to Note 33 to the consolidated financial statements.

The Corporate group reported a net income of $\$ 140.9$ million for the third quarter and $\$ 248.7$ million for the nine months ended September 30, 2013, compared with net loss of $\$ 35.3$ million for the third quarter and $\$ 94.2$ million for the nine months ended September 30, 2012. The favorable variances at the Corporate group were due to the effect of the $\$ 156.6$ million and $\$ 167.8$ million after tax gains recognized during the second and third quarters of 2013 as a result of the sale of EVERTEC shares in connection with their initial and secondary public offerings, respectively. For details on these transactions refer to Note 23 Related party transactions with affiliated company/joint venture to the consolidated financial statements.

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

## Banco Popular de Puerto Rico

The Banco Popular de Puerto Rico reportable segment s net income amounted to $\$ 62.6$ million for the quarter ended September 30, 2013, compared with $\$ 73.2$ million for the same quarter of the previous year. The principal factors that contributed to the variance in the financial results included the following:
higher net interest income by $\$ 8.9$ million, or $3 \%$, mostly due to a reduction of $\$ 5.8$ million in the interest expense on deposits, or 13 basis points, mainly individual certificates of deposits, IRA s and brokered CD s related to renewal of maturities at lower prevailing rates and to lower levels. Also, the cost of borrowings decreased by $\$ 2.9$ million resulting mainly from the maturity of $\$ 405$ million in FHLB notes with an average cost of approximately $3.98 \%$. In addition, contributing to the positive impact in net interest income was an increase of $\$ 5.4$ million in interest from commercial and construction loans due to a higher volume of originations at a higher yield, partially offset by a decrease in exempt income from mortgage loans driven by the reversal of $\$ 5.9$ million in interest from reverse mortgages which had been accrued in excess of the amount insured by FHA. The BPPR reportable segment had a net interest margin of $5.26 \%$ for the quarter ended September 30, 2013, compared with $5.11 \%$ for the same period in 2012;
lower provision for loan losses by $\$ 24.6$ million or $27 \%$, due to the decrease in the provision for loan losses on the non-covered loan portfolio of $\$ 19.4$ million and $\$ 5.2$ million in the provision for loan losses for the covered loan portfolio. The provision for loan losses for the non-covered and covered loan portfolios reflected lower net charge-offs by $\$ 26.4$ million and $\$ 8.2$ million, respectively, mostly driven by the commercial and construction portfolios which reflect lower levels of non-performing loans;
lower non-interest income by $\$ 22.4$ million, or $20 \%$, mainly due to higher trading account losses by $\$ 12.1$ million mostly related to higher losses on Puerto Rico government obligations and close-end funds and net
realized losses on mortgage backed securities sold as compared to net gains reported for the same period in 2012. The negative impact in non-interest income was also the result of higher FDIC loss share expense by $\$ 8.2$ million principally due to lower mirror accounting on credit impairment losses, higher recoveries on covered assets, including rental income on OREOs and higher amortization of the loss share indemnification asset, partially offset by higher mirror accounting on reimbursable expenses, mainly due to higher write-downs on commercial and construction properties. Lower other operating income by $\$ 3.3$ million was mostly related to lower earnings from the equity investment in PRLP 2011 Holdings, LLC, while the net impact of mortgage banking activities was a decrease of $\$ 3.0$ million driven by lower gains on sales of mortgage loans and securitizations by $\$ 16.1$ million, partially offset by lower net losses on derivative positions by $\$ 7.6$ million and a positive impact of $\$ 5.6$ million in the fair value adjustment of mortgage servicing rights;
higher operating expenses by $\$ 12.4$ million, or $5 \%$, mainly due to an increase in OREO expenses by $\$ 11.7$ million related to higher fair value adjustments on commercial and construction properties, consisting primarily of covered assets which

## Table of Contents

are subject to $80 \%$ reimbursement from the FDIC. Other operating taxes were higher by $\$ 5.4$ million principally as a result of the gross receipts tax enacted earlier in the year in Puerto Rico and the reclassification of $\$ 3.3$ million of the related income tax credit from the operating expenses line to income taxes. These unfavorable variances were partially offset by a decrease of $\$ 8.1$ million in FDIC deposit insurance assessment resulting from revisions in the deposit-insurance premium calculation and savings achieved from the internal reorganization of Popular Mortgage into BPPR during the fourth quarter of 2012; and
higher income tax expense by $\$ 9.3$ million which reflects the increase in the marginal tax rate from $30 \%$ to $39 \%$ imposed on corporations in Puerto Rico on June 30, 2013 effective for taxable years beginning after December 31, 2012. The higher income tax provision was offset by the reversal of approximately $\$ 6.0$ million for uncertain tax positions in the BPPR reportable segment due to the expiration of the statute of limitations and the reclassification of $\$ 3.3$ million of income tax credit related to the gross receipt tax from the operating expenses line to income taxes.
Net income for the nine months ended September 30, 2013 totaled $\$ 113.9$ million, compared with $\$ 226.1$ million for the same period in the previous year. These results reflected:
higher net interest income by $\$ 39.8$ million, or $4 \%$ mainly impacted by lower expense from deposits by $\$ 22.7$ million and from borrowings by $\$ 14.9$ million, combined with an increase of $\$ 29.5$ million in the income from mortgage and consumer loans. These positive impacts were partially offset by a reduction of $\$ 10.5$ million in interest income from the covered loans portfolio due to lower levels resulting from the continued resolution of that portfolio. The BPPR reportable segment had a net interest margin of $5.23 \%$ for the nine months period ended September 30, 2013, compared with $5.03 \%$ for the same period in 2012;
higher provision for loan losses by $\$ 263.7$ million, mostly due to the increase in the provision for loan losses on the non-covered loan portfolio of $\$ 281.5$ million, mainly related to the incremental provision of $\$ 148.8$ million and $\$ 169.2$ million recognized in the first and second quarters of 2013, respectively related to the non-performing loans bulk sales. Excluding the impact of the sales, the provision for loan losses declined by $\$ 36.5$ million or $18 \%$ to $\$ 167.1$ million, due to positive trends in credit quality offset by the enhancements to the allowance for loan losses framework implemented during the second quarter of 2013;
lower non-interest income by $\$ 100.6$ million, or $32 \%$ mainly due to:
unfavorable variances of $\$ 49.6$ million and $\$ 13.7$ million in net gains on sale of loans and adjustments to indemnity reserves, respectively, both driven by the negative adjustments recognized in 2013 in connection with the bulk sales of non-performing loans;
higher FDIC loss share expense by $\$ 25.5$ million (refer to Table 6 for components of such variance);

Edgar Filing: POPULAR INC - Form 10-Q
lower other operating income by $\$ 17.8$ million resulting from lower net earnings from the equity investments in PRLP 2011 Holdings, LLC and PR Asset PR Portfolio 2013-1 International LLC by $\$ 6.9$ million, and gains of $\$ 4.7$ million and $\$ 2.5$ million recognized during the first and second quarters of 2012 from the sale of a bank premise and the wholesale indirect property and casualty business of Popular Insurance, respectively;
higher trading account losses by $\$ 18.1$ million mostly related to higher losses on Puerto Rico government obligations and close-end funds and net realized losses on mortgage backed securities sold as compared to net gains reported for the same period in 2012.
The negative impacts in non-interest income detailed above were partially offset by lower unfavorable valuation adjustments on loans held-for-sale by $\$ 26.6$ million, principally related to $\$ 27.3$ million in valuation adjustments recorded during the second quarter of 2012 on commercial and construction loans held-for-sale as a result of updated appraisals and market indicators;
higher operating expenses by $\$ 10.5$ million, mainly due to:
an increase in OREO expenses by $\$ 48.4$ million, primarily related to the loss of $\$ 37.0$ million on the bulk sale of commercial and single family real estate owned during the first quarter of 2013 and to higher fair value adjustments on commercial properties, mainly covered assets which are subject to $80 \%$ reimbursement from the FDIC;

Table of Contents
higher professional fees by $\$ 8.8$ million mostly due to higher appraisal, consulting, legal and processing fees;
higher other operating taxes by $\$ 8.0$ million, principally the result of the recently enacted gross receipts tax imposed on corporations in Puerto Rico.
The negative impacts in other operating expenses detailed above were partially offset by a decrease in FDIC deposit insurance of $\$ 27.4$ million resulting mainly from the factors explained in the quarterly results, and by the $\$ 25$ million prepayment expense recorded during the second quarter of 2012 related to the cancellation of repurchase agreements; and
higher income tax benefit by $\$ 222.9$ million, mainly due to $\$ 215.6$ million benefit recognized during the second quarter of 2013 for the increase on the net deferred tax asset from the change in the corporate tax rate from $30 \%$ to $39 \%$ as compared with a tax benefit of $\$ 72.9$ million recognized in 2012 resulting from the Closing Agreement with the P.R. Treasury related to the tax treatment of the loans acquired in the Westernbank FDIC-assisted transaction. The income tax benefit was also impacted by the tax adjustments described above in the quarterly results.

## Banco Popular North America

For the quarter ended September 30, 2013, the reportable segment of Banco Popular North America reported net income of $\$ 25.2$ million, compared with $\$ 8.7$ million for the same quarter of the previous year. The principal factors that contributed to the variance in the financial results included the following:
higher net interest income by $\$ 3.6$ million, or $5 \%$, which was primarily the effect of a $\$ 5.1$ million decrease in deposits costs or 35 basis points. The BPNA reportable segment had a net interest margin of $3.66 \%$ for the quarter ended September 30, 2013, compared with $3.57 \%$ for the same period in 2012;
lower provision for loan losses by $\$ 9.1$ million principally the result of a reserve release reflecting improvements in credit quality and economic trends, and the effect of the enhancements to the allowance for loan losses methodology completed during the second quarter of 2013;
higher non-interest income by $\$ 5.0$ million, or $43 \%$, mostly due to lower adjustments to representation and warranty reserves of $\$ 4.2$ million as the third quarter of 2012 included additions to the reserve to account for settlement arrangements, and higher gain on sale of loans by $\$ 2.5$ million due to higher gains on commercial and construction loans sold. These variances were partially offset by a decrease of $\$ 1.1$ million in service charge on deposits related to lower non-sufficient funds fees; and
higher operating expenses by $\$ 1.1$ million, or $2 \%$, mainly reflected in personnel costs due to higher medical insurance costs.

Net income for the nine months ended September 30, 2013 totaled $\$ 73.2$ million, compared with $\$ 28.5$ million for the same period in the previous year. These results reflected:
lower net interest income by $\$ 4.2$ million, or $2 \%$, which was primarily the effect of a lower yield in the loan portfolio by 36 basis points due to lower recoveries of past due interest from loans that were previously non-accruing, and a lower yield of investment securities by 39 basis points, both decreasing net interest income by $\$ 18.1$ million. The unfavorable impact resulting from these reductions was partially offset by a $\$ 14.7$ million decrease in deposits costs or 35 basis points. The BPNA reportable segment had a net interest margin of $3.52 \%$ for the nine months period ended September 30, 2013, compared with $3.64 \%$ for the same period in 2012;

## Table of Contents

lower provision for loan losses by $\$ 43.7$ million principally the result of a reserve release reflecting improvements in credit quality and economic trends, and the effect of the enhancements to the allowance for loan losses methodology completed during the second quarter of 2013;
lower non-interest income by $\$ 2.9$ million, or $7 \%$, mostly due to lower service charge on deposits by $\$ 3.4$ million related to lower non-sufficient funds and checking fees; and
lower operating expenses by $\$ 8.1$ million, or $5 \%$, mainly due to a decrease in professional fees by $\$ 4.5$ million and $\$ 4.3$ million in other operating expenses, both mainly related to a legal settlement recognized during the first quarter of 2012 , and a reduction of $\$ 1.1$ million in OREO expenses due primarily to higher net gains on sale of mortgage properties. These favorable variances were partially offset by an increase of $\$ 1.4$ million in net occupancy expense mostly related to higher property taxes and rent expenses.

## FINANCIAL CONDITION ANALYSIS

## Assets

The Corporation stotal assets were $\$ 36.1$ billion at September 30, 2013 and $\$ 36.5$ billion at December 31, 2012. Refer to the consolidated financial statements included in this report for the Corporation s consolidated statements of financial condition as of such dates.

## Money market investments, trading and investment securities

Money market investments totaled $\$ 962$ million at September 30, 2013, compared to $\$ 1.1$ billion at December 31, 2012. The decrease was mainly at BPPR due to lower balances at the Federal Reserve Bank of New York.

Trading account securities amounted to $\$ 339$ million at September 30, 2013, compared to $\$ 315$ million at December 31, 2012. Refer to the Market Risk section of this MD\&A for a table that provides a breakdown of the trading portfolio by security type.

Investment securities available-for-sale and held-to-maturity amounted to $\$ 5.3$ billion at September 30, 2013, compared with $\$ 5.2$ billion at December 31, 2012. The slight increase in investment securities available-for-sale is mainly reflected in the categories of Obligations of US Government sponsored entities and Collateralized mortgage obligations mostly due to purchases at BPPR and BPNA during the nine months ended September 30, 2013, partially offset by portfolio declines in market value in line with underlying market conditions, maturities, mortgage backed securities prepayments and the prepayment of $\$ 22.8$ million of EVERTEC s debentures owned by the Corporation as part of their IPO. At September 30, 2013, the investment securities available-for-sale portfolio was in an unrealized loss position of $\$ 5.2$ million, compared with unrealized gains of $\$ 172.5$ million at December 31, 2012. As of September 30, 2013, the available-for-sale investment portfolio reflects gross unrealized losses of $\$ 99$ million, driven by obligations from the U.S. Government sponsored entities, US Agency Collateralized Mortgage Obligations and Obligations of the Puerto Rico Government and its political subdivisions. As part of its analysis for all U.S. Agency securities, management considers the US Agency guarantee. The portfolio of Obligations of the Puerto Rico Government is comprised of securities with specific sources of income or revenues identified for repayments. The Corporation performs periodic credit quality review on these issuers. Table 10 provides a breakdown of the Corporation s portfolio of investment securities available-for-sale (AFS ) and held-to-maturity ( HTM ) on a combined basis. Also, Notes 5 and 6 to the consolidated financial statements provide additional information with respect to the Corporation s investment securities AFS and HTM.

Edgar Filing: POPULAR INC - Form 10-Q

## Table of Contents

## Table 10 Breakdown of Investment Securities Available-for-Sale and Held-to-Maturity

| (In millions) | September 30, 20 December 31, 2012 Variance |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| U.S. Treasury securities | \$ 43.9 | \$ | 37.2 | \$ | 6.7 |
| Obligations of U.S. Government sponsored entities | 1,285.4 |  | 1,096.3 |  | 189.1 |
| Obligations of Puerto Rico, States and political subdivisions | 169.7 |  | 171.2 |  | (1.5) |
| Collateralized mortgage obligations | 2,534.8 |  | 2,369.7 |  | 165.1 |
| Mortgage-backed securities | 1,195.6 |  | 1,483.1 |  | (287.5) |
| Equity securities | 8.8 |  | 7.4 |  | 1.4 |
| Others | 38.8 |  | 62.1 |  | (23.3) |
| Total investment securities AFS and HTM | \$ 5,277.0 | \$ | 5,227.0 | \$ | 50.0 |

## Loans

Refer to Table 11, for a breakdown of the Corporation s loan portfolio, the principal category of earning assets. Loans covered under the FDIC loss sharing agreements are presented separately in Table 11. The risks on covered loans are significantly different as a result of the loss protection provided by the FDIC. Also, refer to Note 7 for detailed information about the Corporation s loan portfolio composition and loan purchases and sales.

The Corporation s total loan portfolio amounted to $\$ 24.6$ billion at September 30, 2013 compared to $\$ 25.1$ billion at December 31, 2012. The slight decrease of $\$ 466$ million was the net effect of bulk loan sales, early repayments, loan resolutions and portfolio run-off, particularly covered loans, offset by loan originations and purchases.

## Table 11 Loans Ending Balances

| (In thousands) | September 30, 2013ecember 31, 2012 |  |  |  | Variance |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans not covered under FDIC loss sharing agreements: |  |  |  |  |  |  |
| Commercial | \$ | 9,845,477 | \$ | 9,858,202 |  | $(12,725)$ |
| Construction |  | 293,220 |  | 252,857 |  | 40,363 |
| Legacy ${ }^{[1]}$ |  | 235,645 |  | 384,217 |  | $(148,572)$ |
| Lease financing |  | 539,290 |  | 540,523 |  | $(1,233)$ |
| Mortgage |  | 6,613,133 |  | 6,078,507 |  | 534,626 |
| Consumer |  | 3,900,418 |  | 3,868,886 |  | 31,532 |
| Total non-covered loans held-in-portfolio |  | 21,427,183 |  | 20,983,192 |  | 443,991 |
| Loans covered under FDIC loss sharing agreements: |  |  |  |  |  |  |
| Commercial |  | 1,853,851 |  | 2,244,647 |  | $(390,796)$ |
| Construction |  | 201,437 |  | 361,396 |  | $(159,959)$ |
| Mortgage |  | 965,779 |  | 1,076,730 |  | $(110,951)$ |

Edgar Filing: POPULAR INC - Form 10-Q

| Consumer | 54,942 | 73,199 | $(18,257)$ |
| :--- | ---: | ---: | ---: |
| Total covered loans held-in-portfolio ${ }^{[2]}$ | $3,076,009$ | $3,755,972$ | $(679,963)$ |
| Total loans held-in-portfolio | $24,503,192$ | $24,739,164$ | $(235,972)$ |
| Loans held-for-sale: |  |  |  |
| Commercial |  | 16,047 | $(16,047)$ |
| Construction |  | 78,140 | $(78,140)$ |
| Legacy |  |  | $(1,680$ |
| Mortgage | 122,852 | 258,080 | $(400)$ |
| Total loans held-for-sale | 124,532 | $(135,349)$ |  |
| Total loans | $\$$ | $24,627,724$ | $\$$ |

[1] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.
[2] Refer to Note 7 to the consolidated financial statements for the composition of the loans covered under FDIC loss sharing agreements.

## Table of Contents

## Non-covered loans

The explanations for loan portfolio variances discussed below exclude the impact of the covered loans.
Non-covered loans held-in-portfolio amounted to $\$ 21.4$ billion, an increase $\$ 444$ million from December 31, 2012 due to the following:

An increase of $\$ 535$ million in mortgage loans held-in-portfolio principally at the BPPR segment. The increase at BPPR segment of $\$ 395$ million was principally driven by purchases (including repurchases of $\$ 108$ million) by $\$ 1.2$ billion during the nine month period ended September 30, 2013, partially offset by the loan sales of $\$ 575$ million (including the bulk sale of non-performing mortgage loans of $\$ 435$ million during the second quarter of 2013), and net charge-offs of $\$ 40.8$ million for the nine month period ended September 30, 2013. The BPNA segment increase of $\$ 140$ million was due to purchases of mortgage loans by $\$ 356$ million, partially offset by loan sales of $\$ 38.9$ million, net charge-offs of $\$ 7.1$ million and portfolio amortization for the nine months ended September 30, 2013.

An increase of $\$ 40.4$ million in construction loans held-in-portfolio mostly reflected in the BPPR segment, which increased by $\$ 39.6$ million, due to two large construction loans in Puerto Rico.

An increase of $\$ 31.5$ million in the consumer loan portfolio, mainly at the BPPR segment, which increased by $\$ 40.2$ million, partially offset by a decrease of $\$ 8.7$ million in the BPNA segment. The increase at the BPPR segment was mostly reflected in the category of auto loans, which increased by approximately $\$ 98$ million, partially offset by lower personal loans and credit cards.

A decrease of $\$ 148.6$ million in the legacy portfolio of the BPNA segment due to the run-off status of this portfolio and net charge-offs.

A decrease of $\$ 12.7$ million in commercial loans, mostly at BPPR segment, which decreased by $\$ 41.3$ million, partially offset by an increase of $\$ 28.5$ million at the BPNA segment. The decrease at the BPPR segment was mainly related to the bulk loan sale completed during the first quarter of 2013, which decreased the commercial loan portfolio by $\$ 337.6$ million, net of write-downs related to loans sold by $\$ 161.3$ million, the early repayment of one large relationship for approximately $\$ 74.3$ million during this quarter, and net charge-offs of $\$ 70.4$ million for the nine month period ended September 30, 2013, partially offset by the joint venture financing of $\$ 182.4$ million that resulted from the bulk loan sale on first quarter and other large commercial relationships entered into during the period. The increase at the BPNA segment was due to normal business origination activities and purchases of loans, partially offset by net charge-offs and loan sales during the period.
The decrease in loans held-for-sale from December 31, 2012 to September 30, 2013 of $\$ 229.9$ million was mostly at the BPPR segment driven by the bulk sale of non-performing assets, which reduced construction and commercial loans held-for-sale by approximately $\$ 49.7$ million and $\$ 9.8$ million, respectively, the reclassification of the remaining construction and commercial balance of $\$ 14.9$ million to the held-in-portfolio category, loans charge-offs, loan repayments and loans transferred to OREO. There was also a decrease in mortgage loans held-for-sale at the BPPR
segment, principally related to net outflows from whole loan sales transactions of $\$ 129.1$ million during the nine month period ended September 30, 2013.

The covered loans portfolio balance decreased by approximately $\$ 680.0$ million from December 31, 2012 to September 30, 2013 mainly due to the resolution of a large relationship during the first quarter of 2013, loan resolutions and the normal portfolio run-off. Refer to Table 11 for a breakdown of the covered loans by major loan type categories. Tables 12 and 13 provide the activity in the carrying amount and outstanding discount on the covered loans accounted for under ASC 310-30. The outstanding accretable discount is impacted by increases in cash flow expectations on the loan pool based on quarterly revisions of the portfolio. The increase in the accretable discount is recognized as interest income using the effective yield method over the estimated life of each applicable loan pool.

Table of Contents

## Table 12 Activity in the Carrying Amount of Covered Loans Accounted for Under ASC 310-30

|  | Quarter ended September 30, Nine months ended September 30, |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 | 2012 | 2013 | 2012 |  |
| Beginning balance | $\$ 3,012,866$ | $\$ 3,729,489$ | $\$ 2,491,759$ | $\$ 4,036,471$ |  |
| Accretion | 68,529 | 66,168 | 196,055 | 209,493 |  |
| Collections / charge-offs | $(190,346)$ | $(168,448)$ | $(796,765)$ | $(618,755)$ |  |
| Ending balance | $\$ 2,891,049$ | $\$ 3,627,209$ | $\$ 2,891,049$ | $\$ 3,627,209$ |  |
| Allowance for loan losses (ALLL) | $(108,874)$ | $(103,547)$ | $(108,874)$ | $(103,547)$ |  |
| Ending balance, net of ALLL | $\$ 2,782,175$ | $\$ 3,523,662$ | $\$ 2,782,175$ | $\$$ | $3,523,662$ |

Table 13 Activity in the Outstanding Accretable Discount on Covered Loans Accounted for Under ASC 310-30

|  | Quarter ended September 30, Nine months ended September 30, |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 | 2012 | 2013 | 2012 |  |
| Beginning balance | $\$ 1,379,612$ | $\$ 1,574,850$ | $\$$ | $1,451,669$ | $\$ 1,470,259$ |
| Accretion [1] | $(68,529)$ | $(66,168)$ | $(196,055)$ | $(209,493)$ |  |
| Change in expected cash flows | $(1,465)$ | $(37,800)$ |  | 54,004 | 210,116 |
|  |  |  |  |  |  |
| Ending balance | $\$ 1,309,618$ | $\$ 1,470,882$ | $\$$ | $1,309,618$ | $\$$ |

[1] Positive to earnings, which is included in interest income.
FDIC loss share asset
Table 14 sets forth the activity in the FDIC loss share asset for the quarters and nine months ended September 30, 2013 and 2012.

Table 14 Activity of Loss Share Asset

Quarters ended September 30, ine months ended September 30,

| (In thousands) | 2013 | 2012 | 2013 | 2012 |
| :--- | :---: | :---: | :---: | :---: |
| Balance at beginning of year | $\$ 1,379,342$ | $\$ 1,631,594$ | $\$$ | $1,399,098$ |$\$ 1,915,128$

unfunded commitments

| Reimbursable expenses | 25,641 | 7,577 | 45,555 | 20,619 |
| :--- | :---: | :---: | :---: | :---: |
| Net payments to (from) FDIC under loss <br> sharing agreements | $(52,865)$ | $(64,932)$ | $(52,758)$ | $(327,739)$ |
| Other adjustments attributable to FDIC loss <br> sharing agreements | $(3,585)$ | $(3,845)$ | $(3,598)$ | $(13,178)$ |

$$
\begin{array}{lllllll}
\text { Balance at end of period } & \$ 1,324,711 & \$ 1,559,057 & \$ & 1,324,711 & \$ 1,559,057
\end{array}
$$

The FDIC loss share indemnification asset is recognized on the same basis as the assets subject to the loss share protection from the FDIC, except that the amortization / accretion terms differ. Decreases in expected reimbursements from the FDIC due to improvements in expected cash flows to be received from borrowers, as compared with the initial estimates, are recognized as a reduction to non-interest income prospectively over the life of the loss share agreements. This is because the indemnification asset balance is being reduced to the expected reimbursement amount from the FDIC. Table 15 presents the activity associated with the outstanding balance of the FDIC loss share asset amortization (or negative discount) for the periods presented.

