OFG BANCORP
Form 10-K
March 08, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2018

or

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

For the transition period from ______________ to ______________

Commission File No. 001-12647

OFG Bancorp

Incorporated in the Commonwealth of Puerto Rico

IRS Employer Identification No. 66-0538893

Principal Executive Offices:

254 Muñoz Rivera Avenue

San Juan, Puerto Rico 00918

Telephone Number: (787) 771-6800

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock ($1.00 par value per share)

7.125% Noncumulative Monthly Income Preferred Stock, Series A ($25.00 liquidation preference per share)

7.0% Noncumulative Monthly Income Preferred Stock, Series B ($25.00 liquidation preference per share)

7.125% Noncumulative Perpetual Preferred Stock, Series D ($25.00 liquidation preference per share)

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filings pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

Emerging Growth Company

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

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

The aggregate market value of the common stock held by non-affiliates of OFG Bancorp (the "Company") was approximately $618.0 million as of June 30, 2018 based upon 43,983,195 shares outstanding and the reported closing price of $14.05 on the New York Stock Exchange on that date.

As of February 28, 2019, the Company had 51,318,899 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company’s definitive proxy statement relating to the 2019 annual meeting of shareholders are incorporated herein by reference in response to Items 10 through 14 of Part III, except for certain information set forth herein under Item 12.

OFG Bancorp

FORM 10-K

For the Year Ended December 31, 2018

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FORWARD-LOOKING STATEMENTS

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

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

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

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

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

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

ITEM 1. *BUSINESS*

General

Oriental is a publicly-owned financial holding company incorporated on June 14, 1996 under the laws of the Commonwealth of Puerto Rico, providing a full range of banking and financial services through its subsidiaries. Oriental is subject to the provisions of the U.S. Bank Holding Company Act of 1956, as amended, (the “BHC Act”) and accordingly, subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”).

Oriental provides comprehensive banking and financial services to its clients through a complete range of banking and financial solutions, including commercial, consumer, auto, and mortgage lending; checking and savings accounts; financial planning, insurance, financial services, and investment brokerage; and corporate and individual trust and retirement services. Oriental operates through three major business segments: Banking, Wealth Management, and Treasury, differentiating the Oriental brand through customer segmentation and innovative solutions, primarily in Puerto Rico. Oriental provides these services through various subsidiaries including, a commercial bank, Oriental Bank (the "Bank"), a securities broker-dealer, Oriental Financial Services Corp. (“Oriental Financial Services”), an insurance agency, Oriental Insurance, LLC (“Oriental Insurance”), a retirement plan administrator, Oriental Pension Consultants, Inc. (“OPC”), and a commercial lender, OFG USA LLC ("OFG USA"), which is part of the Bank. All of our subsidiaries are based in San Juan, Puerto Rico, except for OPC which is based in Boca Raton, Florida and OFG USA which is based in Cornelius, North Carolina. Oriental has 37 branches in Puerto Rico. Oriental’s long-term goal is to strengthen its banking and financial services franchise by expanding its lending businesses, increasing the level of integration in the marketing and delivery of banking and financial services, maintaining effective asset-liability management, growing non-interest revenue from banking and financial services, and improving operating efficiencies.

Oriental’s strategy involves:

- Expanding its ability to attract deposits and build relationships with customers by refining service delivery and providing innovative banking technologies for day-to-day customer transactions, and achieving sustainable levels of differentiation in the market;

- Focusing on greater growth in commercial and consumer lending, trust and financial services, and insurance products;

- Improving operating efficiencies, and continuing to maintain effective asset-liability management;

- Implementing a broad ranging effort to instill in employees and make customers aware of Oriental's determination to effectively serve and advise its customer base in a responsive and professional manner; and

- Matching its portfolio of investment securities with the related funding to achieve favorable spreads, and primarily investing in U.S. government-sponsored agency obligations.

Together with a highly experienced group of senior and mid-level executives and the benefits from the acquisitions of Eurobank Puerto Rico and the Puerto Rico operations of Banco Bilbao Vizcaya Argentaria, S.A. ("BBVA"), this strategy has resulted in sustained growth in Oriental's deposit-taking activities, commercial, consumer and mortgage lending and financial service activities, allowing Oriental to distinguish itself in a highly competitive industry. Oriental is not immune from general and local financial and economic conditions. Past experience is not necessarily indicative of future performance but given market uncertainties and on a reasonable time horizon of three to five years, this strategy is expected to maintain its steady progress towards Oriental's long-term goal.

Oriental's principal funding sources are branch deposits, securities sold under agreements to repurchase, Federal Home Loan Bank ("FHLB") advances, wholesale deposits, and subordinated capital notes. Through its branch network, Oriental Bank offers personal non-interest and interest-bearing checking accounts, savings accounts, certificates of deposit, individual retirement accounts ("IRAs") and commercial non-interest bearing checking accounts. The FDIC insures the Bank's deposit accounts up to applicable limits. Management makes retail deposit pricing decisions periodically, adjusting the rates paid on retail deposits in response to general market conditions and local competition. Pricing decisions take into account the rates being offered by other local banks, the London Interbank Offered Rate ("LIBOR"), and mainland U.S. market interest rates.

Segment Disclosure

Oriental has three reportable segments: Banking, Wealth Management, and Treasury. Management established the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as Oriental's organizational structure, nature of products, distribution channels and economic characteristics of the products were also considered in the determination of the reportable segments. Oriental measures the performance of these reportable segments based on pre-established annual goals involving different financial parameters such as net income, interest rate spread, loan production, and fees generated.

For detailed information regarding the performance of Oriental's operating segments, please refer to Note 29 in Oriental's accompanying consolidated financial statements.

Banking Activities

The Bank, Oriental's main subsidiary, is a full-service Puerto Rico commercial bank with its main office located in San Juan, Puerto Rico. The Bank has 37 branches throughout Puerto Rico and was incorporated in October 1964 as a federal mutual savings and loan association. It became a federal mutual savings bank in July 1983 and converted to a federal stock savings bank in April 1987. Its conversion from a federally-chartered savings bank to a commercial bank chartered under the banking law of the Commonwealth of Puerto Rico, on June 30, 1994, allowed the Bank to more effectively pursue opportunities in its market and obtain more flexibility in its businesses. As a Puerto Rico-chartered commercial bank, it is subject to examination by the FDIC and the Office of the Commissioner of Financial Institutions of Puerto Rico (the "OCFI"). The Bank offers banking services such as commercial, consumer, and mortgage lending, savings and time deposit products, financial planning, and corporate and individual trust services, and capitalizes on its retail banking network to provide commercial and mortgage lending products to its clients. The Bank has an operating subsidiary, OFG USA, which is organized in Delaware. It also has two international banking entities (each an "IBE") organized in Puerto Rico pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended (the "IBE Act"), one is a unit operating within the Bank, named Oriental Overseas (the "IBE Unit"), and the other is a wholly-owned subsidiary of the Bank, named Oriental International Bank, Inc. (the "IBE Subsidiary"). The IBE Unit and IBE Subsidiary offer the Bank certain Puerto Rico tax advantages, and their services are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.

Banking activities include the Bank's branches and mortgage banking activities with traditional retail banking products such as deposits, commercial loans, consumer loans and mortgage loans. The Bank's significant lending activities are with consumers located in Puerto Rico. The Bank's lending transactions include a diversified number of industries and activities, all of which are encompassed within four main categories: commercial, consumer, mortgage and auto.

Oriental’s mortgage banking activities are conducted through a division of the Bank. The mortgage banking activities include the origination of mortgage loans for the Bank’s own portfolio, and the sale of loans directly into the secondary market or the securitization of conforming loans into mortgage-backed securities. The Bank originates Federal Housing Administration (“FHA”) insured mortgages, Veterans Administration (“VA”) guaranteed mortgages, and Rural Housing Service (“RHS”) guaranteed loans that are primarily securitized for issuance of Government National Mortgage Association (“GNMA”) mortgage-backed securities which can be resold to individual or institutional investors in the secondary market. Conventional loans that meet the underwriting requirements for sale or exchange under standard Federal National Mortgage Association (the “FNMA”) or the Federal Home Loan Mortgage Corporation (the “FHLMC”) programs are referred to as conforming mortgage loans and are also securitized for issuance of FNMA or FHLMC mortgage-backed securities. The Bank is an approved seller of FNMA and FHLMC mortgage loans for issuance of FNMA and FHLMC mortgage-backed securities. The Bank is also an approved issuer of GNMA mortgage-backed securities. Oriental outsources the servicing of the residential mortgage loan portfolio acquired in 2012 as part of its acquisition of the Puerto Rico operations of BBVA (the "BBVAPR Acquisition") and services the GNMA, FNMA, and FHLMC pools that it issues and the rest of its residential mortgage loan portfolio.

Loan Underwriting

Auto loans: Oriental provides financing for the purchase of new or used motor vehicles. These loans are generated mainly through dealers authorized and approved by the auto credit department committee of Oriental. The auto credit department has the specialized structure and resources to provide the service required for this product according to market demands and trends. The auto loan credit policy establishes specific guidance and parameters for the underwriting and origination processes. Underwriting procedures, lending limits, interest rate approval, insurance coverage, and automobile brand restrictions are some parameters and internal controls implemented to ensure the quality and profitability of the auto loan portfolio. The proprietary credit scoring system is a fundamental part of the decision process.

Consumer loans: Consumer loans include personal loans, credit cards, lines of credit and other loans made by banks to individual borrowers. All loan originations must be underwritten in accordance with Oriental's underwriting criteria and include an assessment of each borrower's personal financial condition, including verification of income, assets, Fair Isaac Corporation ("FICO") score, and credit reports. The proprietary credit scoring system is a fundamental part of the decision process.

Residential mortgage loans: All loan originations, regardless of whether originated through Oriental's retail banking network or purchased from third parties, must be underwritten in accordance with Oriental's underwriting criteria, including loan-to-value ratios, borrower income qualifications, debt ratios and credit history, investor requirements, and title insurance and property appraisal requirements. Oriental's mortgage underwriting standards comply with the relevant guidelines set forth by the Department of Housing and Urban Development ("HUD"), VA, FNMA, FHLMC, federal and Puerto Rico banking regulatory authorities, as applicable. Oriental's underwriting personnel, while operating within Oriental's loan offices, make underwriting decisions independent of Oriental's mortgage loan origination personnel.

Commercial loans: Commercial loans include lines of credit and term facilities to finance business operations and to provide working capital for specific purposes, such as to finance the purchase of assets, equipment or inventory. Since a borrower's cash flow from operations is generally the primary source of repayment, Oriental's analysis of the credit risk focuses heavily on the borrower's debt-repayment capacity. Commercial term loans generally have terms from one to five years, may be collateralized by the asset being acquired, real estate, or other available assets, and bear interest rates that float with the prime rate, LIBOR or another established index, or are fixed for the term of the loan. Lines of credit are extended to businesses based on an analysis of the financial strength and integrity of the borrowers and are generally secured primarily by real estate, accounts receivables or inventory, and have a maturity of one year or less. Such lines of credit bear an interest rate that floats with a base rate, the prime rate, LIBOR, or another established index.

Sale of Loans and Securitization Activities

Oriental may engage in the sale or securitization of the residential mortgage loans that it originates. Oriental is an approved issuer of GNMA-guaranteed mortgage-backed securities which involves the packaging of FHA loans, RHS loans and VA loans into pools. Oriental can also act as issuer in the case of conforming conventional loans which involves grouping these types of loans into pools and issuing FNMA or FHLMC mortgage-backed securities. The issuance of mortgage-backed securities provides Oriental with the flexibility of either selling the security into the open market or retaining it on books. In the case of conforming conventional loans, Oriental may also sell such loans through the FNMA and FHLMC cash window programs.

Wealth Management Activities

Wealth management activities are generated by such businesses as securities brokerage, trust services, retirement planning, insurance, pension administration, and other financial services.

Oriental Financial Services is a Puerto Rico corporation and Oriental's subsidiary engaged in securities brokerage activities in accordance with Oriental's strategy of providing fully integrated financial solutions, covering various investment alternatives such as tax-advantaged fixed income securities, mutual funds, stocks, and bonds to retail and institutional clients. It also offers separately-managed accounts and mutual fund asset allocation programs sponsored by unaffiliated professional asset managers. These services are designed to meet each client's specific needs and preferences, including transaction-based pricing and asset-based fee pricing. It has managed and participated in public offerings and private placements of debt and equity securities in Puerto Rico and has engaged in municipal securities business with the Commonwealth of Puerto Rico and its instrumentalities, municipalities, and public corporations. Oriental Financial Services, a member of FINRA and the Securities Investor Protection Corporation, is a registered securities broker-dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934. The broker-dealer does not carry customer accounts and is, accordingly, exempt from the Customer Protection Rule (SEC Rule 15c3-3) pursuant to subsection (k)(2)(ii) of such rule. It clears securities transactions through Pershing LLC, a clearing agent that carries the accounts of its customers on a "fully disclosed" basis.

Oriental Insurance is a Puerto Rico limited liability company and Oriental's subsidiary engaged in insurance agency services. It provides Oriental with cross-marketing opportunities under the legal framework established by the financial modernization legislation.

Oriental Insurance currently earns commissions by acting as a licensed insurance agent in connection with the issuance of insurance policies by unaffiliated insurance companies and continues to cross market its services to Oriental's existing customer base.

OPC, a Florida corporation, is Oriental's subsidiary engaged in the administration of retirement plans in the U.S., Puerto Rico, and the Caribbean.

Corporate and individual trust services are provided by the Bank's trust division.

Treasury Activities

Treasury activities encompass all of Oriental's treasury-related functions. Oriental's investment portfolio consists of mortgage-backed securities, obligations of U.S. government-sponsored agencies and money market instruments. Agency mortgage-backed securities, the largest component of the investment portfolio, consist principally of pools of residential mortgage loans that are made to consumers and then resold in the form of pass-through certificates in the secondary market, the payment of interest and principal of which is guaranteed by GNMA, FNMA or FHLMC.

Market Area and Competition

The main geographic business and service area of Oriental is in Puerto Rico, where the banking market is highly competitive. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States of America. Oriental also competes with brokerage firms with retail operations, credit unions, savings and loan cooperatives, small loan companies, insurance agencies, and mortgage banks in Puerto Rico. Oriental encounters intense competition in attracting and retaining deposits and in its consumer and commercial lending activities. Management believes that Oriental has been able to compete effectively for deposits and loans by offering a variety of transactional account products and loans with competitive terms, emphasizing the quality of its service, pricing its products at competitive interest rates, offering convenient branch locations, and offering financial planning and financial services at most of its branch locations. The phase-out consolidation of three failed Puerto Rico banks in 2010 and the failure of another Puerto Rico bank in 2015 has created an environment for more rational loan and deposit pricing. Oriental's ability to originate loans depends primarily on the services that it provides to its borrowers, in making prompt credit decisions, and on the rates and fees that it charges.

Oriental is also developing new commercial relationships in the United States, as it launched in late 2017 the U.S. commercial loan program, generally consisting of purchases of loan participations in credit facilities to commercial borrowers in the U.S. mainland.

Regulation and Supervision

General

Oriental is a financial holding company subject to supervision and regulation by the Federal Reserve Board under the BHC Act, as amended by the Gramm-Leach-Bliley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The qualification requirements and the process for a bank holding company that elects to be treated as a financial holding company requires that a bank holding company and all of the subsidiary banks controlled by it at the time of election must be and remain at all times “well capitalized” and “well managed.”

Oriental elected to be treated as a financial holding company as permitted by the Gramm-Leach-Bliley Act. Under that law, if Oriental fails to meet the requirements for being a financial holding company and is unable to correct such deficiencies within certain prescribed time periods, the Federal Reserve Board could require Oriental to divest control of its depository institution subsidiary or alternatively cease conducting activities that are not permissible for bank holding companies that are not financial holding companies.

Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature or incidental to such financial activity, or (ii) complementary to a financial activity provided it does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Gramm-Leach-Bliley Act specifically provides that the following activities have been determined to be “financial in nature”: (a) lending, trust and other banking activities; (b) insurance activities; (c) financial, investment or economic advisory services; (d) securitization of assets; (e) securities underwriting and dealing; (f) existing bank holding company domestic activities; (g) existing bank holding company foreign activities; and (h) merchant banking activities. A financial holding company may generally commence any activity, or acquire any company, that is financial in nature without prior approval of the Federal Reserve Board. As provided by the Dodd-Frank Act, a financial holding company may not acquire a company, without prior Federal Reserve Board approval, in a transaction in which the total consolidated assets to be acquired by the financial holding company exceed $10 billion.

In addition, the Gramm-Leach-Bliley Act specifically gives the Federal Reserve Board the authority, by regulation or order, to expand the list of financial or incidental activities, but requires consultation with the U.S. Treasury Department and gives the Federal Reserve Board authority to allow a financial holding company to engage in any activity that is complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system.

Oriental is required to file with the Federal Reserve Board and the SEC periodic reports and other information concerning its own business operations and those of its subsidiaries. In addition, Federal Reserve Board approval must also be obtained before a bank holding company acquires all or substantially all of the assets of another bank or merges or consolidates with another bank holding company. The Federal Reserve Board also has the authority to issue cease and desist orders against bank holding companies and their non-bank subsidiaries.

The Bank is regulated by various agencies in the United States and the Commonwealth of Puerto Rico. Its main regulators are the OCFI and the FDIC. The Bank is subject to extensive regulation and examination by the OCFI and the FDIC and is subject to the Federal Reserve Board’s regulation of transactions between the Bank and its affiliates. The federal and Puerto Rico laws and regulations which are applicable to the Bank regulate, among other things, the scope of its business, its investments, its reserves against deposits, the timing of the availability of deposited funds, and the nature and amount of and collateral for certain loans. In addition to the impact of such regulations, commercial banks are affected significantly by the actions of the Federal Reserve Board as it attempts to control the money supply and credit availability in order to control inflation in the economy.

Oriental’s mortgage banking business is subject to the rules and regulations of FHA, VA, RHS, FNMA, FHLMC, HUD and GNMA with respect to the origination, processing, servicing and selling of mortgage loans and the sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines which include provisions for inspections and appraisal reports, require credit reports on prospective borrowers and fix maximum loan amounts, and, with respect to VA loans, fix maximum interest rates. Mortgage origination activities are subject to, among others, the Equal Credit Opportunity Act, the Truth-in-Lending Act, the Real Estate Settlement Procedures Act and the regulations promulgated thereunder which, among other things, prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. Oriental is also subject to regulation by the OCFI with respect to, among other things, licensing requirements and maximum origination fees on certain types of mortgage loan products.

Oriental and its subsidiaries are subject to the rules and regulations of certain other regulatory agencies. Oriental Financial Services, as a registered broker-dealer, is subject to the supervision, examination and regulation of FINRA, the SEC, and the OCFI in matters relating to the conduct of its securities business, including record keeping and reporting requirements, supervision and licensing of employees, and obligations to customers.

Oriental Insurance is subject to the supervision, examination and regulation of the Office of the Commissioner of Insurance of Puerto Rico in matters relating to insurance sales, including but not limited to, licensing of employees, sales practices, charging of commissions and reporting requirements.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act implemented a variety of far-reaching changes and has been described as the most sweeping reform of the financial services industry since the 1930's. It has a broad impact on the financial services industry, including significant regulatory and compliance changes, such as: (i) enhanced resolution authority of troubled and failing banks and their holding companies; (ii) enhanced lending limits strengthening the existing limits on a depository institution's credit exposure to one borrower; (iii) increased capital and liquidity requirements; (iv) increased regulatory examination fees; (v) changes to assessments to be paid to the FDIC for federal deposit insurance; (vi) prohibiting bank holding companies, such as Oriental, from including in regulatory Tier 1 capital future issuances of trust preferred securities or other hybrid debt and equity securities; and (vii) numerous other provisions designed to improve supervision and oversight of, and strengthening safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act established a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the Federal Reserve Board, the Office of the Comptroller of the Currency and the FDIC. Further, the Dodd-Frank Act addresses many corporate governance and executive compensation matters that affect most U.S. publicly traded companies, including Oriental. A few provisions of the Dodd-Frank Act became effective immediately, while various provisions have become effective in stages. Many of the requirements called for in the Dodd-Frank Act have been implemented over time and most are subject to implementing regulations.

The Dodd-Frank Act also created a new consumer financial services regulator, the Bureau of Consumer Financial Protection (the “CFPB”), which assumed most of the consumer financial services regulatory responsibilities previously exercised by federal banking regulators and other agencies. The CFPB’s primary functions include the supervision of “covered persons” (broadly defined to include any person offering or providing a consumer financial product or service and any affiliated service provider) for compliance with federal consumer financial laws. It has primary authority to enforce the federal consumer financial laws, as well as exclusive authority to require reports and conduct examinations for compliance with such laws, in the case of any insured depository institution with total assets of more than $10 billion and any affiliate thereof. The CFPB also has broad powers to prescribe rules applicable to a covered person or service provider in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.

Holding Company Structure

The Bank is subject to restrictions under federal laws that limit the transfer of funds to its affiliates (including Oriental), whether in the form of loans, other extensions of credit, investments or asset purchases, among others. Such transfers are limited to 10% of the transferring institution’s capital stock and surplus with respect to any affiliate (including Oriental), and, with respect to all affiliates, to an aggregate of 20% of the transferring institution’s capital stock and surplus. Furthermore, such loans and extensions of credit are required to be secured in specified amounts, carried out on an arm’s length basis, and consistent with safe and sound banking practices.

Under the Dodd-Frank Act, a bank holding company, such as Oriental, must serve as a source of financial strength for any subsidiary depository institution. The term “source of financial strength” is defined as the ability of a company to provide financial assistance to its insured depository institution subsidiaries in the event of financial distress at such subsidiaries. This support may be required at times when, absent such requirement, the bank holding company might not otherwise provide such support. In the event of a bank holding company’s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. The Bank is currently the only depository institution subsidiary of Oriental.

Since Oriental is a financial holding company, its right to participate in the assets of any subsidiary upon the latter’s liquidation or reorganization will be subject to the prior claims of the subsidiary’s creditors (including depositors in the case of the Bank) except to the extent that Oriental is a creditor with recognized claims against the subsidiary.

Dividend Restrictions

The principal source of funds for Oriental is the dividends from the Bank. The ability of the Bank to pay dividends on its common stock is restricted by the Puerto Rico Banking Act of 1933, as amended (the “Banking Act”), the Federal Deposit Insurance Act, as amended (the “FDIA”), and the FDIC regulations. In general terms, the Banking Act provides that when the expenditures of a bank are greater than its receipts, the excess of expenditures over receipts shall be charged against the undistributed profits of the bank and the balance, if any, shall be charged against the required reserve fund of the bank. If there is no sufficient reserve fund to cover such balance in whole or in part, the outstanding amount shall be charged against the bank’s capital account. The Banking Act provides that until said capital has been restored to its original amount and the reserve fund to 20% of the original capital, the bank may not declare any dividends. In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding a bank.

The payment of dividends by the Bank may also be affected by other regulatory requirements and policies, such as maintenance of adequate capital. If, in the opinion of the regulatory authority, a depository institution under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice (that, depending on the financial condition of the depository institution, could include the payment of dividends), such authority may require, after notice and hearing, that such depository institution cease and desist from such practice. The Federal Reserve Board has a policy statement that provides that an insured bank or bank holding company should not maintain its existing rate of cash dividends on common stock unless (i) the organization’s net income available to common shareholders over the past year has been sufficient to fully fund the dividends and (ii) the prospective rate of earnings retention appears consistent with the organization’s capital needs, asset quality, and overall financial condition. In addition, all insured depository institutions are subject to the capital-based limitations required by the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”).