## Table 15 Activity in the Remaining FDIC Loss Share Asset Discount

|  | Quarter ended September 30,Nine months ended September 30, |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 | 2012 | 2013 | 2012 |  |  |
| Balance at beginning of period ${ }^{[1]}$ | $\$ 122,124$ | $\$$ | 121,308 | $\$$ | 141,800 | $\$$ |
| Amortization of negative discount ${ }^{[2]}$ | $(37,681)$ |  | $(29,184)$ |  | $(116,442)$ | $(95,972)$ |
| Impact of lower projected losses |  | 38,053 | 4,300 |  | 97,138 | 74,480 |
| Balance at end of period | $\$ 122,496$ | $\$$ | 96,424 | $\$$ | 122,496 | $\$$ |

[1] Positive balance represents negative discount (debit to assets), while a negative balance represents a discount (credit to assets).
[2] Amortization results in a negative impact to non-interest income, while a positive balance results in a positive impact to non-interest income, particularly FDIC loss share (expense) income.

## Table of Contents

While the Corporation was originally accreting to the future value of the loss share indemnity asset, the lowered loss estimates required the Corporation to amortize the loss share asset to its currently lower expected collectible balance, thus resulting in negative accretion. Due to the shorter life of the indemnity asset compared with the expected life of the covered loans, this negative accretion temporarily offsets the benefit of higher cash flows accounted through the accretable yield on the loans.

## Other real estate owned

Other real estate (OREO) represents real estate property received in satisfaction of debt. At September 30, 2013, OREO amounted to $\$ 295$ million from $\$ 406$ million at December 31, 2012. The decrease was mainly as a result of write-downs in value and sales, including the bulk sale of non-performing assets completed during the first quarter of 2013, which reduced OREO by $\$ 108$ million. Refer to Table 16 for the activity in other real estate owned. The amounts included as covered other real estate are subject to the FDIC loss sharing agreements.

## Table 16 Other Real Estate Owned Activity



For the nine months ended September 30, 2013
Non-covered Non-covered Covered Covered
OREO OREO OREO OREO

| (In thousands) | Commercial/ Construckilontgageomercial/ Constructidrortgage | Total |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at beginning of period | $\$ 135,862$ | $\$$ | 130,982 | $\$$ | 99,398 | $\$ 39,660$ | $\$ 405,902$ |
| Write-downs in value | $(8,767)$ | $(8,939)$ | $(16,961)$ | $(3,166)$ | $(37,833)$ |  |  |
| Additions | 26,598 | 69,369 | 73,020 | 22,796 | 191,783 |  |  |
| Sales | $(103,556)$ | $(107,282)$ | $(41,417)$ | $(13,743)$ | $(265,998)$ |  |  |
| Other adjustments | 290 | 945 | 240 | 141 | 1,616 |  |  |
|  |  |  |  |  |  |  |  |
| Ending balance | $\$ 50,427$ | $\$$ | 85,075 | $\$$ | 114,280 | $\$ 45,688$ | $\$ 295,470$ |

Edgar Filing: POPULAR INC - Form 10-Q

| Non-covered | Non-covered | Covered | Covered |
| :---: | :---: | :---: | :---: |
| OREO | OREO | OREO | OREO |

Commercial/ ConstrudiortgagCommercial/ ConstructiMfortgage

| Balance at beginning of period | \$ 107,391 | \$ | 119,238 | \$ | 91,817 | \$ 33,276 | \$ 351,722 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Write-downs in value | $(2,948)$ |  | (39) |  |  | (54) | $(3,041)$ |
| Additions | 32,435 |  | 17,194 |  | 14,814 | 3,800 | 68,243 |
| Sales | $(9,099)$ |  | $(11,314)$ |  | $(14,750)$ | $(3,071)$ | $(38,234)$ |
| Other adjustments | 538 |  | $(1,372)$ |  | (186) | (132) | $(1,152)$ |

Ending balance
$\begin{array}{lllllll}\$ 128,317 & \$ 123,707 & \$ 1 & 91,695 & \$ 33,819 & \$ 377,538\end{array}$

For the nine months ended September 30, 2012
Non-covered Non-covered Covered Covered
OREO OREO OREO OREO

| (In thousands) | Commercial/ Construckilomtgageommercial/ ConstructiMhortgage | Total |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at beginning of period | $\$ 90,401$ | $\$$ | 82,096 | $\$$ | 78,129 | $\$ 31,006$ |$\$ 281,632$

Ending balance
\$ 128,317 \$ 123,707 \$ 91,695 \$ 33,819 \$ 377,538

## Table of Contents

## Other assets

Table 17 provides a breakdown of the principal categories that comprise the caption of Other assets in the consolidated statements of financial condition at September 30, 2013 and December 31, 2012.

Table 17 Breakdown of Other Assets

| (In thousands) | September 30, 2013 |  | December 31, 2012 | Variance |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Net deferred tax assets (net of |  |  |  |  |  |
| valuation allowance) | $\$$ | 844,242 | $\$$ | 541,499 | $\$ 302,743$ |
| Investments under the equity method |  | 213,614 |  | 246,776 | $(33,162)$ |
| Bank-owned life insurance program |  | 227,916 |  | 233,475 | $(5,559)$ |
| Prepaid FDIC insurance assessment |  | 98,972 | 27,533 | $(27,533)$ |  |
| Prepaid taxes | 65,319 | 88,360 | 10,612 |  |  |
| Other prepaid expenses | 32,732 | 60,626 | 4,693 |  |  |
| Derivative assets |  | 41,925 | $(9,193)$ |  |  |
| Trades receivables from brokers and <br> counterparties |  | 85,746 |  | 137,542 | $(51,796)$ |
| Others |  | 234,937 |  | 191,842 | 43,095 |
| Total other assets |  | $1,803,478$ | $\$$ | $1,569,578$ | $\$ 233,900$ |

The increase in other assets from December 31, 2012 to September 30, 2013 of approximately $\$ 234$ million was mainly due to the deferred tax assets that resulted from the losses on the bulk sales of non-performing assets completed during the year and the impact of the increase in the corporate tax rate from $30 \%$ to $39 \%$ during this quarter, partially offset by lower trades receivables from brokers and counterparties.

## Deposits and Borrowings

The composition of the Corporation sfinancing sources to total assets at September 30, 2013 and December 31, 2012 is included in Table 18.

## Table 18 Financing to Total Assets

|  | September 30, |  | December 31\% increase (decrease) | $\%$ of total assets |  |  |
| :--- | ---: | :---: | :---: | :---: | :---: | :---: |
| (In millions) | 2013 | 2012 | from 2012 to 2013 | 2013 | 2012 |  |
| Non-interest bearing deposits | $\$ 5,763$ | $\$$ | 5,795 | $(0.6) \%$ | $16.0 \%$ | $15.9 \%$ |
| Interest-bearing core deposits | 16,132 | 15,993 | 0.9 | 44.7 | 43.8 |  |
| Other interest-bearing deposits | 4,500 | 5,213 | $(13.7)$ | 12.5 | 14.3 |  |
| Fed funds purchased and repurchase |  |  |  |  |  |  |
| agreements | 1,793 | 2,017 | $(11.1)$ | 5.0 | 5.5 |  |
| Other short-term borrowings | 826 | 636 | 29.9 | 2.3 | 1.7 |  |
| Notes payable | 1,545 | 1,778 | $(13.1)$ | 4.3 | 4.9 |  |
| Other liabilities | 1,099 | 966 | 13.8 | 3.0 | 2.6 |  |


| Stockholders equity | 4,394 | 4,110 | 6.9 | 12.2 | 11.3 |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Deposits |  |  |  |  |  |

The Corporation s deposits totaled $\$ 26.4$ billion at September 30, 2013 compared to $\$ 27.0$ billion at December 31, 2012. The decrease of $\$ 0.6$ billion was mostly due to lower balances in brokered and non-brokered time deposits, partially offset by higher savings and money market deposits. Lower deposit costs have contributed favorably to maintain the Corporation s net interest margin above $4 \%$. Refer to Table 19 for a breakdown of the Corporation s deposits at September 30, 2013 and December 31, 2012.

Table of Contents
Table 19 Deposits Ending Balances

| (In thousands) | September 30, 2013 |  | December 31, 2012 | Variance |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Demand deposits [1] | $\$$ | $6,410,458$ | $\$$ | $6,442,739$ | $\$(32,281)$ |
| Savings, NOW and money market |  | $11,335,441$ |  | $11,190,335$ | 145,106 |
| deposits (non-brokered) |  | 552,053 |  | 456,830 | 95,223 |
| Savings, NOW and money market <br> deposits (brokered) | $6,181,676$ |  | $6,541,660$ | $(359,984)$ |  |
| Time deposits (non-brokered) |  | $1,915,426$ |  | $2,369,049$ | $(453,623)$ |
| Time deposits (brokered CDs) | $\$$ | $26,395,054$ | $\$$ | $27,000,613$ | $\$(605,559)$ |
| Total deposits |  |  |  |  |  |

[1] Includes interest and non-interest bearing demand deposits.

## Borrowings

The Corporation s borrowings amounted to $\$ 4.2$ billion at September 30, 2013, compared with $\$ 4.4$ billion at December 31, 2012. The decrease from December 31, 2012 to September 30, 2013 was mostly related to the repayment of $\$ 233.2$ million in senior notes during this quarter. Refer to Note 15 to the consolidated financial statements for detailed information on the Corporation s borrowings at September 30, 2013 and December 31, 2012. Also, refer to the Liquidity section in this MD\&A for additional information on the Corporation s funding sources.

## Other liabilities

Other liabilities increased by $\$ 132.8$ million from December 31, 2012 to September 30, 2013. The increase was principally driven by higher securities trade payables at BPPR segment of $\$ 141.3$ million due to purchases near the end of the quarter.

## Stockholders Equity

Stockholders equity totaled $\$ 4.4$ billion at September 30, 2013, compared with $\$ 4.1$ billion at December 31, 2012. This increase mainly resulted from the Corporation s net income of $\$ 436.3$ million for the nine months ended September 30, 2013, partially offset by a decrease of $\$ 160.1$ million in unrealized gains in the portfolio of investments securities available-for-sale, reflected net of tax in accumulated other comprehensive income. Refer to the consolidated statements of financial condition, comprehensive income and of changes in stockholders equity for information on the composition of stockholders equity.

## Table of Contents

## REGULATORY CAPITAL

The Corporation continues to exceed the well-capitalized guidelines under the federal banking regulations. The regulatory capital ratios and amounts of total risk-based capital, Tier 1 risk-based capital and Tier 1 leverage at September 30, 2013 and December 31, 2012 are presented on Table 20. As of such dates, BPPR and BPNA were well-capitalized.

## Table 20 Capital Adequacy Data

| (Dollars in thousands) | September 30, 2013 December 31, 2012 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Risk-based capital: |  |  |  |  |
| Tier I capital | \$ | 4,274,568 | \$ | 4,058,242 |
| Supplementary (Tier II) capital |  | 294,157 |  | 298,906 |
| Total capital | \$ | 4,568,725 | \$ | 4,357,148 |
| Minimum requirement to be well capitalized |  | 2,305,243 |  | 2,339,157 |
| Excess capital | \$ | 2,263,482 | \$ | 2,017,991 |
| Risk-weighted assets: |  |  |  |  |
| Balance sheet items | \$ | 21,136,137 | \$ | 21,175,833 |
| Off-balance sheet items |  | 1,916,295 |  | 2,215,739 |
| Total risk-weighted assets | \$ | 23,052,432 | \$ | 23,391,572 |
| Adjusted quarterly average assets | \$ | 34,863,920 | \$ | 35,226,183 |
| Ratios: |  |  |  |  |
| Tier I capital (minimum required - 4.00\%) |  | 18.54\% |  | 17.35\% |
| Total capital (minimum required - 8.00\%) |  | 19.82 |  | 18.63 |
| Leverage ratio * |  | 12.26 |  | 11.52 |

* All banks are required to have a minimum Tier 1 Leverage ratio of $3 \%$ or $4 \%$ of adjusted quarterly average assets, depending on the bank s classification. At September 30, 2013, the capital adequacy minimum requirement for Popular, Inc. was (in thousands): Total Capital of $\$ 1,844,195$; Tier 1 Capital of $\$ 922,097$; and Tier 1 Leverage of $\$ 1,045,918$, based on a $3 \%$ ratio, or $\$ 1,394,557$, based on a $4 \%$ ratio, according to the entity s classification. The tangible common equity ratio and tangible book value per common share, which are presented in the table that follows, are non-GAAP measures. 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 with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase accounting method of accounting for mergers and acquisitions. 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 generally accepted accounting principles in the

United States of America ( GAAP ). Moreover, the manner in which the Corporation calculates its tangible common equity, tangible assets and any other related measures may differ from that of other companies reporting measures with similar names.

## Table of Contents

Table 21 provides a reconciliation of total stockholders equity to tangible common equity and total assets to tangible assets at September 30, 2013 and December 31, 2012.

Table 21 Reconciliation of Tangible Common Equity and Tangible Assets

| Total stockholders equity | \$ | 4,393,885 | \$ | 4,110,000 |
| :---: | :---: | :---: | :---: | :---: |
| Less: Preferred stock |  | $(50,160)$ |  | $(50,160)$ |
| Less: Goodwill |  | $(647,757)$ |  | $(647,757)$ |
| Less: Other intangibles |  | $(46,892)$ |  | $(54,295)$ |
| Total tangible common equity | \$ | 3,649,076 | \$ | 3,357,788 |
| Total assets | \$ | 36,052,116 | \$ | 36,507,535 |
| Less: Goodwill |  | $(647,757)$ |  | $(647,757)$ |
| Less: Other intangibles |  | $(46,892)$ |  | $(54,295)$ |
| Total tangible assets | \$ | 35,357,467 | \$ | 35,805,483 |
| Tangible common equity to tangible assets |  | 10.32\% |  | 9.38\% |
| Common shares outstanding at end of period |  | 103,327,146 |  | 103,169,806 |
| Tangible book value per common share | \$ | 35.32 | \$ | 32.55 |

The Tier 1 common equity to risk-weighted assets ratio is another non-GAAP measure. Ratios calculated based upon Tier 1 common equity have become a focus of regulators and investors, and management believes ratios based on Tier 1 common equity assist investors in analyzing the Corporation s capital position.

Because Tier 1 common equity is not formally defined by GAAP or, unlike Tier 1 capital, codified in the federal banking regulations currently in place as of September 30, 2013, this measure is considered to be a non-GAAP financial measure. Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied and are not audited. To mitigate these limitations, the Corporation 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.

## Table of Contents

Table 22 provides a reconciliation of the Corporation s total common stockholders equity (GAAP) to Tier 1 common equity at September 30, 2013 and December 31, 2012 (non-GAAP).

Table 22 Reconciliation Tier 1 Common Equity

| (In thousands) | September 30, 2013December 31, 2012 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Common stockholders equity | \$ | 4,343,725 | \$ | 4,059,840 |
| Less: Unrealized losses (gains) on available-for-sale securities, net of tax ${ }^{[1]}$ |  | 5,514 |  | $(154,568)$ |
| Less: Disallowed deferred tax assets ${ }^{[2]}$ |  | $(643,716)$ |  | $(385,060)$ |
| Less: Disallowed goodwill and other intangible assets, net of deferred tax liability |  | $(646,464)$ |  | $(662,201)$ |
| Less: Aggregate adjusted carrying value of non-financial equity investments |  | $(1,398)$ |  | $(1,160)$ |
| Add: Pension and postretirement benefit plan liability adjustment, net of tax and of accumulated net gains (losses) on cash flow hedges ${ }^{[1]}$ |  | 216,274 |  | 226,159 |
| Total Tier 1 common equity | \$ | 3,273,935 | \$ | 3,083,010 |
| Tier 1 common equity to risk-weighted assets |  | 14.20\% |  | 13.18\% |

[1] In accordance with regulatory risk-based capital guidelines, Tier 1 capital excludes certain components of accumulated other comprehensive income (loss) (AOCI), including: (1) net unrealized gains or losses on available-for-sale debt securities; (2) net unrealized gains on available-for-sale equity securities; (3) any amounts recorded in AOCI attributed to defined benefit pension and postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans; and (4) accumulated net gains or losses on cash flow hedges.
[2] Approximately $\$ 160$ million of the Corporation s $\$ 844$ million of net deferred tax assets at September 30, 2013 ( $\$ 118$ million and $\$ 541$ million, respectively, at December 31, 2012), were included without limitation in regulatory capital pursuant to the risk-based capital guidelines, while approximately $\$ 644$ million of such assets at September 30, 2013 ( $\$ 385$ million at December 31, 2012) exceeded the limitation imposed by these guidelines and, as disallowed deferred tax assets , were deducted in arriving at Tier 1 capital. The remaining $\$ 40$ million of the Corporation s other net deferred tax assets at September 30, 2013 ( $\$ 38$ million at December 31, 2012) represented primarily the following items (a) the deferred tax effects of unrealized gains and losses on available-for-sale debt securities, which are permitted to be excluded prior to deriving the amount of net deferred tax assets subject to limitation under the guidelines; (b) the deferred tax asset corresponding to the pension liability adjustment recorded as part of accumulated other comprehensive income; and (c) the deferred tax liability associated with goodwill and other intangibles.
New Capital Rules to Implement Basel III Capital Requirements
On July 2, 2013, the Board of Governors of the Federal Reserve System ( Board ) approved final rules ( New Capital Rules ) to establish a new comprehensive regulatory capital framework for all U.S. banking organizations. On July 9, 2013, the New Capital Rules were approved by the Office of the Comptroller of the Currency ( OCC ) and (as interim
final rules) by the Federal Deposit Insurance Corporation ( FDIC ) (together with the Board, the Agencies ).
The New Capital Rules generally implement the Basel Committee on Banking Supervision s (the Basel Committee ) December 2010 final capital framework referred to as Basel III for strengthening international capital standards. The New Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including Popular, BPPR and BPNA, as compared to the current U.S. general risk-based capital rules. The New Capital Rules revise the definitions and the components of regulatory capital, as well as address other issues affecting the numerator in banking institutions regulatory capital ratios. The New Capital Rules also address asset risk weights and other matters affecting the denominator in banking institutions regulatory capital ratios and replace the existing general risk-weighting approach, which was derived from the Basel Committee s 1988 Basel I capital accords, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee s 2004 Basel II capital accords. In addition, the New Capital Rules implement certain provisions of Dodd-Frank Act, including the requirements of Section 939A to remove references to credit ratings from the federal agencies rules. The New Capital Rules are effective for Popular, BPPR and BPNA on January 1, 2015, subject to phase-in periods for certain of their components and other provisions.

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 existing regulations. Under the New Capital Rules, for most banking organizations, including the Corporation, the most common form of Additional Tier 1 capital is non-cumulative perpetual preferred stock and the most common form of Tier 2 capital is subordinated notes and a portion of the allocation for loan and lease losses, in each case, subject to the New Capital Rules specific requirements.

Table of Contents
Pursuant to the New Capital Rules, the minimum capital ratios as of January 1, 2015 will be 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\% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the leverage ratio ).
The New Capital Rules also introduce a new capital conservation buffer , composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. Thus, when fully phased-in on January 1, 2019, Popular, BPPR and BPNA will be required to maintain such additional capital conservation buffer of $2.5 \%$ of CET1, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7\%, (ii) Tier 1 capital to risk-weighted assets of at least $8.5 \%$, and
(iii) Total capital to risk-weighted assets of at least $10.5 \%$.

The New Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds $10 \%$ of CET1 or all such items, in the aggregate, exceed $15 \%$ of CET1.

In addition, under the current general risk-based capital rules, the effects of accumulated other comprehensive income or loss ( AOCI ) items included in shareholders equity (for example, marks-to-market of securities held in the available for sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios. Pursuant to the New Capital Rules, the effects of certain AOCI items are not excluded; however, non-advanced approaches banking organizations, including Popular, BPPR and BPNA, may make a one-time permanent election to continue to exclude these items. This election must be made concurrently with the first filing of certain of the Popular s, BPPR s and BPNA s periodic regulatory reports in the beginning of 2015. Popular, BPPR and BPNA expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of their securities portfolio. The New Capital Rules also preclude certain hybrid securities, such as trust preferred securities, from inclusion in bank holding companies Tier 1 capital, subject to phase-out in the case of bank holding companies that had $\$ 15$ billion or more in total consolidated assets as of December 31, 2009. The Corporation s Tier I capital level at September 30, 2013, included $\$ 427$ million of trust preferred securities that are subject to the phase-out provisions of the New Capital Rules. The Corporation would be allowed to include only 25 percent of such trust preferred securities in Tier 1 capital as of January 1, 2015 and 0 percent as of January 1, 2016, and thereafter. Trust preferred securities no longer included in Popular s Tier 1 capital may nonetheless be included as a component of Tier 2 capital on a permanent basis without phase-out and irrespective of whether such securities otherwise meet the revised definition of Tier 2 capital set forth in the New Capital Rules. The Corporation s trust preferred securities issued to the U.S. Treasury pursuant to the Emergency Economic

Stabilization Act of 2008 are exempt from the phase-out provision.
Implementation of the deductions and other adjustments to CET1 will begin on January 1, 2015 and will be phased-in over a 4 -year period (beginning at $40 \%$ on January 1, 2015 and an additional $20 \%$ per year thereafter). The implementation of the capital conservation buffer will begin on January 1, 2016 at the $0.625 \%$ level and increase by $0.625 \%$ on each subsequent January 1, until it reaches $2.5 \%$ on January 1, 2019.

With respect to BPPR and BPNA, the New Capital Rules revise the prompt corrective action ( PCA ) regulations adopted pursuant to Section 38 of the Federal Deposit Insurance Act, by: (i) introducing a CET1 ratio requirement at each PCA category (other than critically undercapitalized), with the required CET1 ratio being $6.5 \%$ for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 capital ratio for well-capitalized status being $8 \%$ (as compared to the current $6 \%$ ); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a $3 \%$ leverage ratio and still be adequately capitalized. The New Capital Rules do not change the total risk-based capital requirement for any PCA category.

## Table of Contents

The New Capital Rules prescribe a new standardized approach for risk weightings that expand the risk-weighting categories from the current 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.

We believe that Popular, BPPR and BPNA will be able to meet well-capitalized capital ratios upon implementation of the revised requirements, as finalized.

## Contractual Obligations and Commercial Commitments

The Corporation has various financial obligations, including contractual obligations and commercial commitments, which require future cash payments on debt and lease agreements. Also, in the normal course of business, the Corporation enters into contractual arrangements whereby it commits to future purchases of products or services from third parties. Obligations that are legally binding agreements, whereby the Corporation agrees to purchase products or services with a specific minimum quantity defined at a fixed, minimum or variable price over a specified period of time, are defined as purchase obligations.

Purchase obligations include major legal and binding contractual obligations outstanding at September 30, 2013, primarily for services, equipment and real estate construction projects. Services include software licensing and maintenance, facilities maintenance, supplies purchasing, and other goods or services used in the operation of the business. Generally, these contracts are renewable or cancelable at least annually, although in some cases the Corporation has committed to contracts that may extend for several years to secure favorable pricing concessions. Purchase obligations amounted to $\$ 155$ million at September 30, 2013 of which approximately $46 \%$ matures in 2013, $29 \%$ in 2014, $14 \%$ in 2015 and $11 \%$ thereafter.

The Corporation also enters into derivative contracts under which it is required either to receive or pay cash, depending on changes in interest rates. These contracts are carried at fair value on the consolidated statement of financial condition with the fair value representing the net present value of the expected future cash receipts and payments based on market rates of interest as of the statement of condition date. The fair value of the contract changes daily as interest rates change. The Corporation may also be required to post additional collateral on margin calls on the derivatives and repurchase transactions.

Refer to Note 15 for a breakdown of long-term borrowings by maturity.
The Corporation utilizes lending-related financial instruments in the normal course of business to accommodate the financial needs of its customers. The Corporation s exposure to credit losses in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit and commercial letters of credit is represented by the contractual notional amount of these instruments. The Corporation uses credit procedures and policies in making those commitments and conditional obligations as it does in extending loans to customers. Since many of the commitments may expire without being drawn upon, the total contractual amounts are not representative of the Corporation sactual future credit exposure or liquidity requirements for these commitments.

Table 23 presents the contractual amounts related to the Corporation s off-balance sheet lending and other activities at September 30, 2013.

Table 23 Off-Balance Sheet Lending and Other Activities

Edgar Filing: POPULAR INC - Form 10-Q

| (In millions) | Amount of commitment - Expiration Period |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { Remaining } \\ 2013 \end{gathered}$ | $\begin{gathered} \text { Years } 2014- \\ 2016 \end{gathered}$ |  | $\begin{gathered} \text { Years } 2017-19 \\ 2019 \end{gathered}$ |  | Years 2020 thereafter |  | Total |
| Commitments to extend credit | \$4,338 | \$ | 2,692 | \$ | 182 | \$ | 75 | \$7,287 |
| Commercial letters of credit | 4 |  |  |  |  |  |  | 4 |
| Standby letters of credit | 25 |  | 52 |  |  |  |  | 77 |
| Commitments to originate or fund mortgage loans | 26 |  | 13 |  |  |  |  | 39 |
| Unfunded investment obligations | 1 |  | 9 |  |  |  |  | 10 |
| Total | \$ 4,394 | \$ | 2,766 | \$ | 182 | \$ | 75 | \$ 7,417 |

## Table of Contents

At September 30, 2013, the Corporation maintained a reserve of approximately $\$ 4$ million for probable losses associated with unfunded loan commitments related to commercial and consumer lines of credit. The estimated reserve is principally based on the expected draws on these facilities using historical trends and the application of the corresponding reserve factors determined under the Corporation s allowance for loan losses methodology. This reserve for unfunded loan commitments remains separate and distinct from the allowance for loan losses and is reported as part of other liabilities in the consolidated statement of financial condition.

Refer to Note 21 to the consolidated financial statements for additional information on credit commitments and contingencies.

## Guarantees associated with loans sold / serviced

At September 30, 2013, the Corporation serviced $\$ 2.6$ billion in residential mortgage loans subject to lifetime credit recourse provisions, principally loans associated with FNMA and FHLMC residential mortgage loan securitization programs, compared with $\$ 2.9$ billion at December 31, 2012. The Corporation s last sale of mortgage loans subject to credit recourse was in 2009.

In the event of any customer default, pursuant to the credit recourse provided, the Corporation is required to repurchase the loan or reimburse the third party investor for the incurred loss. The maximum potential amount of future payments that the Corporation would be required to make under the recourse arrangements in the event of nonperformance by the borrowers is equivalent to the total outstanding balance of the residential mortgage loans serviced with recourse and interest, if applicable. In the event of nonperformance by the borrower, the Corporation has rights to the underlying collateral securing the mortgage loan. The Corporation suffers losses on these loans when the proceeds from a foreclosure sale of the property underlying a defaulted mortgage loan are less than the outstanding principal balance of the loan plus any uncollected interest advanced and the costs of holding and disposing the related property.

In the case of Puerto Rico, most claims are settled by repurchases of delinquent loans, the majority of which are greater than 90 days past due. The average time period to prepare an initial response to a repurchase request is from 30 to 120 days from the initial written notice depending on the type of repurchase request. Failure by the Corporation to respond to a request for repurchase on a timely basis could result in a deterioration of the seller/servicer relationship and the seller/servicer s overall standing. In certain instances, investors could require additional collateral to ensure compliance with the servicer s repurchase obligation or cancel the seller/servicer license and exercise their rights to transfer the servicing to an eligible seller/servicer.

Table 24 below presents the delinquency status of the residential mortgage loans serviced by the Corporation that are subject to lifetime credit recourse provisions.

Table 24 Delinquency of Residential Mortgage Loans Subject to Lifetime Credit Recourse

| (In thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :--- | :---: | :---: | :---: | :---: |
| Total portfolio | $\$$ | $2,625,262$ | $\$$ | $2,932,555$ |
| Days past due: | $\$$ | 371,029 | $\$$ | 412,313 |
| 30 days and over | $\$$ | 141,054 | $\$$ | 158,679 |

As a percentage of total portfolio:

| 30 days past due or more | $14.13 \%$ | $14.06 \%$ |
| :--- | ---: | ---: |
| 90 days past due or more | $5.37 \%$ | $5.41 \%$ |

During the nine months ended September 30, 2013, the Corporation repurchased approximately $\$ 95$ million (unpaid principal balance) in mortgage loans subject to the credit recourse provisions, compared with $\$ 115$ million during the same period of 2012. There are no particular loan characteristics, such as loan vintages, loan type, loan-to-value ratio, or other criteria, that denote any specific trend or a concentration of repurchases in any particular segment. Based on historical repurchase experience, the loan delinquency status is the main factor which causes the repurchase request. In 2011 and 2012, the Corporation experienced an increase in mortgage loan repurchases from recourse portfolios that led to increases in non-performing mortgage loans. The deteriorating economic conditions in those years provoked a closer monitoring by investors of loan performance and recourse triggers, thus causing an increase in loan repurchases. Once the loans are repurchased, they are put through the Corporation s loss mitigation programs.

## Table of Contents

At September 30, 2013, there were 5 outstanding unresolved claims related to the credit recourse portfolio with a principal balance outstanding of $\$ 0.9$ million, compared with 59 and $\$ 8.0$ million, respectively, at December 31, 2012. The outstanding unresolved claims at September 30, 2013 and December 31, 2012 pertained to FNMA.

At September 30, 2013, the Corporation s liability established to cover the estimated credit loss exposure related to loans sold or serviced with credit recourse amounted to $\$ 44$ million, compared with $\$ 52$ million at December 31, 2012.

The following table presents the changes in the Corporation s liability for estimated losses related to loans serviced with credit recourse provisions for the quarters and nine months periods ended September 30, 2013 and 2012.

Table 25 Changes in Liability of Estimated Losses from Credit Recourse Agreements

| (In thousands) | Quarters ended September 30Nine months ended September 30, |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 |  | 2012 |  | 2013 |  | 2012 |  |
| Balance as of beginning of period | \$ | 45,892 | \$ | 55,783 | \$ | 51,673 | \$ | 58,659 |
| Additions for new sales |  |  |  |  |  |  |  |  |
| Provision for recourse liability |  | 5,180 |  | 5,576 |  | 15,965 |  | 15,138 |
| Net charge-offs / terminations |  | $(7,243)$ |  | $(5,068)$ |  | $(23,809)$ |  | $(17,506)$ |
| Balance as of end of period | \$ | 43,829 | \$ | 56,291 | \$ | 43,829 | \$ | 56,291 |

The provision for credit recourse liability remained stable, increasing slightly for the nine months ended September 30, 2013, when compared with the same period in 2012, as this portfolio continues to show credit quality stabilization.

The estimated losses to be absorbed under the credit recourse arrangements are recorded as a liability when the loans are sold or credit recourse is assumed as part of acquired servicing rights and are updated by accruing or reversing expense (categorized in the line item adjustments (expense) to indemnity reserves on loans sold in the consolidated statements of operations) throughout the life of the loan, as necessary, when additional relevant information becomes available. The methodology used to estimate the recourse liability is a function of the recourse arrangements given and considers a variety of factors, which include actual defaults and historical loss experience, foreclosure rate, estimated future defaults and the probability that a loan would be delinquent. Statistical methods are used to estimate the recourse liability. Expected loss rates are applied to different loan segmentations. 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 90 days delinquent within the following twelve-month period. Regression analysis quantifies the relationship between the default event and loan-specific characteristics, including credit scores, loan-to-value ratios and loan aging, among others.

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 FHLMC, require the Corporation 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, 2013, the Corporation serviced $\$ 17.1$ billion in mortgage loans for third-parties, including the loans serviced with credit recourse, compared with $\$ 16.7$ billion at December 31, 2012. The Corporation generally recovers funds advanced pursuant to these arrangements from the mortgage borrower, from liquidation proceeds when the mortgage loan is foreclosed or, in the case of FHA/VA loans, under the applicable FHA and VA
insurance and guarantees programs. However, in the meantime, the Corporation must absorb the cost of the funds it advances during the time the advance is outstanding. The Corporation must also bear the costs of attempting to collect on delinquent and defaulted mortgage loans. In addition, if a defaulted loan is not cured, the mortgage loan would be canceled as part of the foreclosure proceedings and the Corporation would not receive any future servicing income with respect to that loan. At September 30, 2013, the outstanding balance of funds advanced by the Corporation under such mortgage loan servicing agreements was approximately $\$ 29$ million, compared with $\$ 19$ million at December 31, 2012. To the extent the mortgage loans underlying the Corporation s servicing portfolio experience increased delinquencies, the Corporation 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.

## Table of Contents

When the Corporation sells or securitizes mortgage loans, it generally makes customary representations and warranties regarding the characteristics of the loans sold. The Corporation s mortgage operations in Puerto Rico conform mortgage loans into pools which are exchanged for FNMA and GNMA mortgage-backed securities, which are generally sold to private investors, or are sold directly to FNMA for cash. As required under the government agency programs, quality review procedures are performed by the Corporation to ensure that asset guideline qualifications are met. To the extent the loans do not meet specified characteristics, the Corporation may be required to repurchase such loans or indemnify for losses and bear any subsequent loss related to the loans. Repurchases under representation and warranty arrangements in which the Corporation s Puerto Rico banking subsidiaries were required to repurchase the loans amounted to $\$ 4.0$ million in unpaid principal balance with losses amounting to $\$ 0.8$ million during the nine months period ended September 30, 2013. A substantial amount of these loans reinstate to performing status or have mortgage insurance, and thus the ultimate losses on the loans are not deemed significant.

During the quarter ended June 30, 2013, the Corporation established a reserve for certain specific representation and warranties made in connection with BPPR s sale of non-performing mortgage loans. The purchaser s sole remedy under the indemnity clause is to seek monetary damages from BPPR, for a maximum of $\$ 16.3$ million. BPPR recognized a reserve of approximately $\$ 3.0$ million, representing its best estimate of the loss that would be incurred in connection with this indemnification. BPPR s obligations under this clause end one year after the closing except to any claim asserted prior to such termination date.

During the quarter ended March 31, 2013, the Corporation established a reserve for certain specific representation and warranties made in connection with BPPR s sale of commercial and construction loans, and commercial and single family real estate owned. The purchaser s sole remedy under the indemnity clause is to seek monetary damages from BPPR, for a maximum of $\$ 18.0$ million. BPPR is not required to repurchase any of the assets. BPPR recognized a reserve of approximately $\$ 10.7$ million, representing its best estimate of the loss that would be incurred in connection with this indemnification. BPPR s obligations under this clause end one year after the closing except to any claim asserted prior to such termination date.

Also, during the quarter ended June 30, 2011, the Corporation s banking subsidiary, BPPR, reached an agreement (the June 2011 agreement ) with the FDIC, as receiver for a local Puerto Rico institution, and the financial institution with respect to a loan servicing portfolio that BPPR services since 2008, related to FHLMC and GNMA pools. The loans were originated and sold by the financial institution and the servicing rights were transferred to BPPR in 2008. As part of the 2008 servicing agreement, the financial institution was required to repurchase from BPPR any loans that BPPR, as servicer, was required to repurchase from the investors under representation and warranty obligations. As part of the June 2011 agreement, the Corporation received cash to discharge the financial institution from any repurchase obligation and other claims over the serviced portfolio.

The following table presents the changes in the Corporation s liability for estimated losses associated with indemnifications and customary representations and warranties related to loans sold by BPPR for the quarters and nine month periods ended September 30, 2013 and 2012.

Table 26 Changes in Liability of Estimated Losses from Indemnifications and Customary Representations and
Warranties Agreements

|  | Quarters ended September 30,ine months ended September 30, |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2013 | 2012 | 2013 | 2012 |  |  |
| Balance as of beginning of period | $\$$ | 20,959 | $\$$ | 8,179 | $\$$ | 7,587 |


| Additions for new sales |  |  | 13,747 |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Provision (reversal) for representation and |  |  |  |  |  |
| warranties | $(1,100)$ | 110 | $(975)$ | 356 |  |
| Net charge-offs / terminations | $(945)$ | $(327)$ | $(1,445)$ | $(916)$ |  |
| Balance as of end of period | $\$ 18,914$ | $\$$ | 7,962 | $\$$ | 18,914 |

In addition, at September 30, 2013, the Corporation has reserves for customary representations and warranties related to loans sold by its U.S. subsidiary E-LOAN prior to 2009. Loans were sold to investors on a servicing released basis subject to certain representations and warranties. Although the risk of loss or default was generally assumed by the investors, the Corporation made certain representations relating to borrower creditworthiness, loan documentation and collateral, which if not correct, may result in requiring the Corporation to repurchase the loans or indemnify investors for any related losses associated with these loans. At September 30, 2013 and December 31, 2012, the Corporation s reserve for estimated losses from such representation and warranty arrangements amounted to $\$ 7$ million and $\$ 8$ million, respectively. E-LOAN is no longer originating and selling loans since the subsidiary ceased these activities in 2008 and most of the outstanding agreements with major counterparties were settled during 2010 and 2011.

## Table of Contents

On a quarterly basis, the Corporation reassesses its estimate for expected losses associated with E-LOAN s customary representation and warranty arrangements. The analysis incorporates expectations on future disbursements based on quarterly repurchases and make-whole events. The analysis also considers factors such as the average length of time between the loan s funding date and the loan repurchase date, as observed in the historical loan data. The liability is estimated as follows: (1) three year average of disbursement amounts (two year historical and one year projected) are used to calculate an average quarterly amount; (2) the quarterly average is annualized and multiplied by the repurchase distance, which currently averages approximately three years, to determine a liability amount; and (3) the calculated reserve is compared to current claims and disbursements to evaluate adequacy. The Corporation s success rate in clearing the claims in full or negotiating lesser payouts has been fairly consistent. On average, the Corporation avoided paying on $59 \%$ of claimed amounts during the 24-month period ended September 30, 2013 ( $40 \%$ during the 24 -month period ended December 31, 2012). On the remaining $41 \%$ of claimed amounts, the Corporation either repurchased the balance in full or negotiated settlements. For the accounts where the Corporation settled, it averaged paying $62 \%$ of claimed amounts during the 24-month period ended September 30, 2013 ( $60 \%$ during the 24-month period ended December 31, 2012). In total, during the 24-month period ended September 30, 2013, the Corporation paid an average of 27\% of claimed amounts (24-month period ended December 31, 2012-33\%).

E-LOAN s outstanding unresolved claims related to representation and warranty obligations from mortgage loan sales prior to 2009 are presented in Table 27.

Table 27 E-LOAN s Outstanding Unresolved Claims from Loans Sold

| (In thousands) |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| By Counterparty: | Sept | 30, 2013 | Dec | 31, 2012 |
| GSEs | \$ | 527 | \$ | 1,270 |
| Whole loan and private-label securitization investors |  | 1,408 |  | 533 |
| Total outstanding claims by counterparty | \$ | 1,935 | \$ | 1,803 |
| By Product Type: |  |  |  |  |
| 1st lien (Prime loans) | \$ | 1,935 | \$ | 1,803 |
| Total outstanding claims by product type | \$ | 1,935 | \$ | 1,803 |

The outstanding claims balance from private-label investors are comprised by one counterparty at September 30, 2013 and two counterparties at December 31, 2012.

In the case of E-LOAN, the Corporation indemnifies the lender, repurchases the loan, or settles the claim, generally for less than the full amount. Each repurchase case is different and each lender / servicer has different requirements. The large majority of the loans repurchased have been greater than 90 days past due at the time of repurchase and are included in the Corporation s non-performing loans. Historically, claims have been predominantly for first mortgage agency loans and principally consist of underwriting errors related to undisclosed debt or missing documentation. The following table presents the changes in the Corporation s liability for estimated losses associated with customary representations and warranties related to loans sold by E-LOAN for the quarters and nine month periods ended September 30, 2013 and 2012.

## Table 28 Changes in Liability for Estimated Losses Related to Loans Sold by E-LOAN

| (In thousands) | Quarters ended September 30,Nine months ended September 30 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 |  | 2012 |  | 2013 |  | 2012 |  |
| Balance as of beginning of period | \$ | 8,760 | \$ | 10,131 | \$ | 7,740 | \$ | 10,625 |
| Additions for new sales |  |  |  |  |  |  |  |  |
| Provision (reversal) for representation and warranties |  | $(1,710)$ |  | $(1,841)$ |  | 314 |  | $(1,841)$ |
| Net charge-offs / terminations |  | (1) |  | (1) |  | $(1,005)$ |  | (495) |
| Balance as of end of period | \$ | 7,049 | \$ | 8,289 | \$ | 7,049 | \$ | 8,289 |

## Table of Contents

## MARKET RISK

The financial results and capital levels of Popular, Inc. are constantly exposed to market risk. Market risk represents the risk of loss due to adverse movements in market rates or financial asset prices, which include interest rates, foreign exchange rates, and bond and equity security prices; the failure to meet financial obligations coming due because of the inability to liquidate assets or obtain adequate funding; and the inability to easily unwind or offset specific exposures without significantly lowering prices because of inadequate market depth or market disruptions.

While the Corporation is exposed to various business risks, the risks relating to interest rate risk and liquidity are major risks that can materially impact future results of operations and financial condition due to their complexity and dynamic nature.

The Asset Liability Management Committee ( ALCO ) and the Corporate Finance Group are responsible for planning and executing the Corporation s market, interest rate risk, funding activities and strategy, and for implementing the policies and procedures approved by the Corporation s Risk Management Committee. In addition, the Risk Management Group independently monitors and reports adherence with established market and liquidity policies and recommends actions to enhance and strengthen controls surrounding interest, liquidity, and market risks. The ALCO meets mostly on a weekly basis and reviews the Corporation s current and forecasted asset and liability positions as well as desired pricing strategies and other relevant topics. Also, on a monthly basis the ALCO reviews various interest rate risk metrics, ratios and portfolio information, including but not limited to, the Corporation s liquidity positions, projected sources and uses of funds, interest rate risk positions and economic conditions.

Interest rate risk ( IRR ), a component of market risk, is considered by management as a predominant market risk in terms of its potential impact on profitability or market value. Management utilizes various tools to assess IRR, including simulation modeling, static gap analysis, and Economic Value of Equity ( EVE ). The three methodologies complement each other and are use jointly in the evaluation of the Corporation SIRR. Simulation modeling is prepared for a five year period, which in conjunction with the EVE analysis, provides Management a better view of long term IRR.

Net interest income simulation analysis performed by legal entity and on a consolidated basis is a tool used by the Corporation in estimating the potential change in future net interest income resulting from hypothetical changes in interest rates. Sensitivity analysis is calculated using a simulation model which incorporates actual balance sheet figures detailed by maturity and interest yields or costs. It also incorporates assumptions on balance sheet growth and expected changes in its composition, estimated prepayments in accordance with projected interest rates, pricing and maturity expectations on new volumes and other non-interest related data.

Management assesses interest rate risk using various interest rate scenarios that differ in magnitude and direction, the speed of change and the projected shape of the yield curve. For example, the types of interest rate scenarios processed include most likely economic scenarios, flat or unchanged rates, yield curve twists, +200 and +400 basis points parallel ramps and +200 and +400 basis points parallel shocks. Given the fact that during the quarter ended September 30, 2013, some market interest rates were close to zero, management has focused on measuring the risk on net interest income in rising rate scenarios. Management also performs analyses to isolate and measure basis and prepayment risk exposures.

The asset and liability management group also evaluates the reasonableness of assumptions used and results obtained in the monthly sensitivity analyses. In addition, the model and processes used to assess IRR are subject to third-party validations according to the guidelines established in the Model Governance and Validation policy. Due to the importance of critical assumptions in measuring market risk, the risk models incorporate third-party developed data
for critical assumptions such as prepayment speeds on mortgage loans and mortgage-backed securities, estimates on the duration of the Corporation s deposits and interest rate scenarios.

The Corporation runs net interest income simulations under interest rate scenarios in which the yield curve is assumed to rise gradually by the same amount. The rising rate scenarios considered in these market risk disclosures reflect gradual parallel changes of 200 and 400 basis points during the twelve-month period ending September 30, 2014. Under a 200 basis points rising rate scenario, projected net interest income increases by $\$ 31$ million, while under a 400 basis points rising rate scenario, projected net interest income increases by $\$ 50$ million, when compared against the Corporation sflat or unchanged interest rates forecast scenario. These interest rate simulations exclude the impact on loans accounted pursuant to ASC Subtopic 310-30, whose yields are based on management s current expectation of future cash flows.

Simulation analyses are based on many assumptions, including relative levels of market interest rates, interest rate spreads, loan prepayments and deposit decay. They should not be relied upon as indicative of actual results. Further, the estimates do not contemplate actions that management could take to respond to changes in interest rates. By their nature, these forward-looking computations are only estimates and may be different from what may actually occur in the future.

## Table of Contents

The Corporation estimates the sensitivity of economic value of equity to changes in interest rates. EVE is equal to the estimated present value of the Corporation s assets minus the estimated present value of the liabilities. This sensitivity analysis is a useful tool to measure long-term IRR because it captures the impact of rate changes in expected cash flows from all future periods, including principal and interest.

EVE sensitivity using interest rate shock scenarios is estimated on a quarterly basis. The current EVE sensitivity is focused on rising 200 and 400 basis point parallel shocks. Management has a defined limit for the increase in EVE sensitivity resulting from the shock scenario.

The Corporation maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in net interest income or market value that are caused by interest rate volatility. The market value of these derivatives is subject to interest rate fluctuations and counterparty credit risk adjustments which could have a positive or negative effect in the Corporation searnings.

## Trading

The Corporation engages in trading activities in the ordinary course of business at its subsidiaries, Banco Popular de Puerto Rico ( BPPR ) and Popular Securities. Popular Securities trading activities consist primarily of market-making activities to meet expected customers needs related to its retail brokerage business and purchases and sales of U.S. Government and government sponsored securities with the objective of realizing gains from expected short-term price movements. BPPR s trading activities consist primarily of holding U.S. Government sponsored mortgage-backed securities classified as trading and hedging the related market risk with TBA (to-be-announced) market transactions. The objective is to derive spread income from the portfolio and not to benefit from short-term market movements. In addition, BPPR uses forward contracts or TBAs to hedge its securitization pipeline. Risks related to variations in interest rates and market volatility are hedged with TBAs that have characteristics similar to that of the forecasted security and its conversion timeline.

At September 30, 2013, the Corporation held trading securities with a fair value of $\$ 339$ million, representing approximately $0.9 \%$ of the Corporation s total assets, compared with $\$ 315$ million and $0.9 \%$ at December 31, 2012. As shown in Table 29, the trading portfolio consists principally of mortgage-backed securities, which at September 30, 2013 were investment grade securities. As of September 30, 2013, the trading portfolio also included $\$ 13.2$ million in Puerto Rico government obligations and shares of Closed-end funds that invest primarily in Puerto Rico government obligations (December 31, 2012 - $\$ 33.7$ million). Trading instruments are recognized at fair value, with changes resulting from fluctuations in market prices, interest rates or exchange rates reported in current period earnings. The Corporation recognized a net trading account loss of $\$ 6.6$ million for the quarter ended September 30, 2013, compared with a gain of $\$ 5.4$ million for the same quarter in 2012. Table 29 provides the composition of the trading portfolio at September 30, 2013 and December 31, 2012.

## Table 29 Trading Portfolio

| (Dollars in thousands) | September 30, 2013 |  | December 31, 2012 |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amount | Weighted Average Yield[1] | Amount | Weighted verage Yield[1] |
| Mortgage-backed securities | \$ 309,988 | 4.93\% | \$ 262,863 | 4.64\% |
| Collateralized mortgage obligations | 1,941 | 4.67 | 3,117 | 4.57 |
| Commercial paper |  |  | 1,778 | 5.05 |

Edgar Filing: POPULAR INC - Form 10-Q

| Puerto Rico obligations | 9,464 | 5.07 | 24,801 | 4.74 |
| :--- | ---: | ---: | ---: | ---: |
| Interest-only strips | 959 | 10.08 | 1,136 | 11.40 |
| Other (includes related trading <br> derivatives) | 16,496 | 3.60 | 20,830 | 4.07 |
| Total | $\$ 338,848$ | $4.88 \%$ | $\$ 314,525$ | $4.64 \%$ |

[1] Not on a taxable equivalent basis.
The Corporation strading activities are limited by internal policies. For each of the two subsidiaries, the market risk assumed under trading activities is measured by the 5 -day net value-at-risk ( VAR ), with a confidence level of $99 \%$. The VAR measures the maximum estimated loss that may occur over a 5 -day holding period, given a $99 \%$ probability. Under the Corporation s current policies, trading exposures cannot exceed $2 \%$ of the trading portfolio market value of each subsidiary, subject to a cap.

## Table of Contents

The Corporation s trading portfolio had a 5-day VAR of approximately $\$ 2.1$ million, assuming a confidence level of $99 \%$, for the last week in September 2013. There are numerous assumptions and estimates associated with VAR modeling, and actual results could differ from these assumptions and estimates. Backtesting is performed to compare actual results against maximum estimated losses, in order to evaluate model and assumptions accuracy.

In the opinion of management, the size and composition of the trading portfolio does not represent a significant source of market risk for the Corporation.

## FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS

The Corporation currently measures at fair value on a recurring basis its trading assets, available-for-sale securities, derivatives, mortgage servicing rights and contingent consideration. Occasionally, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as loans held-for-sale, impaired loans held-in-portfolio that are collateral dependent and certain other assets. These nonrecurring fair value adjustments typically result from the application of lower of cost or fair value accounting or write-downs of individual assets.

The Corporation categorizes its assets and liabilities measured at fair value under the three-level hierarchy. The level within the hierarchy is based on whether the inputs to the valuation methodology used for fair value measurement are observable.

Refer to Note 24 to the consolidated financial statements for information on the Corporation s fair value measurement disclosures required by the applicable accounting standard. At September 30, 2013, approximately $\$ 5.5$ billion, or $97 \%$, of the assets measured at fair value on a recurring basis used market-based or market-derived valuation inputs in their valuation methodology and, therefore, were classified as Level 1 or Level 2. The majority of instruments measured at fair value were classified as Level 2, including U.S. Treasury securities, obligations of U.S. Government sponsored entities, obligations of Puerto Rico, States and political subdivisions, most mortgage-backed securities ( MBS ) and collateralized mortgage obligations ( CMOs ), and derivative instruments.

At September 30, 2013, the remaining 3\% of assets measured at fair value on a recurring basis were classified as Level 3 since their valuation methodology considered significant unobservable inputs. The financial assets measured as Level 3 included mostly tax-exempt GNMA mortgage-backed securities and mortgage servicing rights ( MSRs ). Additionally, the Corporation reported $\$ 32$ million of financial assets that were measured at fair value on a nonrecurring basis at September 30, 2013, all of which were classified as Level 3 in the hierarchy.