Federal Home Loan Bank System

The FHLB system, of which the Bank is a member, consists of 12 regional FHLBs governed and regulated by the Federal Housing Finance Agency. The FHLB serves as a credit facility for member institutions within their assigned regions. They are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system. They make loans (i.e., advances) to members in accordance with policies and procedures established by the FHLB and the boards of directors of each regional FHLB.

As a system member, the Bank is entitled to borrow from the FHLB of New York (the “FHLB-NY”) and is required to invest in FHLB membership and activity-based stock. The Bank must purchase membership stock equal to the greater of $1,000 or 0.15% of certain mortgage-related assets held by the Bank. The Bank is also required to purchase activity-based stock equal to 4.50% of outstanding advances to the Bank by the FHLB. The Bank is in compliance with the membership and activity-based stock ownership requirements described above. All loans, advances and other extensions of credit made by the FHLB to the Bank are secured by a portion of the Bank’s mortgage loan portfolio, certain other investments, and the capital stock of the FHLB held by the Bank. The Bank is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances.

Prompt Corrective Action Regulations

Pursuant to the Dodd-Frank Act, federal banking agencies adopted capital rules based on the framework of the Basel Committee on Banking Supervision in “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems” (“Basel III”), which became effective January 1, 2014 for advanced approaches banking organizations (i.e., those with consolidated assets greater than $250 billion or consolidated on-balance sheet foreign exposures of at least $10 billion) and January 1, 2015 for all other covered organizations (subject to certain phase-in periods through January 1, 2019) replaced their general risk-based capital rules, advanced approaches rule, market risk rule, and leverage rules.

The Basel III capital rules provide certain changes to the prompt corrective action regulations adopted by the agencies under Section 38 of the FDIA, as amended by FDICIA. These regulations are designed to place restrictions on U.S. insured depository institutions if their capital levels begin to show signs of weakness. The five capital categories established by the agencies under their prompt corrective action framework are: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized”.

The Basel III capital rules expand such categories by introducing a common equity tier 1 capital requirement for all depository institutions, revising the minimum risk-based capital ratios and, beginning in 2018, the proposed supplementary leverage requirement for advanced approaches banking organizations. The common equity tier 1 capital ratio is a new minimum requirement designed to ensure that banking organizations hold sufficient high-quality regulatory capital that is available to absorb losses on a going-concern basis. Under such rules, an insured depository institution is:

(i) “well capitalized,” if it has a total risk-based capital ratio of 10% or more, a tier 1 risk-based capital ratio of 8% or more, a common equity tier 1 capital ratio of 6.5% or more, and a tier 1 leverage capital ratio of 5% or more, and is not subject to any written capital order or directive;

(ii) “adequately capitalized,” if it has a total risk-based capital ratio of 8% or more, a tier 1 risk-based capital ratio of 6% or more, a common equity tier 1 capital ratio of 4.5% or more, and a tier 1 leverage capital ratio of 4% or more;

(iii) “undercapitalized,” if it has a total risk-based capital ratio that is less than 8%, a tier 1 risk-based ratio that is less than 6%, a common equity tier 1 capital ratio that is less than 4.5%, or a tier 1 leverage capital ratio that is less than 4%;

(iv) “significantly undercapitalized,” if it has a total risk-based capital ratio that is less than 6%, a tier 1 risk-based capital ratio that is less than 4%, a common equity tier 1 capital ratio that is less than 3%, or a tier 1 leverage capital ratio that is less than 3%; and

(v) “critically undercapitalized,” if it has a ratio of tangible equity (defined as tier 1 capital plus non-tier 1 perpetual preferred stock) to total assets that is equal to or less than 2%.

The new capital rules also include a policy statement by the agencies that all banking organizations should maintain capital commensurate with their risk profiles, which may entail holding capital significantly above the minimum requirements. They also provide a reservation of authority permitting examiners to require that such organizations hold additional regulatory capital.

FDICIA generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fees to its holding company if the depository institution would thereafter be undercapitalized. Undercapitalized depository institutions are subject to restrictions on borrowing from the Federal Reserve System. In addition, undercapitalized depository institutions are subject to growth limitations and are required to submit capital restoration plans. A depository institution's holding company must guarantee the capital plan, up to an amount equal to the lesser of 5% of the depository institution's assets at the time it becomes undercapitalized or the amount of the capital deficiency when the institution fails to comply with the plan. The federal banking agencies may not accept a capital plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. Critically undercapitalized depository institutions are subject to the appointment of a receiver or conservator.

FDIC Insurance Assessments

The Bank is subject to FDIC deposit insurance assessments. The Federal Deposit Insurance Reform Act of 2005 (the "Reform Act") merged the Bank Insurance Fund ("BIF") and the Savings Association Insurance Fund ("SAIF") into a single Deposit Insurance Fund, and increased the maximum amount of the insurance coverage for certain retirement accounts, and possible "inflation adjustments" in the maximum amount of coverage available with respect to other insured accounts. In addition, it granted a one-time initial assessment credit (of approximately $4.7 billion) to recognize institutions' past contributions to the fund. As a result of the merger of the BIF and the SAIF, all insured institutions are subject to the same assessment rate schedule.

The Dodd-Frank Act contains several important deposit insurance reforms, including the following: (i) the maximum deposit insurance amount was permanently increased to $250,000; (ii) the deposit insurance assessment is now based on the insured depository institution's average consolidated assets minus its average tangible equity, rather than on its deposit base; (iii) the minimum reserve ratio for the Deposit Insurance Fund was raised from 1.15% to 1.35% of estimated insured deposits by September 30, 2020; (iv) the FDIC is required to "offset the effect" of increased assessments on insured depository institutions with total consolidated assets of less than $10 billion; (v) the FDIC is no longer required to pay dividends if the Deposit Insurance Fund's reserve ratio is greater than the minimum ratio; and (vi) the FDIC temporarily insured the full amount of qualifying "noninterest-bearing transaction accounts" until December 31, 2012. As defined in the Dodd-Frank Act, a "noninterest-bearing transaction account" is a deposit or account maintained at a depository institution with respect to which interest is neither accrued nor paid, on which the depositor or account holder is permitted to make withdrawals by negotiable or transferrable instrument, payment orders of withdrawals, telephone or other electronic media transfers, or other similar items for the purpose of making payments or transfers to third parties or others, and on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal.

The FDIC amended its regulations under the FDIA, as amended by the Dodd-Frank Act, to modify the definition of a depository institution's insurance assessment base; to revise the deposit insurance assessment rate schedules in light of the new assessment base and altered adjustments; to implement the dividend provisions of the Dodd-Frank Act; and to revise the large insured depository institution assessment system to better differentiate for risk and better take into account losses from large institution failures that the FDIC may incur. Since the new assessment base under the Dodd-Frank Act is larger than the current assessment base, the new assessment rates adopted by the FDIC are lower than the former rates.

In 2016, the FDIC adopted two new rules to require large institutions to bear the burden of raising the reserve ratio from 1.15% to 1.35% and amended the pricing for small institutions after the reserve ratio reaches 1.15%. Once the reserve ratio reaches 1.38%, small institutions will receive credits to offset their contribution to raising the reserve ratio above 1.35%. Effective June 30, 2016, the reserve ratio reached 1.15%, and assessment collections decreased for small institutions like the Bank. Furthermore, on September 30, 2018, the reserve ratio reached 1.36%, exceeding the statutorily required minimum reserve ratio of 1.35% ahead of the September 30, 2020 deadline required under the Dodd-Frank Act, and small institutions like the Bank were awarded assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from 1.15% to 1.35%, which will be applied when the reserve ratio is at least 1.38%.

Brokered Deposits

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well capitalized institutions are not subject to limitations on brokered deposits, while adequately capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the interest paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits. As of December 31, 2018, the Bank is a well capitalized institution and is therefore not subject to these limitations on brokered deposits.

However, under the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018, which amended the FDIA, reciprocal deposits are excluded from such limitations if the total reciprocal deposits of the institution do not exceed 20% of its total liabilities. Reciprocal deposits are deposits that banks make with each other in equal amounts.

Regulatory Capital Requirements

Under the Dodd-Frank Act, federal banking regulators are required to establish minimum leverage and risk-based capital requirements, on a consolidated basis, for insured institutions, depository institution holding companies, and non-bank financial companies supervised by the Federal Reserve Board. The minimum leverage and risk-based capital requirements are to be determined based on the minimum ratios established for insured depository institutions under prompt corrective action regulations. In effect, such provision of the Dodd-Frank Act, which is commonly known as the Collins Amendment, applies to bank holding companies the same leverage and risk-based capital requirements that apply to insured depository institutions. Because the capital requirements must be the same for insured depository institutions and their holding companies, the Collins Amendment generally excludes certain debt or equity instruments, such as cumulative perpetual preferred stock and trust preferred securities, from Tier 1 Capital, subject to a three-year phase-out from Tier 1 qualification for such instruments issued before May 19, 2010, which phase-out commenced on January 1, 2014 for advanced approaches banking organizations and January 1, 2015 for other bank holding companies with consolidated assets of $15 billion or more as of December 31, 2009. However, such instruments issued before May 19, 2010 by a bank holding company, such as Oriental, with total consolidated assets of less than $15 billion as of December 31, 2009, are not affected by the Collins Amendments, are “grandfathered” under the new capital rules, and may continue to be included in tier 1 Capital as a restricted core capital element.

The Basel III capital rules adopted by the federal banking agencies revise the agencies’ risk-based and leverage capital requirements for banking organizations and consolidate three separate notices of proposed rulemaking that the OCC, Federal Reserve Board and FDIC published in the Federal Register on August 30, 2012, with selected changes. In particular, and consistent with the Basel III framework, the capital rules include a minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5% and a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets that apply to all banking organizations. The rules also raise the minimum ratio of tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4% for all banking organizations. In addition, for the largest, most internationally active banking organizations, the rules include a new minimum supplementary leverage ratio that takes into account off-balance sheet exposures. The rules incorporate these new requirements into the agencies’ prompt corrective action framework. In addition, the rules establish limits on a banking organization’s capital distributions and certain discretionary bonus payments if the banking organization does not hold a specified amount of common equity tier 1 capital in addition to the amount necessary to meet its minimum risk-based capital requirements. Further, the rules amend the methodologies for determining risk-weighted assets for all banking organizations; introduce disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with $50 billion or more in total assets; and adopt changes to the agencies' regulatory capital requirements that meet the requirements of Section 171 and Section 939A of the Dodd-Frank Act. These rules also codify the agencies' capital rules, which have previously resided in various appendices to their respective regulations, into a harmonized integrated regulatory framework.

Under the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018, federal banking agencies must develop a Community Bank Leverage Ratio (i.e., the ratio of a bank's equity capital to its average total consolidated assets) for banks with assets of less than $10 billion. Such banks that exceed this ratio will generally be deemed to in compliance with all other capital and leverage requirements. On November 21, 2018, the federal banking agencies issued a proposal to simplify regulatory capital requirements for qualifying community banking organizations, as required by this law.

Failure to meet the capital rules could subject an institution to a variety of enforcement actions including the termination of deposit insurance by the FDIC and to certain restrictions on its business. At December 31, 2018, Oriental was in compliance with all applicable capital requirements. For more information, please refer to the accompanying consolidated financial statements.

Safety and Soundness Standards

Section 39 of the FDIA, as amended by FDICIA, requires each federal banking agency to prescribe for all insured depository institutions standards relating to internal control, information systems, and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, and such other operational and managerial standards as the agency deems appropriate. In addition, each federal banking agency is also required to adopt for all insured depository institutions standards relating to asset quality, earnings and stock valuation that the agency determines to be appropriate. Finally, each federal banking agency is required to prescribe standards for the employment contracts and other compensation arrangements of executive officers, employees, directors and principal stockholders of insured depository institutions that would prohibit compensation, benefits and other arrangements that are excessive or that could lead to a material financial loss for the institution. If an institution fails to meet any of the standards described above, it will be required to submit to the appropriate federal banking agency a plan specifying the steps that will be taken to cure the deficiency. If the institution fails to submit an acceptable plan or fails to implement the plan, the appropriate federal banking agency will require the institution to correct the deficiency and, until it is corrected, may impose other restrictions on the institution, including any of the restrictions applicable under the prompt corrective action provisions of FDICIA.

The FDIC and the other federal banking agencies have adopted Interagency Guidelines Establishing Standards for Safety and Soundness that, among other things, set forth standards relating to internal controls, information systems and internal audit systems, loan documentation, credit, underwriting, interest rate exposure, asset growth and employee compensation.

Activities and Investments of Insured State-Chartered Banks

Section 24 of the FDIA, as amended by FDICIA, generally limits the activities and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national banks. Under FDIC regulations of equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank, such as the Bank, is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary engaged in permissible activities, (ii) investing as a limited partner in a partnership, or as a non-controlling interest holder of a limited liability company, the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting stock of an insured depository institution if certain requirements are met, including that it is owned exclusively by other banks. Under the FDIC regulations governing the activities and investments of insured state banks which further implemented Section 24 of the FDIA, as amended by FDICIA, an insured state-chartered bank may not, directly, or indirectly through a subsidiary, engage as "principal" in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the Deposit Insurance Fund and the bank is in compliance with applicable regulatory capital requirements.

Transactions with Affiliates and Related Parties

Transactions between the Bank and any of its affiliates are governed by sections 23A and 23B of the Federal Reserve Act. These sections are important statutory provisions designed to protect a depository institution from transferring to its affiliates the subsidy arising from the institution's access to the Federal safety net. An affiliate of a bank is any company or entity that controls, is controlled by, or is under common control with the bank, including investment funds for which the bank or any of its affiliates is an investment advisor. Generally, sections 23A and 23B (i) limit the extent to which a bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of the bank's capital stock and surplus, and limit such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus, and (ii) require that all such transactions be on terms that are consistent with safe and sound banking practices. The term "covered transactions" includes the making of loans, purchase of or investment in securities issued by the affiliate, purchase of assets, acceptance of securities issued by the affiliate as collateral for a loan or extension of credit, issuance of guarantees and other similar types of transactions. The Dodd-Frank Act expanded the scope of transactions treated as "covered transactions" to include credit exposure to an affiliate on derivatives transactions, credit exposure resulting from a securities borrowing or lending transaction, or derivative transaction, and acceptances of affiliate-issued debt obligations as collateral for a loan or extension of credit. Most loans by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100% to 130% of the loan amount, depending on the nature of the collateral. In addition, any covered transaction by a bank with an affiliate and any sale of assets or provision of services to an affiliate must be on terms that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with nonaffiliated companies. Regulation W of the Federal Reserve Board comprehensively implements sections 23A and 23B. The regulation unified and updated staff interpretations issued over the years prior to its adoption, incorporated several interpretative proposals (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate), and addressed issues arising as a result of the expanded scope of non-banking activities engaged in by banks and bank holding companies and authorized for financial holding companies under the Gramm-Leach-Bliley Act.

Sections 22(g) and 22(h) of the Federal Reserve Act place restrictions on loans by a bank to executive officers, directors, and principal shareholders. Regulation O of the Federal Reserve Board implements these provisions. Under Section 22(h) and Regulation O, loans to a director, an executive officer and a greater-than-10% shareholder of a bank and certain of their related interests (collectively “insiders”), and insiders of its affiliates, may not exceed, together with all other outstanding loans to such person and its related interests, the bank’s single borrower limit (generally equal to 15% of the institution’s unimpaired capital and surplus). Section 22(h) and Regulation O also require that loans to insiders and insiders of affiliates be made on terms substantially the same as offered in comparable transactions to other persons, unless the loans are made pursuant to a benefit or compensation program that (i) is widely available to employees of the bank and (ii) does not give preference to insiders over other employees of the bank. Section 22(h) and Regulation O also require prior board of directors’ approval for certain loans, and the aggregate amount of extensions of credit by a bank to all insiders cannot exceed the institution’s unimpaired capital and surplus. Furthermore, Section 22(g) and Regulation O place additional restrictions on loans to executive officers.

Community Reinvestment Act

Under the Community Reinvestment Act (“CRA”), a financial institution has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires federal examiners, in connection with the examination of a financial institution, to assess the institution’s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution. The CRA also requires all institutions to make public disclosure of their CRA ratings. Oriental has a Compliance Department that oversees the planning of products and services offered to the community, especially those aimed to serve low and moderate income communities.

USA Patriot Act

Under Title III of the USA Patriot Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions, including Oriental, Oriental Financial Services, and the Bank, are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions.

The U.S. Treasury Department (the "US Treasury") has issued a number of regulations implementing the USA Patriot Act that apply certain of its requirements to financial institutions. The regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing.

Failure of a financial institution to comply with the USA Patriot Act's requirements could have serious legal consequences for the institution. Oriental and its subsidiaries, including the Bank, have adopted policies, procedures and controls to address compliance with the USA Patriot Act under existing regulations, and will continue to revise and update their policies, procedures and controls to reflect changes required by the USA Patriot Act and the US Treasury's regulations.

Privacy Policies

Under the Gramm-Leach-Bliley Act, all financial institutions are required to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request, and establish procedures and practices to protect customer data from unauthorized access. Oriental and its subsidiaries have established policies and procedures to assure Oriental's compliance with all privacy provisions of the Gramm-Leach-Bliley Act.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 ("SOX") implemented a range of corporate governance and accounting measures to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of disclosures under federal securities laws. In addition, SOX established membership requirements and responsibilities for the audit committee, imposed restrictions on the relationship between Oriental and external auditors, imposed additional responsibilities for the external financial statements on the chief executive officer and the chief financial officer, expanded the disclosure requirements for corporate insiders, required management to evaluate its disclosure controls and procedures and its internal control over financial reporting, and required the auditors to issue a report on the internal control over financial reporting.

Oriental has included in this annual report on Form 10-K management’s assessment regarding the effectiveness of Oriental’s internal control over financial reporting. The internal control report includes a statement of management’s responsibility for establishing and maintaining adequate internal control over financial reporting for Oriental; management’s assessment as to the effectiveness of Oriental’s internal control over financial reporting based on management’s evaluation as of year-end; and the framework used by management as criteria for evaluating the effectiveness of Oriental’s internal control over financial reporting. As of December 31, 2018 Oriental’s management concluded that its internal control over financial reporting was effective.

Puerto Rico Banking Act

As a Puerto Rico-chartered commercial bank, the Bank is subject to regulation and supervision by the OCFI under the Banking Act, which contains provisions governing the organization of the Bank, rights and responsibilities of directors, officers and stockholders, as well as the corporate powers, savings, lending, capital and investment requirements and other aspects of the Bank and its affairs. In addition, the OCFI is given extensive rulemaking power and administrative discretion under the Banking Act. The OCFI generally examines the Bank at least once every year.

The Banking Act requires that a minimum of 10% of the Bank’s net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid-in capital on common and preferred stock. At December 31, 2018 and 2017, legal surplus amounted to $90.2 million and $81.5 million, respectively. The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders.

The Banking Act also provides that when the expenditures of a bank are greater than the receipts, the excess of the former over the latter must be charged against the undistributed profits of the bank, and the balance, if any, must be charged against the reserve fund. If there is no reserve fund sufficient to cover such balance in whole or in part, the outstanding amount must be charged against the capital account and no dividend may be declared until said capital has been restored to its original amount and the reserve fund to 20% of the original capital.

The Banking Act further requires every bank to maintain a legal reserve which cannot be less than 20% of its demand liabilities, except government deposits (federal, commonwealth and municipal), which are secured by actual collateral.

The Banking Act also requires change of control filings. When any person or entity will own, directly or indirectly, upon consummation of a transfer, 5% or more of the outstanding voting capital stock of a bank, the acquiring parties must inform the OCFI of the details not less than 60 days prior to the date said transfer is to be consummated. The transfer will require the approval of the OCFI if it results in a change of control of the bank. Under the Banking Act, a change of control is presumed if an acquirer who did not own more than 5% of the voting capital stock before the transfer exceeds such percentage after the transfer.

The Banking Act permits Puerto Rico commercial banks to make loans to any one person, firm, partnership or corporation, up to an aggregate amount of 15% of the sum of: (i) the bank's paid-in capital; (ii) the bank's reserve fund; (iii) 50% of the bank's retained earnings, subject to certain limitations; and (iv) any other components that the OCFI may determine from time to time. If such loans are secured by collateral worth at least 25% more than the amount of the loan, the aggregate maximum amount will include 33.33% of 50% of the bank's retained earnings. Such restrictions under the Banking Act on the amount of loans to a single borrower do not apply to loans: (i) to the government of the United States or the government of the Commonwealth of Puerto Rico, or any of their respective agencies, instrumentalities or municipalities, or (ii) that are wholly secured by bonds, securities and other evidence of indebtedness of the government of the United States or of the Commonwealth of Puerto Rico or by bonds, not in default, of municipalities or instrumentalities of the Commonwealth of Puerto Rico.

The Puerto Rico Finance Board is composed of the Commissioner of Financial Institutions of Puerto Rico; the Executive Director of the Puerto Rico Fiscal Agency and Finance Advisory Authority: the Presidents of the Economic Development Bank for Puerto Rico and the Puerto Rico Planning Board; the Secretaries of Commerce and Economic Development, Treasury and Consumer Affairs of Puerto Rico; the Commissioner of Insurance of Puerto Rico; and the President of the Public Corporation for Insurance and Supervision of Puerto Rico Cooperatives. It has the authority to regulate the maximum interest rates and finance charges that may be charged on loans to individuals and businesses in the Commonwealth. The current regulations of the Puerto Rico Finance Board provide that the applicable interest rate on loans to individuals and businesses is to be determined by free competition. The Puerto Rico Finance Board also has the authority to regulate maximum finance charges on retail installment sales contracts and for credit card purchases. There is presently no maximum rate for retail installment sales contracts and for credit card purchases.

Puerto Rico Internal Revenue Code

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the "PR Code”), a corporation pays taxes at a fixed rate of 18.5% (the regular corporate tax) plus a surtax that ranges from 5% for net income subject to surtax in excess of $75,000 to 19% for net income subject to surtax in excess of $275,000. Net income subject to surtax is net income less $25,000. The maximum regular corporate tax decreased to 18.5% for tax years beginning after December 31, 2018. The result is a maximum combined rate of 37.5% (previously the maximum combined rate was 39%) under the PR Code for years beginning after December 31, 2018. The Bank and other subsidiaries of Oriental are treated as separate taxable corporations and are not entitled to file consolidated returns. The PR Code also provides a dividends-received deduction of 100% on dividends received from "controlled subsidiaries" subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

Act No. 77 of 2014 amended the PR Code to increase the Puerto Rico capital gains tax rate from 15% to 20%, and for an asset to be considered long term capital asset, the holding period must be over a year, which before the enactment of this law was defined as having a holding period of over six months. The PR Code was also amended by Act No. 72 of 2015. The most relevant provisions of the Act 72, as applicable to Oriental, for taxable years beginning after December 31, 2014, are as follows: (i) a new definition of “large taxpayers,” which require them to file their tax return following a special procedure established by the Secretary of the Treasury of Puerto Rico, (ii) net operating losses carried forward may be deducted up to 70% of the alternative minimum net income for purposes of computing the alternative minimum tax, and (iii) net operating losses carried forward may be deducted up to 80% of the net income for purposes of computing the regular corporate income tax. Other amendments to the PR Code, for example, include an increase of the sales and use tax ("SUT") from 7% to 11.5%, effective July 1, 2015, and a special 4% SUT for certain business services previously exempted from the SUT, effective October 1, 2015. On December 2018, the Puerto Rico government enacted Act 257-2018 which, among other changes, (i) reduced the maximum corporate income tax rate to 37.5%, from 39%, (ii) increased the net operating losses deduction and carry forward deduction to 90% of taxable income, previously 80%, (iii) included a restriction of the use of partnership gains to offset current and accumulated operating losses generated by a corporate partner, (iv) required that the corporate income tax returns of “large taxpayers” be certified as prepared or reviewed by a Puerto Rico licensed certified public accountant, (v) increased the limitation on the partnership or special partnership loss deduction to 90% (from 80%) of the aggregate net income of partnerships or special partnerships, (vi) increased the limitation of capital losses carryover to 90% (previously 80%) of capital gains for the taxable year, and (vii) amended the formula to compute the alternative minimum tax (“AMT”), which now would be the greater of $500 or 23% of the AMT taxable income (previously 30%).