Broker quotes used for fair value measurements inherently reflect any lack of liquidity in the market since they represent an exit price from the perspective of the market participants. Financial assets that were fair valued using broker quotes amounted to $\$ 32$ million at September 30, 2013, of which $\$ 18$ million were Level 3 assets and $\$$ 14 million were Level 2 assets. Level 3 assets consisted principally of tax-exempt GNMA mortgage-backed securities. Fair value for these securities was based on an internally-prepared matrix derived from an average of two indicative local broker quotes. The main input used in the matrix pricing was non-binding local broker quotes obtained from limited trade activity. Therefore, these securities were classified as Level 3.

During the quarter and nine months ended September 30, 2013, there were no transfers in and/or out of Level 1, Level 2 and Level 3 for financial instruments measured at fair value on a recurring basis. Refer to the Critical Accounting Policies / Estimates in the 2012 Annual Report for additional information on the accounting guidance and the Corporation s policies or procedures related to fair value measurements.

Trading Account Securities and Investment Securities Available-for-Sale

The majority of the values for trading account securities and investment securities available-for-sale are obtained from third-party pricing services and are validated with alternate pricing sources when available. Securities not priced by a secondary pricing source are documented and validated internally according to their significance to the Corporation s financial statements. Management has established materiality thresholds according to the investment class to monitor and investigate material deviations in prices obtained from the primary pricing service provider and the secondary pricing source used as support for the valuation results. During the quarter and nine months ended September 30, 2013, the Corporation did not adjust any prices obtained from pricing service providers or broker dealers.

## Table of Contents

Inputs are evaluated to ascertain that they consider current market conditions, including the relative liquidity of the market. When a market quote for a specific security is not available, the pricing service provider generally uses observable data to derive an exit price for the instrument, such as benchmark yield curves and trade data for similar products. To the extent trading data is not available, the pricing service provider relies on specific information including dialogue with brokers, buy side clients, credit ratings, spreads to established benchmarks and transactions on similar securities, to draw correlations based on the characteristics of the evaluated instrument. If for any reason the pricing service provider cannot observe data required to feed its model, it discontinues pricing the instrument. During the quarter and nine months ended September 30, 2013, none of the Corporation s investment securities were subject to pricing discontinuance by the pricing service providers. The pricing methodology and approach of our primary pricing service providers is concluded to be consistent with the fair value measurement guidance.

Furthermore, management assesses the fair value of its portfolio of investment securities at least on a quarterly basis, which includes analyzing changes in fair value that have resulted in losses that may be considered other-than-temporary. Factors considered include, for example, the nature of the investment, severity and duration of possible impairments, industry reports, sector credit ratings, economic environment, creditworthiness of the issuers and any guarantees.

Securities are classified in the fair value hierarchy according to product type, characteristics and market liquidity. At the end of each period, management assesses the valuation hierarchy for each asset or liability measured. The fair value measurement analysis performed by the Corporation includes validation procedures and review of market changes, pricing methodology, assumption and level hierarchy changes, and evaluation of distressed transactions.

At September 30, 2013, the Corporation sportfolio of trading and investment securities available-for-sale amounted to $\$ 5.5$ billion and represented $97 \%$ of the Corporation s assets measured at fair value on a recurring basis. At September 30, 2013, net unrealized gains on the trading securities approximately $\$ 6$ million and net unrealized losses on available-for-sale investment securities portfolios approximated $\$ 5$ million. Fair values for most of the Corporation strading and investment securities available-for-sale were classified as Level 2. Trading and investment securities available-for-sale classified as Level 3, which were the securities that involved the highest degree of judgment, represented less than $1 \%$ of the Corporation s total portfolio of trading and investment securities available-for-sale.

## Mortgage Servicing Rights

Mortgage servicing rights ( MSRs ), which amounted to $\$ 161$ million at September 30, 2013, do not trade in an active, open market with readily observable prices. Fair value is estimated based upon discounted net cash flows calculated from a combination of loan level data and market assumptions. The valuation model combines loans with common characteristics that impact servicing cash flows (e.g. investor, remittance cycle, interest rate, product type, etc.) in order to project net cash flows. Market valuation assumptions include prepayment speeds, discount rate, cost to service, escrow account earnings, and contractual servicing fee income, among other considerations. Prepayment speeds are derived from market data that is more relevant to the U.S. mainland loan portfolios and, thus, are adjusted for the Corporation s loan characteristics and portfolio behavior since prepayment rates in Puerto Rico have been historically lower. Other assumptions are, in the most part, directly obtained from third-party providers. Disclosure of two of the key economic assumptions used to measure MSRs, which are prepayment speed and discount rate, and a sensitivity analysis to adverse changes to these assumptions, is included in Note 11 to the consolidated financial statements.

## Derivatives

Derivatives, such as interest rate swaps and indexed options, are traded in over-the-counter active markets. These derivatives are indexed to an observable interest rate benchmark, such as LIBOR or equity indexes, and are priced using an income approach based on present value and option pricing models using observable inputs. Other derivatives are liquid and have quoted prices, such as forward contracts or to be announced securities ( TBAs ). All of these derivatives held by the Corporation were classified as Level 2. Valuations of derivative assets and liabilities reflect the values associated with counterparty risk and nonperformance risk, respectively. The non-performance risk, which measures the Corporation s own credit risk, is determined using internally-developed models that consider the net realizable value of the collateral posted, remaining term, and the creditworthiness or credit standing of the Corporation. The counterparty risk is also determined using internally-developed models which incorporate the creditworthiness of the entity that bears the risk, net realizable value of the collateral received, and available public data or internally-developed data to determine their probability of default. To manage the level of credit risk, the Corporation employs procedures for credit approvals and credit limits, monitors the counterparties credit condition, enters into master netting agreements whenever possible and, when appropriate, requests additional collateral. During the quarter ended September 30, 2013, inclusion of

## Table of Contents

credit risk in the fair value of the derivatives resulted in a net loss of $\$ 0.6$ million recorded in the other operating income and interest expense captions of the consolidated statement of operations, which consisted of a loss of $\$ 0.7$ million from the assessment of the counterparties credit risk and a gain of $\$ 0.1$ million resulting from the Corporation s own credit standing adjustment. During the nine months ended September 30, 2013, inclusion of credit risk in the fair value of the derivatives resulted in a net gain of $\$ 0.9$ million recorded in the other operating income and interest expense captions of the consolidated statement of operations, which consisted of a gain of $\$ 0.6$ million resulting from assessment of the counterparties credit risk and a gain of $\$ 0.3$ million resulting from the Corporation s own credit standing adjustment.

## Loans held-in-portfolio considered impaired under ASC Section 310-10-35 that are collateral dependent

The impairment is 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, size and supply and demand. Deterioration of the housing markets and the economy in general have adversely impacted and continue to affect the market activity related to real estate properties. These collateral dependent impaired loans are classified as Level 3 and are reported as a nonrecurring fair value measurement.

## LIQUIDITY

The objective of effective liquidity management is to ensure that the Corporation has sufficient liquidity to meet all of its financial obligations, finance expected future growth and maintain a reasonable safety margin for cash commitments under both normal and stressed market conditions. The Board is responsible for establishing the Corporation s tolerance for liquidity risk, including approving relevant risk limits and policies. The Board has delegated the monitoring of these risks to the Risk Management Committee and the ALCO. The management of liquidity risk, on a long-term and day-to-day basis, is the responsibility of the Corporate Treasury Division. The Corporation s Corporate Treasurer is responsible for implementing the policies and procedures approved by the Board and for monitoring the Corporation s liquidity position on an ongoing basis. Also, the Corporate Treasury Division coordinates corporate wide liquidity management strategies and activities with the reportable segments, oversees policy breaches and manages the escalation process. The Financial and Operational Risk Management Division is responsible for the independent monitoring and reporting of adherence with established policies.

An institution s liquidity may be pressured if, for example, its credit rating is downgraded, it experiences a sudden and unexpected substantial cash outflow, or some other event causes counterparties to avoid exposure to the institution. Factors that the Corporation does not control, such as the economic outlook of its principal markets and regulatory changes, could affect its ability to obtain funding.

Liquidity is managed by the Corporation at the level of the holding companies that own the banking and non-banking subsidiaries. Also, it is managed at the level of the banking and non-banking subsidiaries. The Corporation has adopted policies and limits to monitor more effectively the Corporation s liquidity position and that of the banking subsidiaries. Additionally, contingency funding plans are used to model various stress events of different magnitudes and affecting different time horizons that assist management in evaluating the size of the liquidity buffers needed if those stress events occur. However, such models may not predict accurately how the market and customers might react to every event, and are dependent on many assumptions.

Deposits, including customer deposits, brokered deposits, and public funds deposits, continue to be the most significant source of funds for the Corporation, funding 73\% of the Corporation s total assets at September 30, 2013 and $74 \%$ at December 31, 2012. The ratio of total ending loans to deposits was $93 \%$ at September 30, 2013 and December 31, 2012. In addition to traditional deposits, the Corporation maintains borrowing arrangements. At

Edgar Filing: POPULAR INC - Form 10-Q
September 30, 2013, these borrowings consisted primarily of federal funds purchased and assets sold under agreement to repurchase of $\$ 1.8$ billion, advances with the FHLB of $\$ 1.4$ billion, junior subordinated deferrable interest debentures of $\$ 965$ million (net of discount of $\$ 411$ million) and term notes of $\$ 693$ thousand. A detailed description of the Corporation s borrowings, including their terms, is included in Note 15 to the consolidated financial statements. Also, the consolidated statements of cash flows in the accompanying consolidated financial statements provide information on the Corporation s cash inflows and outflows.

During the third quarter of 2013, the Corporation s liquidity position remained strong. The Corporation executed several strategies to deploy excess liquidity at its banking subsidiaries and improve the Corporation s net interest margin. During the third quarter of 2013, the Corporation prepaid $\$ 233.2$ million in senior notes at Popular North America, which is expected to result in cost savings and improvements in net interest margin. During this quarter, the Corporation increased its level of advances with the FHLB of NY and lowered its levels of repurchase agreements as part of its funding strategies.

## Table of Contents

The following sections provide further information on the Corporation s major funding activities and needs, as well as the risks involved in these activities. A detailed description of the Corporation s borrowings and available lines of credit, including its terms, is included in Note 15 to the consolidated financial statements. Also, the consolidated statements of cash flows in the accompanying consolidated financial statements provide information on the Corporation s cash inflows and outflows.

## Banking Subsidiaries

Primary sources of funding for the Corporation s banking subsidiaries (BPPR and BPNA), or the banking subsidiaries, include retail and commercial deposits, brokered deposits, collateralized borrowings, unpledged investment securities, and, to a lesser extent, loan sales. In addition, the Corporation maintains borrowing facilities with the FHLB and at the Federal Reserve s Discount Window, and has a considerable amount of collateral pledged that can be used to quickly raise funds under these facilities.

The principal uses of funds for the banking subsidiaries include loan originations, investment portfolio purchases, loan purchases and repurchases, repayment of outstanding obligations (including deposits), and operational expenses. Also, the banking subsidiaries assume liquidity risk related to collateral posting requirements for certain activities mainly in connection with contractual commitments, recourse provisions, servicing advances, derivatives, credit card licensing agreements and support to several mutual funds administered by BPPR.

Note 35 to the consolidated financial statements provides a consolidating statement of cash flows which includes the Corporation s banking subsidiaries as part of the All other subsidiaries and eliminations column.

The banking subsidiaries maintain sufficient funding capacity to address large increases in funding requirements such as deposit outflows. This capacity is comprised mainly of available liquidity derived from secured funding sources, as well as on-balance sheet liquidity in the form of cash balances maintained at the Fed and unused secured lines held at the Fed and FHLB, in addition to liquid unpledged securities. The Corporation has established liquidity guidelines that require the banking subsidiaries to have sufficient liquidity to cover all short-term borrowings and a portion of deposits.

The Corporation s ability to compete successfully in the marketplace for deposits depends on various factors, including pricing, service, convenience and financial stability as reflected by capital operating results, credit ratings (by nationally recognized credit rating agencies), and importantly, FDIC deposit insurance. Although a downgrade in the credit ratings of the Corporation s banking subsidiaries may impact their ability to raise retail and commercial deposits or the rate that it is required to pay on such deposits, management does not believe that the impact should be material. Deposits at all of the Corporation $s$ banking subsidiaries are federally insured (subject to FDIC limits) and this is expected to mitigate the effect of a potential downgrade in the credit ratings.

Deposits are a key source of funding as they tend to be less volatile than institutional borrowings and their cost is less sensitive to changes in market rates. Refer to Table 19 for a breakdown of deposits by major types. Core deposits are generated from a large base of consumer, corporate and institutional customers. For purposes of defining core deposits, the Corporation excludes brokered deposits with denominations under $\$ 100,000$. Core deposits have historically provided the Corporation with a sizable source of relatively stable and low-cost funds. Core deposits totaled $\$ 21.9$ billion, or $83 \%$ of total deposits at September 30, 2013 and $\$ 21.8$ billion, or $81 \%$ of total deposits at December 31, 2012. Core deposits financed 70\% of the Corporation s earning assets at September 30, 2013 and $68 \%$ at December 31, 2012.

Certificates of deposit with denominations of $\$ 100,000$ and over at September 30, 2013 totaled $\$ 3.0$ billion, or $11 \%$ of total deposits and $\$ 3.2$ billion, or $12 \%$ at December 31, 2012. Their distribution by maturity at September 30, 2013 was as follows:

Table 30 Distribution by Maturity of Certificate of Deposits of $\$ 100,000$ and Over

| (In thousands) |  |
| :--- | ---: |
| 3 months or less | $\$ 1,256,647$ |
| 3 to 6 months | 419,044 |
| 6 to 12 months | 457,415 |
| Over 12 months | 820,729 |

## \$2,953,835

At September 30, 2013 and December 31, 2012, approximately 7\% and 8\%, respectively, of the Corporation s assets were financed by brokered deposits. The Corporation had $\$ 2.5$ billion in brokered deposits at September 30, 2013, compared with $\$ 2.8$ billion at December 31, 2012. In the event that any of the Corporation s banking subsidiaries regulatory capital ratios fall below those

## Table of Contents

required by a well-capitalized institution or are subject to capital restrictions by the regulators, that banking subsidiary faces the risk of not being able to raise or maintain brokered deposits and faces limitations on the rate paid on deposits, which may hinder the Corporation s ability to effectively compete in its retail markets and could affect its deposit raising efforts.

To the extent that the banking subsidiaries are unable to obtain sufficient liquidity through core deposits, the Corporation may meet its liquidity needs through short-term borrowings by pledging securities for borrowings under repurchase agreements, by pledging additional loans and securities through the available secured lending facilities, or by selling liquid assets. These measures are subject to availability of collateral.

The Corporation s banking subsidiaries have the ability to borrow funds from the FHLB. At September 30, 2013 and December 31, 2012, the banking subsidiaries had credit facilities authorized with the FHLB aggregating to $\$ 2.8$ billion based on assets pledged with the FHLB at those dates. Outstanding borrowings under these credit facilities totaled $\$ 1.4$ billion at September 30, 2013 and $\$ 1.2$ billion at December 31, 2012. Such advances are collateralized by loans held-in-portfolio, do not have restrictive covenants and do not have any callable features. At September 30, 2013 the credit facilities authorized with the FHLB were collateralized by $\$ 3.8$ billion in loans held-in-portfolio and $\$ 3.9$ billion at December 31, 2012. Refer to Note 15 to the consolidated financial statements for additional information on the terms of FHLB advances outstanding.

At September 30, 2013 and December 31, 2012, the Corporation s borrowing capacity at the Fed s Discount Window amounted to approximately $\$ 3.4$ billion and $\$ 3.1$ billion, respectively, which remained unused as of both dates. This facility is a collateralized source of credit that is highly reliable even under difficult market conditions. The amount available under this borrowing facility is dependent upon the balance of performing loans, securities pledged as collateral and the haircuts assigned to such collateral. At September 30, 2013 and December 31, 2012, this credit facility with the Fed was collateralized by $\$ 5.0$ billion and $\$ 4.7$ billion, respectively, in loans held-in-portfolio.

During the quarter ended September 30, 2013, the Corporation s bank holding companies did not make any capital contributions to BPNA or BPPR.

On July 25, 2011, PIHC and BPPR entered into a Memorandum of Understanding with the Federal Reserve Bank of New York and the Office of the Commissioner of Financial Institutions of Puerto Rico that requires the approval of these entities prior to the payment of any dividends by BPPR to PIHC. BPNA could not declare any dividends without the approval of the Federal Reserve Board.

At September 30, 2013, management believes that the banking subsidiaries had sufficient current and projected liquidity sources to meet their anticipated cash flow obligations, as well as special needs and off-balance sheet commitments, in the ordinary course of business and have sufficient liquidity resources to address a stress event. Although the banking subsidiaries have historically been able to replace maturing deposits and advances if desired, no assurance can be given that they would be able to replace those funds in the future if the Corporation s financial condition or general market conditions were to deteriorate. The Corporation sfinancial flexibility will be severely constrained if its banking subsidiaries are unable to maintain access to funding or if adequate financing is not available to accommodate future financing needs at acceptable interest rates. The banking subsidiaries also are required to deposit cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines because of market changes, the Corporation will be required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity. Finally, if management is required to rely more heavily on more expensive funding sources to meet its future growth, revenues may not increase proportionately to cover costs. In this case, profitability would be adversely affected.

## Westernbank FDIC-assisted Transaction and Impact on Liquidity

BPPR s liquidity may also be impacted by the loan payment performance and timing of claims made and receipt of reimbursements under the FDIC loss sharing agreements. Please refer to the Legal Proceedings section of Note 21 to the consolidated financial statements and to Part II, Item 1A - Risk factors herein for a description of an ongoing contractual dispute between BPPR and the FDIC which has impacted the timing of the payment of claims under the loss share agreements.

In the short-term, there may be a significant amount of the covered loans acquired in the FDIC-assisted transaction that will experience deterioration in payment performance, or will be determined to have inadequate collateral values to repay the loans. In such instances, the Corporation will likely no longer receive payments from the borrowers, which will impact cash flows. The loss sharing agreements will not fully offset the financial effects of such a situation. However, if a loan is subsequently charged-off or written down after the Corporation exhausts its best efforts at collection, the loss sharing agreements will cover $80 \%$ of the loss associated with the covered loans, offsetting most of any deterioration in the performance of the covered loans.

## Table of Contents

The effects of the loss sharing agreements on cash flows and operating results in the long-term will be similar to the short-term effects described above. The long-term effects that we may experience will depend primarily on the ability of the borrowers whose loans are covered by the loss sharing agreements to make payments over time. As the loss sharing agreements are in effect for a period of ten years for one-to-four family loans and five years for commercial, construction and consumer loans (with periods commencing on April 30, 2010), changing economic conditions will likely impact the timing of future charge-offs and the resulting reimbursements from the FDIC. Management believes that any recapture of interest income and recognition of cash flows from the borrowers or received from the FDIC on the claims filed may be recognized unevenly over this period, as management exhausts its collection efforts under the Corporation s normal practices.

## Bank Holding Companies

The principal sources of funding for the holding companies include cash on hand, investment securities, dividends received from banking and non-banking subsidiaries (subject to regulatory limits and authorizations) asset sales, credit facilities available from affiliate banking subsidiaries and proceeds from potential securities offerings.

The principal use of these funds include the repayment of debt, and interest payments to holders of senior debt and junior subordinated deferrable interest debentures (related to trust preferred securities) and capitalizing its banking subsidiaries. During the third quarter of 2013, Popular North America prepaid $\$ 233.2$ million in senior notes, incurring $\$ 3.4$ million in early cancellation payments. As mentioned above, this is expected to result in cost savings and improvements in the Corporation s net interest margin.

During the quarter ended September 30, 2013 PIHC received cash proceeds of $\$ 197$ million from the sale of EVERTEC s shares in connection with their secondary public offering. Also, during the quarter ended June 30, 2013, in connection with EVERTEC s IPO and repayment of debt, PIHC received cash proceeds of $\$ 270$ million. During the nine-month period ended September 30, 2012, PIHC received net capital distributions of $\$ 131$ million from the Corporation s equity investment in EVERTEC s parent company, which included $\$ 1.4$ million in dividend distributions. During the quarter ended September 30, 2013, PIHC received $\$ 2.7$ million in dividends from EVERTEC s parent company.

During the quarter ended March 31, 2012, there was a $\$ 50$ million capital contribution from PIHC to PNA, as part of an internal reorganization.

Another use of liquidity at the parent holding company is the payment of dividends on preferred stock. At the end of 2010, the Corporation resumed paying dividends on its Series A and B preferred stock. The preferred stock dividends amounted to $\$ 2.8$ million for the third quarter of 2013. The preferred stock dividends paid were financed by issuing new shares of common stock to the participants of the Corporation s qualified employee savings plans. The Corporation is required to obtain approval from the Fed prior to declaring or paying dividends, incurring, increasing or guaranteeing debt or making any distributions on its trust preferred securities or subordinated debt. The Corporation anticipates that any future preferred stock dividend payments would continue to be financed with the issuance of new common stock in connection with its qualified employee savings plans. The Corporation is not paying dividends to holders of its common stock.

The BHC s have in the past borrowed in the money markets and in the corporate debt market primarily to finance their non-banking subsidiaries, however, the cash needs of the Corporation s non-banking subsidiaries other than to repay indebtedness and interest are now minimal. These sources of funding have become more costly due to the reductions in the Corporation s credit ratings. The Corporation s principal credit ratings are below investment grade which affects the Corporation s ability to raise funds in the capital markets. The Corporation has an open-ended, automatic shelf
registration statement filed and effective with the Securities and Exchange Commission, which permits the Corporation to issue an unspecified amount of debt or equity securities.

Note 35 to the consolidated financial statements provides a statement of condition, of operations and of cash flows for the three BHC s. The loans held-in-portfolio in such financial statements are principally associated with intercompany transactions. The investment securities held-to-maturity at the parent holding company, amounting to $\$ 185$ million at September 30, 2013, consisted of subordinated notes from BPPR.

The outstanding balance of notes payable at the BHC s amounted to $\$ 1.0$ billion at September 30, 2013 and December 31, 2012. These borrowings are principally junior subordinated debentures (related to trust preferred securities), including those issued to the U.S. Treasury as part of the TARP, and unsecured senior debt (term notes). The repayment of the BHC s obligations represents a potential cash need which is expected to be met with a combination of internal liquidity resources stemming mainly from future dividend receipts and new borrowings. Increasing or guaranteeing new debt would be subject to the approval of the Fed.

The contractual maturities of the BHC s notes payable at September 30, 2013 are presented in Table 31.

## Table of Contents

## Table 31 Distribution of BHC s Notes Payable by Contractual Maturity

| Year | (In thousands) |  |
| :--- | ---: | ---: |
| 2013 | $\$$ | 675 |
| 2014 |  |  |
| 2015 |  |  |
| 2016 |  | 939,800 |
| 2017 | 936,000 |  |
| Later years | $1,376,475$ |  |
| No stated maturity |  | 411,129 |
| Sub-total | $\$$ | 965,346 |

As indicated previously, the BHC s did not issue new registered debt in the capital markets during the quarter ended September 30, 2013.

The BHC s liquidity position continues to be adequate with sufficient cash on hand, investments and other sources of liquidity which are expected to be enough to meet all BHC s obligations during the foreseeable future.

## Obligations Subject to Rating Triggers or Collateral Requirements

The Corporation s banking subsidiaries currently do not use borrowings that are rated by the major rating agencies, as these banking subsidiaries are funded primarily with deposits and secured borrowings. The banking subsidiaries had $\$ 18$ million in deposits at September 30, 2013 that are subject to rating triggers.

Some of the Corporation s derivative instruments include financial covenants tied to the bank s well-capitalized status and certain formal regulatory actions. These agreements could require exposure collateralization, early termination or both. The fair value of derivative instruments in a liability position subject to financial covenants approximated $\$ 17$ million at September 30, 2013, with the Corporation providing collateral totaling $\$ 23$ million to cover the net liability position with counterparties on these derivative instruments.

In addition, certain mortgage servicing and custodial agreements that BPPR has with third parties include rating covenants. In the event of a credit rating downgrade, the third parties have the right to require the institution to engage a substitute cash custodian for escrow deposits and/or increase collateral levels securing the recourse obligations. Also, as discussed in the Guarantees section of this MD\&A, the Corporation services residential mortgage loans subject to credit recourse provisions. Certain contractual agreements require the Corporation to post collateral to secure such recourse obligations if the institution s required credit ratings are not maintained. Collateral pledged by the Corporation to secure recourse obligations amounted to approximately $\$ 130$ million at September 30, 2013. The Corporation could be required to post additional collateral under the agreements. Management expects that it would be able to meet additional collateral requirements if and when needed. The requirements to post collateral under certain agreements or the loss of escrow deposits could reduce the Corporation s liquidity resources and impact its operating results.

## CREDIT RISK MANAGEMENT AND LOAN QUALITY

## Non-Performing Assets

Non-performing assets include primarily past-due loans that are no longer accruing interest, renegotiated loans, and real estate property acquired through foreclosure. A summary, including certain credit quality metrics, is presented in Table 32.

The Corporation s non-accruing and charge-off policies by major categories of loan portfolios are as follows:

Commercial and construction loans - recognition of interest income on commercial and construction loans is discontinued when the loans are 90 days or more in arrears on payments of principal or interest or when other factors indicate that the collection of principal and interest is doubtful. The impaired portions of secured loans past due as to principal and interest is charged-off not later than 365 days past due. However, in the case of collateral dependent loans individually evaluated for impairment, the excess of the recorded investment over the fair value of the collateral (portion deemed uncollectible) is

## Table of Contents

generally promptly charged-off, but in any event, not later than the quarter following the quarter in which such excess was first recognized. Commercial unsecured loans are charged-off no later than 180 days past due. Overdrafts are generally charged-off no later than 60 days past their due date.

Lease financing - recognition of interest income for lease financing is ceased when loans are 90 days or more in arrears. Leases are charged-off when they are 120 days in arrears.

Mortgage loans - recognition of interest income on mortgage loans is generally discontinued when loans are 90 days or more in arrears on payments of principal or interest. The impaired portion of a mortgage loan is charged-off when the loan is 180 days past due. The Corporation discontinues the recognition of interest income on residential mortgage loans insured by the Federal Housing Administration ( FHA ) or guaranteed by the U.S. Department of Veterans Affairs ( VA ) when 18 months delinquent as to principal or interest. The principal repayment on these loans is insured.

Consumer loans - recognition of interest income on closed-end consumer loans and home-equity lines of credit is discontinued when the loans are 90 days or more in arrears on payments of principal or interest. Income is generally recognized on open-end consumer loans, except for home equity lines of credit, until the loans are charged-off. Closed-end consumer loans are charged-off when they are 120 days in arrears. Open-end consumer loans are charged-off when they are 180 days in arrears. Overdrafts in excess of 60 days are generally charged-off no later than 60 days past their due date.

Troubled debt restructurings ( TDRs ) - loans classified as TDRs are typically in non-accrual status at the time of the modification. The TDR loan continues in non-accrual status until the borrower has demonstrated a willingness and ability to make the restructured loan payments (generally at least six months of sustained performance after the modification (or one year for loans providing for quarterly or semi-annual payments)) and management has concluded that it is probable that the borrower would not be in payment default in the foreseeable future.

Loans accounted for under ASC Subtopic 310-30 by the Corporation, are not considered non-performing and will continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected.

Covered loans acquired in the Westernbank FDIC-assisted transaction, except for revolving lines of credit, are accounted for by the Corporation in accordance with ASC Subtopic 310-30. Under ASC Subtopic 310-30, the acquired loans were aggregated into pools based on similar characteristics. Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. The covered loans, which are accounted for under ASC Subtopic 310-30 by the Corporation, are not considered non-performing and will continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected. Also, loans charged-off against the non-accretable difference established in purchase accounting are not reported as charge-offs. Charge-offs will be recorded only to the extent that losses exceed the purchase accounting estimates.

Because of the application of ASC Subtopic 310-30 to the Westernbank acquired loans and the loss protection provided by the FDIC which limits the risks on the covered loans, the Corporation has determined to provide certain quality metrics in this MD\&A that exclude such covered loans to facilitate the comparison between loan portfolios and across periods. Given the significant amount of covered loans that are past due but still accruing due to the accounting under ASC Subtopic 310-30, the Corporation believes the inclusion of these loans in certain asset quality ratios in the numerator or denominator (or both) would result in a significant distortion to these ratios. In addition, because charge-offs related to the acquired loans are recorded against the non-accretable balance, the net charge-off ratio including the acquired loans is lower for portfolios that have significant amounts of covered loans. The inclusion of these loans in the asset quality ratios could result in a lack of comparability across periods, and could negatively impact comparability with other portfolios that were not impacted by acquisition accounting. The Corporation believes that the presentation of asset quality measures, excluding covered loans and related amounts from both the numerator and denominator, provides a better perspective into underlying trends related to the quality of its loan portfolio.

Total non-performing non-covered assets of $\$ 755$ million at September 30, 2013 declined by $\$ 1.0$ billion, or $58 \%$, compared with December 31, 2012. Non-covered non-performing loans held-in-portfolio stand at $\$ 618$ million, declining by $\$ 808$ million, or $57 \%$, from December 31, 2012. The ratio of non-performing loans to loans held-in-portfolio, excluding covered loans, decreased from 6.79\% at December 31, 2012 to 2.88\% at September 30, 2013, same level since the first quarter of 2008. These reductions mainly reflect the impact of the bulk sale of assets of $\$ 509$ million and $\$ 435$ million during the first and second quarter of 2013, respectively, coupled with continued disposition of foreclosed properties.

## Table of Contents

The composition of non-performing loans continues to be concentrated in real estate, as $88 \%$ of non-performing loans were secured by real estate as of September 30, 2013. At September 30, 2013, non-performing loans secured by real estate held-in-portfolio, excluding covered loans, amounted to $\$ 381$ million in the BPPR segment and $\$ 164$ million in the BPNA segment. These figures compare to $\$ 1.1$ billion in the BPPR segment and $\$ 208$ million in the BPNA segment at December 31, 2012. In addition to the non-performing loans included in Table 32, at September 30, 2013, there were $\$ 112$ million of non-covered performing loans, mostly commercial loans that in management s opinion, are currently subject to potential future classification as non-performing and are considered impaired, compared with \$96 million at December 31, 2012.

## Table 32 Non-Performing Assets

| (Dollars in thousands) | As a \% of loans |  |  |  |  | As a \% of loans |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | $\begin{aligned} & \text { tember 30, } \\ & 2013 \end{aligned}$ | HIP by category[4] |  | $\begin{gathered} \text { cember } 31, \\ 2012 \end{gathered}$ | HIP by category[4] |
| Commercial | \$ | 316,040 | 3.2\% | \$ | 665,289 | 6.7\% |
| Construction |  | 28,782 | 9.8 |  | 43,350 | 17.1 |
| Legacy ${ }^{[1]}$ |  | 24,206 | 10.3 |  | 40,741 | 10.6 |
| Leasing |  | 3,716 | 0.7 |  | 4,865 | 0.9 |
| Mortgage |  | 203,208 | 3.1 |  | 630,130 | 10.4 |
| Consumer |  | 41,621 | 1.1 |  | 40,758 | 1.1 |
| Total non-performing loans held-in-portfolio, excluding covered loans |  | 617,573 | 2.9\% |  | 1,425,133 | 6.8\% |
| Non-performing loans held-for-sale ${ }^{[2]}$ |  | 2,099 |  |  | 96,320 |  |
| Other real estate owned ( OREO ), excluding covered OREO |  | 135,502 |  |  | 266,844 |  |
| Total non-performing assets, excluding covered assets | \$ | 755,174 |  | \$ | 1,788,297 |  |
| Covered loans and OREO ${ }^{[3]}$ |  | 188,353 |  |  | 213,469 |  |
| Total non-performing assets | \$ | 943,527 |  | \$ | 2,001,766 |  |
| Accruing loans past due 90 days or more ${ }^{[5][6]}$ | \$ | 414,189 |  | \$ | 388,712 |  |
| Ratios excluding covered loans: ${ }^{[7]}$ |  |  |  |  |  |  |
| Non-performing loans held-in-portfolio to loans held-in-portfolio |  | 2.88\% |  |  | 6.79\% |  |
| Allowance for loan losses to loans held-in-portfolio |  | 2.46 |  |  | 2.96 |  |
| Allowance for loan losses to non-performing loans, excluding held-for-sale |  | 85.19 |  |  | 43.62 |  |
| Ratios including covered loans: |  |  |  |  |  |  |
| Non-performing assets to total assets |  | 2.62\% |  |  | 5.48\% |  |


| Non-performing loans held-in-portfolio to loans <br> held-in-portfolio | 2.64 | 6.06 |
| :--- | :---: | :---: |
| Allowance for loan losses to loans <br> held-in-portfolio | 2.62 | 2.95 |
| Allowance for loan losses to non-performing <br> loans, excluding held-for-sale | 99.53 | 48.72 |

HIP $=$ held-in-portfolio
[1] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.
[2] Non-performing loans held-for-sale consist of $\$ 1.7$ million in legacy loans and $\$ 0.4$ million in mortgage loans as of September 30, 2013 (December 31, 2012 - $\$ 78$ million in construction loans, $\$ 16$ million in commercial loans, $\$ 2$ million in legacy loans and $\$ 53$ thousand in mortgage loans).
[3] The amount consists of $\$ 28$ million in non-performing covered loans accounted for under ASC Subtopic 310-20 and $\$ 160$ million in covered OREO as of September 30, 2013 (December 31, 2012 - $\$ 74$ million and $\$ 139$ million, respectively). It excludes covered loans accounted for under ASC Subtopic 310-30 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.
[4] Loans held-in-portfolio used in the computation exclude $\$ 3.1$ billion in covered loans at September 30, 2013 (December 31, 2012 - $\$ 3.8$ billion).

## Table of Contents

[5] The carrying value of covered loans accounted for under ASC Sub-topic 310-30 that are contractually 90 days or more past due was $\$ 0.8$ billion at September 30, 2013 (December 31, 2012 - $\$ 0.7$ billion). This amount is excluded from the above table as the covered loans accretable yield interest recognition is independent from the underlying contractual loan delinquency status.
[6] It is the Corporation s policy to report delinquent residential mortgage loans insured by FHA or guaranteed by the VA as accruing loans past due 90 days or more as opposed to non-performing since the principal repayment is insured. These balances include $\$ 113$ million of residential mortgage loans insured by FHA or guaranteed by the VA that are no longer accruing interest as of September 30, 2013. Furthermore, the Corporation has approximately $\$ 25$ million in reverse mortgage loans which are guaranteed by FHA, but which are currently not accruing interest. Due to the guaranteed nature of the loans, it is the Corporation s policy to exclude these balances from non-performing assets.
[7] These asset quality ratios have been adjusted to remove the impact of covered loans and covered foreclosed property. Appropriate adjustments to the numerator and denominator have been reflected in the calculation of these ratios. Management believes the inclusion of acquired loans in certain asset quality ratios that include non-performing assets, past due loans or net charge-offs in the numerator and denominator results in distortions of these ratios and they may not be comparable to other periods presented or to other portfolios that were not impacted by purchase accounting.
Refer to Table 33 for a summary of the activity in the allowance for loan losses and selected loan losses statistics for the quarters ended September 30, 2013 and 2012.

Table 33 Allowance for Loan Losses and Selected Loan Losses Statistics Quarterly Activity

|  | Quarters ended September 30, |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 | 2013 | 2013 | 2012 | 2012 | 2012 |
|  | Non-covered loans | Covered <br> loans | Total | Non-covered loans | Covered <br> loans | Total |
| Balance at beginning of period | \$ 528,762 | \$ 106,457 | \$ 635,219 | \$ 648,535 | 117,495 | \$766,030 |
| Provision for loan losses | 55,230 | 17,433 | 72,663 | 83,589 | \$ 22,619 | 106,208 |
|  | 583,992 | 123,890 | 707,882 | 732,124 | 140,114 | 872,238 |


| Charged-offs: |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Commercial | 35,203 | 3,186 | 38,389 | 63,381 | 7,013 | 70,394 |
| Construction | 1,456 | 7,395 | 8,851 | 1,733 | 7,483 | 9,216 |
| Leases | 1,098 |  | 1,098 | 1,292 |  | 1,292 |
| Legacy ${ }^{[1]}$ | 6,216 |  | 6,216 | 8,502 | 8,502 |  |
| Mortgage | 13,282 | 1,632 | 14,914 | 16,225 | 736 | 16,961 |
| Consumer | 34,787 | 65 | 34,852 | 37,949 | 9 | 37,958 |
|  |  |  |  |  |  |  |
|  | 92,042 | 12,278 | 104,320 | 129,082 | 15,241 | 144,323 |

Recoveries:

| Commercial | 14,515 | 653 | 15,168 | 16,751 | 16,751 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Construction | 6,362 | 4,502 | 10,864 | 2,260 | 2,260 |
| Leases | 628 |  | 628 | 1,027 | 1,027 |
| Legacy ${ }^{[1]}$ | 3,895 |  | 3,895 | 4,550 | 4,550 |

Edgar Filing: POPULAR INC - Form 10-Q

| Mortgage | 555 | 53 | 608 | 253 | 253 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Consumer | 8,195 | 8 | 8,203 | 8,450 | 8,450 |
|  |  |  |  |  |  |
|  | 34,150 | 5,216 | 39,366 | 33,291 | 33,291 |

Net loans charged-offs (recovered):

| Commercial | 20,688 | 2,533 | 23,221 | 46,630 | 7,013 | 53,643 |
| :--- | :---: | ---: | :---: | ---: | ---: | ---: |
| Construction | $(4,906)$ | 2,893 | $(2,013)$ | $(527)$ | 7,483 | 6,956 |
| Leases | 470 |  | 470 | 265 |  | 265 |
| Legacy ${ }^{[1]}$ | 2,321 |  | 2,321 | 3,952 | 3,952 |  |
| Mortgage | 12,727 | 1,579 | 14,306 | 15,972 | 736 | 16,708 |
| Consumer | 26,592 | 57 | 26,649 | 29,499 | 9 | 29,508 |
|  |  |  |  |  |  |  |
|  | 57,892 | 7,062 | 64,954 | 95,791 | 15,241 | 111,032 |

Net write-downs
$\begin{array}{lllllll}\text { Balance at end of period } & \$ 526,100 & \$ 116,828 & \$ 642,928 & \$ 636,299 & \$ 124,873 & \$ 761,172\end{array}$
Ratios:
Annualized net charge-offs to $\begin{array}{lllll}\text { average loans held-in-portfolio } & 1.08 \% & 1.06 \% & 1.87 \% & 1.82 \% \\ \text { Provision for loan losses to net } & & & & \end{array}$ $\begin{array}{lllll}\text { charge-offs } & 0.95 x & 1.12 x & 0.87 x & 0.96 x\end{array}$
[1] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

## Table of Contents

Refer to Table 34 for a summary of the activity in the allowance for loan losses and selected loan losses statistics for the nine months ended September 30, 2013 and 2012.

## Table 34 Allowance for Loan Losses and Selected Loan Losses Statistics Year-to-date Activity

| (Dollars in thousands) | Nine months ended September 30, |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 <br> Non-covered loans | $2013$ <br> Covered loans | 2013 Total | $2012$ <br> Non-covered loans | $2012$ <br> Covered loans | 2012 Total |
| Balance at beginning of period | \$ 621,701 | \$ 108,906 | \$ 730,607 | \$ 690,363 | 124,945 | \$ 815,308 |
| Provision for loan losses | 485,438 | 60,489 | 545,927 | 247,846 | \$ 78,284 | 326,130 |
|  | 1,107,139 | 169,395 | 1,276,534 | 938,209 | 203,229 | 1,141,438 |
| Charged-offs: |  |  |  |  |  |  |
| Commercial | 133,454 | 14,901 | 148,355 | 187,519 | 45,767 | 233,286 |
| Construction | 5,276 | 33,178 | 38,454 | 4,442 | 22,934 | 27,376 |
| Leases | 4,485 |  | 4,485 | 3,418 |  | 3,418 |
| Legacy ${ }^{[1]}$ | 18,500 |  | 18,500 | 28,168 |  | 28,168 |
| Mortgage | 51,185 | 5,949 | 57,134 | 54,201 | 5,024 | 59,225 |
| Consumer | 103,432 | 4,526 | 107,958 | 122,903 | 4,631 | 127,534 |
|  | 316,332 | 58,554 | 374,886 | 400,651 | 78,356 | 479,007 |


| Recoveries: |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Commercial | 39,820 | 725 | 40,545 | 46,810 | 46,810 |
| Construction | 12,121 | 5,138 | 17,259 | 4,193 | 4,193 |
| Leases | 1,817 |  | 1,817 | 2,991 | 2,991 |
| Legacy $[1]$ | 15,966 |  | 15,966 | 15,199 | 2,199 |
| Mortgage | 3,288 | 64 | 3,352 | 2,594 | 26,988 |
| Consumer | 24,926 | 60 | 24,986 | 26,988 | 98 |
|  |  |  |  |  | 98,775 |

Net loans charged-off

| (recovered): | 93,634 | 14,176 | 107,810 | 140,709 | 45,767 | 186,476 |
| :--- | :---: | ---: | ---: | ---: | ---: | ---: |
| Commercial | $(6,845)$ | 28,040 | 21,195 | 249 | 22,934 | 23,183 |
| Construction | 2,668 |  | 2,668 | 427 | 427 |  |
| Leases | 2,534 |  | 2,534 | 12,969 |  | 12,969 |
| Legacy $[1]$ | 47,897 | 5,885 | 53,782 | 51,607 | 5,024 | 56,631 |
| Mortgage | 78,506 | 4,466 | 82,972 | 95,915 | 4,631 | 100,546 |
| Consumer |  |  |  |  |  |  |
|  | 218,394 | 52,567 | 270,961 | 301,876 | 78,356 | 380,232 |

Net write-downs ${ }^{[3]}$
$(362,645) \quad(362,645)$
(34)
(34)

Table of Contents
Balance at end of period $\quad \$ 526,100 \quad \$ 116,828 \quad \$ \quad 642,928 \quad \$ 636,299 \quad \$ 124,873 \quad \$ 761,172$

Ratios:
Annualized net charge-offs to average loans

| held-in-portfolio ${ }^{[2]}$ <br> Provision for loan losses to net <br> charge-offs${ }^{2]}$ | $1.37 \%$ | $1.47 \%$ | $1.98 \%$ | $2.07 \%$ |
| :--- | :---: | :---: | :---: | :---: |
|  | 0.77 x | 0.84 x | 0.82 x | 0.86 x |

[1] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.
[2] Excluding provision for loan losses and the net write-downs related to the loans sales.
[3] For September 30, 2013, net write-downs are related to the loans sales.

## Table of Contents

Refer to the Allowance for Loan Losses subsection in this MD\&A for tables detailing the composition of the allowance for loan losses between general and specific reserves, and for qualitative information on the main factors driving the variances.

The following table presents annualized net charge-offs to average loans held-in-portfolio ( HIP ) for the non-covered portfolio by loan category for the quarters and nine months ended September 30, 2013 and 2012.

## Table 35 Annualized Net Charge-offs (Recoveries) to Average Loans Held-in-Portfolio (Non-Covered loans)

|  | Quarters ended September 30,Nine months ended September 30, |  |  |  |
| :--- | :---: | :---: | :---: | :---: |
|  | 2013 | 2012 | 2013 | 2012 |
| Commercial ${ }^{[1]}$ | $0.84 \%$ | $1.95 \%$ | $1.27 \%$ | $1.93 \%$ |
| Construction ${ }^{[1]}$ | $(6.72)$ | $(0.84)$ | $(3.28)$ | 0.14 |
| Leases | 0.35 | 0.20 | 0.66 | 0.11 |
| Legacy | 3.75 | 3.23 | 1.23 | 3.11 |
| Mortgage $^{[1]}$ | 0.78 | 1.11 | 0.97 | 1.23 |
| Consumer | 2.72 | 3.06 | 2.71 | 3.44 |

Total annualized net charge-offs to average $\begin{array}{lllll}\text { loans held-in-portfolio } & 1.08 \% & 1.87 \% & 1.37 \% & 1.98 \%\end{array}$
[1] Excluding the net write-down related to the asset sale during the first and second quarters of 2013.
Note: Average loans held-in-portfolio excludes covered loans acquired in the Westernbank FDIC-assisted transaction which were recorded at fair value on date of acquisition, and thus, considered a credit discount component.

The Corporation s annualized net charge-offs to average non-covered loans held-in-portfolio ratio decreased 79 basis points, from $1.87 \%$ for the quarter ended September 30, 2012 to $1.08 \%$ for the same period in 2013, lowest level since the third quarter of 2007. Net charge-offs were $\$ 57.9$ million, compared with $\$ 95.8$ million for the same quarter in 2012. The decline of $\$ 37.9$ million was driven by improvements in the credit performance of the loan portfolios.

While continuing to operate in a challenging economic environment, overall asset quality continued to improve during the third quarter of 2013, as non-performing assets and net charge-offs were at their lowest in over five years. This steady progress is reflective of the Corporation s efforts to reduce its high risk assets and improve the risk profile of its portfolios.

The discussions in the sections that follow assess credit quality performance for the third quarter of 2013 for each of the Corporation s non-covered loan portfolios.

## Commercial loans

Non-covered non-performing commercial loans held-in-portfolio were $\$ 316$ million at September 30, 2013, compared with $\$ 665$ million at December 31, 2012. The decrease of $\$ 349$ million, or $52 \%$, was principally attributed to reductions related to the non-performing bulk sale in the BPPR segment during the first quarter of 2013. The percentage of non-performing commercial loans held-in-portfolio to commercial loans held-in-portfolio decreased
from 6.75\% at December 31, 2012 to $3.21 \%$ at September 30, 2013.
Commercial non-covered non-performing loans held-in-portfolio at the BPPR segment decreased by $\$ 318$ million from December 31, 2012, mainly driven by the impact of the bulk sale of non-performing commercial loans with book value of approximately $\$ 329$ million. Excluding the impact of the sale, commercial non-covered non-performing loans increased by $\$ 11$ million, mainly related to two significant relationships placed in non-performing status during the second quarter of 2013. Commercial non-performing loans held-in-portfolio at the BPNA segment decreased by $\$ 31$ million from December 31, 2012, reflective of improved credit performance and resolution of non-performing loans.

For the quarter ended September 30, 2013, inflows of commercial non-performing loans held-in-portfolio at the BPPR segment amounted to $\$ 40$ million, a decrease of $\$ 56$ million, or $58 \%$, when compared to inflows for the same period in 2012. Inflows of commercial non-performing loans held-in-portfolio at the BPNA segment amounted to $\$ 18$ million, a decrease of $\$ 15$ million, or $45 \%$, compared to inflows for 2012 . These reductions were driven by improvements in the underlying quality of the loan portfolio and proactive portfolio management processes.

## Table of Contents

Tables 36 and 37 present the changes in the non-performing commercial loans held-in-portfolio for the quarters and nine months ended September 30, 2013 and 2012 for the BPPR (excluding covered loans) and the BPNA segments.

Table 36 Activity in Non-Performing Commercial Loans Held-in-Portfolio (Excluding Covered Loans)

|  | For the quarter ended September 30, 2013 |  | For the nine months ended September 30, 2013 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousands) | BPPR | BPNA |  | BPPR |  | BPNA |
| Beginning balance | \$ 199,720 | \$ 123,435 | \$ | 522,733 |  | \$ 142,556 |
| Plus: |  |  |  |  |  |  |
| New non-performing loans | 40,257 | 17,898 |  | 147,728 |  | 48,772 |
| Advances on existing non-performing loans |  | 304 |  |  |  | 1,530 |
| Loans transferred from held-for-sale |  |  |  | 790 |  |  |
| Other |  |  |  |  |  | 4,310 |
| Less: |  |  |  |  |  |  |
| Non-performing loans transferred to OREO | (811) | $(1,036)$ |  | $(12,200)$ |  | $(3,126)$ |
| Non-performing loans charged-off | $(17,773)$ | $(9,572)$ |  | $(79,134)$ |  | $(29,343)$ |
| Loans returned to accrual status / loan collections | $(16,824)$ | $(19,073)$ |  | $(46,080)$ |  | $(50,149)$ |
| Loans transferred to held-for-sale |  | (485) |  |  |  | $(3,079)$ |
| Non-performing loans sold ${ }^{[1]}$ |  |  |  | $(329,268)$ |  |  |
| Ending balance NPLs | \$ 204,569 | \$ 111,471 | \$ | 204,569 |  | \$ 111,471 |

[1] Includes write-downs of loans sold at BPPR.
Table 37 Activity in Non-Performing Commercial Loans Held-in-Portfolio (Excluding Covered Loans)

|  | For the quarter ended September 30, 2012 |  | For the nine months ended September 30, 2012 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousands) | BPPR | BPNA |  | BPPR | BPNA |
| Beginning balance | \$ 591,792 | \$ 176,148 | \$ | 631,171 | \$ 198,921 |
| Plus: |  |  |  |  |  |
| New non-performing loans | 95,836 | 32,395 |  | 246,245 | 94,320 |
| Advances on existing non-performing loans |  | 525 |  |  | 897 |
| Loans transferred from held-for-sale |  |  |  |  | 4,933 |
| Other | 1,139 |  |  | 1,139 |  |
| Less: |  |  |  |  |  |
| Non-performing loans transferred to OREO | $(4,217)$ | $(10,558)$ |  | $(19,741)$ | $(37,625)$ |
| Non-performing loans charged-off | $(43,711)$ | $(9,261)$ |  | $(118,333)$ | $(39,767)$ |
| Loans returned to accrual status / loan collections | $(28,058)$ | $(25,561)$ |  | $(127,700)$ | $(57,224)$ |
| Loans transferred to held-for-sale |  | $(4,252)$ |  |  | $(5,019)$ |
| Ending balance NPLs | \$ 612,781 | \$ 159,436 | \$ | 612,781 | \$ 159,436 |

Table 38 Non-Performing Commercial Loans and Net Charge-offs (Excluding Covered Loans)

|  | BPPR |  |  |  | BPNA |  |  |  | Popular, Inc. |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousan |  | $\begin{aligned} & \text { tember 30, } \\ & 2013 \end{aligned}$ | $\begin{gathered} \text { December 31, } \\ 2012 \end{gathered}$ |  | September 30,2013 |  | $\begin{gathered} \text { December 31, } \\ 2012 \end{gathered}$ |  | $\begin{gathered} \text { September } 30, \\ 2013 \end{gathered}$ |  | $\begin{gathered} \text { December 31, } \\ 2012 \end{gathered}$ |  |
| Non-performing commercial loans | \$ | 204,569 | \$ | 522,733 | \$ | 111,471 | \$ | 142,556 | \$ | 316,040 | \$ | 665,289 |
| Non-performing commercial loans to commercial loans HIP |  | 3.27\% |  | 8.30\% |  | 3.10\% |  | 4.00\% |  | 3.21\% |  | 6.75\% |

Table of Contents

|  | BPPR <br> For the quarters ended |  | For the qua September 30, | NA ters ended September 30 | Popul <br> For the qua eptember 30, | Inc. <br> ters ended eptember 30, |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousands) | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Commercial loan net charge-offs | \$ 16,145 | \$ 37,019 | \$ 4,543 | \$ 9,611 | \$ 20,688 | \$ 46,630 |
| Commercial loan net charge-offs (annualized) to average commercial loans HIP | 1.03\% | 2.41\% | 0.51\% | 1.12\% | 0.84\% | 1.95\% |
|  | BPPR |  | BPNA |  | Popular, Inc. |  |
|  | For the nine months ended For the nine months ended For the nine months ended September 30,September 30September 30,September 30,September 30,September 30, |  |  |  |  |  |
| (Dollars in thousands) | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Commercial loan net charge-offs ${ }^{[1]}$ | \$ 70,423 | \$ 103,101 | 23,211 | \$ 37,608 | \$ 93,634 | \$ 140,709 |
| Commercial loan net charge-offs (annualized) to average |  |  |  |  |  |  |

[1] Excludes write-downs of loans sold at BPPR.
There was one commercial loan relationship greater than $\$ 10$ million in non-accrual status with an outstanding aggregate balance of $\$ 14$ million at September 30, 2013, compared with two commercial loan relationships with an outstanding aggregate balance of \$24 million at December 31, 2012.