International Banking Center Regulatory Act of Puerto Rico

The business and operations of the Bank's IBE Unit and IBE Subsidiary are subject to supervision and regulation by the OCFI. Under the IBE Act, no sale, encumbrance, assignment, merger, exchange or transfer of shares, interest or participation in the capital of an IBE may be initiated without the prior approval of the OCFI if by such transaction a person would acquire, directly or indirectly, control of 10% or more of any class of stock, interest or participation in the capital of the IBE. The IBE Act and the regulations issued thereunder by the OCFI (the "IBE Regulations") limit the business activities that may be carried out by an IBE. Such activities are generally limited to persons and assets/liabilities located outside of Puerto Rico. The IBE Act provides further that every IBE must have not less than $300 thousand of unencumbered assets or acceptable financial guarantees in Puerto Rico.

Pursuant to the IBE Act and the IBE Regulations, the Bank's IBE Unit and IBE Subsidiary have to maintain in Puerto Rico the books and records of all their transactions in the ordinary course of business. They are also required to submit quarterly and annual reports of their financial condition and results of operations to the OCFI, including annual audited financial statements.

The IBE Act empowers the OCFI to revoke or suspend, after notice and hearing, a license issued thereunder if, among other things, the IBE fails to comply with the IBE Act, the IBE Regulations or the terms of its license, or if the OCFI finds that the business or affairs of the IBE are conducted in a manner that is not consistent with the public interest.

In 2012, the IBE Act was superseded by a new law that, among other things, prohibits new license applications to organize and operate an IBE. Any such newly organized entity (now called an "international financial entity") must be licensed under the new law, and such entity (as opposed to existing IBEs organized under the IBE Act, including the Bank's IBE Unit and IBE Subsidiary, which are "grandfathered") will generally be subject to a 4% Puerto Rico income tax rate.

Volcker Rule

The so-called "Volcker Rule" adopted by the federal banking regulatory agencies under Section 619 of the Dodd-Frank Act generally prohibits bank holding companies, insured depository institutions and their affiliates from (i) engaging in short-term proprietary trading of securities, derivatives, commodities futures and options on these instruments for their own account; and (ii) owning, sponsoring or having certain relationships with hedge funds or private equity funds. However, it exempts certain activities, including market making, underwriting, hedging, trading in government and municipal obligations, and organizing and offering a hedge fund or private equity fund, among others. A banking entity that engages in any such covered activity (i.e., proprietary trading or investment activities in hedge funds or private equity funds) is generally required to establish an internal compliance program reasonably designed to ensure and monitor compliance with the Volcker Rule.

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 amended the BHC Act to exempt from the Volcker Rule those bank holding companies, insured depository institutions and their affiliates with total assets that do not exceed $10 billion and trading assets and liabilities comprising not more than 5% of their total assets. Therefore, banking entities that meet such threshold may generally engage in proprietary trading and invest in private equity and hedge funds. On December 21, 2018, the federal banking agencies proposed rules to implement such exemption.

Employees

At December 31, 2018, Oriental had 1,392 employees. None of its employees is represented by a collective bargaining group. Oriental considers its employee relations to be good.

Internet Access to Reports

Oriental's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any and all amendments to such reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, are available free of charge on or through the "SEC filings" link of Oriental's internet website at www.ofgbancorp.com, as soon as reasonably practicable after Oriental electronically files such material with, or furnishes it to, the SEC.

Oriental's corporate governance principles and guidelines, code of business conduct and ethics, and the charters of its audit committee, compensation committee, risk and compliance committee, and corporate governance and nominating committee are available free of charge on Oriental's website at www.ofgbancorp.com under the corporate governance link. Oriental's code of business conduct and ethics applies to its directors, officers, employees and agents, including its principal executive, financial and accounting officers.

ITEM 1A. *RISK FACTORS*

In addition to other information set forth in this report, you should carefully consider the following risk factors, as updated by other filings Oriental makes with the SEC under the Securities Exchange Act of 1934. Additional risks and uncertainties not presently known to us at this time or that Oriental currently deems immaterial may also adversely affect Oriental's business, financial condition or results of operations.

ECONOMIC AND MARKET CONDITIONS RISK

Most of our business is conducted in Puerto Rico, which economic and government fiscal and liquidity challenges, as well as the impact of two major hurricanes during 2017, have adversely impacted and may continue to adversely impact us.

Our loan and deposit activities are directly affected by economic conditions within Puerto Rico. Because a significant portion of our credit risk exposure on our loan portfolio, which is the largest component of our interest-earning assets, is concentrated in Puerto Rico, our profitability and financial condition may be adversely affected by an extended economic recession, adverse political, fiscal or economic developments in Puerto Rico, or the effects of a natural disaster, all of which could result in a reduction in loan originations, an increase in non-performing assets, an increase in foreclosure losses on mortgage loans, and a reduction in the value of our loans and loan servicing portfolio.

Puerto Rico entered recession in the fourth quarter of fiscal year 2006 and its gross national product (GNP) thereafter contracted in real terms every year between fiscal years 2007 and 2017 (inclusive), except fiscal year 2012. Real GNP is projected to have further contracted by approximately 5.6% in fiscal year 2018 according to the latest Puerto Rico Planning Board (the "Planning Board") estimates, exacerbated by the impact of hurricanes Irma and María in September 2017. The Planning Board estimates a 3.5% increase in GNP in fiscal year 2019, in part due to the influx of federal funds and private insurance payments following the impact of the hurricanes. Hurricane Irma and Maria caused extensive destruction in Puerto Rico, disrupting the primary market in which Oriental does business. The damage caused by the hurricanes was substantial and had a material adverse impact on economic activity in Puerto Rico.

The Commonwealth's fiscal and economic crisis prompted the U.S. Congress to enact the Puerto Rico Oversight, Management and Economic Stability Act ("PROMESA") in June 2016. PROMESA, among other things, established a seven-member federally-appointed oversight board (the "Oversight Board") with broad powers over the finances of the Commonwealth and its instrumentalities and provided to the Commonwealth, its public corporations and municipalities, broad-based restructuring authority, including through a bankruptcy-type process similar to that of Chapter 9 of the U.S. Bankruptcy Code. In August 2016, President Obama appointed the seven voting members of the Oversight Board through the process established in PROMESA, which authorized the President to select the members from several lists required to be submitted by congressional leaders. On February 15, 2019, however, the First Circuit of the U.S. Court of Appeals (the “First Circuit”) declared such appointments unconstitutional on the grounds that they did not comply with the Appointments Clause of the U.S. Constitution, which requires that principal federal officers be appointed by the President, with the advice and consent of the U.S. Senate. The First Circuit’s decision provides that its mandate will not issue for 90 days, so as to allow the President and the U.S. Senate to validate the currently defective appointments or reconstitute the Oversight Board in accordance with the Appointments Clause. Such process may delay the Commonwealth’s efforts to restructure its debts and create additional uncertainty regarding the Commonwealth’s prospects for fiscal and economic recovery.

Deterioration in local economic conditions or in the financial condition of an industry on which the local market depends could adversely affect factors such as unemployment rates and real estate vacancy and values. This could result in, among other things, a reduction of creditworthy borrowers seeking loans, an increase in loan delinquencies, defaults and foreclosures, an increase in classified and non-accrual loans, a decrease in the value of collateral for loans, and a decrease in core deposits. Any of these factors could materially impact our business.

For a discussion of the impact of the economy on our loan portfolios, see “—A continuing decline in the real estate market would likely result in an increase in delinquencies, defaults and foreclosures and in a reduction in loan origination activity, which would adversely affect our financial results.”

Puerto Rico is susceptible to hurricanes and major storms, which could further deteriorate Puerto Rico’s economy and infrastructure.

Our branch network and most of our business is concentrated in Puerto Rico, which is susceptible to hurricanes and major storms that affect the local economy and the demand for our loans and financial services, as well as the ability of our customers to repay their loans. Any such natural disasters may further adversely affect Puerto Rico's critical infrastructure, which is generally weak. This makes us vulnerable to downturns in Puerto Rico's economy as a result of natural disasters, such as hurricanes Irma and Maria. Any subsequent hurricanes, major storms or similar natural disasters could further deteriorate Puerto Rico's economy and infrastructure and negatively affect or disrupt our operations and customer base.

Changes in interest rates could reduce Oriental's net interest income

Market risk refers to the probability of variations in the net interest income or the fair value of assets and liabilities due to changes in interest rates, currency exchange rates or equity prices.

Changes in interest rates are one of the principal market risks affecting us. Our earnings are dependent to a large degree on net interest income, which is the difference between the interest rates earned on interest-earning assets, such as loans and investment securities, and the interest rates paid on interest-bearing liabilities, such as deposits and borrowings. Depending on the duration and repricing characteristics of the assets, liabilities and off-balance sheet items, changes in interest rates could either increase or decrease the level of net interest income. For any given period, the pricing structure of the assets and liabilities is matched when an equal amount of such assets and liabilities mature or reprice in that period. Like all financial institutions, our financial position is affected by fluctuations in interest rates. Volatility in interest rates can also result in the flow of funds away from financial institutions. We may suffer losses or experience lower spreads than anticipated if we are not effective in managing our interest rate risk.

CREDIT RISK

We are exposed to credit risk in connection with our loans to certain municipalities of Puerto Rico, and the restructuring of the government could adversely affect the value of such loans.

At December 31, 2018, we had approximately $135.9 million of credit exposure to four Puerto Rico municipalities. This credit exposure consists of collateralized loans or obligations that have special additional property tax revenues pledged for their repayment.

The Puerto Rico government faces a number of severe economic and fiscal challenges that are expected to require a significant government restructuring, as well as severe austerity measures to close its significant budget deficit.

If the government restructuring affects the ability of the municipalities to pay their obligations to us as they become due, or under certain other circumstances, we may be required to adversely classify such loans and increase the provision for loan losses in connection therewith. Such provision may significantly impact our earnings.

Heightened credit risk could require us to increase our provision for credit losses, which could have a material adverse effect on our results of operations and financial condition.

Making loans is an essential element of our business, and there is a risk that the loans will not be repaid. This default risk is affected by a number of factors, including:

- the duration of the loan;
- credit risks of a particular borrower;
- changes in economic or industry conditions; and
- in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral.

Our customers might not repay their loans according to the original terms, and the collateral securing the payment of those loans might be insufficient to pay any remaining loan balance. Hence, we may experience significant loan losses, which could have a materially adverse effect on our operating results. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. In determining the amount of the allowance for loan losses, we rely on loan quality reviews, past loss experience, and an evaluation of economic conditions, among other factors. If our assumptions prove to be incorrect, our allowance for loan losses may not be enough to cover losses inherent in our loan portfolio, resulting in additions to the allowance. Material additions to the allowance would materially decrease our net income.

Our emphasis on the origination of business and retail loans is one of the more significant factors in evaluating our allowance for loan losses. As we continue to increase the amount of these loans, additional or increased provisions for credit losses may be necessary and as a result would decrease our earnings.

We strive to maintain an appropriate allowance for loan and lease losses to provide for probable losses inherent in the loan portfolio. We periodically determine the amount of the allowance based on consideration of several factors such as default frequency, internal risk ratings, expected future cash collections, loss recovery rates and general economic factors, among others. Our methodology for measuring the adequacy of the allowance relies on several key elements, which include a specific allowance for identified problem loans and a general systematic allowance.

We believe our allowance for loan and lease losses is currently sufficient given the constant monitoring of the risk inherent in the loan portfolio. However, there is no precise method of predicting loan losses and therefore we always face the risk that charge-offs in future periods will exceed the allowance for loan and lease losses and that additional increases in the allowance for loan and lease losses will be required. In addition, the FDIC as well as the OCFI may require us to establish additional reserves. Additions to the allowance for loan and lease losses would result in a decrease of net earnings and capital and could hinder our ability to pay dividends.

Given the economic conditions in Puerto Rico, we may continue to experience increased credit costs or need to take greater than anticipated markdowns and make greater than anticipated provisions to increase the allowances for loan losses that could adversely affect our financial condition and results of operations in the future.

Bank regulators periodically review our allowance for loan losses and may require us to increase our provision for credit losses or loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities could have a materially adverse effect on our results of operations and/or financial condition.

We are subject to default and other risks in connection with mortgage loan originations.

From the time that we fund the mortgage loans originated to the time that they are sold, we are generally at risk for any mortgage loan defaults. Once we sell the mortgage loans, the risk of loss from mortgage loan defaults and foreclosures passes to the purchaser or insurer of the mortgage loans. However, in the ordinary course of business, we make representations and warranties to the purchasers and insurers of mortgage loans relating to the validity of such loans. If there is a breach of any of these representations or warranties, we may be required to repurchase the mortgage loan and bear any subsequent loss on the mortgage loan. We also may be required to repurchase mortgage loans in the event that there was improper underwriting or fraud or in the event that the loans become delinquent shortly after they are originated. For the year ended December 31, 2018, we repurchased $7.7 million of loans from GNMA and FNMA. Any such repurchases in the future may negatively impact our liquidity and operating results. Termination of our ability to sell mortgage products to U.S government-sponsored entities would have a material adverse effect on our results of operations and financial condition. In addition, we may be required to indemnify certain purchasers and others against losses they incur in the event of breaches of our representations and warranties and in various other circumstances, including securities fraud claims, and the amount of such losses could exceed the purchase amount of the related loans. Consequently, we may be exposed to credit risk associated with sold loans. In addition, we incur higher liquidity risk with respect to mortgage loans not eligible to be purchased or insured by FNMA, GNMA or FHLMC, due to a lack of secondary market in which to sell these loans.

We have established reserves in our consolidated financial statements for potential losses that are considered to be both probable and reasonably estimable related to the mortgage loans sold by us. The adequacy of the reserve and the ultimate amount of losses incurred will depend on, among other things, the actual future mortgage loan performance, the actual level of future repurchase and indemnification requests, the actual success rate of claimants, developments in litigation related to us and the industry, actual recoveries on the collateral and macroeconomic conditions (including unemployment levels and housing prices). Due to uncertainties relating to these factors, there can be no assurance that our reserves will be adequate or that the total amount of losses incurred will not have a material adverse effect upon our financial condition or results of operations. For additional information related to our allowance for loan and lease losses, see “Note 7—Allowance for Loan and Lease Losses” to our consolidated financial statements included in this annual report on Form 10-K.

A continuing decline in the real estate market would likely result in an increase in delinquencies, defaults and foreclosures and in a reduction in loan origination activity, which would adversely affect our financial results.

The residential mortgage loan origination business has historically been cyclical, enjoying periods of strong growth and profitability followed by periods of lower volumes and industry-wide losses. The market for residential mortgage loan originations in Puerto Rico is currently in decline, and this trend could also reduce the level of mortgage loans that we may originate in the future and may adversely impact our business. During periods of rising interest rates, refinancing originations for many mortgage products tend to decrease as the economic incentives for borrowers to refinance their existing mortgage loans are reduced. In addition, the residential mortgage loan origination business is impacted by home values. A significant trend of decreasing values in several housing segments in Puerto Rico continues to be experienced. There is a risk that a reduction in housing values could negatively impact our loss levels on the mortgage loan portfolio because the value of the homes underlying the loans is a primary source of repayment in the event of foreclosure.

The decline in Puerto Rico’s economy has had an adverse effect in the credit quality of our loan portfolios. Among other things, during the ongoing recession, we have experienced an increase in the level of non-performing assets and loan loss provision, which adversely affected our profitability. Although the delinquency rates have decreased recently, due in part to our 2017 optional and temporary moratorium on most retail loans and some commercial loan, they may increase if the recession continues or worsens. If there is another decline in economic activity, additional increases in the allowance for loan and lease losses could be necessary with further adverse effects on our profitability.

Any sustained period of increased delinquencies, foreclosures or losses could harm our ability to sell loans, the price received on the sale of such loans, and the value of the mortgage loan portfolio, all of which could have a negative impact on our results of operations and financial condition. In addition, any material decline in real estate values would weaken our collateral loan-to-value ratios and increase the possibility of loss if a borrower default. For a discussion of the impact of the Puerto Rico economy on our business operations, see “Most of our business is conducted in Puerto Rico, which is experiencing a deep economic recession, a downturn in the real estate market, and a government fiscal and liquidity crisis.”

OPERATIONS AND BUSINESS RISK

Non-Compliance with USA Patriot Act, Bank Secrecy Act, or other laws and regulations could result in fines and other sanctions.

Financial institutions are generally required under the USA Patriot Act and the Bank Secrecy Act to develop programs to prevent such financial institutions from being used for money-laundering and terrorist financing activities. Financial institutions are generally also required to file suspicious activity reports with the Financial Crimes Enforcement Network of the U.S. Treasury Department if such activities are detected. These rules also require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. We have developed a compliance program reasonably designed to ensure compliance with such laws and regulations. Our failure or the inability to comply with these regulations could result in enforcement actions, fines or penalties, curtailment of expansion opportunities, intervention or sanctions by regulators, costly litigation, or expensive additional internal controls and systems.

We are subject to security and operational risks related to our use of technology, including the risk of cyber-attack or cyber theft.

Our operations rely on the secure processing, transmission and storage of confidential information in our computer systems and networks regarding our customers and their accounts. To provide these products and services, we use information systems and infrastructure that we and third-party service providers operate. As a financial institution, we also are subject to and examined for compliance with an array of data protection laws, regulations and guidance, as well as to our own internal privacy and information security policies and programs.

Such incidents may include unauthorized access to our digital systems for purposes of misappropriation of assets, gaining access to sensitive information, corrupting data, or causing operational disruption. Although our information technology structure continues to be subject to cyber attacks, we have not, to our knowledge, experience a breach of cyber-security. Such an event could compromise our confidential information, as well as that of our customers and third parties with whom we interact with and may result in negative consequences.

While we have policies and procedures designated to prevent or limit the effects of a possible security breach of our information systems, if unauthorized persons were somehow to get access to confidential information in our possession or to our proprietary information, it could result in significant legal and financial exposure, damage to our reputation or a loss of confidence in the security of our systems that could adversely affect our business. Though we have insurance against some cyber-risks and attacks, it may not be sufficient to offset the impact of a material loss event.

We rely on third parties to provide services and systems essential to the operation of our business, and any failure, interruption or termination of such services or systems could have a material adverse affect on our financial condition and results of operations.

Our business relies on the secure, successful and uninterrupted functioning of our core banking platform, information technology, telecommunications, and loan servicing. We outsource some of our major systems, such as customer data and deposit processing, part of our mortgage loan servicing, internet and mobile banking, and electronic fund transfer systems. The failure or interruption of such systems, or the termination of a third-party software license or any service agreement on which any of these systems or services is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such systems fail or experience interruptions. In addition, replacing third party service providers could also entail significant delay and expense.

If sustained or repeated, a failure, denial or termination of such systems or services could result in a deterioration of our ability to process new loans, service existing loans, gather deposits and/or provide customer service. It could also compromise our ability to operate effectively, damage our reputation, result in a loss of customer business and/or subject us to additional regulatory scrutiny and possible financial liability. Any of the foregoing could have a material adverse effect on our financial condition and results of operations.

Our risk management policies, procedures and systems may be inadequate to mitigate all risks inherent in our various businesses.

A comprehensive risk management function is essential to the financial and operational success of our business. The types of risk we monitor and seek to manage include, but are not limited to, operational, technological, organizational, market, fiduciary, legal, compliance, liquidity and credit risks. We have adopted various policies, procedures and systems to monitor and manage these risks. There can be no assurance that those policies, procedures and systems are adequate to identify and mitigate all risks inherent in our various businesses. Our businesses and the markets in which we operate are also continuously evolving. If we fail to fully understand the implications of changes in our business or the financial markets and to adequately or timely enhance the risk framework to address those changes, we could incur losses. In addition, in a difficult or less liquid market environment, our risk management strategies may not be effective because other market participants may be attempting to use the same or similar strategies to deal with the challenging market conditions. In such circumstances, it may be difficult for us to reduce our risk positions due to the activity of such other market participants.

LIQUIDITY RISK

Our business could be adversely affected if we cannot maintain access to stable funding sources.

Our business requires continuous access to various funding sources. We are able to fund our operations through deposits as well as through advances from the FHLB-NY and FRB-NY; however, our business is significantly dependent upon other wholesale funding sources, such as repurchase agreements and brokered deposits, which consisted of approximately 22% of our total interest-bearing liabilities as of December 31, 2018.

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

We expect to have continued access to credit from the foregoing sources of funds. However, there can be no assurance that such financing sources will continue to be available or will be available on favorable terms. In a period of financial disruption, or if negative developments occur with respect to us, the availability and cost of funding sources could be adversely affected. In that event, our cost of funds may increase, thereby reducing the net interest income, or we may need to dispose of a portion of the investment portfolio, which, depending upon market conditions, could result in realizing a loss or experiencing other adverse accounting consequences upon such dispositions. The interest rates that we pay on our securities are also influenced by, among other things, applicable credit ratings from recognized rating agencies. A downgrade to any of these credit ratings could affect our ability to access the capital markets, increase our borrowing costs and have a negative impact on our results of operations. Our efforts to monitor and manage liquidity risk may not be successful to deal with dramatic or unanticipated changes in the global securities markets or other reductions in liquidity driven by us or market-related events. In the event that such sources of funds are reduced or eliminated, and we are not able to replace them on a cost-effective basis, we may be forced to curtail or cease our loan origination business and treasury activities, which would have a material adverse effect on our operations and financial condition.

Our ability to receive dividends from our subsidiaries could affect our liquidity and ability to pay dividends.

We are a separate and distinct legal entity from our subsidiaries. Dividends to us from our subsidiaries have represented a major source of funds for us to pay dividends on our common and preferred stock, make payments on corporate debt securities and meet other obligations. There are various U.S. federal and Puerto Rico law limitations on the extent to which Oriental Bank, our main subsidiary, can finance or otherwise supply funds to us through dividends and loans. These limitations include minimum regulatory capital requirements, U.S. federal and Puerto Rico banking law requirements concerning the payment of dividends out of net profits or surplus, Sections 23A and 23B of the Federal Reserve Act and Regulation W of the Federal Reserve Board governing transactions between an insured depository institution and its affiliates, as well as general federal regulatory oversight to prevent unsafe or unsound practices. Further, under the Basel III capital rules adopted by the federal banking regulatory agencies, a banking organization will need to hold a capital conservation buffer (composed of common equity tier 1 capital) greater than 2.5% of total risk-weighted assets to avoid limitations on capital distributions and discretionary bonus payments. Compliance with the capital conservation buffer is determined as of the end of the calendar quarter prior to any such capital distribution or discretionary bonus payment and is subject to a three-year transition period beginning in 2016.