Commercial loan net charge-offs, excluding net charge-offs for covered loans, decreased by $\$ 25.9$ million for the quarter ended September 30, 2013 when compared to the same period in 2012. Commercial loans annualized net charge-offs to average non-covered loans held-in-portfolio decreased from $1.95 \%$ for the quarter ended September 30, 2012 to $0.84 \%$ for the same period in 2013.

Net charge-offs at the BPPR segment were $\$ 16.1$ million, or $1.03 \%$ of average non-covered loans held-in-portfolio on an annualized basis, decreasing by $\$ 20.9$ million from the third quarter of 2012. Net charge-offs at the BPNA segment were $\$ 4.5$ million, or $0.51 \%$ of average non-covered loans held-in-portfolio on an annualized basis, decreasing by $\$ 5.1$ million from the third quarter of 2012. For the quarter ended September 30, 2013, the charge-offs associated with commercial loans individually evaluated for impairment amounted to approximately $\$ 8.9$ million in the BPPR segment and $\$ 1.3$ million in the BPNA segment. Management identified commercial loans considered impaired and charged-off specific reserves based on the value of the collateral.

The allowance for loan losses of the commercial loans held-in-portfolio, excluding covered loans, amounted to $\$ 157$ million, or $1.60 \%$ of that portfolio at September 30, 2013, compared with $\$ 298$ million, or $3.02 \%$, at December 31, 2012. The ratio of the allowance to non-performing loans held-in-portfolio in the commercial loan category increased to $49.78 \%$ at September 30, 2013, from $44.74 \%$ at December 31, 2012, mostly driven by the combined effect of the reductions to the allowance for loan losses and non-performing loans during the period.

The allowance for loan losses for the commercial loan portfolio in the BPPR segment, excluding the allowance for covered loans, totaled $\$ 103$ million, or $1.65 \%$ of non-covered commercial loans held-in-portfolio at September 30, 2013, compared with $\$ 218$ million, or $3.46 \%$, at December 31, 2012. At the BPNA segment, the allowance for loan

## Edgar Filing: POPULAR INC - Form 10-Q

losses of the commercial loan portfolio totaled $\$ 54$ million, or $1.50 \%$ of commercial loans held-in-portfolio at September 30, 2013, compared with $\$ 80$ million or $2.25 \%$ at December 31, 2012. The decrease in the allowance for loan losses for the commercial loans held-in-portfolio derives mainly from improvements in credit quality and the effect of the enhancements to the allowance for loan losses methodology.

The Corporation s commercial loan portfolio secured by real estate ( CRE ), excluding covered loans, amounted to \$6.4 billion at September 30, 2013, of which $\$ 2.4$ billion was secured with owner occupied properties, compared with $\$ 6.5$ billion and $\$ 2.8$ billion, respectively, at December 31, 2012. CRE non-performing loans, excluding covered loans, amounted to $\$ 260$ million at September 30, 2013, compared with $\$ 528$ million at December 31, 2012. The CRE non-performing loan ratios for the BPPR and BPNA segments were $4.33 \%$ and $3.78 \%$, respectively, at September 30, 2013, compared with $11.13 \%$ and $4.73 \%$, respectively, at December 31, 2012.

## Table of Contents

Commercial and industrial loans held-in-portfolio modified in a TDR often involve temporary interest-only payments, term extensions, and converting evergreen revolving lines of credit to long-term loans. Commercial real estate loans held-in-portfolio modified in a TDR often involve reducing the interest rate for a limited period of time or for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or reductions in the payment plan. In addition, in order to expedite the resolution of delinquent commercial loans, the Corporation may enter into a liquidation agreement with borrowers. Although in general, these liquidation agreements do not contemplate the forgiveness of principal or interest, loans under this program are considered TDRs since it could be construed that the Corporation has granted concession by temporarily accepting a payment schedule different from the contractual payment schedule. At September 30, 2013, commercial loans TDRs, excluding covered loans, for the BPPR and BPNA segments amounted to $\$ 171$ million and $\$ 18$ million, respectively, of which $\$ 59$ million and $\$ 18$ million were in non-performing status. This compares with $\$ 297$ million and $\$ 16$ million, respectively, of which $\$ 192$ million and $\$ 16$ million were in non-performing status at December 31, 2012. The outstanding commitments for these commercial loan TDRs amounted to $\$ 5$ million in the BPPR segment and no commitments outstanding in the BPNA segment at September 30, 2013. Commercial loans that have been modified as part of loss mitigation efforts were individually evaluated for impairment, resulting in a specific reserve of $\$ 22$ million for the BPPR segment and none for the BPNA segment at September 30, 2013, compared with $\$ 17$ million and $\$ 12$ thousand, respectively, at December 31, 2012.

## Construction loans

Non-covered non-performing construction loans held-in-portfolio were $\$ 29$ million at September 30, 2013, compared to $\$ 43$ million at December 31, 2012. The decrease of $\$ 14$ million, or approximately $33 \%$, was mainly due to the resolution of a significant borrower in the BPPR segment. Stable credit trends in the construction portfolio are the result of de-risking strategies executed by the Corporation over the past several years to downsize its construction loan portfolio. The ratio of non-performing construction loans to construction loans held-in-portfolio, excluding covered loans, decreased from 17.14\% at December 31, 2012 to $9.82 \%$ at September 30, 2013.

Tables 39 and 40 present changes in non-performing construction loans held-in-portfolio for the quarters and nine months ended September 30, 2013 and 2012 for the BPPR (excluding covered loans) and the BPNA segments.

Table 39 Activity in Non-Performing Construction Loans Held-in-Portfolio (Excluding Covered Loans)

|  | For the quarter ended September 30, 2013 |  | For the nine months ended September 30, 2013 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousands) | BPPR | BPNA |  | BPPR |  | PNA |
| Beginning balance | \$ 39,044 | \$ 5,834 | \$ | 37,390 | \$ | 5,960 |
| Plus: |  |  |  |  |  |  |
| New non-performing loans | 2,000 |  |  | 2,000 |  |  |
| Loans transferred from held-for-sale |  |  |  | 14,152 |  |  |
| Less: |  |  |  |  |  |  |
| Non-performing loans transferred to OREO | (775) |  |  | (775) |  |  |
| Non-performing loans charged-off | $(1,442)$ |  |  | $(4,699)$ |  |  |
| Loans returned to accrual status / loan collections | $(15,808)$ | (71) |  | $(21,565)$ |  | (197) |
| Other |  |  |  | $(3,484)$ |  |  |
| Ending balance NPLs | \$ 23,019 | \$ 5,763 | \$ | 23,019 | \$ | 5,763 |

[1] Includes write-downs of loans sold at BPPR.

Table of Contents
Table 40 Activity in Non-Performing Construction Loans Held-in-Portfolio (Excluding Covered Loans)

|  | For the quarter ended September 30, 2012 |  | For the nine months ended September 30, 2012 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousands) | BPPR | BPNA |  | BPPR |  | BPNA |
| Beginning balance | \$ 55,534 | \$ 12,004 | \$ | 53,859 | \$ | 42,427 |
| Plus: |  |  |  |  |  |  |
| New non-performing loans | 3,917 |  |  | 11,122 |  |  |
| Advances on existing non-performing loans |  | 136 |  | 145 |  | 465 |
| Less: |  |  |  |  |  |  |
| Non-performing loans transferred to OREO | (280) |  |  | (280) |  |  |
| Non-performing loans charged-off | $(1,366)$ |  |  | $(2,737)$ |  | $(1,380)$ |
| Loans returned to accrual status / loan collections | $(18,873)$ |  |  | $(23,177)$ |  | $(19,040)$ |
| Loans transferred to held-for-sale |  |  |  |  |  | $(10,332)$ |
| Other | $(1,139)$ |  |  | $(1,139)$ |  |  |
| Ending balance NPLs | \$ 37,793 | \$ 12,140 | \$ | 37,793 | \$ | 12,140 |

For the quarter ended September 30, 2013, inflows of construction non-performing loans held-in-portfolio at the BPPR segment amounted to $\$ 2$ million, decreasing by $\$ 2$ million, or $49 \%$, when compared to inflows for the same period in 2012. There were no additions of new construction non-performing loans held-in-portfolio at the BPNA segments, decreasing by $\$ 136$ thousand when compared to September 30, 2012. This declining trend is the result of the Corporation sefforts to significantly reduce its construction loan exposure.

There were no construction loan relationships greater than $\$ 10$ million in non-accrual status at September 30, 2013, compared to one construction loan relationship with an aggregate outstanding balance of approximately $\$ 11$ million at December 31, 2012.

Construction loan net charge-offs, excluding covered loans, for the quarter ended September 30, 2013, decreased by $\$ 4.4$ million when compared with the quarter ended September 30, 2012, mainly related to net recoveries of $\$ 4.9$ million in the BPPR segment. For the quarter ended September 30, 2013, there were no charge-offs associated with construction loans individually evaluated for impairment in the BPPR and BPNA segments. Management identified construction loans considered impaired and charged-off specific reserves based on the value of the collateral.

The allowance for loan losses of the construction loans held-in-portfolio, excluding covered loans, amounted to $\$ 10$ million, or $3.28 \%$ of that portfolio at September 30, 2013, compared with $\$ 7$ million, or $2.94 \%$, at December 31, 2012. The ratio of the allowance to non-performing loans held-in-portfolio in the construction loans category was $33.42 \%$ at September 30, 2013, compared with $17.14 \%$ at December 31, 2012.

Table 41 provides information on construction non-performing loans and net charge-offs for the BPPR (excluding the covered loan portfolio) and the BPNA segments.

Table of Contents

## Table 41 Non-Performing Construction Loans and Net Charge-offs (Excluding Covered Loans)



BPPR BPNA Popular, Inc.
For the
For the quarters ended quarters ended For the quarters ended

|  | September 30September SOptembeseotember September 30September 30, |  |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousands) | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |  |

Construction loan net charge-offs (recoveries) (annualized) to average construction loans HIP

$$
\begin{equation*}
(1.05) \% \tag{7.52}
\end{equation*}
$$

\%
\% (6.72)\%
(0.84)\%

BPPR BPNA Popular, Inc.
For the nine months endEdr the nine months endEdr the nine months ended
September 30,SeptembeiS20tember SӨptember 3\&,eptember 30,September 30,

| (Dollars in thousands) | 2013 | 2012 |  | 2013 |  | 2012 | 2013 | 2012 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Construction loan net charge-offs (recoveries) ${ }^{[1]}$ | \$ (6,845) | \$ | 87 | \$ | \$ | 162 | \$ (6,845) | \$ | 249 |
| Construction loan net charge-offs (recoveries) (annualized) to average construction loans HIP ${ }^{[1]}$ | (3.74)\% |  | 0.06\% |  | \% | 0.39\% | (3.27)\% |  | 0.14\% |

[1] Excludes write-downs of loans sold at BPPR.
The allowance for loan losses corresponding to the construction loan portfolio for the BPPR segment, excluding the allowance for covered loans, totaled $\$ 9$ million, or $3.69 \%$ of non-covered construction loans held-in-portfolio at September 30, 2013, compared with $\$ 6$ million, or $2.76 \%$, at December 31, 2012. The increase was in part associated with a loan individually evaluated for impairment. At the BPNA segment, the allowance for loan losses of the construction loan portfolio totaled $\$ 314$ thousand, or $0.76 \%$ of construction loans held-in-portfolio at September 30, 2013, compared with $\$ 2$ million, or $3.86 \%$, at December 31, 2012.

Construction loans held-in-portfolio modified in a TDR often involve reducing the interest rate for a limited period of time or the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or reductions in the payments plan. Construction loans modified in a TDR may also involve extending the interest-only payment period. At September 30, 2013, there were $\$ 6$ million of construction loan TDRs for the BPPR and BPNA segments, which were in non-performing status, compared with $\$ 7$ million and
$\$ 6$ million, respectively, which were in non-performing status at December 31, 2012. There were no outstanding commitments to lend additional funds to debtors owing loans whose terms have been modified in troubled debt restructurings in both the BPPR segment and the BPNA segments at September 30, 2013. These construction loan TDRs were individually evaluated for impairment resulting in a specific reserves of $\$ 588$ thousand for the BPPR segment and none for the BPNA segment at September 30, 2013. At December 31, 2012, there were no specific reserves for the BPPR and BPNA segments.

## Legacy loans

The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

Legacy non-performing loans held-in-portfolio were $\$ 24$ million at September 30, 2013, compared with $\$ 41$ million at December 31, 2012. The decrease of $\$ 17$ million, or approximately $41 \%$, was primarily driven by lower inflows to non-performing loans and loan resolutions. The percentage of non-performing legacy loans held-in-portfolio to legacy loans held-in-portfolio decreased from $10.60 \%$ at December 31, 2012 to $10.27 \%$ at September 30, 2013.

## Table of Contents

For the quarter ended September 30, 2013, additions to legacy loans in non-performing status amounted to $\$ 3$ million, a decrease of $\$ 6$ million, or $64 \%$, compared with the same quarter in 2012. The decrease in the inflows of non-performing legacy loans reflects improvements in the overall loan credit performance and greater economic stability.

Tables 42 and 43 present the changes in non-performing legacy loans held in-portfolio for the quarters and nine months ended September 30, 2013 and 2012.

## Table 42 Activity in Non-Performing Legacy Loans Held-in-Portfolio

For the quarter enFed the nine months ended September 30, 2013 September 30, 2013

| (In thousands) | BPNA |  | BPNA |  |
| :---: | :---: | :---: | :---: | :---: |
| Beginning balance | \$ | 28,434 | \$ | 40,741 |
| Plus: |  |  |  |  |
| New non-performing loans |  | 3,168 |  | 14,196 |
| Advances on existing non-performing loans |  | 97 |  | 105 |
| Loans transferred from held-for-sale |  |  |  | 400 |
| Less: |  |  |  |  |
| Non-performing loans charged-off |  | $(5,013)$ |  | $(15,686)$ |
| Loans returned to accrual status / loan collections |  | $(2,480)$ |  | $(11,241)$ |
| Other |  |  |  | $(4,309)$ |
| Ending balance NPLs | \$ | 24,206 | \$ | 24,206 |

## Table 43 Activity in Non-Performing Legacy Loans Held-in-Portfolio

| (Dollars in thousands) | For the quarter encterdthe nine months ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { September 30, } \\ 2012 \end{gathered}$ |  | September 30, 2012 |  |
|  | BPNA |  | BPNA |  |
| Beginning balance | \$ | 54,730 | \$ | 75,660 |
| Plus: |  |  |  |  |
| New non-performing loans |  | 9,011 |  | 34,739 |
| Advances on existing non-performing loans |  |  |  | 17 |
| Less: |  |  |  |  |
| Non-performing loans transferred to OREO |  |  |  | $(3,435)$ |
| Non-performing loans charged-off |  | $(7,900)$ |  | $(24,660)$ |
| Loans returned to accrual status / loan collections |  | $(4,405)$ |  | $(15,643)$ |
| Loans transferred to held-for-sale |  | $(2,701)$ |  | $(17,943)$ |
| Ending balance NPLs | \$ | 48,735 | \$ | 48,735 |

There were no legacy loan relationships greater than $\$ 10$ million in non-accrual status at September 30, 2013 and at December 31, 2012.

For the quarter ended September 30, 2013, legacy net charge-offs decreased by $\$ 1.6$ million when compared with the quarter ended September 30, 2012. Net charge-off stability reflects lower level of problem loan and the continued run-off of the portfolio. For the quarter ended September 30, 2013, the charge-offs associated with collateral dependent legacy loans amounted to approximately $\$ 390$ thousand.

The allowance for loan losses for the legacy loans held-in-portfolio amounted to $\$ 17$ million, or $7.09 \%$ of that portfolio at September 30, 2013, compared with $\$ 33$ million, or $8.62 \%$, at December 31, 2012. The decrease in the allowance for loan losses stems from sustained improvements in credit quality and economic trends, and the effect of the enhancements to the allowance for loan losses methodology. The ratio of allowance to non-performing loans held-in portfolio in the legacy loan category was $68.97 \%$ at September 30, 2013, compared with $81.25 \%$ at December 31, 2012.

## Table of Contents

Legacy loans held-in-portfolio modified in a TDR often involve reducing the interest rate for a limited period of time or the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, reductions in the payment plan or other actions intended to maximize collection. At September 30, 2013, the Corporation s legacy loans held-in-portfolio included a total of $\$ 4$ million of loan modifications, compared to $\$ 6$ million at December 31, 2012. These loans were in non-performing status at such dates. There were no commitments outstanding for these legacy loan TDRs at September 30, 2013. The legacy loan TDRs were evaluated for impairment requiring no specific reserves at September 30, 2013 and December 31, 2012.

Table 44 provides information on legacy non-performing loans and net charge-offs.

## Table 44 Non-Performing Legacy Loans and Net Charge-offs

|  | BPNA |  |  |
| :--- | :---: | :---: | :---: |
| (Dollars in thousands) | September 30, 20DBcember 31, 2012 |  |  |
| Non-performing legacy loans | $\$ 24,206$ | $\$$ | 40,741 |
| Non-performing legacy loans to legacy loans HIP | $10.27 \%$ | $10.60 \%$ |  |


|  | BPNA |  |  |
| :--- | :---: | :---: | :---: |
|  | For the quarters ended |  |  |
| (Dollars in thousands) | September 30, 28\&ßtember 30, 2012 |  |  |
| Legacy loan net charge-offs | $\$ 2,321$ | $\$$ | 3,952 |
| Legacy loan net charge-offs (annualized) to average <br> legacy loans HIP | $3.74 \%$ | $3.23 \%$ |  |

## BPNA

For the nine months ended

| (Dollars in thousands) | September 30, | 0, 2012 |
| :---: | :---: | :---: |
| Legacy loan net charge-offs | \$ 2,534 | 12,969 |
| Legacy loan net charge-offs (annualized) to average legacy loans HIP | 1.23\% | 3.11\% |

## Mortgage loans

Non-covered non-performing mortgage loans held-in-portfolio were $\$ 203$ million at September 30, 2013, compared to $\$ 630$ million at December 31, 2012. The decrease of $\$ 427$ million was driven by reductions of $\$ 418$ million and $\$ 9$ million in the BPPR and BPNA segments, respectively. The decrease in the BPPR segment was principally due to the impact of the bulk loan sale with a book value of approximately $\$ 435$ million. Excluding the impact of the sale, mortgage non-covered non-performing loans increased by $\$ 17$ million. Although mortgage non-performing loan inflows continued decreasing, low NPL balances resulting from the bulk sale completed during the second quarter of 2013 have led to reduced level of outflows.

Tables 45 and 46 present changes in non-performing mortgage loans held-in-portfolio for the quarters and nine months ended September 30, 2013 and 2012.

Edgar Filing: POPULAR INC - Form 10-Q

Table of Contents
Table 45 Activity in Non-Performing Mortgage Loans Held-in-Portfolio (Excluding Covered Loans)

|  | For the quarter ended September 30, 2013 |  | For the nine months ended September 30, 2013 |  |
| :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousands) | BPPR | BPNA | BPPR | BPNA |
| Beginning balance | \$ 144,717 | \$ 27,105 | \$ 596,106 | \$ 34,024 |
| Plus: |  |  |  |  |
| New non-performing loans | 93,867 | 5,265 | 302,365 | 16,660 |
| Less: |  |  |  |  |
| Non-performing loans transferred to OREO | $(3,161)$ | $(1,236)$ | $(41,071)$ | $(3,089)$ |
| Non-performing loans charged-off | $(5,539)$ | $(1,791)$ | $(26,512)$ | $(7,537)$ |
| Loans returned to accrual status / loan collections | $(52,049)$ | $(3,970)$ | $(203,478)$ | $(14,685)$ |
| Loans transferred to held-for-sale |  |  | $(14,968)$ |  |
| Non-performing loans sold ${ }^{[1]}$ |  |  | $(434,607)$ |  |
| Ending balance NPLs | \$ 177,835 | \$ 25,373 | \$ 177,835 | \$ 25,373 |

[1] Includes write-downs of loans sold at BPPR.

## Table 46 Activity in Non-Performing Mortgage loans Held-in-Portfolio (Excluding Covered Loans)

|  | For the quarter ended September 30, 2012 |  | For the nine months ended September 30, 2012 |  |
| :---: | :---: | :---: | :---: | :---: |
| (Dollars in thousands) | BPPR | BPNA | BPPR | BPNA |
| Beginning balance | \$ 600,082 | \$ 32,817 | \$ 649,279 | \$ 37,223 |
| Plus: |  |  |  |  |
| New non-performing loans | 157,114 | 9,457 | 509,107 | 22,189 |
| Less: |  |  |  |  |
| Non-performing loans transferred to OREO | $(19,522)$ | $(1,858)$ | $(60,518)$ | $(6,029)$ |
| Non-performing loans charged-off | $(12,811)$ | $(2,541)$ | $(53,813)$ | $(8,165)$ |
| Loans returned to accrual status / loan collections | $(126,340)$ | $(4,346)$ | $(445,532)$ | $(11,689)$ |
| Ending balance NPLs | \$ 598,523 | \$33,529 | \$ 598,523 | \$ 33,529 |

Table 47 provides information on non-performing mortgage loans and net charge-offs for the BPPR, excluding covered loans portfolio, and the BPNA segments.

Table 47 Non-Performing Mortgage Loans and Net Charge-offs (Excluding Covered Loans)

BPPR BPNA Popular, Inc.
September 30,December 31September 30, ecember 31September 30,December 31,

| (Dollars in thousands) | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Non-performing mortgage loans $\$ 177,835$ $\$ 596,106$ $\$ 25,373$ $\$ 34,024$$\$ 203,208$ | $\$ 630,130$ |  |  |  |  |  |
| Non-performing mortgage loans to <br> mortgage loans HIP | $3.33 \%$ | $12.05 \%$ | $2.00 \%$ | $3.01 \%$ | $3.07 \%$ | $10.37 \%$ |

BPPR BPNA Popular, Inc.
For the quarters
For the quarters ended ended For the quarters ended September 3OSeptember 38eptember 38eptember 3\$,eptember 3OSeptember 30,
$\left.\begin{array}{lccccccc}\text { (Dollars in thousands) } & 2013 & 2012 & 2013 & 2012 & 2013 & 2012 \\ \hline \text { Mortgage loan net charge-offs } & \$ 11,393 & \$ & 12,431 & \$ 1,334 & \$ & 3,541 & \$ 12,727\end{array}\right) \$ 15,972$

Table of Contents

|  | For the | R ne months ed |  | For the nine months | months | Popul <br> For the n | , | onths |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | September 30 | September 38 | tember 3 |  | ember 30 | ptember 30 |  | mber 30, |
| (Dollars in thousands) | 2013 | 2012 | 2013 |  | 2012 | 2013 |  | 2012 |
| Mortgage loan net charge-offs[1] | \$ 40,755 | \$ 39,467 | 7,142 | \$ | 12,140 | \$ 47,897 | \$ | 51,607 |
| Mortgage loan net charge-offs (annualized) to average mortgage |  |  |  |  |  |  |  |  |
| loans HIP[1] | 1.02\% | 1.14\% | 0.79\% |  | 1.69\% | 0.97\% |  | 1.23\% |

[1] Excludes write-downs of loans sold at BPPR.
For the quarter ended September 30, 2013, inflows of mortgage non-performing loans held-in-portfolio at the BPPR segment amounted to $\$ 94$ million, a decrease of $\$ 63$ million, or $40 \%$, when compared to inflows for the same period in 2012. Inflows of mortgage non-performing loans held-in-portfolio at the BPNA segment amounted to $\$ 5$ million, a decrease of $\$ 4$ million, or $44 \%$, compared to inflows for 2012. Inflows are at the lowest level in over four years.

Mortgage loan net charge-offs, excluding covered loans, decreased by $\$ 3.2$ million, for the quarter ended September 30, 2013, compared with the same period in 2012. Mortgage loan net charge-offs to average mortgage non-covered loans held-in-portfolio decreased from $1.11 \%$ for the quarter ended September 30, 2012 to $0.78 \%$ for the same period in 2013.

Net charge-offs at the BPPR segment, were $\$ 11.4$ million or $0.87 \%$ of average non-covered loans held-in-portfolio on an annualized basis, decreasing by $\$ 1.0$ million from the third quarter of 2012. For the quarter ended September 30, 2013, charge-offs associated with mortgage loans individually evaluated for impairment amounted to $\$ 2.8$ million in the BPPR segment.

Mortgage loans net charge-offs at the BPNA segment amounted to $\$ 1.3$ million for the quarter ended September 30, 2013, a decrease of $\$ 2.2$ million when compared to the same period in 2012. Mortgage loan net charge-offs to average mortgage non-covered loans held-in-portfolio decreased from $1.33 \%$ for the quarter ended September 30, 2012 to $0.41 \%$ for the same period in 2013. The net charge-offs for BPNA s non-conventional mortgage loan portfolio amounted to approximately $\$ 1.4$ million, or $1.28 \%$ of average non-conventional mortgage loans held-in-portfolio for the quarter ended September 30, 2013, compared with $\$ 2.5$ million, or $2.11 \%$ of average loans for the same period last year. For the quarter ended September 30, 2013, charge-offs associated with mortgage loans individually evaluated for impairment amounted to $\$ 0.2$ million in the BPNA segment.

The allowance for loan losses for mortgage loans held-in-portfolio, excluding covered loans, amounted to $\$ 162$ million, or $2.45 \%$ of that portfolio at September 30, 2013, compared with $\$ 149$ million, or $2.46 \%$, at December 31, 2012. The allowance for loan losses corresponding to the mortgage loan portfolio for the BPPR segment totaled $\$ 132$ million, or $2.47 \%$ of mortgage loans held-in-portfolio, excluding covered loans, at September 30, 2013, compared with $\$ 119$ million, or $2.41 \%$, respectively, at December 31, 2012. The increase in the allowance was principally driven by the enhancements to the allowance for loan losses methodology as a result of the recalibration of the environmental factors adjustment, offset by a reserve release of $\$ 30$ million related to the mortgage NPL sale. At the BPNA segment, the allowance for loan losses corresponding to the mortgage loan portfolio totaled $\$ 30$ million, or $2.35 \%$ of mortgage loans held-in-portfolio at September 30, 2013, compared with $\$ 30$ million, or $2.69 \%$, at December 31, 2012. The allowance for loan losses for BPNA s non-conventional mortgage loan portfolio amounted to $\$ 26$ million, or $6.02 \%$ of that particular loan portfolio, compared with $\$ 25$ million, or $5.60 \%$, respectively, at December 31, 2012. The Corporation is no longer originating non-conventional mortgage loans at BPNA.

Residential mortgage loans modified in a TDR are primarily comprised of loans where monthly payments are lowered to accommodate the borrowers financial needs for a period of time, normally five years. After the lowered monthly payment period ends, the borrower reverts back to paying principal and interest per the original terms with the maturity date adjusted accordingly. At September 30, 2013, the mortgage loan TDRs for the BPPR and BPNA segments amounted to $\$ 530$ million (including $\$ 217$ million guaranteed by U.S. sponsored entities) and $\$ 53$ million, respectively, of which $\$ 65$ million and $\$ 9$ million, were in non-performing status. This compares to $\$ 624$ million (including $\$ 148$ million guaranteed by U.S. sponsored entities) and $\$ 54$ million, respectively, of which $\$ 263$ million and $\$ 10$ million, were in non-performing status at December 31, 2012. These mortgage loan TDRs were evaluated for impairment resulting in a specific allowance for loan losses of $\$ 36$ million and $\$ 18$ million for the BPPR and BPNA segments, respectively, at September 30, 2013, compared to $\$ 59$ million and $\$ 16$ million, respectively, at December 31, 2012.

## Table of Contents

## Consumer loans

Consumer non-covered non-performing loans held-in-portfolio remained stable from December 31, 2013 to September 30, 2013, increasing slightly by $\$ 863$ thousand. Additions to consumer non-performing loans amounted to $\$ 22$ million in the BPPR segment for the quarter ended September 30, 2013, compared with additions of $\$ 27$ million in the third quarter of 2012.The additions to consumer non-performing loans in the BPNA segment amounted to $\$ 6$ million for the quarter ended September 30, 2013, compared with additions of $\$ 10$ million in the third quarter of 2012.

Consumer loan net charge-offs, excluding covered loans, decreased by $\$ 2.9$ million for the quarter ended September 30, 2013 when compared with the same period in 2012, mainly driven by reductions of $\$ 2.6$ million in the BPNA segment, led by improved credit quality of the portfolios. Consumer loan net charge-offs to average consumer non-covered loans held-in-portfolio decreased from $3.06 \%$ for the quarter ended September 30, 2012 to $2.72 \%$ for the quarter ended September 30, 2013.

The allowance for loan losses for the consumer portfolio, excluding covered loans, amounted to $\$ 170$ million, or $4.36 \%$ of that portfolio at September 30, 2013, compared to $\$ 131$ million, or $3.39 \%$, at December 31, 2012. The allowance for loan losses of the non-covered consumer loan portfolio in the BPPR segment totaled $\$ 144$ million, or $4.40 \%$ of that portfolio at September 30, 2013, compared with $\$ 100$ million, or $3.09 \%$, at December 31, 2012. The increase in the allowance for loan losses at the BPPR segment was principally due to an increase of $\$ 31$ million and $\$ 14$ million in the general and specific reserves, respectively, mainly arising from the enhancement to the allowance for loan losses methodology during the second quarter of 2013 and refinements of certain assumptions in the expected future cash flow analysis of the consumer troubled debt restructures. At the BPNA segment, the allowance for loan losses of the consumer loan portfolio totaled $\$ 26$ million, or $4.14 \%$ of consumer loans at September 30, 2013, compared with $\$ 31$ million, or $4.94 \%$, at December 31, 2012.

At September 30, 2013, the consumer loan TDRs for the BPPR and BPNA segments amounted to $\$ 127$ million and $\$ 2$ million, respectively, of which $\$ 10$ million and $\$ 599$ thousand, respectively, were in non-performing status, compared with $\$ 132$ million and $\$ 3$ million, respectively, of which $\$ 8$ million and $\$ 643$ thousand, respectively, were in non-performing status at December 31, 2012. These consumer loan TDRs were evaluated for impairment resulting in a specific allowance for loan losses of $\$ 31$ million and $\$ 324$ thousand for the BPPR and BPNA segments, respectively, at September 30, 2013, compared with $\$ 18$ million and $\$ 107$ thousand, respectively, at December 31, 2012.

Table 48 provides information on consumer non-performing loans and net charge-offs by segments.
Table 48 Non-Performing Consumer Loans and Net Charge-offs (Excluding Covered Loans)


BPPR BPNA Popular, Inc.

For the quarters
ended For the quarters ended
For the quarters ended September 30September 38eptember 38eptember 3\$,eptember 30September 30,

| (Dollars in thousands) | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Consumer loan net charge-offs | $\$ 21,576$ | $\$$ | 21,853 | $\$ 5,016$ | $\$$ | 7,646 | $\$ 26,592$ | $\$$ |
| Consumer loan net charge-offs <br> (annualized) to average consumer loans |  |  |  |  |  |  |  |  |
| HIP | $2.64 \%$ | $2.74 \%$ | $3.15 \%$ | $4.64 \%$ | $2.72 \%$ | $3.06 \%$ |  |  |

Table of Contents


Combined net charge-offs for E-LOAN s home equity lines of credit and closed-end second mortgages amounted to approximately $\$ 2.5$ million or $3.54 \%$ of those particular average loan portfolios for the quarter ended September 30, 2013, compared with $\$ 4.6$ million, or $5.56 \%$, for the quarter ended September 30, 2012. With the downsizing of E-LOAN, this subsidiary ceased originating these types of loans in 2008. Home equity lending includes both home equity loans and lines of credit. This type of lending is secured by a first or second mortgage on the borrower s residence, allow customers to borrow against the equity in their home. Real estate market values at the time the loan or line is granted directly affect the amount of credit extended and, in addition, changes in these values impact the severity of losses. E-LOAN s portfolio of home equity lines of credit and closed-end second mortgages outstanding at September 30, 2013 totaled $\$ 270$ million with a related allowance for loan losses of $\$ 12$ million, representing $4.33 \%$ of that particular portfolio. E-LOAN s portfolio of home equity lines of credit and closed-end second mortgages outstanding at December 31, 2012 totaled $\$ 312$ million with a related allowance for loan losses of $\$ 17$ million, representing $5.47 \%$ of that particular portfolio. At September 30, 2013, home equity lines of credit and closed-end second mortgages in which E-LOAN holds both the first and second lien amounted to $\$ 47$ thousand and $\$ 289$ thousand, respectively, representing $0.01 \%$ and $0.05 \%$, respectively, of the consumer loan portfolio of the BPNA segment. At September 30, 2013, $47 \%$ are paying the minimum amount due on the home equity lines of credit. At September 30, 2013, all closed-end second mortgages in which E-LOAN holds the first lien mortgage were in performing status.

## Troubled debt restructurings

The following tables present the covered and non-covered loans classified as TDRs according to their accruing status at September 30, 2013 and December 31, 2012.

## Table 49 TDRs Non-Covered Loans

September 30, 2013

| (In thousands) | Accruing | Non-Accruing | Total |  |
| :--- | ---: | ---: | ---: | ---: |
| Commercial | $\$ 111,645$ | $\$$ | 77,558 | $\$ 189,203$ |
| Construction | 449 | 11,542 | 11,991 |  |
| Legacy | 508,337 | 74,649 | 3,949 |  |
| Mortgage | 968 | 583,017 |  |  |
| Leases | 119,204 | 10,391 | 3,159 |  |
| Consumer |  |  | 129,537 |  |
|  | $\$ 740,603$ | $\$$ | 180,253 | $\$ 920,856$ |

## Table 50 TDRs Non-Covered Loans

|  | December 31, 2012 |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
| (In thousands) | Accruing | Non-Accruing | Total |  |
| Commercial | $\$ 105,648$ | $\$$ | 208,119 | $\$$ |
| Construction | 2,969 | 10,310 | 13,279 |  |
| Legacy | 405,063 | 5,978 | 5,978 |  |
| Mortgage | 1,726 | 3,042 | 678,105 |  |
| Leases | 125,955 | 8,981 | 134,981 |  |
| Consumer |  |  |  |  |
|  | $\$ 641,361$ | $\$$ | 509,585 | $\$ 1,150,946$ |

## Table of Contents

## Table 51 TDRs Covered Loans

|  | September 30, 2013 |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
| (In thousands) | Accruing Non-Accruing | Total |  |  |
| Commercial | $\$ 7,412$ | $\$$ | 9,142 | $\$ 16,554$ |
| Construction |  |  | 5,241 | 5,241 |
| Mortgage | 147 | 189 | 336 |  |
| Consumer | 254 | 64 | 318 |  |
| Total | $\$ 7,813$ | $\$$ | 14,636 | $\$ 22,449$ |

## Table 52 TDRs Covered Loans

December 31, 2012

| (In thousands) | Accruing |  | Non-Accruing | Total |
| :--- | ---: | ---: | ---: | ---: |
| Commercial | $\$ 46,142$ | $\$$ | 4,071 | $\$ 50,213$ |
| Construction |  | 7,435 | 7,435 |  |
| Mortgage | 149 | 220 | 369 |  |
| Consumer | 517 | 106 | 623 |  |
|  |  |  |  |  |
| Total | $\$ 46,808$ | $\$$ | 11,832 | $\$ 58,640$ |

The Corporation s TDR loans totaled $\$ 921$ million at September 30, 2013, a decrease of $\$ 230$ million, or 20\%, from December 31, 2012, mainly due to reductions of $\$ 125$ million, or $40 \%$, and $\$ 95$ million or $14 \%$, in the commercial and mortgage portfolios, respectively, primarily related to the bulk loan sales at the BPPR segment during the first half of the year. TDRs in accruing status increased by $\$ 99$ million from December 31, 2012, due to sustained borrower performance.

Refer to Note 7 to the consolidated financial statements for additional information on modifications considered troubled debt restructurings, including certain qualitative and quantitative data about troubled debt restructurings.

## Other real estate

Other real estate represents real estate property acquired through foreclosure, part of the Corporation s continuous efforts to aggressively resolve non-performing loans. Other real estate not covered under loss sharing agreements with the FDIC decreased by $\$ 131$ million from December 31, 2012 to September 30, 2013, mainly driven by decreases of $\$ 114$ million and $\$ 17$ million in the BPPR and BPNA segments, respectively.

Other real estate covered under loss sharing agreements with the FDIC, comprised principally of repossessed commercial real estate properties, amounted to $\$ 160$ million at September 30, 2013, compared with $\$ 139$ million at December 31, 2012. The increase was principally from repossessed commercial real estate properties. Generally, $80 \%$ of the write-downs taken on these properties based on appraisals or losses on the sale are covered under the loss sharing agreements.

During the nine months period ended September 30, 2013, the Corporation transferred $\$ 192$ million of loans to other real estate, sold $\$ 266$ million of foreclosed properties and recorded write-downs and other adjustments of approximately $\$ 36$ million.

Updated appraisals or third-party opinions of value ( BPOs ) are obtained to adjust the values of the other real estate assets. Commencing in 2011, the appraisal for a commercial or construction other real estate property with a book value greater than $\$ 1$ million is updated annually and if lower than $\$ 1$ million it is updated at least every two years. For residential other real estate property, the Corporation requests third-party BPOs or appraisals generally on an annual basis. Appraisals may be adjusted due to age, collateral inspections and property profiles or due to general market conditions. The adjustments applied are based upon internal information like other appraisals for the type of properties and loss severity information that can provide historical trends in the real estate market, and may change from time to time based on market conditions.

For commercial and construction other real estate properties at the BPPR segment, depending on the type of property and/or the age of the appraisal, downward adjustments currently may range between $5 \%$ to $40 \%$, including estimated cost to sell. For commercial and construction properties at the BPNA segment, the most typically applied collateral discount rate currently ranges from $10 \%$ to $50 \%$, including cost to sell. This discount was determined based on a study of other real estate owned and loan sale transactions during the past two years, comparing net proceeds received by the lender relative to the most recent appraised value of the properties. However, additional haircuts can be applied depending upon the age of appraisal, the region and the condition of the property or project.

## Table of Contents

In the case of the BPPR segment, during the third quarter of 2013, appraisals of residential properties were subject to downward adjustments of up to approximately $15 \%$, including cost to sell of $5 \%$. In the case of the BPNA segment residential properties, the downward adjustment approximated up to $30 \%$, including cost to sell of $10 \%$.

## Allowance for Loan Losses

## Non-Covered Loan Portfolio

The allowance for loan losses, which represents management s estimate of credit losses inherent in the loan portfolio, is maintained at a sufficient level to provide for estimated credit losses on individually evaluated loans as well as estimated credit losses inherent in the remainder of the loan portfolio. The Corporation s management evaluates the adequacy of the allowance for loan losses on a quarterly basis. In this evaluation, management considers current economic conditions and the resulting impact on Popular Inc. s loan portfolio, the composition of the portfolio by loan type and risk characteristics, historical loss experience, results of periodic credit reviews of individual loans, regulatory requirements and loan impairment measurement, among other factors.

The Corporation must rely on estimates and exercise judgment regarding matters where the ultimate outcome is unknown, such as economic developments affecting specific customers, industries or markets. Other factors that can affect management s estimates are the years of historical data when estimating losses, changes in underwriting standards, financial accounting standards and loan impairment measurements, among others. Changes in the financial condition of individual borrowers, in economic conditions, in historical loss experience and in the condition of the various markets in which collateral may be sold may all affect the required level of the allowance for loan losses. Consequently, the business financial condition, liquidity, capital and results of operations could also be affected.

The Corporation s assessment of the allowance for loan losses is determined in accordance with accounting guidance, specifically guidance of loss contingencies in ASC Subtopic 450-20 and loan impairment guidance in ASC Section 310-10-35. Decreases in expected cash flows after the acquisition date for loans (pools) accounted for under ASC Subtopic 310-30 are recognized by recording an allowance for loan losses in the current period. For purposes of loans accounted for under ASC Subtopic 310-20 and new loans originated as a result of loan commitments assumed, the Corporation s assessment of the allowance for loan losses is determined in accordance with the accounting guidance of loss contingencies in ASC Subtopic 450-20 (general reserve for inherent losses) and loan impairment guidance in ASC Section 310-10-35 for loans individually evaluated for impairment. As explained in the Critical Accounting Policies / Estimates section of this MD\&A, during the second quarter of 2013, the Corporation enhanced the estimation process for evaluating the adequacy of its allowance for loan losses for the Corporation s commercial and construction loan portfolios by (i) incorporating risk ratings to the commercial, construction and legacy loan segmentation, and (ii) updating and enhancing the framework utilized to quantify and establish environmental factors adjustments.

## Table of Contents

The following tables set forth information concerning the composition of the Corporation s allowance for loan losses at September 30, 2013 and December 31, 2012 by loan category and by whether the allowance and related provisions were calculated individually pursuant to the requirements for specific impairment or through a general valuation allowance.

## Table 53 Composition of ALLL

September 30, 2013

[1] Excludes covered loans acquired on the Westernbank FDIC-assisted transaction.
[2] Excludes covered loans acquired on the Westernbank FDIC-assisted transaction. At September 30, 2013, the general allowance on the covered loans amounted to $\$ 113$ million while the specific reserve amounted to $\$ 4$ million.
[3] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

## Table 54 Composition of ALLL

December 31, 2012

| (Dollars in thousand | Commercial |  | Construction |  | Legacy ${ }^{[3]}$ | Leasing |  | Mortgage |  | Consumer |  | Total ${ }^{[2]}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Specific ALLL | \$ | 17,348 | \$ | 120 |  | \$ | 1,066 | \$ | 74,667 | \$ | 17,886 | \$ | 111,087 |
| Impaired loans ${ }^{[1]}$ | \$ | 527,664 | \$ | 41,809 | \$ 18,744 | \$ | 4,881 | \$ | 611,230 | \$ | 133,377 | \$ | 1,337,705 |
| Specific ALLL to impaired loans ${ }^{[1]}$ |  | 3.29\% |  | 0.29\% |  | \% | 21.84\% |  | 12.22\% |  | 13.41\% |  | 8.30\% |



Loans
held-in-portfolio, excluding impaired
loans ${ }^{[1]} \quad \$ 9,330,538 \quad \$ 211,048 \quad \$ 365,473 \quad \$ 535,642 \quad \$ 5,467,277 \quad \$ 3,735,509 \quad \$ 19,645,487$

General ALLL to
loans
held-in-portfolio, excluding impaired

| loans ${ }^{[1]}$ |  | $3.00 \%$ | $3.46 \%$ |  | $9.06 \%$ |  | $0.34 \%$ |  | $1.37 \%$ |  | $3.03 \%$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |

[1] Excludes covered loans acquired on the Westernbank FDIC-assisted transaction.
[2] Excludes covered loans acquired on the Westernbank FDIC-assisted transaction. At December 31, 2012, the general allowance on the covered loans amounted to $\$ 100$ million while the specific reserve amounted to $\$ 9$ million.
[3] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.
At September 30, 2013, the allowance for loan losses, excluding covered loans, decreased by approximately $\$ 96$ million from December 31, 2012. The ratio of the allowance for loan losses to loans held-in-portfolio, excluding covered loans, stood at $2.46 \%$ as of September 30, 2013, compared with $2.96 \%$ as of December 31, 2012. The general and specific reserves related to non-covered

## Table of Contents

loans totaled $\$ 418$ million and $\$ 108$ million, respectively, at quarter-end, compared with $\$ 511$ million and $\$ 111$ million, respectively, as of December 31, 2012. The reduction in the allowance for loan losses was primarily due to the combined effect of the release related to the non-performing loans bulk sales, continued improvements in credit quality, offset by the enhancements to the allowance for loan losses methodology.

At September 30, 2013, the allowance for loan losses for non-covered loans at the BPPR segment totaled $\$ 399$ million, or $2.55 \%$ of non-covered loans held-in-portfolio, compared with $\$ 445$ million, or $2.92 \%$ of non-covered loans held-in-portfolio at December 31, 2012. Excluding the reserve release of $\$ 30.3$ million related to the bulk sale, the decrease in the allowance mainly reflects the net effect of positive credit quality trends, offset by a $\$ 22.6$ million increase arising from the enhancements to the allowance for loan losses methodology.

For the period ended September 30, 2013, 12\% of the ALLL for our BPPR non-covered loan portfolios utilized the recent loss trend adjustment instead of the base loss. The effect of replacing the base loss with the recent loss trend adjustment was mainly concentrated in the commercial multi-family, leasing, and auto loan portfolios. For the period ended December 31, 2012, $32 \%$ of the ALLL for our BPPR non-covered loan portfolios utilized the recent loss trend adjustment instead of the base loss. The effect of replacing the base loss with the recent loss trend adjustment was mainly concentrated in the commercial multi-family, commercial and industrial, construction, credit cards, and personal loan portfolios.

The allowance for loan losses at the BPNA segment totaled $\$ 127$ million, or $2.20 \%$ of loans held-in-portfolio, compared with $\$ 176$ million, or $3.07 \%$ of loans held-in-portfolio at December 31, 2012. The decline in the allowance for loan losses reflects the sustained improvement in the overall quality of the loan portfolios, and the favorable effect from the enhancements in the allowance for loan losses methodology during the second quarter of 2013.

For the period ended September 30, 2013, 23\% of the ALLL for our BPNA loan portfolios utilized the recent loss trend adjustment instead of the base loss. The effect of replacing the base loss with the recent loss trend adjustment was mainly concentrated in the commercial multi-family, commercial real estate non-owner occupied, commercial and industrial, and legacy loan portfolios. For the period ended December 31, 2012, 8\% of the ALLL for our BPNA loan portfolios utilized the recent loss trend adjustment instead of the base loss. The effect of replacing the base loss with the recent loss trend adjustment was mainly concentrated in the construction and legacy loan portfolios.

The following table presents the Corporation s recorded investment in loans, excluding covered loans, that were considered impaired and the related valuation allowance at September 30, 2013 and December 31, 2012.

Table 55 Impaired Loans (Non-Covered Loans) and the Related Valuation Allowance

|  | September 30, 2013 |  | December 31, 2012 |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Recorded | Valuation | Recorded | Valuation |  |  |  |
| (In millions) | Investment | Allowance | Investment | Allowance |  |  |
| Impaired loans: | $\$ 666.1$ | $\$$ | 108.1 | $\$ 897.6$ | $\$$ | 111.1 |
| Valuation allowance | 288.0 |  |  |  | 440.1 |  |
| No valuation allowance required | $\$ 954.1$ | $\$$ | 108.1 | $\$ 1,337.7$ | $\$$ | 111.1 |

With respect to the $\$ 288$ million portfolio of impaired loans for which no allowance for loan losses was required at September 30, 2013, management followed the guidance for specific impairment of a loan. When a loan is impaired, the measurement of the impairment may be based on: (1) the present value of the expected future cash flows of the impaired loan discounted at the loan s original effective interest rate; (2) the observable market price of the impaired loan; or (3) the fair value of the collateral, if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. Impaired loans with no valuation allowance were mostly collateral dependent loans for which management charged-off specific reserves based on the fair value of the collateral less estimated costs to sell.

## Table of Contents

Average impaired loans, excluding covered loans, during the quarters ended September 30, 2013 and September 30, 2012 were $\$ 958$ million and $\$ 1.4$ billion, respectively. The Corporation recognized interest income on impaired loans of $\$ 7.4$ million and $\$ 10.1$ million, respectively, for the quarters ended September 30, 2013 and 2012.

The following tables set forth the activity in the specific reserves for impaired loans, excluding covered loans, for the quarters ended September 30, 2013 and 2012.