If our subsidiaries' earnings are not sufficient to make dividend payments while maintaining adequate capital levels, our liquidity may be affected, and we may not be able to make dividend payments to our holders of common and preferred stock or payments on outstanding corporate debt securities or meet other obligations, each of which could have a material adverse impact on our results of operations, financial position or perception of financial health.

In addition, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors.

COMPETITIVE AND STRATEGIC RISK

Competition with other financial institutions could adversely affect our profitability.

We face substantial competition in originating loans and in attracting deposits and assets to manage. The competition in originating loans and attracting assets comes principally from other U.S., Puerto Rico and foreign banks, investment advisors, securities broker-dealers, mortgage banking companies, consumer finance companies, credit unions, insurance companies, and other institutional lenders and purchasers of loans. We will encounter greater competition as we expand our operations. Increased competition may require us to increase the rates paid on deposits or lower the rates charged on loans which could adversely affect our profitability.

We operate in a highly regulated environment and may be adversely affected by changes in federal and local laws and regulations.

Our operations are subject to extensive regulation by federal and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on all or part of our operations. Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to regular modification and change. For example, the Dodd-Frank Act has a broad impact on the financial services industry, including significant regulatory and compliance changes, as discussed under the subheading "Dodd-Frank Wall Street Reform and Consumer Protection Act" in Item 1of this annual report. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business.

We may be required to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to our investors.

Competition in attracting talented people could adversely affect our operations.

We depend on our ability to attract and retain key personnel and we rely heavily on our management team. The inability to recruit and retain key personnel or the unexpected loss of key managers may adversely affect our operations. Our success to date has been influenced strongly by the ability to attract and retain senior management experienced in banking and financial services. Retention of senior managers and appropriate succession planning will continue to be critical to the successful implementation of our strategies.

Reputational risk and social factors may impact our results.

Our ability to originate loans and to attract deposits and assets is highly dependent upon the perceptions of consumer, commercial and funding markets of our business practices and our financial health. Negative public opinion could result from actual or alleged conduct in any number of activities or circumstances, including lending practices, regulatory compliance, inadequate protection of customer information, or sales and marketing, and from actions taken by regulators in response to such conduct. Adverse perceptions regarding us could lead to difficulties in originating loans and generating and maintaining accounts as well as in financing them.

In addition, a variety of social factors may cause changes in borrowing activity, including credit card use, payment patterns and the rate of defaults by account holders and borrowers. If consumers develop or maintain negative attitudes about incurring debt, or if consumption trends decline, our business and financial results will be negatively affected.

ACCOUNTING AND TAX RISK

Changes in accounting standards issued by the Financial Accounting Standards Board ("FASB") or other standard-setting bodies may adversely affect our financial statements.

Our financial statements are subject to the application of GAAP, which are periodically revised and/or expanded. Accordingly, from time to time we are required to adopt new or revised accounting standards issued by FASB. Market conditions have prompted accounting standard setters to promulgate new guidance which further interprets or seeks to revise accounting pronouncements related to financial instruments, structures or transactions as well as to issue new standards expanding disclosures. See "Note 1—Summary of Significant Accounting Policies" to our consolidated financial statements included herein for a discussion of any accounting developments that have been issued but not yet implemented. An assessment of proposed standards is not provided as such proposals are subject to change through the exposure process and, therefore, the effects on our consolidated financial statements cannot be meaningfully assessed. It is possible that future accounting standards that we are required to adopt could change the current accounting treatment that applies to the consolidated financial statements and that such changes could have a material effect on our financial condition and results of operations.

Our goodwill and other intangible assets could be determined to be impaired in the future and could decrease Oriental's earnings.

We are required to test our goodwill, core deposit and customer relationship intangible assets for impairment on a periodic basis. The impairment testing process considers a variety of factors, including the current market price of our common shares, the estimated net present value of our assets and liabilities, and information concerning the terminal valuation of similarly situated insured depository institutions. If an impairment determination is made in a future reporting period, our earnings and the book value of these intangible assets will be reduced by the amount of the impairment. If an impairment loss is recorded, it will have little or no impact on the tangible book value of our common shares or our regulatory capital levels, but such an impairment loss could significantly restrict Oriental's ability to make dividend payments without prior regulatory approval.

Based on our annual goodwill impairment test, we determined that no impairment charges were necessary. As of December 31, 2018, we had on our consolidated balance sheet $86.1 million of goodwill in connection with the BBVAPR Acquisition and the FDIC-assisted Eurobank acquisition, $2.5 million of core deposit intangible in connection with the FDIC-assisted Eurobank acquisition and the BBVAPR Acquisition, and $0.9 million of customer relationship intangible in connection with the BBVAPR Acquisition. There can be no assurance that future evaluations of such goodwill or intangibles will not result in any impairment charges. Among other factors, further declines in our common stock as a result of macroeconomic conditions and the general weakness of the Puerto Rico economy, could lead to an impairment of such assets. If such assets become impaired, it could have a negative impact on our results of operations.

Legislative and other measures that may be taken by Puerto Rico governmental authorities could materially increase our tax burden or otherwise adversely affect our financial condition, results of operations or cash flows.

Legislative changes, particularly changes in tax laws, could adversely impact our results of operations. In an effort to address the Commonwealth's ongoing fiscal problems, the Puerto Rico government has enacted tax reforms in the past and is expected to do so in the future. In 2014, the government of Puerto Rico approved an amendment to the PR Code, which, among other things, changed the income tax rate for capital gains from 15% to 20%. In May 2015, the government approved an increase in the Puerto Rico sales and use tax, effective July 1, 2015, from 7% to 11.5%, included a new 4% business to business tax and expanded the sales and use tax to certain business services that were previously exempt. In addition, in December 2018, the Puerto Rico government enacted Act 257-2018, which reduced the maximum corporate income tax rate from 39% to 37.5% included a restriction on the use of partnership gains to offset current and accumulated operating losses generated by a corporate partner and amended the formula to compute the AMT, among other changes, as described above under "Puerto Rico Internal Revenue Code," Item 1. The recent change in tax rate resulted in a reduction of our deferred tax assets, with a corresponding non-cash increase to income tax expense.

We operate the IBE Unit and IBE Subsidiary pursuant to the IBE Act which provides significant tax advantages. The IBEs have an exemption from Puerto Rico income taxes on interest earned on, or gain realized from the sale of, non-Puerto Rico assets, including U.S. government obligations and certain mortgage-backed securities. This exemption has allowed us to have an effective tax rate below the maximum statutory tax rate. In the past, the Legislature of Puerto Rico has considered proposals to curb the tax benefits afforded to IBEs. In 2012, a new Puerto Rico law was enacted in this area, although it did not repeal the IBE Act, the new law does not allow new license applications under the IBE Act. Any newly organized "international financial entity" must be licensed under a new law and such entity (as opposed to existing IBEs organized under the IBE Act, including the Bank's IBE Unit and IBE Subsidiary, which are "grandfathered") are generally subject to a 4% Puerto Rico income tax rate. In the event other legislation is enacted by the Puerto Rico government to eliminate or modify the tax exemption provided to IBEs, the consequences could have a materially adverse impact on our financial results, including an increase in income tax expense and consequently our effective tax rate, adversely affecting our financial condition, results of operations and cash flows.

ITEM 1B. ***UNRESOLVED STAFF COMMENTS***

None.

ITEM 2. ***PROPERTIES***

Oriental owns a fifteen-story office building located at 254 Muñoz Rivera Avenue, San Juan Puerto Rico, known as Oriental Center. Oriental operates a full-service branch at the plaza level and our centralized units and subsidiaries occupy approximately 84% of the office floor space. Approximately 3% of the office space is leased to outside tenants and 13% is available for lease.

The Bank owns five branch premises and leases thirty-two branch commercial offices throughout Puerto Rico. The Bank's management believes that each of its facilities is well maintained and suitable for its purpose and can readily obtain appropriate additional space as may be required at competitive rates by extending expiring leases or finding alternative space.

At December 31, 2018, the aggregate future rental commitments under the terms of the leases, exclusive of taxes, insurance and maintenance expenses payable by Oriental, was approximately $24.4 million.

Oriental's investment in premises and equipment, exclusive of leasehold improvements at December 31, 2018, was $114.9 million, gross of accumulated depreciation.

ITEM 3. ***LEGAL PROCEEDINGS***

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

ITEM 4. ***MINE SAFETY DISCLOSURE***

Not applicable.

PART II

ITEM 5. ***MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***

Oriental's common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "OFG". Information concerning the range of high and low sales prices for Oriental's common stock for each quarter in the years ended December 31, 2018 and 2017, as well as cash dividends declared for such periods is set forth under the sub-heading "Stockholders' Equity" in the "Analysis of Financial Condition" caption in the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A").

Information concerning legal or regulatory restrictions on the payment of dividends by Oriental and the Bank is contained under the sub-heading "Dividend Restrictions" in Item 1 of this annual report.

As of December 31, 2018, Oriental had approximately 6,340 holders of record of its common stock, including all directors and officers of Oriental, and beneficial owners whose shares are held in "street" name by securities broker-dealers or other nominees.

Stock Performance Graph

The graph below compares the percentage change in Oriental's cumulative total stockholder return during the measurement period with the cumulative total return, assuming reinvestment of dividends, of the Russell 2000 Index and the SNL Bank Index.

The cumulative total stockholder return was obtained by dividing (a) the sum of (i) the cumulative amount of dividends per share, assuming dividend reinvestment, for the measurement period beginning December 31, 2013, and (ii) the difference between the share price at the beginning and the end of the measurement period, by (b) the share price at the beginning of the measurement period.

Comparison of 5 Year Cumulative Total Return

Assumes Initial Investment of $100

Index	**12/31/2013**	**12/31/2014**	**12/31/2015**	**12/31/2016**	**12/31/2017**	**12/31/2018**
OFG Bancorp	100.00	97.98	44.47	81.72	60.09	107.12
Russell 2000	100.00	104.89	100.26	121.63	139.44	124.09
SNL Bank	100.00	111.79	113.69	143.65	169.64	140.98

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ITEM 6. ***SELECTED FINANCIAL DATA***

The following selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" under Item 7 and "Financial Statements and Supplementary Data" under Item 8 of this annual report.

OFG Bancorp
SELECTED FINANCIAL DATA
YEARS ENDED DECEMBER 31, 2018, 2017, 2016, 2015, AND 2014

	Year Ended December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
EARNINGS DATA:	**(In thousands, except per share data)**				
Interest income	$ 360,419	$ 345,647	$ 356,592	$ 406,568	$ 485,257
Interest expense	44,525	41,475	57,165	69,196	76,782
Net interest income	**315,894**	**304,172**	**299,427**	**337,372**	**408,475**
Provision for loan and lease losses	56,108	113,139	65,076	161,501	60,640
Net interest income after provision for loan and leases losses	**259,786**	**191,033**	**234,351**	**175,871**	**347,835**
Non-interest income	80,095	78,687	66,819	52,472	17,323
Non-interest expenses	207,081	201,631	215,990	248,401	242,725
Income (loss) before taxes	**132,800**	**68,089**	**85,180**	**(20,058)**	**122,433**
Income tax (benefit) expense	48,390	15,443	25,994	(17,554)	37,252
Net income (loss)	**84,410**	**52,646**	**59,186**	**(2,504)**	**85,181**
Less: dividends on preferred stock	(12,024)	(13,862)	(13,862)	(13,862)	(13,862)
Income (loss) available to common shareholders	**$ 72,386**	**$ 38,784**	**$ 45,324**	**$ (16,366)**	**$ 71,319**
PER SHARE DATA:					
Basic	**$ 1.59**	**$ 0.88**	**$ 1.03**	**$ (0.37)**	**$ 1.58**
Diluted	**$ 1.52**	**$ 0.88**	**$ 1.03**	**$ (0.37)**	**$ 1.50**
Average common shares outstanding	**45,400**	**43,939**	**43,913**	**51,455**	**45,024**
Average common shares outstanding and equivalents	**51,349**	**51,096**	**51,088**	**44,231**	**52,326**
Cash dividends declared per common share	**$ 0.25**	**0.24**	**0.24**	**0.36**	**0.34**
Cash dividends declared on common shares	**$ 11,511**	**10,553**	**10,544**	**15,932**	**15,286**
PERFORMANCE RATIOS:					
	1.31%	**0.84%**	**0.88%**	**-0.03%**	**1.10%**

Return on average assets (ROA)					
Return on average tangible common stockholders' equity	**9.95%**	**5.64%**	**6.94%**	**-2.47%**	**10.91%**
Return on average common equity (ROE)	**8.85%**	**4.98%**	**6.08%**	**-2.16%**	**9.50%**
Equity-to-assets ratio	**15.19%**	**15.27%**	**14.16%**	**12.64%**	**12.65%**
Efficiency ratio	**53.07%**	**53.99%**	**57.82%**	**60.00%**	**49.90%**
Interest rate spread	**5.19%**	**5.15%**	**4.74%**	**4.95%**	**5.79%**
Interest rate margin	**5.28%**	**5.23%**	**4.82%**	**5.03%**	**5.84%**

	December 31,				
	2018	2017	2016	2015	2014
PERIOD END BALANCES AND CAPITAL RATIOS:	(In thousands, except per share data)				
Investments and loans					
Investment securities	$ 1,279,604	$ 1,166,050	$ 1,362,511	$ 1,615,872	$ 1,402,056
Loans and leases, net	4,431,594	4,056,329	4,147,692	4,434,213	4,826,646
Total investments and loans	**$ 5,711,198**	**$ 5,222,379**	**$ 5,510,203**	**$ 6,050,085**	**$ 6,228,702**
Deposits and borrowings					
Deposits	$ 4,908,115	$ 4,799,482	$ 4,664,487	$ 4,717,751	$ 4,924,406
Securities sold under agreements to repurchase	455,508	192,869	653,756	934,691	980,087
Other borrowings	114,917	135,879	141,598	436,843	439,919
Total deposits and borrowings	**$ 5,478,540**	**$ 5,128,230**	**$ 5,459,841**	**$ 6,089,285**	**$ 6,344,412**
Stockholders' equity					
Preferred stock	$ 92,000	$ 176,000	$ 176,000	$ 176,000	$ 176,000
Common stock	59,885	52,626	52,626	52,626	52,626
Additional paid-in capital	619,381	541,600	540,948	540,512	539,311
Legal surplus	90,167	81,454	76,293	70,435	70,435
Retained earnings	253,040	200,878	177,808	148,886	181,184
Treasury stock, at cost	(103,633)	(104,502)	(104,860)	(105,379)	(97,070)
Accumulated other comprehensive (loss) income	(10,963)	(2,949)	1,596	13,997	19,711
Total stockholders' equity	**$ 999,877**	**$ 945,107**	**$ 920,411**	**$ 897,077**	**$ 942,197**
Per share data					
Book value per common share	**$ 17.90**	**$ 17.73**	**$ 17.18**	**$ 16.67**	**$ 17.40**
Tangible book value per common share	**$ 16.15**	**$ 15.67**	**$ 15.08**	**$ 14.53**	**$ 15.25**
Market price at end of period	**$ 16.46**	**$ 9.40**	**$ 13.10**	**$ 7.32**	**$ 16.65**
Capital ratios					
Leverage capital	**14.22%**	**13.92%**	**12.99%**	**11.18%**	**10.61%**
Tier 1 common equity to risk-weighted assets	**N/A**	**N/A**	**N/A**	**N/A**	**11.88%**
Common equity Tier 1 capital	**16.78%**	**14.59%**	**14.05%**	**12.14%**	**N/A**
Tier 1 risk-based capital	**19.20%**	**19.05%**	**18.35%**	**15.99%**	**16.02%**
Total risk-based capital	**20.48%**	**20.34%**	**19.62%**	**17.29%**	**17.57%**
Financial assets managed					
Trust assets managed	$ 2,771,462	$ 3,039,998	$ 2,850,494	$ 2,691,423	$ 2,841,111

Broker-dealer assets gathered		2,116,035		2,250,460		2,350,718		2,374,709		2,622,001
Total assets managed	**$**	**4,887,497**	**$**	**5,290,458**	**$**	**5,201,212**	**$**	**5,066,132**	**$**	**5,463,112**

The ratios shown below demonstrate Oriental's ability to generate sufficient earnings to pay the fixed charges or expenses of its debt and preferred stock dividends. Oriental's consolidated ratios of earnings to combined fixed charges and preferred stock dividends were computed by dividing earnings by combined fixed charges and preferred stock dividends, as specified below, using two different assumptions, one excluding interest on deposits and the second including interest on deposits:

	Year Ended December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
Consolidated Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends					
Excluding interests on deposits	5.54	2.91x	2.60x	(A)	2.81x
Including interests on deposits	3.03x	1.92x	1.97x	(A)	2.16x

(A) In 2015, earnings were not sufficient to cover preferred stock dividends, and the ratio was less than 1:1. The Company would have had to generate additional earnings of $34 million to achieve a ratio of 1:1 in 2015.

For purposes of computing these consolidated ratios, earnings represent income before income taxes plus fixed charges and amortization of capitalized interest, less interest capitalized. Fixed charges consist of interest expensed and capitalized, amortization of debt issuance costs, and Oriental's estimate of the interest component of rental expense. The term "preferred stock dividends" is the amount of pre-tax earnings that is required to pay dividends on Oriental's outstanding preferred stock. As of December 31, 2018, Oriental had noncumulative perpetual preferred stock issued and outstanding amounting to $92.0 million, as follows: (i) Series A amounting to $33.5 million or 1,340,000 shares at a $25 liquidation value; (ii) Series B amounting to $34.5 million or 1,380,000 shares at a $25 liquidation value; and (iii) Series D amounting to $24.0 million or 960,000 shares at a $25 liquidation value. As of December 31, 2017, 2016, 2015, and 2014, Oriental had non-cumulative perpetual preferred stock issued and outstanding amounting to $176.0 million, which included $84.0 million or 84,000 shares of Series C at $1,000 liquidation value, which was converted on October 22, 2018 by Oriental into common shares at a conversion rate of 86.4225.

ITEM 7. ***MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2018

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The accounting and reporting policies followed by Oriental conform with GAAP and general practices within the financial services industry. Oriental's significant accounting policies are described in detail in Note 1 to the consolidated financial statements and should be read in conjunction with this section.

Critical accounting policies require management to make estimates and assumptions, which involve significant judgment about the effect of matters that are inherently uncertain and that involve a high degree of subjectivity. 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. The following MD&A section is a summary of what management considers Oriental's critical accounting policies and estimates.

Fair Value Measurement of Financial Instruments

Oriental currently measures at fair value on a recurring basis its trading assets, available-for-sale securities, derivatives, mortgage servicing rights and contingent consideration. Occasionally, Oriental 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.

Oriental 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.

Oriental requires the use of observable inputs when available, in order to minimize the use of unobservable inputs to determine fair value. The inputs or methodologies used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. The amount of judgment involved in estimating the fair value of a financial instrument depends upon the availability of quoted market prices or observable market parameters. In addition, it may be affected by other factors such as the type of instrument, the liquidity of the market for the instrument, transparency around the inputs to the valuation, as well as the contractual characteristics of the instrument.

If listed prices or quotes are not available, Oriental employs valuation models that primarily use market-based inputs including yield curves, interest rate curves, volatilities, credit curves, and discount, prepayment and delinquency rates, among other considerations. When market observable data is not available, the valuation of financial instruments becomes more subjective and involves substantial judgment. The need to use unobservable inputs generally results from diminished observability of both actual trades and assumptions resulting from the lack of market liquidity for those types of loans or securities. When fair values are estimated based on modeling techniques such as discounted cash flow models, Oriental uses assumptions such as interest rates, prepayment speeds, default rates, loss severity rates and discount rates. Valuation adjustments are limited to those necessary to ensure that the financial instrument's fair value is adequately representative of the price that would be received or paid in the marketplace.

Management believes that fair values are reasonable and consistent with the fair value measurement guidance based on Oriental's internal validation procedure and consistency of the processes followed, which include obtaining market quotes when possible or using valuation techniques that incorporate market-based inputs.

Refer to Note 27 to the consolidated financial statements for information on Oriental's fair value measurement disclosures required by the applicable accounting standard. At December 31, 2018, 99%, of the assets measured at fair value on a recurring basis used market-based or market-derived valuation methodology and, therefore, were classified as Level 1 or Level 2. Level 2 classified instruments consisted primarily of U.S. Treasury securities, obligations of U.S. Government-sponsored entities, most mortgage-backed securities ("MBS"), and collateralized mortgage obligations ("CMOs"), and derivative instruments.

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 for Oriental'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 year ended December 31, 2018, Oriental did not adjust any prices obtained from pricing service providers.

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 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 year ended December 31, 2018, none of Oriental'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 Oriental includes validation procedures and review of market changes, pricing methodology, assumption and level hierarchy changes, and evaluation of distressed transactions.

Refer to Note 27 to the consolidated financial statements for a description of Oriental's valuation methodologies used for the assets and liabilities measured at fair value.

Interest on Loans and Allowance for Loan and Lease Losses

Interest on loans is accrued and recorded as interest income based upon the principal amount outstanding.

Non-accrual loans are those loans on which the accrual of interest is discontinued. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is charged against income and the loan is accounted for either on a cash-basis method or on the cost-recovery method. Loans designated as non-accruing are returned to accrual status when Oriental expects repayment of the remaining contractual principal and interest. The determination as to the ultimate collectability of the loan's balance may involve management's judgment in the evaluation of the borrower's financial condition and prospects for repayment.

Refer to the MD&A section titled Credit Risk Management, particularly the "Non-performing Assets" sub-section, for a detailed description of Oriental's non-accruing and charge-off policies by major loan categories.

One of the most critical and complex accounting estimates is associated with the determination of the allowance for loan and lease losses. The provision for loan losses charged to current operations is based on this determination. Oriental's assessment of the allowance for loan and lease 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.

For a detailed description of the principal factors used to determine the general reserves of the allowance for loan and lease losses and for the principal enhancements management made to its methodology, refer to Notes 1 and 7 to the consolidated financial statements.

According to the loan impairment accounting guidance in ASC Section 310-10-35, a loan is impaired when, based on current information and events, it is probable that the principal and/or interest are not going to be collected according to the original contractual terms of the loan agreement. Current information and events include "environmental" factors, such as existing industry, geographical, economic and political factors. Probable means the future event or events which will confirm the loss or impairment of the loan is likely to occur. The collateral dependent method is generally used for the impairment determination on commercial loans since the expected realizable value of the loan is based upon the proceeds received from the liquidation of the collateral property. For commercial properties, the "as is" value or the "income approach" value is used depending on the financial condition of the subject borrower and/or the nature of the subject collateral. In most cases, impaired commercial loans do not have reliable or sustainable cash flow to use the discounted cash flow valuation method. Appraisals may be adjusted due to their age, property conditions, geographical area 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. Discount rates used may change from time to time based on management's estimates.

For additional information on Oriental's policy of its impaired loans, refer to Note 1 to the consolidated financial statements.

Oriental's management evaluates the adequacy of the allowance for loan and lease losses on a quarterly basis following a systematic methodology in order to provide for known and inherent risks in the loan portfolio. In developing its assessment of the adequacy of the allowance for loan and lease losses, Oriental 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 to include when estimating losses, the level of volatility of losses in a specific portfolio, changes in underwriting standards, financial accounting standards and loan impairment measurement, 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.

A restructuring constitutes a "troubled-debt restructuring" ("TDR") when Oriental separately concludes that the restructuring constitutes a concession and the debtor is experiencing financial difficulties. For information on Oriental’s TDR policy, refer to Note 1 to the financial consolidated statements.

Acquisition Accounting for Loans

Oriental has acquired loans in two separate acquisitions, the BBVAPR Acquisition in December 2012 and the FDIC-assisted Eurobank acquisition in April 2010. Oriental accounted for both acquisitions under the accounting guidance of ASC Topic 805, Business Combinations, which requires the use of the purchase method of accounting.

All identifiable assets and liabilities acquired were initially recorded at fair value. No allowance for loan and lease losses related to the acquired loans was recorded on the acquisition date as the fair value of the loans acquired incorporated assumptions regarding credit risk. Loans acquired were recorded at fair value in accordance with the fair value methodology prescribed in ASC Topic 820. These fair value estimates associated with the loans included estimates related to expected prepayments and the amount and timing of expected principal, interest and other cash flows.

Because the FDIC agreed to reimburse Oriental for losses related to the acquired loans in the FDIC-assisted Eurobank transaction, subject to certain provisions specified in the agreements, an indemnification asset was recorded at fair value at the acquisition date. The indemnification asset was recognized at the same time as the indemnified loans, and was measured on the same basis, subject to collectability or contractual limitations. The shared-loss indemnification asset on the acquisition date reflected the reimbursements expected to be received from the FDIC, using an appropriate discount rate, which reflected counterparty credit risk and other uncertainties. On February 6, 2017, the Bank and the FDIC agreed to terminate the single family and commercial shared-loss agreements related to the FDIC-assisted acquisition.

The initial valuation of these loans and related indemnification asset required management to make subjective judgments concerning estimates about how the acquired loans would perform in the future using valuation methods, including discounted cash flow analyses and independent third-party appraisals. Factors that may significantly affect the initial valuation included, among others, market-based and industry data related to expected changes in interest rates, assumptions related to probability and severity of credit losses, estimated timing of credit losses including the timing of foreclosure and liquidation of collateral, expected prepayment rates, required or anticipated loan modifications, unfunded loan commitments, the specific terms and provisions of any shared-loss agreement, and specific industry and market conditions that may impact discount rates and independent third-party appraisals.

For both acquisitions, Oriental considered the following factors as indicators that an acquired loan had evidence of deterioration in credit quality and was therefore in the scope of ASC 310-30:

- Loans that were 90 days or more past due;
- Loans that had an internal risk rating of substandard or worse substandard is consistent with regulatory definitions and is defined as having a well-defined weakness that jeopardizes liquidation of the loan;
- Loans that were classified as nonaccrual by the acquired bank at the time of acquisition; and

- Loans that had been previously modified in a troubled debt restructuring.

Any acquired loans that were not individually in the scope of ASC 310-30 because they did not meet the criteria above were either (i) pooled into groups of similar loans based on the borrower type, loan purpose, and collateral type and accounted for under ASC 310-30 by analogy or (ii) accounted for under ASC 310-20 (Non-refundable fees and other costs).

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

Revolving credit facilities such as credit cards, retail and commercial lines of credit and floor plans which are specifically scoped out of ASC 310-30 are accounted for under the provisions of ASC 310-20. Also, performing auto loans with FICO scores over 660 acquired at a premium in the BBVAPR Acquisition are accounted for under this guidance. Auto loans with FICO scores below 660 were acquired at a discount and are accounted for under the provisions of ASC 310-30. The provisions of ASC 310-20 require that any differences between the contractually required loan payments in excess of Oriental’s initial investment in the loans be accreted into interest income on a level-yield basis over the life of the loan. Loans acquired in the BBVAPR Acquisition that were accounted for under the provisions of ASC 310-20, which had fully amortized their premium or discount recorded at the date of acquisition, are removed from the acquired loan category. Loans accounted for under ASC 310-20 are placed on non-accrual status when past due in accordance with Oriental’s non-accruing policy and any accretion of discount is discontinued. These assets were recorded at estimated fair value on their acquisition date, incorporating an estimate of future expected cash flows. Such fair value includes a credit discount which accounts for expected loan losses over the estimated life of these loans. Management takes into consideration this credit discount when determining the necessary allowance for acquired loans that are accounted for under the provisions of ASC 310-20.

The allowance for loan and lease losses model for acquired loans accounted for under ASC 310-20 is the same as for the originated loan portfolio.

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

Oriental performed a fair market valuation of each of the loan pools, and each pool was recorded at a discount. Oriental determined that at least part of the discount on the acquired individual or pools of loans was attributable to credit quality by reference to the valuation model used to estimate the fair value of these pools of loans. The valuation model incorporated lifetime expected credit losses into the loans' fair valuation in consideration of factors such as evidence of credit deterioration since origination and the amounts of contractually required principal and interest that Oriental did not expect to collect as of the acquisition date. Based on the guidance included in the December 18, 2009 letter from the AICPA Depository Institutions Panel to the Office of the Chief Accountant of the SEC, Oriental has made an accounting policy election to apply ASC 310-30 by analogy to all of these acquired pools of loans as they all (i) were acquired in a business combination or asset purchase, (ii) resulted in recognition of a discount attributable, at least in part, to credit quality, and (iii) were not subsequently accounted for at fair value.

The excess of expected cash flows from acquired loans over the estimated fair value of acquired loans at acquisition is referred to as the accretable discount and is recognized into interest income over the remaining life of the acquired loans using the interest method. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable discount. The nonaccretable discount represents estimated future credit losses expected to be incurred over the life of the acquired loans. Subsequent decreases to the expected cash flows require Oriental to evaluate the need for an addition to the allowance for loan losses. Subsequent improvements in expected cash flows result in the reversal of the associated allowance for loan losses, if any, and the reversal of a corresponding amount of the nonaccretable discount which Oriental then reclassifies as accretable discount that is recognized into interest income over the remaining life of the loan using the interest method. Oriental's evaluation of the amount of future cash flows that it expects to collect takes into account actual credit performance of the acquired loans to date and Oriental's best estimates for the expected lifetime credit performance of the loans using currently available information. Charge-offs of the principal amount on acquired loans would be first applied to the nonaccretable discount portion of the fair value adjustment.

In accordance with ASC 310-30, recognition of income is dependent on having a reasonable expectation about the timing and amount of cash flows expected to be collected. Oriental performs such an evaluation on a quarterly basis on both its acquired loans individually accounted for under ASC 310-30 and those in pools accounted for under ASC 310-30 by analogy.

Cash flows for acquired loans individually accounted for under ASC 310-30 are estimated on a quarterly basis. Based on this evaluation, a determination is made as to whether or not Oriental has a reasonable expectation about the timing and amount of cash flows. Such an expectation includes cash flows from normal customer repayment, collateral value, foreclosure or other collection efforts. Cash flows for acquired loans accounted for on a pooled basis under ASC 310-30 by analogy are also estimated on a quarterly basis. For residential real estate, home equity and other consumer loans, cash flow loss estimates are calculated based on a model that incorporates a projected probability of default and loss. For commercial loans, lifetime loss rates are assigned to each pool with consideration given for pool make-up, including risk rating profile. Lifetime loss rates are developed from internally generated historical loss data and are applied to each pool.

To the extent that Oriental cannot reasonably estimate cash flows, interest income recognition is discontinued. The unit of account for loans in pools accounted for under ASC 310-30 by analogy is the pool of loans. Accordingly, as long as Oriental can reasonably estimate cash flows for the pool as a whole, accretable yield on the pool is recognized and all individual loans within the pool - even those more than 90 days past due - would be considered to be accruing interest in Oriental’s financial statement disclosures, regardless of whether or not Oriental expects any principal or interest cash flows on an individual loan 90 days or more past due.

Oriental writes-off the loan’s recorded investment and derecognizes the associated allowance for loan and lease losses for loans that exit the acquired pools.

FINANCIAL HIGHLIGHTS

Summary for the fourth quarter of 2018

- Net income available to shareholders of $23.1 million or $0.45 per fully diluted share compared to the third quarter of 2018 with $19.6 million or $0.42 per share and to the fourth quarter of 2017 with $13.6 million or $0.30 per share.

- Originated loan growth of 3.0% from the preceding quarter to $3.66 billion, with new loan production of $323.0 million, continuing to exceed $300 million for the fourth consecutive quarter.

- Strong performance metrics, with net interest margin of 5.26%, return on average assets of 1.50%, return on average tangible common stockholders' equity of 11.67%, and efficiency ratio of 51.06%.

- Record total stockholders' equity of approximately $1 billion, with book value per common share of $17.90, tangible book value per common share of $16.15, and capital metrics at multi-year highs.

- Common equity increased $84.0 million and preferred dividend payments dropped 53.0% from the preceding quarter with the conversion into common stock of the Series C 8.750% Non-Cumulative Convertible Perpetual Preferred Stock.

- 16.7% increase in the regular quarterly cash dividend per common share to $0.07, resulting in an annualized rate of $0.28 per share.

Summary for the year ended 2018

Oriental achieved strong core growth in 2018 based on the continued success of our strategy of differentiation – providing superior customer service, convenience and technology – coupled with Puerto Rico's emerging economic rebound.

Oriental's operational and financial results for the year included the following:

Operationally:

- originated loans were up 17.3%;

- average deposits grew 4.3% year over year;

- average non-interest-bearing deposits were up 25%;
- customer count expanded 4.6%;
- NIM increased 5 basis points; and
- credit quality consistently improved.

Financially:

- earnings per share increased 73%;
- return on average assets expanded 47 basis points and return on average tangible common equity increased 431 basis points;
- converted the Series C preferred into common stock, which significantly boosted stockholders' equity and enabled Oriental to reduce our payout of preferred dividends;
- increased Oriental's quarterly common dividend 17% to 28 cents per share a year; and
- all capital metrics hit multi-year highs.

Net income available to shareholders of $72.4 million or $1.52 per fully diluted share compared to the year ended 2017 with $38.8 million or $0.88 per share. 2017 included a $32.4 million pre-tax loan loss provision related to hurricanes Irma and Maria.

ANALYSIS OF RESULTS OF OPERATIONS

The following tables show major categories of interest-earning assets and interest-bearing liabilities, their respective interest income, expenses, yields and costs, and their impact on net interest income due to changes in volume and rates for the years ended December 31, 2018 and 2017:

TABLE 1 - ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	Interest		Average rate		Average balance	
	December 2018	December 2017	December 2018	December 2017	December 2018	December 2017
			(Dollars in thousands)			
A - TAX EQUIVALENT SPREAD						
Interest-earning assets	**$ 360,419**	**$ 345,647**	**6.02%**	**5.94%**	**$ 5,985,523**	**$ 5,818,597**
Tax equivalent adjustment	8,003	4,791	0.13%	0.08%	-	-
Interest-earning assets - tax equivalent	**368,422**	**350,438**	**6.15%**	**6.02%**	**5,985,523**	**5,818,597**
Interest-bearing liabilities	44,525	41,475	0.83%	0.79%	5,353,138	5,226,654
Tax equivalent net interest income / spread	**323,897**	**308,963**	**5.32%**	**5.23%**	**632,385**	**591,943**
Tax equivalent interest rate margin			**5.45%**	**5.31%**		
B - NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	32,340	28,607	2.50%	2.28%	1,293,407	1,255,881
Interest bearing cash and money market investments	6,698	4,619	1.95%	1.06%	343,982	436,913
Total investments	**39,038**	**33,226**	**2.38%**	**1.96%**	**1,637,389**	**1,692,794**
Non-acquired loans						
Mortgage	35,499	37,465	5.20%	5.37%	683,228	697,873
Commercial	86,734	71,685	5.97%	5.73%	1,452,314	1,251,051
Consumer	42,112	39,133	11.94%	11.99%	352,760	326,482
Auto and leasing	95,805	78,626	9.31%	9.61%	1,029,039	818,155
Total non-acquired loans	**260,150**	**226,909**	**7.40%**	**7.33%**	**3,517,341**	**3,093,561**

Acquired loans:						
Acquired BBVAPR						
Mortgage	27,248	30,205	5.45%	5.63%	499,874	536,247
Commercial	14,408	20,488	7.54%	8.53%	191,176	240,267
Consumer	2,880	4,534	21.04%	15.98%	13,691	28,375
Auto	3,861	9,726	11.61%	10.72%	33,251	90,698
Total acquired BBVAPR loans	**48,397**	**64,953**	**6.56%**	**7.25%**	**737,992**	**895,587**
Acquired Eurobank	**12,834**	**20,559**	**13.83%**	**15.04%**	**92,801**	**136,655**
Total loans	**321,381**	**312,421**	**7.39%**	**7.57%**	**4,348,134**	**4,125,803**
Total interest-earning assets	**360,419**	**345,647**	**6.02%**	**5.94%**	**5,985,523**	**5,818,597**

	Interest		Average rate		Average balance	
	December 2018	December 2017	December 2018	December 2017	December 2018	December 2017
			(Dollars in thousands)			
Interest-bearing liabilities:						
Deposits:						
NOW Accounts	4,496	3,893	0.42%	0.37%	1,079,538	1,059,051
Savings and money market	6,364	5,922	0.52%	0.51%	1,216,635	1,170,800
Time deposits	11,483	11,352	1.13%	1.09%	1,019,062	1,039,034
Total core deposits	**22,343**	**21,167**	**0.67%**	**0.65%**	**3,315,235**	**3,268,885**
Brokered deposits	9,751	8,211	1.97%	1.47%	496,171	557,115
	32,094	**29,378**	**0.84%**	**0.77%**	**3,811,406**	**3,826,000**
Non-interest bearing deposits	-	-	0.00%	0.00%	1,075,681	860,287
Core deposit intangible amortization	859	920	0.00%	0.00%	-	-
Total deposits	**32,953**	**30,298**	**0.67%**	**0.65%**	**4,887,087**	**4,686,287**
Borrowings:						
Securities sold under agreements to repurchase	7,794	7,223	2.18%	1.80%	357,086	401,070
Advances from FHLB and other borrowings	1,875	2,398	2.57%	2.32%	72,882	103,214
Subordinated capital notes	1,903	1,556	5.28%	4.31%	36,083	36,083
Total borrowings	**11,572**	**11,177**	**2.48%**	**2.07%**	**466,051**	**540,367**
Total interest bearing liabilities	**44,525**	**41,475**	**0.83%**	**0.79%**	**5,353,138**	**5,226,654**
Net interest income / spread	**$ 315,894**	**$ 304,172**	**5.19%**	**5.15%**		
Interest rate margin			**5.28%**	**5.23%**		
Excess of average interest-earning assets over average interest-bearing liabilities					**$ 632,385**	**$ 591,943**
Average interest-earning assets to average interest-bearing liabilities ratio					**111.81%**	**111.33%**

C - CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
		(In thousands)	
Interest Income:			
Investments	$ (1,087)	$ 6,899	$ 5,812
Loans	12,878	(3,918)	8,960

Total interest income		**11,791**		**2,981**		**14,772**
Interest Expense:						
Deposits		1,298		1,357		2,655
Repurchase agreements		(791)		1,362		571
Other borrowings		(863)		687		(176)
Total interest expense		**(356)**		**3,406**		**3,050**
Net Interest Income	**$**	**12,147**	**$**	**(425)**	**$**	**11,722**

TABLE 1A - ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	Interest		Average rate		Average balance	
	December 2017	December 2016	December 2017	December 2016	December 2017	December 2016
			(Dollars in thousands)			
A - TAX EQUIVALENT SPREAD						
Interest-earning assets	**$ 345,647**	**$ 356,592**	5.94%	5.74%	**$ 5,818,597**	**$ 6,210,003**
Tax equivalent adjustment	4,791	4,724	0.08%	0.08%	-	-
Interest-earning assets - tax equivalent	**350,438**	**361,316**	6.02%	5.82%	**5,818,597**	**6,210,003**
Interest-bearing liabilities	41,475	57,136	0.79%	1.00%	5,226,654	**5,703,927**
Tax equivalent net interest income / spread	**308,963**	**304,180**	5.23%	4.82%	**591,943**	**506,076**
Tax equivalent interest rate margin			5.31%	4.90%		
B - NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	28,607	32,146	2.28%	2.39%	1,255,881	1,346,261
Interest bearing cash and money market investments	4,619	2,501	1.06%	0.52%	436,913	484,586
Total investments	**33,226**	**34,647**	**1.96%**	**1.89%**	**1,692,794**	**1,830,847**
Non-acquired loans						
Mortgage	37,465	39,621	5.37%	5.33%	697,873	743,838
Commercial	71,685	63,186	5.73%	4.56%	1,251,051	1,385,421
Consumer	39,133	33,723	11.99%	11.77%	326,482	286,489
Auto and leasing	78,626	69,152	9.61%	9.65%	818,155	716,373
Total non-acquired loans	**226,909**	**205,682**	7.33%	6.57%	**3,093,561**	**3,132,121**
Acquired loans:						
Acquired BBVAPR						
Mortgage	30,205	32,833	5.63%	5.60%	536,247	586,100
Commercial	20,488	26,288	8.53%	8.70%	240,267	302,323
Consumer	4,534	5,627	15.98%	16.72%	28,375	33,662
Auto	9,726	21,016	10.72%	11.34%	90,698	185,280
Total acquired BBVAPR loans	**64,953**	**85,764**	7.25%	7.74%	**895,587**	**1,107,365**
Acquired Eurobank	**20,559**	**30,499**	15.04%	21.84%	**136,655**	**139,670**
Total loans	**312,421**	**321,945**	**7.57%**	**7.35%**	**4,125,803**	**4,379,156**
Total interest-earning assets	**345,647**	**356,592**	**5.94%**	**5.74%**	**5,818,597**	**6,210,003**

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	Interest		Average rate		Average balance	
	December 2017	December 2016	December 2017	December 2016	December 2017	December 2016
	(Dollars in thousands)					
Interest-bearing liabilities:						
Deposits:						
NOW Accounts	$ 3,893	$ 5,086	0.37%	0.42%	$ 1,059,051	$ 1,200,394
Savings and money market	5,922	5,441	0.51%	0.49%	1,170,800	1,114,931
Time deposits	11,352	10,582	1.09%	1.06%	1,039,034	999,231
Total core deposits	**21,167**	**21,109**	**0.65%**	**0.64%**	**3,268,885**	**3,314,556**
Brokered deposits	8,211	7,450	1.47%	1.20%	557,115	619,569
	29,378	**28,559**	**0.77%**	**0.73%**	**3,826,000**	**3,934,125**
Non-interest bearing deposits	-	-	0.00%	0.00%	860,287	$ 781,877
Deposits fair value premium amortization	-	(340)	0.00%	0.00%	-	-
Core deposit intangible amortization	920	1,034	0.00%	0.00%	-	-
Total deposits	**30,298**	**29,253**	**0.65%**	**0.62%**	**4,686,287**	**4,716,002**
Borrowings:						
Securities sold under agreements to repurchase	7,223	18,805	1.80%	2.83%	401,070	663,845
Advances from FHLB and other borrowings	2,398	6,186	2.32%	2.60%	103,214	238,366
Subordinated capital notes	1,556	2,921	4.31%	3.41%	36,083	85,714
Total borrowings	**11,177**	**27,912**	**2.07%**	**2.83%**	**540,367**	**987,925**
Total interest-bearing liabilities	**41,475**	**57,165**	**0.79%**	**1.00%**	**5,226,654**	**5,703,927**
Net interest income / spread	**$ 304,148**	**$ 299,395**	**5.15%**	**4.74%**		
Interest rate margin			**5.23%**	**4.82%**		
Excess of average interest-earning assets over average interest-bearing liabilities					**$ 591,943**	**$ 506,076**
Average interest-earning assets to average interest-bearing liabilities ratio					**111.33%**	**108.87%**

C - CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
	(In thousands)		
Interest Income:			
Investments	$ (2,613)	$ 1,192	$ (1,421)
Loans	(17,868)	8,344	(9,524)
Total interest income	(20,481)	9,536	(10,945)
Interest Expense:			
Deposits	(184)	1,229	1,045
Repurchase agreements	(7,444)	(4,138)	(11,582)
Other borrowings	(5,193)	40	(5,153)
Total interest expense	(12,821)	(2,869)	(15,690)
Net Interest Income	**$** (7,660)	**$** 12,405	**$** 4,745

Net Interest Income

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

Comparison of the years ended December 31, 2018 and 2017

Net interest income of $315.9 million increased $11.7 million from $304.2 million. Interest rate spread increased 4 basis points to 5.19% from 5.15% and net interest margin increased 5 basis points to 5.28% from 5.23%. These increases are mainly due to the net effect of an increase of 8 basis points in the average yield of total interest-earning assets and an increase of 4 basis point in average cost of interest-bearing liabilities.

Net interest income increased as a result of:

- Higher interest income from investment of $5.8 million, reflecting an increase in interest rates of $6.8 million, partially offset by a decrease in volume of $944 thousand. Cash and money market investments increased 87 basis points and investments securities increased 22 basis points, both mainly due to higher rates; and

- Higher interest income from originated loans of $33.5 million, reflecting higher balances in the auto, commercial and consumer portfolios. This increase also reflects higher interest rates in the originated loan portfolio by 7 basis points.

Such increases in net interest income were adversely impacted:

- A decrease of $24.5 million in the interest income from acquired loans as such loans continue to be repaid, and a decrease of $2.6 million in cost recoveries.

Comparison of years ended December 31, 2017 and 2016

Net interest income of $304.2 million increased $4.8 million from $299.4 million. Interest rate spread increased 41 basis points to 5.15% from 4.74% and net interest margin increased 41 basis points to 5.23% from 4.82%. These increases are mainly due to the net effect of a 20 basis point increase in the average yield of interest-earning assets from 5.74% to 5.94% and a 21 basis point decrease in average costs of interest-bearing liabilities from 1.00% to 0.79%.

Net interest income was positively impacted by:

- Higher interest income from originated loans of $21.4 million, reflecting the recognition of $4.8 million from the pay-off before maturity of a commercial loan previously classified as non-accrual, and from higher yields in the commercial and retail loan portfolios;

- The recognition of $3.1 million in cost recoveries from the loan pay-off by the Puerto Rico Housing Finance Authority (PRHFA) included as interest income from acquired BBVAPR loans; and

- Lower interest expenses on securities sold under agreements to repurchase due to decreases in volume and interest rate of $7.4 million and $4.1 million, respectively, mainly as a result of (i) the repayment at maturity of a $232.0 million repurchase agreement at 4.78% in March 2017, and (ii) the unwinding of $180.0 million repurchase agreements during 2017.

Net interest income was adversely impacted by:

- A decrease of $30.9 million in the interest income from the acquired BBVAPR and Eurobank loan portfolios as such loans continue to be repaid;

- A slight increase in interest expenses from deposits of 3.6% to $30.3 million, reflecting lower volume balances by $184 thousand, offset by $1.2 million higher interest rates; and

- A slight decrease in interest income from investments of 4.1% to $1.4 million, reflecting lower volume balances offset by higher yields on cash balances.

TABLE 2 - NON-INTEREST INCOME SUMMARY

	Year Ended December 31,		
	2018	2017	Variance
	(Dollars in thousands)		
Banking service revenue	$ 43,638	$ 39,468	10.6%
Wealth management revenue	25,934	25,790	0.6%
Mortgage banking activities	4,767	4,050	17.7%
Total banking and financial service revenue	**74,339**	**69,308**	**7.3%**
FDIC shared-loss benefit	-	1,403	-100.0%
Net gain on:			
Sale of securities available for sale	-	6,896	-100.0%
Derivatives	-	132	-100.0%
Early extinguishment of debt	-	(80)	100.0%
Other non-interest income	5,756	1,028	459.9%
	5,756	9,379	-38.6%
Total non-interest income, net	**$ 80,095**	**$ 78,687**	**1.8%**

Non-Interest Income

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

Comparison of years ended December 31, 2018 and 2017

Oriental recorded non-interest income, net, in the amount of $80.1 million, compared to $78.7 million, an increase of 1.8%, or $1.4 million. The net increase in non-interest income was mainly due to:

- An increase of $4.2 million in banking service revenue, mainly due to higher electronic banking fees from higher transaction volume and sales. Merchant business fees increased $2.1 million and debit card interchange fees increased $2.0 million.