Table 56 Activity in Specific ALLL for the Quarter Ended September 30, 2013

| (In thousands) | Commercial | Construction | Mortgage | Legacy | Consumer | Leasing | Total |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Beginning balance | $\$$ | 18,719 | $\$$ | 1,401 | $\$ 53,278$ | $\$$ | $\$ 31,254$ | $\$ 1,399$ | $\$ 106,051$ |
| Provision for impaired loans | 12,235 | $(813)$ | 3,447 | 390 | 2,665 | $(202)$ | 17,722 |  |  |
| Less: Net charge-offs | $(10,118)$ |  | $(2,943)$ | $(390)$ | $(2,257)$ |  | $(15,708)$ |  |  |
|  |  |  |  |  |  |  |  |  |  |
| Specific allowance for loan <br> losses at September 30, 2013 | $\$$ | 20,836 | $\$$ | 588 | $\$ 53,782$ | $\$$ | $\$ 31,662$ | $\$ 1,197$ | $\$ 108,065$ |

Table 57 Activity in Specific ALLL for the Quarter Ended September 30, 2012

| (In thousands) | Commercial | Construction | Mortgage | Legacy | Consumer | Leasing | Total |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Beginning balance | $\$ 6,830$ | $\$$ | 434 | $\$ 59,723$ | $\$$ | 99 | $\$ 19,656$ | $\$ 766$ | $\$ 87,508$ |
| Provision for impaired loans | 33,386 | 2,409 | 4,259 | 370 | 1,537 | 212 | 42,173 |  |  |
| Less: Net charge-offs | $(17,977)$ | $(2,652)$ | $(1,159)$ | $(469)$ |  |  |  | $(22,257)$ |  |

Specific allowance for loan losses
$\begin{array}{lllllllllll}\text { at September 30, } 2012 & \$ 22,239 & \$ & 191 & \$ 62,823 & \$ & \$ 21,193 & \$ 978 & \$ 107,424\end{array}$
For the quarter ended September 30, 2013, total charge-offs for individually evaluated impaired loans amounted to approximately $\$ 15.7$ million, of which $\$ 13.9$ million pertained to the BPPR segment and $\$ 1.8$ million to the BPNA segment. Most of these charge-offs were related to the commercial loan portfolio.

The Corporation requests updated appraisal reports from pre-approved appraisers for loans that are considered impaired, and individually analyzes them following the Corporation s reappraisal policy. This policy requires updated appraisals for loans secured by real estate (including construction loans) either annually or every two years depending on the total exposure of the borrower. As a general procedure, the Corporation internally reviews appraisals as part of the underwriting and approval process and also for credits considered impaired. Generally, the specialized appraisal review unit of the Corporation s Credit Risk Management Division internally reviews appraisals following certain materiality benchmarks. In addition to evaluating the reasonability of the appraisal reports, these reviews monitor that appraisals are performed following the Uniform Standards of Professional Appraisal Practice ( USPAP ).

Appraisals may be adjusted due to age or general market conditions. The adjustments applied are based upon internal information, like other appraisals and/or loss severity information that can provide historical trends in the real estate market. Specifically, in commercial and construction impaired loans for the BPPR segment, and depending on the type of property and/or the age of the appraisal, downward adjustments currently range from $5 \%$ to $40 \%$ (including
costs to sell). At September 30, 2013, the weighted average discount rate for the BPPR segment was $20 \%$.
For commercial and construction loans at the BPNA segment, downward adjustments to the collateral value currently range from $10 \%$ to $50 \%$ depending on the age of the appraisals and the type, location and condition of the property. This discount used was determined based on a study of other real estate owned and loan sale transactions during the past two years, comparing net proceeds received by the bank relative to the most recent appraised value of the properties. However, additional haircuts can be applied depending upon the age of appraisal, the region and the condition of the project. Factors are based on appraisal changes and/or trends in loss severities. Discount rates discussed above include costs to sell and may change from time to time based on market conditions. At September 30, 2013, the weighted average discount rate for the BPNA segment was $29 \%$.

## Table of Contents

For mortgage loans secured by residential real estate properties, a current assessment of value is made not later than 180 days past the contractual due date. Any outstanding balance in excess of the estimated value of the collateral property, less estimated costs to sell, is charged-off. For this purpose, the Corporation requests third-party Broker Price Opinion of Value BPOs of the subject collateral property at least annually. In the case of the mortgage loan portfolio for the BPPR segment, BPOs of the subject collateral properties are currently subject to downward adjustment of up to approximately $26 \%$, including cost to sell of $5 \%$. In the case of the BPNA mortgage loan portfolio, a $30 \%$ haircut is taken, which includes costs to sell.

Discount rates discussed above include costs to sell and may change from time to time based on market conditions.
The table that follows presents the approximate amount and percentage of non-covered impaired loans for which the Corporation relied on appraisals dated more than one year old for purposes of impairment requirements at September 30, 2013.

Table 58 Non-Covered Impaired Loans with Appraisals Dated 1 year or Older

| (In thousands) | Total Impaired Loans -Held-in-portfolio (HIP) |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Impaired Loans with Outstanding Principal Appraisals Over One |  |  |  |
|  |  |  |  |  |
|  | Loan Count | Balance |  | Year Old[1] |
| Commercial | 206 | \$ | 286,280 | 20\% |
| Construction | 11 |  | 24,525 | 31 |
| Legacy | 8 |  | 11,597 |  |

[1] Based on outstanding balance of total impaired loans.
The percentage of the Corporation s impaired construction loans that were relied upon as developed and as is for the period ended September 30, 2013 is presented in Table 59.

Table 59 Impaired Construction Loans Relied Upon As is or As Developed

| As is |  |  |  | As developed |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Outstandings a \% Of Total |  |  |  |  | Outstandings a \% Of Total |
| Loan | Principal | Construction | Loan | Principal | ConstructionAverage \% Of |  |

[1] Includes $\$ 5$ million of construction loans from the BPNA legacy portfolio.
At September 30, 2013, the Corporation accounted for $\$ 10$ million impaired construction loans under the as developed value. This approach is used since the current plan is that the project will be completed and it reflects the best strategy to reduce potential losses based on the prospects of the project. The costs to complete the project and the related increase in debt are considered an integral part of the individual reserve determination.

Costs to complete are deducted from the subject as developed collateral value on impaired construction loans. Impairment determinations are calculated following the collateral dependent method, comparing the outstanding principal balance of the respective impaired construction loan against the expected realizable value of the subject collateral. Realizable values of subject collaterals have been defined as the as developed appraised value less costs to complete, costs to sell and discount factors. Costs to complete represent an estimate of the amount of money to be disbursed to complete a particular phase of a construction project. Costs to sell have been determined as a percentage of the subject collateral value, to cover related collateral disposition costs (e.g. legal and commission fees). As discussed previously, discount factors may be applied to the appraised amounts due to age or general market conditions.

Table of Contents

## Allowance for loan losses Covered loan portfolio

The Corporation s allowance for loan losses for the covered loan portfolio acquired in the Westernbank FDIC-assisted transaction amounted to $\$ 117$ million at September 30, 2013. This allowance covers the estimated credit loss exposure related to: (i) acquired loans accounted for under ASC Subtopic 310-30, which required an allowance for loan losses of $\$ 109$ million at September 30, 2013, compared with $\$ 95$ million at December 31, 2012; and (ii) acquired loans accounted for under ASC Subtopic 310-20, which required an allowance for loan losses of $\$ 8$ million, compared with $\$ 14$ million at December 31, 2012.

Decreases in expected cash flows after the acquisition date for loans (pools) accounted for under ASC Subtopic 310-30 are recognized by recording an allowance for loan losses in the current period. For purposes of loans accounted for under ASC Subtopic 310-20 and new loans originated as a result of loan commitments assumed, the Corporation s assessment of the allowance for loan losses is determined in accordance with the accounting guidance of loss contingencies in ASC Subtopic 450-20 (general reserve for inherent losses) and loan impairment guidance in ASC Section 310-10-35 for loans individually evaluated for impairment. Concurrently, the Corporation records an increase in the FDIC loss share asset for the expected reimbursement from the FDIC under the loss sharing agreements.

## Geographic and government risk

The Corporation is exposed to geographical and government risk. The Corporation s assets and revenue composition by geographical area and by business segment reporting are presented in Note 33 to the consolidated financial statements. A significant portion of the Corporation s financial activities and credit exposure is concentrated in Puerto Rico, which has been going through a challenging economic cycle. Puerto Rico sfiscal and economic situation is expected to continue to be difficult.

The gross product of Puerto Rico increased $0.1 \%$ in fiscal 2012, the first positive growth in five years, according to the Puerto Rico Planning Board. However, the Planning Board forecasts a slight deceleration of growth for fiscal 2013. The agency s Economic Analysis Division forecasts a decrease in the gross product of $0.03 \%$ for fiscal 2013, which ended in June 2013, and a decrease of $0.08 \%$ for fiscal 2014.

Puerto Rico continues to be susceptible to fluctuations in the price of crude oil due to its high dependence on fuel oil for energy production. An unexpected rise in the price of oil could have a negative impact on the overall economy, as it is dependent on oil for most of its electricity and transportation. Also, loan demand in the Puerto Rico market continues to be sluggish. Lower loan demand could impact our level of earning assets and profitability. A slowdown in the economy could increase the level of non-performing assets and could adversely affect profitability. Recent increases in the yields of Commonwealth bonds in the U.S. municipal market - caused by a number of factors, including expectations that interest rates will rise further, weakness in the U.S. municipal bond market after the bankruptcy filing in July 2013 of the city of Detroit, Michigan, volatility in economic indicators of Puerto Rico and leveraged investments that have caused forced sales of Commonwealth bonds - may hamper the government $s$ ability to finance itself through bond issues.

To counter chronic budget deficits, the government recently reformed the principal retirement system of public employees, privatized the international airport, enacted measures to create self-sufficiency at public corporations and raised corporate taxes. The primary sources of increased revenues include an expansion of the sales and use tax, the introduction of a new gross receipts tax and a tax on insurance underwriting premiums.

## Edgar Filing: POPULAR INC - Form 10-Q

The government estimates that the revenue-generating measures will reduce the budget deficit from $\$ 2.375$ billion in fiscal 2012 and a preliminary $\$ 1.290$ billion in fiscal 2013 to $\$ 820$ million in fiscal 2014.

For the first quarter of fiscal 2014, General Fund net revenues increased $\$ 88$ million to $\$ 1.699$ billion, when compared with the same quarter in fiscal 2013, according to the Puerto Rico Treasury Department, which stated that the revenues exceeded budget estimates by $\$ 10.4$ million.

While these revenue-generating measures should help the government address its fiscal deficit, they could have a negative impact in the business sector and on economic growth. Employment continues to be a challenge, with the economy losing 22,000 total jobs in 2013 as of August 2013, when compared with the same month a year ago, according to the U.S. Labor Bureau. The August 2013 unemployment rate stood at $13.9 \%$ as compared to $14.0 \%$ in August 2012.

## Table of Contents

The current administration has prioritized in its economic plan the defense of anchor industries, such as life sciences and knowledge services, and a renewed policy focus on tourism, small-and medium-sized enterprises and agriculture. At an investor conference call held in October 15, 2013, administration officials announced recent business expansions in Puerto Rico by global manufacturers Johnson \& Johnson, Bristol Myers Squibb, CooperVision, Covidien and Saint Jude Medical.

The Commonwealth s general obligation debt is currently rated Baa3 with a negative outlook by Moody s Investors Service ( Moody s ), BBB- with a negative outlook by Standard \& Poor s Ratings Services (S\&P ), and BBB- with negative outlook by Fitch, Inc. ( Fitch ).

Citing current declining economic and population trends, Standard \& Poor s revised on September 30, 2013 its outlook on Puerto Rico Sales Tax Financing Corp. s (COFINA) first- and second-liens bonds to negative from stable, while affirming its AA- rating on COFINA s senior (first-lien) sales tax-revenue bonds and its A+ rating on the first subordinate (second-lien) sales tax-revenue bonds outstanding.

At September 30, 2013, the Corporation had $\$ 0.9$ billion of credit facilities granted to or guaranteed by the Puerto Rico Government, its municipalities and public corporations, of which $\$ 25$ million were uncommitted lines of credit. Of the total credit facilities granted, $\$ 681$ million were outstanding at September 30, 2013, of which none were uncommitted lines of credit. A substantial portion of the Corporation scredit exposure to the Government of Puerto Rico is either collateralized loans or obligations that have a specific source of income or revenues identified for their repayment. Some of these obligations consist of senior and subordinated loans to public corporations that obtain revenues from rates charged for services or products, such as water and electric power utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it. The Corporation also has loans to various municipalities in Puerto Rico for which, in most cases, the good faith, credit and unlimited taxing power of the applicable municipality has been pledged to their repayment. These municipalities are required by law to levy special property taxes in such amounts as shall be required for the payment of all of its general obligation bonds and loans. Another portion of these loans consists of special obligations of various municipalities that are payable from the real and personal property taxes collected within such municipalities. These loans have seniority to the payment of operating cost and expenses of the municipality.

Furthermore, at September 30, 2013, the Corporation had outstanding $\$ 204$ million in obligations of Puerto Rico government as part of its investment securities portfolio. This portfolio is comprised of bonds with specific sources of income or revenues identified for repayments. This includes $\$ 64$ million of securities issued by three Municipalities of Puerto Rico that are payable from the real and personal property taxes collected within such municipalities. These bonds have seniority to the payment of operating cost and expenses of the municipality. At September 30, 2013, management performed its quarterly analysis of all debt securities in an unrealized loss position. Based on the analyses performed, management concluded that no individual debt security was other-than-temporarily impaired as of such date. We continue to closely monitor the political and economic situation of Puerto Rico and evaluate the portfolio for any declines in value that management may consider being other-than-temporary.

Additionally, the Corporation holds consumer mortgage loans with an outstanding balance of $\$ 272$ million at September 30, 2013 that are guaranteed by the Puerto Rico Housing Finance Authority (December 31, 2012 - \$294 million). These mortgage loans are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default.

As further detailed in Notes 5 and 6 to the consolidated financial statements, a substantial portion of the Corporation s investment securities represented exposure to the U.S. Government in the form of U.S. Government sponsored entities, as well as agency mortgage-backed and U.S. Treasury securities. In addition, $\$ 905$ million of residential
mortgages and $\$ 159$ million in commercial loans were insured or guaranteed by the U.S. Government or its agencies at September 30, 2013. The Corporation does not have any exposure to European sovereign debt.

Table of Contents

# ADOPTION OF NEW ACCOUNTING STANDARDS AND ISSUED BUT NOT YET EFFECTIVE ACCOUNTING STANDARDS 

FASB Accounting Standards Update 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ( ASU 2013-11 )

The FASB issued ASU 2013-11 in July 2013 which requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. When a net operating loss, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional taxes that would result from the disallowance of a tax position, or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purposes, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. Currently, there is no explicit guidance under U.S. GAAP on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendment of this guidance does not require new recurring disclosures.

ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments of this ASU should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted.

The Corporation does not anticipate that the adoption of this guidance will have a material effect on its consolidated statements of financial condition or results of operations.

FASB Accounting Standards Update 2013-10, Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes ( ASU 2013-10 )

The FASB issued ASU 2013-10 in July 2013 which permits the use of the Overnight Index Swap Rate (OIS), also referred to as the Fed Funds Effective Swap Rate as a U.S. GAAP benchmark interest rate for hedge accounting purposes under Topic 815. Currently, only the interest rates on direct Treasury obligations of the U.S. government (UST) and the London Interbank Offered Rate (LIBOR) swap rate are considered benchmark interest rates in the United States. This update also removes the restriction on using different benchmark rates for similar hedges. Including the Fed Funds Effective Swap Rate as an acceptable U.S. benchmark interest rate in addition to UST and LIBOR will provide risk managers with a more comprehensive spectrum of interest rate resets to utilize as the designated interest risk component under the hedge accounting guidance in Topic 815.

The amendments of this ASU are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013.

The adoption of this guidance has not had a material effect on its consolidated statements of financial condition or results of operations.

FASB Accounting Standards Update 2013-05, Foreign Currency Matters (Topic 830): Parent s Accounting for the Cumulative Translation Adjustment Upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign

Entity or of an Investment in a Foreign Entity ( ASU 2013-05 )
The FASB issued ASU 2013-05 in March 2013 which clarifies the applicable guidance for the release of the cumulative translation adjustment. When a reporting entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity, the parent is required to apply the guidance in ASC 830-30 to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets has resided.

For an equity method investment that is a foreign entity, the partial sale guidance in ASC 830-30-40 still applies. As such, a pro rata portion of the cumulative translation adjustment should be released into net income upon a partial sale of such equity method investment. However, this treatment does not apply to an equity method investment that is not a foreign entity. In those instances, the cumulative translation adjustment is released into net income only if the partial sale represents a complete or substantially complete liquidation of the foreign entity that contains the equity method investment.

## Table of Contents

Additionally, the amendments in this ASU clarify that the sale of an investment in a foreign entity includes both: (1) events that result in the loss of a controlling financial interest in a foreign entity and (2) events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date. Accordingly, the cumulative translation adjustment should be released into net income upon the occurrence of those events.

ASU 2013-05 is effective for fiscal years and interim periods within those years, beginning on or after December 15, 2013. The amendments should be applied prospectively to derecognition events occurring after the effective date. Prior periods should not be adjusted. Early adoption is permitted. If an entity elects to early adopt the amendments of this ASU it should apply them as of the beginning of the entity s fiscal year of adoption.

The Corporation does not anticipate that the adoption of this guidance will have a material effect on its consolidated statements of financial condition or results of operations.

## Item 3. Ouantitative and Oualitative Disclosures About Market Risk

Quantitative and qualitative disclosures for the current period can be found in the Market Risk section of this report, which includes changes in market risk exposures from disclosures presented in the Corporation s 2012 Annual Report.

## Item 4. Controls and Procedures

## Disclosure Controls and Procedures

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

## Internal Control Over Financial Reporting

There have been no changes in the Corporation s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

## Part II Other Information

## Item 1. Legal Proceedings

For a discussion of Legal Proceedings, see Note 21, Commitments and Contingencies , to the Consolidated Financial Statements.

Item 1A. Risk Factors

## Edgar Filing: POPULAR INC - Form 10-Q

In addition to the other information set forth in this report, you should carefully consider the factors discussed under Part I - Item 1A - Risk Factors in our 2012 Annual Report. These factors could materially adversely affect our business, financial condition, liquidity, results of operations and capital position, and could cause our actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report. Also refer to the discussion in Part I-Item 2 - Management s Discussion and Analysis of Financial Condition and Results of Operations in this report for additional information that may supplement or update the discussion of risk factors in our 2012 Annual Report.

## Table of Contents

There have been no material changes to the risk factors previously disclosed under Item 1A of the Corporation s 2012 Annual Report, except for the risks described below.

The risks described in our 2012 Annual Report and in this report are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or results of operations.

## Table of Contents

## RISKS RELATED TO THE FDIC-ASSISTED TRANSACTION

Our ability to obtain reimbursement under the loss sharing agreements on covered assets depends on our compliance with the terms of the loss sharing agreements.

The loss share agreements contain specific terms and conditions regarding the management of the covered assets that BPPR must follow to receive reimbursement on losses from the FDIC. Under the loss share agreements, BPPR must:
manage and administer the covered assets and collect and effect charge-offs and recoveries with respect to such covered assets in a manner consistent with its usual and prudent business and banking practices and, with respect to single family shared-loss loans, the procedures (including collection procedures) customarily employed by BPPR in servicing and administering mortgage loans for its own account and the servicing procedures established by FNMA or FHLMC, as in effect from time to time, and in accordance with accepted mortgage servicing practices of prudent lending institutions;
exercise its best judgment in managing, administering and collecting amounts on covered assets and effecting charge-offs with respect to the covered assets;
use commercially reasonable efforts to maximize recoveries with respect to losses on single family shared-loss assets and best efforts to maximize collections with respect to commercial shared-loss assets;
retain sufficient staff to perform the duties under the loss share agreements;
adopt and implement accounting, reporting, record-keeping and similar systems with respect to the commercial shared-loss assets;
comply with the terms of the modification guidelines approved by the FDIC or another federal agency for any single-family shared loss loan;
provide notice with respect to proposed transactions pursuant to which a third party or affiliate will manage, administer or collect any commercial shared-loss assets; and
file monthly and quarterly certificates with the FDIC specifying the amount of losses, charge-offs and recoveries.
Under the loss share agreements, BPPR is also required to maintain books and records sufficient to ensure and document compliance with the terms of the loss share agreements.

Under the terms of the loss share agreements, BPPR is also required to deliver certain certificates regarding compliance with the terms of each of the loss share agreements and the computations required there under. The

## Edgar Filing: POPULAR INC - Form 10-Q

required terms of the agreements are extensive and failure to comply with any of the guidelines could result in a specific asset or group of assets permanently losing their loss sharing coverage. BPPR believes that it has complied with the terms and conditions regarding the management of the covered assets. No assurances can be given that we will manage the covered assets in such a way as to always maintain loss share coverage on all such assets and fully recover the value of our loss share asset.

For the quarters ended June 30, 2010 through March 31, 2012, BPPR received reimbursement for loss-share claims submitted to the FDIC, including for charge-offs for certain commercial late stage real-estate-collateral-dependent loans calculated in accordance with BPPR s charge-off policy for non-covered assets. When BPPR submitted its shared-loss claim in connection with the June 30, 2012 quarter, however, the FDIC refused to reimburse BPPR for a portion of the claim because of a difference related to the methodology for the computation of charge-offs for certain commercial late stage real-estate-collateral-dependent loans. In accordance with the terms of the commercial loss share agreement, BPPR applied a methodology for charge-offs for late stage real-estate-collateral-dependent loans that conforms to its regulatory supervisory criteria and is calculated in accordance with BPPR s charge-off policy for non-covered assets. The FDIC has stated that it believes that BPPR should use a different methodology for those charge-offs. Notwithstanding the FDIC s refusal to reimburse BPPR for certain shared-loss claims, BPPR has continued to submit shared-loss claims for quarters subsequent to June 30, 2012. As of September 30, 2013, BPPR had unreimbursed shared-loss claims of $\$ 541.3$ million under the commercial loss share agreement with the FDIC. On October 21, 2013, BPPR received a payment of $\$ 143.1$ million related to reimbursable shared-loss claims for the FDIC. After giving effect to this payment, BPPR has unreimbursed shared-loss claims amounting to $\$ 398.2$ million, including $\$ 248.1$ million related to commercial late stage real-estate-collateral-dependent loans, determined in accordance with BPPR s regulatory supervisory criteria and BPPR s charge-off policy for non-covered assets. If the reimbursement amount for these claims were calculated in accordance with the FDIC s preferred methodology for late stage real-estate-collateral-dependent loans, the amount of such claims would be reduced by approximately $\$ 123.6$ million.

## Table of Contents

BPPR s loss share agreements with the FDIC specify that disputes can be submitted to arbitration before a review board under the commercial arbitration rules of the American Arbitration Association. On July 31, 2013, BPPR filed a statement of claim with the American Arbitration Association requesting that the review board determine certain matters relating to the loss-share claims under the commercial loss share agreement with the FDIC, including that the review board award BPPR the amounts owed under its unpaid quarterly certificates. The statement of claim also requests reimbursement of certain valuation adjustments for costs to sell troubled assets. The review board is comprised of one arbitrator appointed by BPPR, one arbitrator appointed by the FDIC and a third arbitrator selected either by those arbitrators or by the American Arbitration Association.

To the extent we are not able to successfully resolve this matter through the arbitration process described above, a material difference could result in the timing and amount of charge-offs recorded by us and the amount of charge-offs reimbursed by the FDIC under the commercial loss share agreement. No assurance can be given that we would be able to claim reimbursement from the FDIC for such difference prior to the expiration, in the quarter ending June 30, 2015, of the FDIC s obligation to reimburse BPPR under commercial loss share agreement, which could require us to make a material adjustment to the value of our loss share asset and the related true up payment obligation to the FDIC and could have a material adverse effect on our financial results for the period in which such adjustment is taken.

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

In April 2004, the Corporation s shareholders adopted the Popular, Inc. 2004 Omnibus Incentive Plan. The Corporation has to date used shares purchased in the market to make grants under the Plan. As of September 30, 2013 the maximum number of shares of common stock that may have been granted under this plan was $3,500,000$.

In connection with the Corporation s participation in the Capital Purchase Program under the Troubled Asset Relief Program, the consent of the U.S. Department of the Treasury will be required for the Corporation to repurchase its common stock other than in connection with benefit plans consistent with past practice and certain other specified circumstances.

The following table sets forth the details of purchases of Common Stock during the quarter ended September 30, 2013 under the 2004 Omnibus Incentive Plan.

Issuer Purchases of Equity Securities
Not in thousands


Edgar Filing: POPULAR INC - Form 10-Q
Total September 30, 2013
1,669 \$ 33.54

210

## Table of Contents

## Item 6. Exhibits

## Exhibit No.

## Exhibit Description

12.1 Computation of the ratios of earnings to fixed charges and preferred stock dividends ${ }^{(1)}$
31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 ${ }^{(1)}$
31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 ${ }^{(1)}$
32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(1)
32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(1)
101.INS XBRL Instance Document ${ }^{(1)}$
101.SCH XBRL Taxonomy Extension Schema Document ${ }^{(1)}$
101.CAL XBRL Taxonomy Extension Calculation Linkbase Document ${ }^{(1)}$
101.DEF XBRL Taxonomy Extension Definitions Linkbase Document ${ }^{(1)}$
101.LAB XBRL Taxonomy Extension Label Linkbase Document ${ }^{(1)}$
101.PRE XBRL Taxonomy Extension Presentation Linkbase Document ${ }^{(1)}$
(1) Included herewith

Table of Contents

## SIGNATURES

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

## POPULAR, INC.

(Registrant)
Date: November 12, 2013

Date: November 12, 2013

By: /s/ Carlos J. Vázquez<br>Carlos J. Vázquez<br>Senior Executive Vice President \&<br>Chief Financial Officer<br>By: /s/ Jorge J. García<br>Jorge J. García<br>Senior Vice President \& Corporate Comptroller


[^0]:    Table of Contents