- An increase of $717 thousand in mortgage banking activities, mainly from higher net servicing fees by $1.1 million due to higher valuation of servicing asset by $931 thousand, related to an increase in price, partially offset by lower gains on loans sold due to lower volume by $364 thousand; and

- A $5.0 million cash payment received from the Company’s insurance carrier covering hurricane Marias’s impact on Oriental’s operations included in other non-interest income, offset by the sale of $166.0 million mortgage-backed securities at a gain of $6.9 million and the FDIC shared-loss benefit of $1.4 million in 2017.

Comparison of years ended December 31, 2017 and 2016

Oriental recorded non-interest income, net, in the amount of $78.7 million, compared to $66.8 million, an increase of 17.8%, or $11.9 million. The increase in non-interest income was mainly due to:

- The elimination of the FDIC shared-loss expense as Oriental entered into an agreement with the FDIC to terminate the shared-loss agreements covering certain assets during the first quarter of 2017. During 2016, Oriental recorded expenses of $13.6 million related to such agreement; and

- The sale of $166.0 million of its mortgage-backed securities, generating a gain of $6.9 million. As a result of this sale, Oriental unwound $100 million of repurchase agreements at a cost of $80 thousand, included as a loss on early extinguishment of debt in the consolidated statements of operations. The transaction resulted in a net benefit of $6.8 million.

In the same period in 2016, Oriental sold $277.2 million in mortgage-backed securities and $11.1 million in Puerto Rico government bonds, resulting in a gain of $12.2 million. This transaction resulted in the repayment before maturity of $268.0 million of a repurchase agreement at a cost of $12.0 million, included as a loss on the early extinguishment of debt in the consolidated statements of operations. The transaction resulted in a net benefit of $207 thousand.

The increase in non-interest income was partially offset by:

- A decrease in banking service revenue of 5.2% or $2.2 million, reflecting lower electronic banking fees, mainly related to business interruption from the lack of electricity as a consequence of hurricanes Irma and Maria which struck the island on September 7, 2017 and September 20, 2017, respectively; and

- A decrease in other non-interest income of $5.1 million which reflects the receipt of $5.0 million during 2016 from a loss in 2009 related to a private label collateralized mortgage obligation.

TABLE 3 - NON-INTEREST EXPENSES SUMMARY

	Year Ended December 31, 2018	2017	Variance %
	(Dollars in thousands)		
Compensation and employee benefits	$ 76,524	$ 79,751	-4.0%
Occupancy and equipment	33,084	32,557	1.6%
Electronic banking charges	21,234	19,322	9.9%
Professional and service fees	12,442	12,406	0.3%
Taxes, other than payroll and income taxes	9,017	9,187	-1.9%
Credit related expenses	8,890	7,992	11.2%
Information technology expenses	8,227	8,010	2.7%
Insurance	6,249	5,223	19.6%
Advertising, business promotion, and strategic initiatives	5,084	5,616	-9.5%
Loan servicing and clearing expenses	4,810	4,693	2.5%
Loss on sale of foreclosed real estate and other repossessed assets	4,662	4,634	0.6%
Communication	3,447	3,415	0.9%
Printing, postage, stationery and supplies	2,217	2,437	-9.0%
Director and investor relations	1,089	1,072	1.6%
Other operating expenses	10,105	5,316	90.1%
Total non-interest expenses	**$ 207,081**	**$ 201,631**	**2.7%**
Relevant ratios and data:			
Efficiency ratio	**53.07%**	**53.99%**	
Compensation and benefits to non-interest expense	**36.95%**	**39.55%**	
Compensation to average total assets owned	**1.19%**	**1.27%**	
Average number of employees	**1,392**	**1,450**	
Average compensation per employee	**$ 54.97**	**$ 55.00**	
Average loans per average employee	**$ 3,124**	**$ 2,846**	

Non-Interest Expenses

Comparison of years ended December 31, 2018 and 2017

Non-interest expense was $207.1 million, representing an increase of 2.7% compared to $201.6 million.

The increase in non-interest expenses was driven by:

- Higher other operating expenses by $4.8 million, mainly attributed to an increase in the reasonable estimate accrual of claims and settlements in the broker-dealer subsidiary and to minor repairs to physical assets related to the impact of hurricanes;

- Higher electronic banking charges by $1.9 million from increased transaction volume;

- Higher insurance expenses by $1.0 million related to an increase in insurance premiums renewal as a consequence of hurricanes; and

- Higher credit-related expenses by $898 thousand related to higher legal fees on foreclosed properties and other real estate owned expenses.

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

- Lower compensation and employee benefits by $3.2 million, mainly due to a decrease in the average number of employees.

The efficiency ratio improved from 53.99% to 53.07%. The efficiency ratio measures how much of Oriental's revenues is used to pay operating expenses. Oriental computes its efficiency ratio by dividing non-interest expenses by the sum of its net interest income and non-interest income, but excluding gains on the sale of investment securities, derivatives gains or losses, FDIC shared-loss benefit, losses on the early extinguishment of debt, other gains and losses, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permits consistent comparability. Amounts presented as part of non-interest income that are excluded from efficiency ratio computation for the years ended December 31, 2018 and 2017 amounted to $5.8 million and $9.4 million, respectively.

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

Oriental maintains insurance for casualty losses as well as for disaster response costs and certain revenue lost through business interruption. Oriental received a $1.0 million partial payment from its insurance carrier in December 2017 and a $5.7 million payment during 2018.

Comparison of years ended December 31, 2017 and 2016

Non-interest expense was $201.6 million, representing a decrease of 6.6% compared to $216.0 million.

The decrease in non-interest expenses was driven by:

- Lower losses on the sale of foreclosed real estate and other repossessed assets by $5.6 million due to higher sales of foreclosed real estate at a gain and lower write-downs, mainly in the acquired portfolio;

- Lower insurance expenses by $3.9 million as a result of a change in the calculation method of the FDIC Deposit Insurance Fund insurance. The change was effective beginning with June 30, 2016 invoice, which was received during the third quarter of 2016;

- Lower loan servicing and clearing expenses by $3.6 million, mainly due to a reduction of $3.2 million in mortgage servicing expense from the migration to in-house servicing during the third quarter of 2016;

- Lower credit related expenses by $2.3 million, mainly due to a decrease in legal expenses from foreclosures of $1.9 million; and

- Lower other operating expense by $3.4 million due to the settlement of outstanding claims at amounts below those previously reserved by $1.4 million and decrease of $2.4 million in accrual for claims and settlements expenses in our broker dealer subsidiary.

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

- Higher compensation and employee benefits by $3.0 million as a result of higher average employees until hurricane Maria; and

- Higher occupancy and equipment expenses by $2.3 million, primarily due to lower rent income and an increase in internet services.

The efficiency ratio improved to 53.99% from 57.82%. The efficiency ratio measures how much of Oriental's revenues is used to pay operating expenses. Oriental computes its efficiency ratio by dividing non-interest expenses by the sum of its net interest income and non-interest income, but excluding gains on the sale of investment securities, derivatives gains or losses, FDIC shared-loss benefit/expense, losses on the early extinguishment of debt, other gains and losses, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permits consistent comparability. Amounts presented as part of non-interest income that are excluded from efficiency ratio computation for 2017 and 2016 amounted to $9.4 million income and a $7.3 million loss, respectively.

Provision for Loan and Lease Losses

Comparison of years ended December 31, 2018 and 2017

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

Provision for loan and lease losses decreased 50.4%, or $57.0 million, to $56.1 million. The decrease in the provision was mostly due to:

The hurricanes provision of $32.4 million in 2017;

A $4.3 million provision in the second quarter of 2017 to charge-off the loss on sale of a loan to a Puerto Rico government municipality and a $5.9 million provision to increase the general allowance on the remaining municipal loan portfolio; and

The decrease in acquired loan portfolio provision of $9.2 million, mainly from lower portfolio balances.

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

Comparison of years ended December 31, 2017 and 2016

Provision for loan and lease losses increased 73.9%, or $48.1 million, to $113.1 million. Oriental was impacted by hurricanes Irma and Maria, which struck the island on September 7, 2017 and September 20, 2017, respectively. Based on our assessment of the facts related to these hurricanes, we increased our provision for loan losses $32.4 million, $17.2 million for originated loans and $15.2 million for acquired loans.

Excluding the special provision made as a result of the hurricanes in 2017, the total provision increased $15.7 million. Provision for originated and other loan and lease losses increased by $17.3 million, mainly from the increase in the provision for commercial loans. Such provision includes $4.3 million recorded to charge-off the loss on sale of a municipal loan and another provision of $5.9 million recorded for the general allowance on the municipal loan portfolio during the second quarter of 2017.

Income Taxes

Comparison of years ended December 31, 2018 and 2017

Income tax expense was $48.4 million, compared to $15.4 million, reflecting the effective income tax rate of 33.6% and the net income before income taxes of $132.8 million for 2018. The income tax expense included a non-cash expenses of $4.1 million reflecting the impact of changes required as a result of new Puerto Rico tax reform legislation, which will reduce the corporate income tax rate by 1.5% in 2019 and, therefore, caused Oriental to take a deferred tax asset write-down.

Comparison of years ended December 31, 2017 and 2016

Income tax expense was $15.4 million, compared to $26.0 million, reflecting the effective income tax rate of 22.7% and the net income before income taxes of $68.1 million for 2017, due to higher a proportion of exempt income and income subject to preferential rates.

Business Segments

Oriental segregates its businesses into the following major reportable segments: Banking, Wealth Management, and Treasury. Management established the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as Oriental's organization, nature of its products, distribution channels and economic characteristics of its services were also considered in the determination of the reportable segments. Oriental measures the performance of these reportable segments based on pre-established goals of different financial parameters such as net income, net interest income, loan production, and fees generated. Oriental's methodology for allocating non-interest expenses among segments is based on several factors such as revenue, employee headcount, occupied space, dedicated services or time, among others. Following are the results of operations and the selected financial information by operating segment for the years ended December 31, 2018 and 2017.

	Year Ended December 31, 2018					
	Banking	**Wealth Management**	**Treasury**	**Total Major Segments**	**Eliminations**	**Consolidated Total**
	(In thousands)					
Interest income	$ 320,084	$ 46	$ 40,289	$ 360,419	$ -	$ **360,419**
Interest expense	(29,746)	-	(14,779)	(44,525)	-	**(44,525)**
Net interest income	290,338	46	25,510	315,894	-	**315,894**
Provision for loan and lease losses	(55,885)	-	(223)	(56,108)	-	**(56,108)**
Non-interest income	53,592	26,457	46	80,095	-	**80,095**
Non-interest expenses	(186,460)	(16,440)	(4,181)	(207,081)	-	**(207,081)**
Intersegment revenue	2,126	-	-	2,126	(2,126)	**-**
Intersegment expenses	-	(788)	(1,338)	(2,126)	2,126	**-**
Income before income taxes	$ 103,711	$ 9,275	$ 19,814	$ 132,800	$ -	$ **132,800**
Income tax expense	40,447	3,617	4,326	48,390	-	**48,390**
Net income	**$ 63,264**	**$ 5,658**	**$ 15,488**	**$ 84,410**	**$ -**	**$ 84,410**
Total assets	**$ 5,863,067**	**$ 25,757**	**$ 1,708,455**	**$ 7,597,279**	**$ (1,013,927)**	**$ 6,583,352**

	Year Ended December 31, 2017					
	Banking	**Wealth Management**	**Treasury**	**Total Major Segments**	**Eliminations**	**Consolidated Total**
	(In thousands)					
Interest income	$ 311,503	$ 53	$ 34,091	$ 345,647	$ -	$ **345,647**

Interest expense	(26,308)	-	(15,167)	(41,475)	-	**(41,475)**
Net interest income	285,195	53	18,924	304,172	-	**304,172**
Provision for loan and lease losses	(113,108)	-	(31)	(113,139)	-	**(113,139)**
Non-interest income (loss)	45,102	26,069	7,516	78,687	-	**78,687**
Non-interest expenses	(184,567)	(13,486)	(3,578)	(201,631)	-	**(201,631)**
Intersegment revenue	1,604	-	748	2,352	(2,352)	**-**
Intersegment expenses	(748)	(1,137)	(467)	(2,352)	2,352	**-**
Income before income taxes	$ 33,478	$ 11,499	$ 23,112	$ 68,089	$ -	$ **68,089**
Income tax expense (benefit)	13,057	4,485	(2,099)	15,443	-	**15,443**
Net income	**$ 20,421**	**$ 7,014**	**$ 25,211**	**$ 52,646**	**$ -**	**$ 52,646**
Total assets	**$ 5,597,077**	**$ 25,980**	**$ 1,536,417**	**$ 7,159,474**	**$ (970,421)**	**$ 6,189,053**

	Year Ended December 31, 2016					
	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations	Consolidated Total
	(In thousands)					
Interest income	$ 321,868	$ 65	$ 34,659	$ 356,592	$ -	$ **356,592**
Interest expense	(27,838)	-	(29,327)	(57,165)	-	**(57,165)**
Net interest income	294,030	65	5,332	299,427	-	**299,427**
Provision for loan and lease losses	(65,076)	-	-	(65,076)	-	**(65,076)**
Non-interest income	35,587	26,788	4,444	66,819	-	**66,819**
Non-interest expenses	(193,156)	(17,443)	(5,391)	(215,990)	-	**(215,990)**
Intersegment revenue	1,521	-	883	2,404	(2,404)	**-**
Intersegment expenses	(883)	(1,108)	(413)	(2,404)	2,404	**-**
Income before income taxes	$ 72,023	$ 8,302	$ 4,855	$ 85,180	$ -	$ **85,180**
Income tax expense (benefit)	28,089	3,238	(5,333)	25,994	-	**25,994**
Net income	**$ 43,934**	**$ 5,064**	**$ 10,188**	**$ 59,186**	**$ -**	**$ 59,186**
Total assets	**$ 5,584,866**	**$ 23,315**	**$ 1,837,514**	**$ 7,445,695**	**$ (943,871)**	**$ 6,501,824**

Comparison of years ended December 31, 2018 and 2017

Banking

Oriental's banking segment net income before taxes increased $64.2 million from $39.5 million to $103.7 million, mainly reflecting:

- The special provision for loan and lease losses of $32.4 million related to hurricanes Irma and Maria in 2017;

- A $4.3 million provision in the second quarter of 2017 to charge-off the loss on sale of a loan to a Puerto Rico government municipality and a $5.9 million provision to increase the general allowance on the remaining municipal loan portfolio;

- A decrease in acquired loan portfolio provision of $9.2 million, mainly from lower portfolio balances.

- A $5.0 million cash payment received from the Company’s insurance carrier covering hurricane Marias’s impact on Oriental’s operations included in other non-interest income.

Wealth Management

Wealth management segment revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, decreased $1.4 million to $5.7 million due to higher non-interest expenses by $3.0 million, mainly driven from the increase in the reasonable estimate accrual of claims and settlements in the broker-dealer subsidiary by $4.2 million.

Treasury

Treasury segment net income before taxes decreased $1.6 million from $21.4 million to $19.8 million, reflecting:

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

Such decrease was partially offset by:

- Higher interest income from investment by $5.8 million, reflecting an increase in interest rates of $6.8 million, partially offset by a decrease in volume of $944 thousand.

Comparison of years ended December 31, 2017 and 2016

Banking

Oriental's banking segment net income before taxes decreased $32.5 million to $39.5 million, reflecting:

- A decrease in net interest income by $8.8 million, mainly from the acquired BBVAPR and Eurobank loan portfolios as such loans continue to be repaid;

- The special provision for loan and lease losses of $32.4 million related to hurricanes Irma and Maria;

- An increase in the provision for loan and lease losses, excluding the aforementioned special hurricane provision, of $15.6 million, which includes $4.3 million recorded to charge-off the loss on sale of a municipal loan and another provision of $5.9 million recorded for the general allowance on the municipal loan portfolio during the second quarter of 2017;

- Higher non-interest income by $9.5 million, reflecting the termination of the FDIC shared-loss agreement in the first quarter of 2017; and

- Lower non-interest expenses by $14.6 million mainly as a result of lower losses on the sale of foreclosed real estate and other repossessed assets by $5.6 million, lower insurance expenses by $3.9 million, lower loan servicing and clearing expenses by $3.6 million, and to lower credit related expenses by $2.3 million.

Wealth Management

Wealth management segment revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, decreased $1.1 million to $7.2 million mainly due to lower activity levels in the third quarter of 2017 related to hurricanes Irma and Maria.

Treasury

Treasury segment net income before taxes, which consists of Oriental's asset/liability management activities, such as purchase and sale of investment securities, interest rate risk management, derivatives, and borrowings, increased to $21.4 million, compared to $4.9 million, reflecting:

- Lower interest expenses on securities sold under agreements to repurchase as a result of (i) the repayment at maturity of a $232.0 million repurchase agreement at 4.78% in March 2017, and (ii) the unwinding of $180.0 million repurchase agreements during 2017; and

- The sale of $166.0 million mortgage-backed securities, generating a gain of $6.9 million during 2017.

ANALYSIS OF FINANCIAL CONDITION

Assets Owned

At December 31, 2018, Oriental's total assets amounted to $6.583 billion representing an increase of 6.4% when compared to $6.189 billion at December 31, 2017. This increase is attributable to an increase in the loans and investments portfolios of $375.3 million and $113.6 million, respectively, partially offset by a decrease in cash and cash equivalents of $38.2 million.

Oriental's loan portfolio is comprised of residential mortgage loans, commercial loans collateralized by mortgages on real estate, other commercial and industrial loans, consumer loans, and auto loans. At December 31, 2018, Oriental's loan portfolio increased 9.3%. Loan production during 2018, reached $1.411 billion compared to $917.8 million a year ago, a 53.8% increase. The non-acquired loan portfolio increased $540.2 million from December 31, 2017 to $3.745 billion at December 31, 2018. From December 31, 2017, the BBVAPR acquired loan portfolio decreased $149.4 million to $676.5 million and the Eurobank acquired loan portfolio decreased $12.2 million to $87.1 million at December 31, 2018.

Oriental's investment portfolio increased 9.7% to $1.280 billion at December 31, 2018, mainly attributed to the purchase of $272.1 million mortgage-backed securities available-for-sale and retained securitized GNMA pools totaling $74.1 million, partially offset by maturities and paydowns in the investment available-for-sale portfolio of $138.5 million and in the investment securities held-to-maturity portfolio of $77.6 million during the year ended December 31, 2018.

Cash and cash equivalents decreased 7.9% to $447.0 million, mainly attributed to funding of new loans.

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

Financial Assets Managed

Oriental's financial assets include those managed by Oriental's trust division, retirement plan administration subsidiary, and assets gathered by its broker-dealer and insurance subsidiaries. Oriental's trust division offers various types of individual retirement accounts ("IRAs") and manages 401(k) and Keogh retirement plans and custodian and corporate trust accounts, while the retirement plan administration subsidiary, OPC, manages private retirement plans. At December 31, 2018, total assets managed by Oriental's trust division and OPC amounted to $2.771 billion, compared to $3.040 billion at December 31, 2017. Oriental Financial Services offers a wide array of investment alternatives to its client base, such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money management wrap-fee programs. At December 31, 2018, total assets gathered by Oriental Financial Services and Oriental Insurance from its customer investment accounts amounted to $2.116 billion, compared to $2.250 billion at December 31, 2017. Changes in trust and broker-dealer related assets primarily reflect changes in portfolio balances and differences in market values.

Goodwill

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

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

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

As of December 31, 2018, Oriental had $86.1 million of goodwill allocated as follows: $84.1 million to the Banking unit and $2.0 million to the Wealth Management unit. During the last quarter of 2018, based on its annual goodwill impairment test, Oriental determined that both units passed step one of the two-step impairment test. As a result of step one, the fair value of both units exceeded its adjusted net book value. Accordingly, Oriental determined that the carrying value of the goodwill allocated to the Banking unit and Wealth Management was not impaired as of the valuation date.

FDIC Indemnification Asset

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

TABLE 4 - ASSETS SUMMARY AND COMPOSITION

	December 31 2018	December 31 2017	Variance %
	(Dollars in thousands)		
Investments:			
FNMA and FHLMC certificates	$ 978,071	$ 887,779	10.2%
Obligations of US government-sponsored agencies	2,265	2,879	-21.3%
US Treasury securities	10,805	10,163	6.3%
CMOs issued by US government-sponsored agencies	64,064	80,071	-20.0%
GNMA certificates	210,169	167,338	25.6%
Puerto Rico government and public instrumentalities	-	2,093	-100.0%
FHLB stock	12,644	13,995	-9.7%
Other debt securities	1,222	1,538	-20.5%
Other investments	364	194	87.6%
Total investments	**1,279,604**	**1,166,050**	**9.7%**
Loans	**4,431,594**	**4,056,329**	**9.3%**
Total investments and loans	**5,711,198**	**5,222,379**	**9.4%**
Other assets:			
Cash and due from banks (including restricted cash)	445,133	481,212	-7.5%
Money market investments	4,930	7,021	-29.8%
Foreclosed real estate	33,768	44,174	-23.6%
Accrued interest receivable	34,254	49,969	-31.4%
Deferred tax asset, net	113,763	127,421	-10.7%
Premises and equipment, net	68,892	67,860	1.5%
Servicing assets	10,716	9,821	9.1%
Derivative assets	347	771	-55.0%
Goodwill	86,069	86,069	0.0%
Other assets and customers' liability on acceptances	74,282	92,356	-19.6%
Total other assets	**872,154**	**966,674**	**-9.8%**
Total assets	**$ 6,583,352**	**$ 6,189,053**	**6.4%**
Investment portfolio composition:			
FNMA and FHLMC certificates	76.5%	76.1%	
Obligations of US government-sponsored agencies	0.2%	0.2%	
US Treasury securities	0.8%	0.9%	
CMOs issued by US government-sponsored agencies	5.0%	6.9%	
GNMA certificates	16.4%	14.4%	
Puerto Rico government and public instrumentalities	0.0%	0.2%	
FHLB stock	1.0%	1.2%	
Other debt securities and other investments	0.1%	0.1%	
	100.0%	**100.0%**	

TABLE 5 — LOANS RECEIVABLE COMPOSITION

	December 31 2018	December 31 2017	Variance %
	(In thousands)		
Originated and other loans and leases held for investment:			
Mortgage	$ 668,809	$ 683,607	-2.2%
Commercial	1,597,588	1,307,261	22.2%
Consumer	348,980	330,039	5.7%
Auto and leasing	1,129,695	883,985	27.8%
	3,745,072	**3,204,892**	**16.9%**
Allowance for loan and lease losses on originated and other loans and leases	(95,188)	(92,718)	2.7%
	3,649,884	**3,112,174**	**17.3%**
Deferred loan costs, net	7,740	6,695	15.6%
Total originated and other loans held for investment, net	**3,657,624**	**3,118,869**	**17.3%**
Acquired loans:			
Acquired BBVAPR loans:			
Accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)			
Commercial	2,546	4,380	-41.9%
Consumer	23,988	28,915	-17.0%
Auto	4,435	21,969	-79.8%
	30,969	**55,264**	**-44.0%**
Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-20	(2,062)	(3,862)	-46.6%
	28,907	**51,402**	**-43.8%**
Accounted for under ASC 310-30 (Loans acquired with deteriorated credit quality, including those by analogy)			
Mortgage	492,890	532,053	-7.4%
Commercial	182,319	243,092	-25.0%
Consumer	-	1,431	-100.0%
Auto	14,403	43,696	-67.0%
	689,612	**820,272**	**-15.9%**
Allowance for loan and lease losses on acquired BBVAPR loans accounted for under ASC 310-30	(42,010)	(45,755)	-8.2%
	647,602	**774,517**	**-16.4%**
Total acquired BBVAPR loans, net	**676,509**	**825,919**	**-18.1%**
Acquired Eurobank loans:			
Loans secured by 1-4 family residential properties	63,392	69,538	-8.8%
Commercial	47,826	53,793	-11.1%
Consumer	846	1,112	-23.9%

		112,064		**124,443**	**-9.9%**
Allowance for loan and lease losses on Eurobank loans		(24,971)		(25,174)	-0.8%
Total acquired Eurobank loans, net		**87,093**		**99,269**	**-12.3%**
Total acquired loans, net		**763,602**		**925,188**	**-17.5%**
Total held for investment, net		**4,421,226**		**4,044,057**	**9.3%**
Mortgage loans held for sale		**10,368**		**12,272**	**-15.5%**
Total loans, net	**$**	**4,431,594**	**$**	**4,056,329**	**9.3%**

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Oriental's loan portfolio is composed of two segments, loans initially accounted for under the amortized cost method (referred to as "originated and other" loans) and loans acquired (referred to as "acquired" loans). Acquired loans are further segregated between acquired BBVAPR loans and acquired Eurobank loans. Acquired Eurobank loans were purchased subject to loss-sharing agreements with the FDIC, which were terminated on February 6, 2017.

As shown in Table 5 above, total loans, net, amounted to $4.432 billion at December 31, 2018 and $4.056 billion at December 31, 2017. Oriental's originated and other loans held-for-investment portfolio composition and trends were as follows:

- Mortgage loan portfolio amounted to $668.8 million (17.9% of the gross originated loan portfolio) compared to $683.6 million (21.3% of the gross originated loan portfolio) at December 31, 2017. Mortgage loan production totaled $119.7 million for 2018, which represents a decrease of 13.1% from $137.8 million for the same periods in 2017. Mortgage loans included delinquent loans in the GNMA buy-back option program amounting to $19.7 million and $8.3 million at December 31, 2018 and December 31, 2017, respectively. Servicers of loans underlying GNMA mortgage-backed securities must report as their own assets the defaulted loans that they have the option (but not the obligation) to repurchase, even when they elect not to exercise that option.

- Commercial loan portfolio amounted to $1.598 billion (42.7% of the gross originated loan portfolio) compared to $1.307 billion (40.8% of the gross originated loan portfolio) at December 31, 2017. Commercial loan production, including the U.S. loan program production of $236.1 million, increased 101.1% to $603.5 million for 2018, from $300.2 million for the same period in 2017.

- Consumer loan portfolio amounted to $349.0 million (9.3% of the gross originated loan portfolio) compared to $330.0 million (10.3% of the gross originated loan portfolio) at December 31, 2017. Consumer loan production increased 10.9% to $164.9 million for 2018 from $148.6 million when compared to the same period in 2017.

- Auto and leasing portfolio amounted to $1.130 billion (30.1% of the gross originated loan portfolio) compared to $884.0 million (27.6% of the gross originated loan portfolio) at December 31, 2017. Auto production increased by 58.0% to $523.4 million for 2018, compared to $331.2 million for the same period in 2017.

The following table summarizes the remaining contractual maturities of Oriental's total gross non-covered loans, excluding loans accounted for under ASC 310-30, segmented to reflect cash flows as of December 31, 2018. Contractual maturities do not necessarily reflect the period of resolution of a loan, considering prepayments.

			Maturities From One to Five Years		After Five Years	
	Balance Outstanding at December 31, 2018	**One Year or Less**	**Fixed Interest Rates**	**Variable Interest Rates**	**Fixed Interest Rates**	**Variable Interest Rates**
			(In thousands)			
Originated and other loans:						
Mortgage	$ 668,809	$ 2,771	$ 11,608	$ -	$ 654,430	$ -
Commercial	1,597,588	972,012	584,996	-	40,580	-
Consumer	348,980	37,017	241,454	-	70,509	-
Auto and leasing	1,129,695	11,044	467,136	-	651,515	-
Total	$ **3,745,072**	$ **1,022,844**	$ **1,305,194**	$ **-**	$ **1,417,034**	$ **-**
Acquired loans accounted under ASC 310-20						
Commercial	$ 1,510	$ 1,510	$ -	$ -	$ -	$ -
Commercial secured by real estate	1,036	941	95	-	-	-
Consumer	23,988	23,988	-	-	-	-
Auto	4,435	4,106	329	-	-	-
Total	$ **30,969**	**$ 30,545**	**$ 424**	**$ -**	**$ -**	**$ -**

TABLE 6 — HIGHER RISK RESIDENTIAL MORTGAGE LOANS

	December 31, 2018								
	Higher-Risk Residential Mortgage Loans*								
	Junior Lien Mortgages			Interest Only Loans			High Loan-to-Value Ratio Mortgages LTV 90% and over		
	Carrying Value	Allowance	Coverage	Carrying Value	Allowance	Coverage	Carrying Value	Allowance	Coverage
	(In thousands)								
Delinquency:									
0 - 89 days	$ 8,970	$ 324	3.61%	$ 7,977	$ 328	4.11%	$ 56,217	$ 1,183	2.10%
90 - 119 days	49	7	14.29%	-	-	0.00%	1,955	37	1.89%
120 - 179 days	67	9	13.43%	-	-	0.00%	991	79	7.97%
180 - 364 days	164	30	18.29%	441	86	19.50%	1,964	135	6.87%
365+ days	232	33	14.22%	1,465	283	19.32%	8,081	569	7.04%
Total	$ 9,482	$ 403	4.25%	$ 9,883	$ 697	7.05%	$ 69,208	$ 2,003	2.89%
Percentage of total loans excluding acquired loans accounted for under ASC 310-30	0.25%			0.26%			1.83%		
Refinanced or Modified Loans:									
Amount	$ 2,274	$ 273	12.01%	$ 511	$ 61	11.94%	$ 15,807	$ 1,254	7.93%
Percentage of Higher-Risk Loan Category	23.98%			5.17%			22.84%		
Loan-to-Value Ratio:									
Under 70%	$ 6,321	$ 260	4.11%	$ 1,199	$ 43	3.59%	$ -	$ -	-
70% - 79%	1,366	79	5.78%	2,194	112	5.10%	-	-	-
80% - 89%	998	5	0.50%	3,208	232	7.23%	-	-	-
90% and over	797	59	7.40%	3,282	310	9.45%	69,208	2,003	2.89%
	$ 9,482	$ 403	4.25%	$ 9,883	$ 697	7.05%	$ 69,208	$ 2,003	2.89%

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

Deposits from the Puerto Rico government totaled $207.4 million at December 31, 2018. The following table includes the maturities of Oriental's lending and investment exposure to the Puerto Rico government, which is limited solely to loans to municipalities secured by ad valorem taxation, without limitation as to rate or amount, on all taxable property within the issuing municipalities. The good faith, credit and unlimited taxing power of each issuing municipality are pledged for the payment of its general obligations.

TABLE 7 - PUERTO RICO GOVERNMENT RELATED LOANS AND SECURITIES

	December 31, 2018			
		Maturity		
Loans and Securities:	**Carrying Value**	**Less than 1 Year**	**1 to 3 Years**	**More than 3 Years**
		(In thousands)		
Municipalities	**$ 135,871**	**$ 18,567**	**$ 73,451**	**$ 43,853**

Credit Risk Management

Allowance for Loan and Lease Losses

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

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

At December 31, 2018, Oriental’s allowance for loan and lease losses amounted to $164.2 million, a $3.3 million decrease from $167.5 million at December 31, 2017.

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

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

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

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

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

During 2018, Oriental continued its monitoring process of the performance of those affected borrowers. As additional information became available, it was incorporated into the allowance framework.

At December 31, 2018 and 2017, Oriental's ALLL incorporated all risks associated to our loan portfolio, including the impact of hurricanes Irma and Maria.

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

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

Non-performing Assets

Oriental's non-performing assets include non-performing loans and foreclosed real estate (see Tables 11 and 12). At December 31, 2018 and 2017, Oriental had $119.7 million and $99.7 million, respectively, of non-accrual loans, including acquired BBVAPR loans accounted for under ASC 310-20 (loans with revolving feature and/or acquired at a premium).

At December 31, 2018 and 2017, loans whose terms have been extended and which are classified as troubled-debt restructurings that are not included in non-performing assets amounted to $112.9 million and $109.2 million, respectively.

At December 31, 2018 and 2017, loans that are current in their monthly payments, but placed in non-accrual amounted to $21.2 million and $20.1 million, respectively. During 2018, a $8.7 million loan that is current in its monthly payments was placed in non-accrual due to credit deterioration after the hurricanes.

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

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

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

At December 31, 2018, Oriental's non-performing assets increased by 3.0% to $161.3 million (2.76% of total assets, excluding acquired loans with deteriorated credit quality) from $156.7 million (2.95% of total assets, excluding acquired loans with deteriorated credit quality) at December 31, 2017. Foreclosed real estate and other repossessed assets amounting to $33.8 million and $3.0 million, respectively, at December 31, 2018, and $44.2 million and $3.5 million, respectively, at December 31, 2017, were recorded at fair value. Oriental does not expect non-performing loans to result in significantly higher losses. At December 31, 2018, the allowance coverage ratio for originated loan and lease losses to non-performing loans was 77.38% (87.35% at December 31, 2017).

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

The following items comprise non-performing assets:

- Originated and other loans held for investment:

Residential mortgage loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan, except for FHA and VA insured mortgage loans which are placed in non-accrual when they become 12 months or more past due. At December 31, 2018, Oriental's originated non-performing mortgage loans totaled $63.7 million (51.1% of Oriental's non-performing loans), a 0.6% decrease from $64.1 million (58.7% of Oriental's non-performing loans) at December 31, 2017.

Commercial loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the underlying collateral, if any. At December 31, 2018, Oriental's originated non-performing commercial loans amounted to $42.5 million (34.1% of Oriental's non-performing loans), a 20.4% increase from $35.3 million at December 31, 2017 (32.4% of Oriental's non-performing loans). This increase is mainly from a $8.7 million loan that is current in its monthly payments but was placed in non-accrual during 2018 due to credit deterioration after the hurricanes.

Consumer loans — are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 120 days in personal loans and 180 days in credit cards and personal lines of credit. At December 31, 2018, Oriental's originated non-performing consumer loans amounted to $3.4 million (2.7% of Oriental's non-performing loans), a 30.4% increase from $2.6 million at December 31, 2017 (2.4% of Oriental's non-performing loans).

Auto loans and leases — are placed on non-accrual status when they become 90 days past due, partially written-off to collateral value when payments are delinquent 120 days, and fully written-off when payments are delinquent 180 days. At December 31, 2018, Oriental's originated non-performing auto loans and leases amounted to $13.5 million (10.8% of Oriental's total non-performing loans), an increase of 218.9% from $4.2 million at December 31, 2017 (3.9% of Oriental's total non-performing loans), mainly due to higher balance in the portfolio.

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

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

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

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

TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES BREAKDOWN

	December 31, 2018	December 31, 2017	Variance %
	(Dollars in thousands)		
Originated and other loans held for investment			
Allowance balance:			
Mortgage	$ 19,783	$ 20,439	-3.2%
Commercial	30,326	30,258	0.2%
Consumer	15,571	16,454	-5.4%
Auto and leasing	29,508	25,567	15.4%
Total allowance balance	**$ 95,188**	**$ 92,718**	**2.7%**
Allowance composition:			
Mortgage	20.8%	22.0%	-5.7%
Commercial	31.9%	32.6%	-2.3%
Consumer	16.4%	17.8%	-7.8%
Auto and leasing	31.0%	27.6%	12.4%
	100.0%	**100.0%**	
Allowance coverage ratio at end of period applicable to:			
Mortgage	2.96%	2.99%	-1.0%
Commercial	1.90%	2.31%	-17.7%
Consumer	4.46%	4.99%	-10.6%
Auto and leasing	2.61%	2.89%	-9.7%
Total allowance to total originated loans	**2.54%**	**2.89%**	**-12.1%**
Allowance coverage ratio to non-performing loans:			
Mortgage	31.05%	31.89%	-2.6%
Commercial	71.43%	85.83%	-16.8%
Consumer	464.25%	639.74%	-27.4%
Auto and leasing	218.67%	604.14%	-63.8%
Total	**77.38%**	**87.35%**	**-11.4%**

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

	December 31, 2018	December 31, 2017	Variance %
	(Dollars in thousands)		
Acquired BBVAPR loans accounted for under ASC 310-20			
Allowance balance:			
Commercial	$ 22	$ 42	-47.6%
Consumer	1,905	3,225	-40.9%
Auto	135	595	-77.3%
Total allowance balance	**$ 2,062**	**$ 3,862**	**-46.6%**
Allowance composition:			
Commercial	1.1%	1.09%	-1.8%
Consumer	92.4%	83.50%	10.6%
Auto	6.6%	15.41%	-57.5%
	100.0%	**100.00%**	
Allowance coverage ratio at end of period applicable to:			
Commercial	0.86%	0.96%	-10.4%
Consumer	7.94%	11.15%	-28.8%
Auto	3.04%	2.71%	12.2%
Total allowance to total acquired loans	**6.66%**	**6.99%**	**-4.7%**
Allowance coverage ratio to non-performing loans:			
Commercial	2.32%	3.31%	-29.9%
Consumer	478.64%	238.01%	101.1%
Auto	67.50%	332.40%	-79.7%
Total	**133.20%**	**137.73%**	**-3.3%**

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

	December 31,		Variance
	2018	2017	%
	(Dollars in thousands)		
Acquired BBVAPR loans accounted for under ASC 310-30			
Allowance balance:			
Mortgage	$ 15,225	$ 14,085	8.1%
Commercial	20,641	23,691	-12.9%
Consumer	-	18	-100.0%
Auto	6,144	7,961	-22.8%
Total allowance balance	**$ 42,010**	**$ 45,755**	**-8.2%**
Allowance composition:			
Mortgage	36.2%	30.8%	17.7%
Commercial	49.1%	51.8%	-5.1%
Consumer	0.0%	0.0%	-100.0%
Auto	14.6%	17.4%	-15.9%
	100.0%	**100.0%**	
Acquired Eurobank loans accounted for under ASC 310-30			
Allowance balance:			
Mortgage	$ 15,382	$ 15,187	1.3%
Commercial	9,585	9,983	-4.0%
Consumer	4	4	0.0%
Total allowance balance	**$ 24,971**	**$ 25,174**	**-0.8%**
Allowance composition:			
Mortgage	61.6%	60.3%	2.1%
Commercial	38.4%	39.7%	-3.2%
	100.0%	**100.0%**	

TABLE 9 — ALLOWANCE FOR LOAN AND LEASE LOSSES SUMMARY

	Year Ended December 31,			
	2018	2017	Variance %	2016
	(Dollars in thousands)			
Originated and other loans:				
Balance at beginning of year	$ 92,718	$ 59,300	56.4%	$ 112,626
Provision for loan and lease losses	52,061	79,885	-34.8%	45,058
Charge-offs	(72,393)	(61,856)	17.0%	(112,497)
Recoveries	22,802	15,389	48.2%	14,113
Balance at end of year	**$ 95,188**	**$ 92,718**	**2.7%**	**$ 59,300**
Acquired loans:				
BBVAPR loans				
Acquired loans accounted for under ASC 310-20:				
Balance at beginning of year	$ 3,862	$ 4,300	-10.2%	$ 5,542
Provision (recapture) for loan and lease losses	(297)	1,847	-116.1%	2,255
Charge-offs	(2,837)	(4,156)	-31.7%	(5,816)
Recoveries	1,334	1,871	-28.7%	2,319
Balance at end of year	**$ 2,062**	**$ 3,862**	**-46.6%**	**$ 4,300**
Acquired loans accounted for under ASC 310-30:				
Balance at beginning of year	$ 45,755	$ 31,056	47.3%	$ 25,785
Provision for loan and lease losses	1,786	24,681	-92.8%	15,508
Loan pools fully charged off	-	-	0.0%	(282)
Allowance de-recognition	(5,531)	(9,982)	-44.6%	(9,955)
Balance at end of year	**$ 42,010**	**$ 45,755**	**-8.2%**	**$ 31,056**
Eurobank loans				
Balance at beginning of year	$ 25,174	$ 21,281	18.3%	$ 90,178
Provision for loan and lease losses	2,567	6,725	-61.8%	2,255
Loan pools fully charged off	-	-	0.0%	(134)
FDIC shared-loss portion on recapture of loan and lease losses	-	-	0.0%	3,391
Allowance de-recognition	(2,770)	(2,832)	-2.2%	(74,409)
Balance at end of year	**$ 24,971**	**$ 25,174**	**-0.8%**	**$ 21,281**

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

	Year Ended December 31,			
	2018	2017	Variance %	2016
	(Dollars in thousands)			
Originated and other loans and leases:				
Mortgage				
Charge-offs	$ (5,297)	$ (6,623)	-20.0%	$ (6,767)
Recoveries	1,047	585	79.0%	330
Total	**(4,250)**	**(6,038)**	**-29.6%**	**(6,437)**
Commercial				
Charge-offs	(6,782)	(7,684)	-11.7%	(62,445)
Recoveries	654	1,281	-48.9%	460
Total	**(6,128)**	**(6,403)**	**-4.3%**	**(61,985)**
Consumer				
Charge-offs	(17,629)	(13,641)	29.2%	(11,554)
Recoveries	1,757	1,209	45.3%	452
Total	**(15,872)**	**(12,432)**	**27.7%**	**(11,102)**
Auto				
Charge-offs	(42,685)	(33,908)	25.9%	(31,731)
Recoveries	19,344	12,314	57.1%	12,871
Total	**(23,341)**	**(21,594)**	**8.1%**	**(18,860)**
Net credit losses				
Total charge-offs	(72,393)	(61,856)	17.0%	(112,497)
Total recoveries	22,802	15,389	48.2%	14,113
Total	**$ (49,591)**	**$ (46,467)**	**6.7%**	**$ (98,384)**
Net credit losses to average loans outstanding:				
Mortgage	0.62%	0.85%	-27.1%	0.87%
Commercial	0.42%	0.51%	-17.6%	4.47%
Consumer	4.50%	3.81%	18.2%	4.39%
Auto	2.27%	2.63%	-13.8%	2.63%
Total	**1.41%**	**1.49%**	**-5.6%**	**3.18%**
Recoveries to charge-offs	**31.50%**	**24.88%**	**26.6%**	**12.55%**
Average originated loans:				
Mortgage	$ 683,228	709,933	-3.8%	754,732
Commercial	1,452,314	1,255,645	15.7%	1,388,424
Consumer	352,760	326,482	8.0%	286,489
Auto	1,029,039	819,863	25.5%	717,913
Total	**$ 3,517,341**	**$ 3,111,923**	**13.0%**	**$ $3,147,558**

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

	Year Ended December 31,			
	2018	2017	Variance %	2016
	(Dollars in thousands)			
Acquired loans accounted for under ASC 310-20:				
Commercial				
Charge-offs	$ (6)	$ (132)	-95.5%	(42)
Recoveries	23	5	360.0%	73
Total	**17**	**(127)**	**-113.4%**	**31**
Consumer				
Charge-offs	(2,459)	(3,048)	-19.3%	(3,619)
Recoveries	480	446	7.6%	301
Total	**(1,979)**	**(2,602)**	**-23.9%**	**(3,318)**
Auto				
Charge-offs	(372)	(976)	-61.9%	(2,155)
Recoveries	831	1,420	-41.5%	1,945
Total	**459**	**444**	**3.4%**	**(210)**
Net credit losses				
Total charge-offs	(2,837)	(4,156)	-31.7%	(5,816)
Total recoveries	1,334	1,871	-28.7%	2,319
Total	**$ (1,503)**	**$ (2,285)**	**-34.2%**	**(3,497)**
Net credit losses to average loans outstanding:				
Commercial	-5.69%	32.82%	-117.3%	-5.78%
Consumer	3.66%	4.49%	-18.4%	5.55%
Auto	-2.14%	-1.15%	86.0%	0.28%
Total	**1.98%**	**2.36%**	**-15.9%**	**2.60%**
Recoveries to charge-offs	**47.02%**	**45.02%**	**4.4%**	**39.87%**
Average loans accounted for under ASC 310-20:				
Commercial	$ 299	387	-22.7%	536
Consumer	54,061	57,971	-6.7%	59,772
Auto	21,448	38,587	-44.4%	74,431
Total	**$ 75,808**	**$ 96,945**	**-21.8%**	**134,739**

TABLE 11 — NON-PERFORMING ASSETS

	December 31, 2018		December 31, 2017		Variance (%)
	(Dollars in thousands)				
Non-performing assets:					
Non-accruing loans					
Troubled-Debt Restructuring loans	$	41,679	$	25,354	64.4%
Other loans		78,047		74,360	5.0%
Accruing loans					
Troubled-Debt Restructuring loans		4,302		6,704	-35.8%
Other loans		541		2,528	-78.6%
Total non-performing loans	$	124,569	$	108,946	14.3%
Foreclosed real estate		33,768		44,174	-23.6%
Other repossessed assets		2,986		3,548	-15.8%
	$	**161,323**	$	**156,668**	**3.0%**
Non-performing assets to total assets, excluding acquired loans with deteriorated credit quality (including those by analogy)		**2.76%**		**2.95%**	**-6.4%**
Non-performing assets to total capital		**16.13%**		**16.58%**	**-2.7%**

	Year Ended December 31, 2018		Year Ended December 31, 2017		Year Ended December 31, 2016
	(In thousands)				
Interest that would have been recorded in the period if the loans had not been classified as non-accruing loans	$	3,338	$	3,181	2,917

TABLE 12 — NON-PERFORMING LOANS

	December 31, 2018	December 31, 2017	Variance %
	(Dollars in thousands)		
Non-performing loans:			
Originated and other loans held for investment			
Mortgage	$ 63,717	$ 64,085	-0.6%
Commercial	42,456	35,253	20.4%
Consumer	3,354	2,572	30.4%
Auto and leasing	13,494	4,232	218.9%
	123,021	106,142	15.9%
Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)			
Commercial	950	1,270	-25.2%
Consumer	398	1,355	-70.6%
Auto	200	179	11.7%
	1,548	2,804	-44.8%
Total	**$ 124,569**	**$ 108,946**	**14.3%**
Non-performing loans composition percentages:			
Originated loans			
Mortgage	51.1%	58.7%	
Commercial	34.1%	32.4%	
Consumer	2.7%	2.4%	
Auto and leasing	10.8%	3.9%	
Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)			
Commercial	0.8%	1.2%	
Consumer	0.3%	1.2%	
Auto	0.2%	0.2%	
Total	**100.0%**	**100.0%**	
Non-performing loans to:			
Total loans, excluding loans accounted for under ASC 310-30 (including those by analogy)	**3.30%**	**3.34%**	**-1.2%**
Total assets, excluding loans accounted for under ASC 310-30 (including those by analogy)	**2.13%**	**2.05%**	**3.9%**
Total capital	**12.46%**	**11.53%**	**8.1%**

Non-performing loans with partial charge-offs to:			
Total loans, excluding loans accounted for under ASC 310-30 (including those by analogy)	**1.16%**	**1.15%**	**0.87%**
Non-performing loans	**35.30%**	**34.49%**	**2.3%**
Other non-performing loans ratios:			
Charge-off rate on non-performing loans to non-performing loans on which charge-offs have been taken	**59.20%**	**57.69%**	**2.6%**
Allowance for loan and lease losses to non-performing loans on which no charge-offs have been taken	**120.67%**	**134.26%**	**-10.1%**

TABLE 13 - ACTIVITY OF FDIC INDEMNIFICATION ASSET

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
FDIC indemnification asset:			
Balance at beginning of period	$ -	$ 14,411	$ 22,599
Shared-loss agreements reimbursements from the FDIC	-	-	(1,573)
Increase in expected credit losses to be covered under shared-loss agreements, net	-	-	3,391
FDIC indemnification asset benefit (expense)	-	1,403	(8,040)
Net expenses incurred under shared-loss agreements	-	-	(1,966)
Shared-loss termination settlement	-	(15,814)	-
Balance at end of period	**$ -**	**$ -**	**14,411**

TABLE 14 - ACTIVITY IN THE REMAINING FDIC INDEMNIFICATION ASSET DISCOUNT

	Year Ended December 31		
	2018	2017	2016
	(In thousands)		
Balance at beginning of year	$ -	$ 8,670	$ 4,814
Amortization of negative discount	-	-	(8,040)
Impact of lower projected losses	-	-	11,896
Shared-loss termination	-	(8,670)	-
Balance at end of year	**$ -**	**$ -**	**$ 8,670**

TABLE 15 - LIABILITIES SUMMARY AND COMPOSITION

	December 31, 2018	December 31, 2017	Variance %
	(Dollars in thousands)		
Deposits:			
Non-interest bearing deposits	$ 1,105,324	$ 969,525	14.0%
NOW accounts	1,086,447	1,069,572	1.6%
Savings and money market accounts	1,212,260	1,251,396	-3.1%
Certificates of deposit	1,501,002	1,507,101	-0.4%
Total deposits	**4,905,033**	**4,797,594**	**2.2%**
Accrued interest payable	3,082	1,888	63.2%
Total deposits and accrued interest payable	**4,908,115**	**4,799,482**	**2.3%**
Borrowings:			
Securities sold under agreements to repurchase	455,508	192,869	136.2%
Advances from FHLB	77,620	99,643	-22.1%
Subordinated capital notes	36,083	36,083	0.0%
Other term notes	1,214	153	693.5%
Total borrowings	**570,425**	**328,748**	**73.5%**
Total deposits and borrowings	**5,478,540**	**5,128,230**	**6.8%**
Other Liabilities:			
Derivative liabilities	333	1,281	-74.0%
Acceptances outstanding	16,937	27,644	-38.7%
Other liabilities	87,665	86,791	1.0%
Total liabilities	**$ 5,583,475**	**$ 5,243,946**	**6.5%**
Deposits portfolio composition percentages:			
Non-interest bearing deposits	22.5%	20.2%	
NOW accounts	22.1%	22.3%	
Savings and money market accounts	24.7%	26.1%	
Certificates of deposit	30.7%	31.4%	
	100.0%	**100.0%**	
Borrowings portfolio composition percentages:			
Securities sold under agreements to repurchase	79.9%	58.7%	
Advances from FHLB	13.6%	30.3%	
Other term notes	0.2%	0.0%	
Subordinated capital notes	6.3%	11.0%	
	100.0%	**100.0%**	
Securities sold under agreements to repurchase (excluding accrued interest)			
Amount outstanding at period-end	$ 454,723	$ 192,500	
Daily average outstanding balance	$ 357,086	$ 393,133	
Maximum outstanding balance at any month-end	$ 457,053	$ 606,210	

Liabilities and Funding Sources

As shown in Table 15 above, at December 31, 2018, Oriental's total liabilities were $5.583 billion, 6.5% more than the $5.244 billion reported at December 31, 2017. Deposits and borrowings, Oriental's funding sources, amounted to $5.479 billion at December 31, 2018 versus $5.128 billion at December 31, 2017, a 6.8% increase.

Borrowings consist mainly of repurchase agreements, FHLB-NY advances and subordinated capital notes. At December 31, 2018, borrowings amounted to $570.4 million, representing an increase of 73.5% when compared with the $328.7 million reported at December 31, 2017. The increase in borrowings reflects:

- An increase of $262.2 million in new repurchase agreements used for the purchase of investment securities during the year ended December 31, 2018; and

- A decrease of $21.9 million in advances from the FHLB-NY attributable to $68.1 million of new advances, offset by the maturing of $90.0 million of advances that were not renewed.

At December 31, 2018, deposits represented 88% and borrowings represented 12% of interest-bearing liabilities. At December 31, 2018, deposits, the largest category of Oriental's interest-bearing liabilities, were $4.908 billion, an increase of 2.3% from $4.798 billion at December 31, 2017.

Stockholders' Equity

At December 31, 2018, Oriental's total stockholders' equity was $999.9 million, a 5.8% increase when compared to $945.1 million at December 31, 2017. This increase in stockholders' equity reflects increases in retained earnings of $52.2 million, legal surplus of $8.7 million, reduction in treasury stock, at cost, of $869 thousand, partially offset by a decrease in accumulated other comprehensive loss, net of tax of $8.0 million. Book value per share was $17.90 at December 31, 2018 compared to $17.73 at December 31, 2017.

From December 31, 2017 to December 31, 2018, tangible common equity to total assets increased from 11.12% to 12.59%, leverage capital ratio increased from 13.92% to 14.22%, common equity tier 1 capital ratio increased from 14.59% to 16.78%, tier 1 risk-based capital ratio increased from 19.05% to 19.20%, and total risk-based capital ratio increased from 20.34% to 20.48%. The increase in these ratios reflect an increase of $54.8 million in total capital.

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

Capital Rules to Implement Basel III Capital Requirements

Oriental and the Bank are subject to regulatory capital requirements established by the Federal Reserve Board and the FDIC. The current risk-based capital standards applicable to Oriental and the Bank ("Basel III capital rules"), which have been effective since January 1, 2015, are based on the final capital framework for strengthening international capital standards, known as Basel III, of the Basel Committee on Banking Supervision. As of December 31, 2018, the capital ratios of Oriental and the Bank continue to exceed the minimum requirements for being "well-capitalized" under the Basel III capital rules.

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

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

TABLE 16 — CAPITAL, DIVIDENDS AND STOCK DATA

	December 31,				Variance
		2018		2017	%
	(Dollars in thousands, except per share data)				
Capital data:					
Stockholders' equity	$	999,877	$	945,107	5.8%
Regulatory Capital Ratios data:					
Common equity tier 1 capital ratio		**16.78%**		**14.59%**	**15.0%**
Minimum common equity tier 1 capital ratio required		4.50%		4.50%	0.0%
Actual common equity tier 1 capital	$	811,707		644,804	25.9%
Minimum common equity tier 1 capital required	$	217,675		198,930	9.4%
Minimum capital conservation buffer required	$	90,698		55,258	64.1%
Excess over regulatory requirement	$	503,334		390,615	28.9%
Risk-weighted assets	$	4,837,214		4,420,667	9.4%
Tier 1 risk-based capital ratio		**19.20%**		**19.05%**	**0.8%**
Minimum tier 1 risk-based capital ratio required		6.00%		6.00%	0.0%
Actual tier 1 risk-based capital	$	928,577	$	842,133	10.3%
Minimum tier 1 risk-based capital required	$	290,233	$	265,240	9.4%
Excess over regulatory requirement	$	638,344	$	576,893	10.7%
Risk-weighted assets	$	4,837,214	$	4,420,667	9.4%
Total risk-based capital ratio		**20.48%**		**20.34%**	**0.7%**
Minimum total risk-based capital ratio required		8.00%		8.00%	0.0%
Actual total risk-based capital	$	990,499	$	899,258	10.1%
Minimum total risk-based capital required	$	386,977	$	353,653	9.4%
Excess over regulatory requirement	$	603,522	$	545,604	10.6%
Risk-weighted assets	$	4,837,214	$	4,420,667	9.4%
Leverage capital ratio		**14.22%**		**13.92%**	**2.2%**
Minimum leverage capital ratio required		4.00%		4.00%	0.0%
Actual tier 1 capital	$	928,577	$	842,133	10.3%
Minimum tier 1 capital required	$	261,125	$	242,057	7.9%
Excess over regulatory requirement	$	667,452	$	600,076	11.2%
Tangible common equity to total assets		**12.59%**		**11.12%**	**13.2%**
Tangible common equity to risk-weighted assets		**17.13%**		**15.57%**	**10.0%**
Total equity to total assets		**15.19%**		**15.27%**	**-0.5%**
Total equity to risk-weighted assets		**20.67%**		**21.38%**	**-3.3%**
Stock data:					

Outstanding common shares		51,293,924		43,947,442	16.7%
Book value per common share	$	17.90	$	17.73	0.9%
Tangible book value per common share	$	16.15	$	15.67	3.1%
Market price at end of period	$	16.46	$	9.40	75.1%
Market capitalization at end of period	$	844,298	$	413,106	104.4%

	Year Ended December 31,			
	2018	2017	Variance %	2016
	(Dollars in thousands)			
Common dividend data:				
Cash dividends declared	$ 11,511	$ 10,553	9.1%	$ 10,544
Cash dividends declared per share	$ 0.25	$ 0.24	4.2%	$ 0.24
Payout ratio	16.45%	27.91%	-41.1%	23.30%
Dividend yield	1.52%	2.55%	-40.4%	1.83%

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

	December 31,	
	2018	2017
	(In thousands, except share or per share information)	
Total stockholders' equity	$ 999,877	$ 945,107
Preferred stock	(92,000)	(176,000)
Preferred stock issuance costs	10,130	10,130
Goodwill	(86,069)	(86,069)
Core deposit intangible	(2,480)	(3,339)
Customer relationship intangible	(888)	(1,348)
Total tangible common equity (non-GAAP)	**$ 828,570**	**$ 688,481**
Total assets	6,583,352	6,189,053
Goodwill	(86,069)	(86,069)
Core deposit intangible	(2,480)	(3,339)
Customer relationship intangible	(888)	(1,348)
Total tangible assets	**$ 6,493,915**	**$ 6,098,297**
Tangible common equity to tangible assets	**12.76%**	**11.29%**
Common shares outstanding at end of period	51,293,924	43,947,442
Tangible book value per common share	**$ 16.15**	**$ 15.67**

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

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

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

	December 31, 2018	December 31, 2017	Variance %
	(Dollars in thousands)		
Risk-based capital:			
Common equity tier 1 capital	$ 811,707	$ 644,804	25.9%
Additional tier 1 capital	116,870	197,329	-40.8%
Tier 1 capital	**928,577**	**842,133**	**10.3%**
Additional Tier 2 capital	61,922	57,125	8.4%
Total risk-based capital	**$ 990,499**	**$ 899,258**	**10.1%**
Risk-weighted assets:			
Balance sheet items	$ 4,641,998	$ 4,249,042	9.2%
Off-balance sheet items	195,216	171,625	13.7%
Total risk-weighted assets	**$ 4,837,214**	**$ 4,420,667**	**9.4%**
Ratios:			
Common equity tier 1 capital (minimum required - 4.5%)	**16.78%**	**14.59%**	**15.0%**
Tier 1 capital (minimum required - 6%)	**19.20%**	**19.05%**	**0.8%**
Total capital (minimum required - 8%)	**20.48%**	**20.34%**	**0.7%**
Leverage ratio (minimum required - 4%)	**14.22%**	**13.92%**	**2.2%**
Equity to assets	**15.19%**	**15.27%**	**-0.5%**
Tangible common equity to assets	**12.59%**	**11.12%**	**13.2%**

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

	December 31,				Variance
	2018		2017		%
	(Dollars in thousands)				
Oriental Bank Regulatory Capital Ratios:					
Common Equity Tier 1 Capital to Risk-Weighted Assets		**18.40%**		**18.63%**	**-1.2%**
Actual common equity tier 1 capital	$	887,918	$	822,776	7.9%
Minimum capital requirement (4.5%)	$	217,120	$	198,712	9.3%
Minimum capital conservation buffer requirement (1.875% at December 31, 2018 - 1.25% at December 31, 2017)	$	90,467	$	55,198	63.9%
Minimum to be well capitalized (6.5%)	$	313,618	$	287,028	9.3%
Tier 1 Capital to Risk-Weighted Assets		**18.40%**		**18.63%**	**-1.2%**
Actual tier 1 risk-based capital	$	887,918	$	822,776	7.9%
Minimum capital requirement (6%)	$	289,494	$	264,949	9.3%
Minimum to be well capitalized (8%)	$	385,992	$	353,265	9.3%
Total Capital to Risk-Weighted Assets		**19.68%**		**19.92%**	**-1.2%**
Actual total risk-based capital	$	949,596	$	879,648	8.0%
Minimum capital requirement (8%)	$	385,992	$	353,265	9.3%
Minimum to be well capitalized (10%)	$	482,490	$	441,581	9.3%
Total Tier 1 Capital to Average Total Assets		**13.68%**		**13.63%**	**0.4%**
Actual tier 1 capital	$	887,918	$	822,776	7.9%
Minimum capital requirement (4%)	$	259,547	$	241,417	7.5%
Minimum to be well capitalized (5%)	$	324,434	$	301,771	7.5%

Oriental’s common stock is traded on the New York Stock Exchange (“NYSE”) under the symbol “OFG.” At December 31, 2018 and 2017, Oriental’s market capitalization for its outstanding common stock was $844.3 million ($16.46 per share) and $413.1 million ($9.40 per share), respectively.

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

	Price				Cash Dividend
	High		Low		Per share
2018					
December 31, 2018	$	18.56	$	14.93	$ 0.07
September 30, 2018	$	17.60	$	14.45	$ 0.06
June 30, 2018	$	14.75	$	10.60	$ 0.06
March 31, 2018	$	12.05	$	8.60	$ 0.06
2017					
December 31, 2017	$	10.25	$	7.90	$ 0.06
September 30, 2017	$	10.40	$	8.40	$ 0.06
June 30, 2017	$	12.03	$	9.19	$ 0.06
March 31, 2017	$	13.80	$	10.90	$ 0.06
2016					
December 31, 2016	$	14.30	$	9.56	$ 0.06
September 30, 2016	$	11.09	$	8.07	$ 0.06
June 30, 2016	$	9.14	$	6.32	$ 0.06
March 31, 2016	$	7.32	$	4.77	$ 0.06

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

At December 31, 2018, the number of shares that may yet be purchased under such program is estimated at 469,675 and was calculated by dividing the remaining balance of $7.7 million by $16.46 (closing price of Oriental's common stock at December 31, 2018).

Contractual Obligations and Commercial Commitments

As disclosed in the notes to the consolidated financial statements, Oriental has certain obligations and commitments to make future payments under contracts. At December 31, 2018, the aggregate contractual obligations and commercial commitments, excluding accrued interest and unamortized premiums (discounts), are as follows:

	Payments Due by Period				
	Total	**Less than 1 year**	**1 - 3 years**	**3 - 5 years**	**After 5 years**
			(In thousands)		
CONTRACTUAL OBLIGATIONS:					
Securities sold under agreements to repurchase	$ 454,723	$ 264,723	$ 190,000	$ -	$ -
Advances from FHLB	77,444	33,572	8,867	35,005	-
Subordinated capital notes	35,000	-	-	-	35,000
Annual rental commitments under noncancelable					
operating leases	24,412	5,618	7,653	11,141	-
Certificates of deposits	1,501,004	850,451	573,537	77,016	-
Total	**$ 2,092,583**	**$ 1,154,364**	**$ 780,057**	**$ 123,162**	**$ 35,000**

Loan commitments, which represent unused lines of credit, increased to $541.4 million at December 31, 2018 as compared to $485.0 million in December 31, 2017, while letters of credit provided to customers, decreased to $340 thousand as compared to $494 thousand at December 31, 2017. Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates, bear variable interest rate and may require payment of a fee. Since the commitments may expire unexercised, the total commitment amounts do not necessarily represent future cash requirements. Oriental evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by Oriental upon extension of credit, is based on management's credit evaluation of the customer.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein (except for certain non-GAAP measures as previously indicated) have been prepared in accordance with GAAP which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services since such prices are affected by inflation.

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QUARTERLY FINANCIAL DATA

The following is a summary of the quarterly results of operations:

TABLE 17 — SELECTED QUARTERLY FINANCIAL DATA:

	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018	Total 2018
EARNINGS DATA:	**(In thousands, except per share data)**				
Interest income	$ 83,170	$ 88,006	$ 94,137	$ 95,106	$ 360,419
Interest expense	9,176	10,418	11,860	13,071	44,525
Net interest income	**73,994**	**77,588**	**82,277**	**82,035**	**315,894**
Provision for loan and lease losses	15,460	14,747	14,601	11,300	56,108
Net interest income after provision for loan and lease losses	**58,534**	**62,841**	**67,676**	**70,735**	**259,786**
Non-interest income	18,514	18,703	18,620	24,258	80,095
Non-interest expenses	52,121	52,300	50,941	51,719	207,081
Income before taxes	**24,927**	**29,244**	**35,355**	**43,274**	**132,800**
Income tax expense	8,010	9,595	12,255	18,530	48,390
Net income	**16,917**	**19,649**	**23,100**	**24,744**	**84,410**
Less: dividends on preferred stock	(3,465)	(3,465)	(3,466)	(1,628)	(12,024)
Income available to common shareholders	**$ 13,452**	**$ 16,184**	**$ 19,634**	**$ 23,116**	**$ 72,386**
PER SHARE DATA:					
Basic	**$** 0.31	**$** 0.36	**$** 0.45	**$** 0.47	**$** 1.58
Diluted	**$** 0.30	**$** 0.35	**$** 0.42	**$** 0.45	**$** 1.52

	March 31, 2017	June 30, 2017	September 30, 2017	December 31, 2017	Total 2017
EARNINGS DATA:	**(In thousands, except per share data)**				
Interest income	$ 86,178	$ 85,940	$ 90,355	$ 83,174	$ 345,647
Interest expense	11,560	10,377	9,877	9,661	41,475
Net interest income	**74,618**	**75,563**	**80,478**	**73,513**	**304,172**
	17,654	26,536	44,042	24,907	113,139

Provision for loan and lease losses										
Net interest income after provision for loan										
and lease losses		**56,964**		**49,027**		**36,436**		**48,606**		**191,033**
Non-interest income		19,074		24,886		17,912		16,815		78,687
Non-interest expenses		51,684		52,816		50,469		46,662		201,631
(Loss) income before taxes		**24,354**		**21,097**		**3,879**		**18,759**		**68,089**
Income tax expense (benefit)		9,204		3,993		560		1,686		15,443
Net (loss) income		**15,150**		**17,104**		**3,319**		**17,073**		**52,646**
Less: dividends on preferred stock		(3,465)		(3,466)		(3,465)		(3,466)		(13,862)
(Loss) income available to common shareholders	**$**	**11,685**	**$**	**13,638**	**$**	**(146)**	**$**	**13,607**	**$**	**38,784**
PER SHARE DATA:										
Basic	**$**	0.27	**$**	0.30	**$**	-	**$**	0.31	**$**	0.88
Diluted	**$**	0.26	**$**	0.30	**$**	-	**$**	0.30	**$**	0.88

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

Background

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

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

Market Risk

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

Interest Rate Risk

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

In executing its responsibilities, ALCO examines current and expected conditions in global financial markets, competition and prevailing rates in the local deposit market, liquidity, unrealized gains and losses in securities, recent or proposed changes to the investment portfolio, alternative funding sources and their costs, hedging and the possible purchase of derivatives such as swaps, and any tax or regulatory issues which may be pertinent to these areas.

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

(i) using a static balance sheet as Oriental had on the simulation date, and

(ii) using a dynamic balance sheet based on recent growth patterns and business strategies.

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

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

These simulations are complex, and use many assumptions that are intended to reflect the general behavior of Oriental over the period in question. There can be no assurance that actual events will match these assumptions in all cases. For this reason, the results of these simulations are only approximations of the true sensitivity of net interest income to changes in market interest rates. The following table presents the results of the simulations at December 31, 2018 for the most likely scenario, assuming a one-year time horizon:

	Net Interest Income Risk (one-year projection)					
	Static Balance Sheet			Growing Simulation		
		Amount Change	Percent Change		Amount Change	Percent Change
Change in interest rate	(Dollars in thousands)					
+ 200 Basis points	$	11,424	3.63%	$	12,683	3.99%
+ 100 Basis points	$	5,750	1.83%	$	6,381	2.01%
- 100 Basis points	$	(5,643)	-1.79%	$	(6,271)	-1.97%
- 200 Basis points	$	(11,330)	-3.60%	$	(12,584)	-3.96%

Future net interest income could be affected by Oriental’s investments in callable securities, prepayment risk related to mortgage loans and mortgage-backed securities, and any structured repurchase agreements and advances from the FHLB-NY in which it may enter into from time to time. As part of the strategy to limit the interest rate risk and reduce the re-pricing gaps of Oriental’s assets and liabilities, Oriental has executed certain transactions which include extending the maturity and the re-pricing frequency of the liabilities to longer terms reducing the amounts of its structured repurchase agreements and entering into hedge-designated swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings that only consist of advances from the FHLB-NY as of December 31, 2018.

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

Derivative instruments that are used as part of Oriental’s interest risk management strategy include interest rate swaps, forward-settlement swaps, futures contracts, and option contracts that have indices related to the pricing of specific balance sheet assets and liabilities. Interest rate swaps generally involve the exchange of fixed and variable-rate interest payments between two parties based on a common notional principal amount and maturity date. Interest rate futures generally involve exchanged-traded contracts to buy or sell U.S. Treasury bonds and notes in the future at specified prices. Interest rate options represent contracts that allow the holder of the option to (i) receive cash or (ii) purchase, sell, or enter into a financial instrument at a specified price within a specified period. Some purchased option contracts give Oriental the right to enter into interest rate swaps and cap and floor agreements with the writer of the option. In addition, Oriental enters into certain transactions that contain embedded derivatives. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated and carried at fair value. Please refer to Note 12 to the accompanying consolidated financial statements for further information concerning Oriental’s derivative activities.

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

Interest rate swaps — Oriental entered into hedge-designated swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings attributable to changes in the one-month LIBOR rate. Once the forecasted wholesale borrowing transactions occurred, the interest rate swap effectively fixes Oriental’s interest payments on an amount of forecasted interest expense attributable to the one-month LIBOR rate corresponding to the swap notional stated rate. A derivative asset of $14 thousand (notional amount of $34.0 million) was recognized at December 31, 2018 related to the valuation of these swaps.

In addition, Oriental has certain derivative contracts, including interest rate swaps not designated as hedging instruments, which are utilized to convert certain variable-rate loans to fixed-rate loans, and the mirror-images of these interest rate swaps in which Oriental enters into to minimize its interest rate risk exposure that results from offering the derivatives to clients. These interest rate swaps are marked to market through earnings. At December 31, 2018, interest rate swaps offered to clients not designated as hedging instruments represented a derivative asset of $126 thousand (notional amounts of $12.5 million), and the mirror-image interest rate swaps in which Oriental entered into represented a derivative liability of $126 thousand (notional amounts of $12.5 million).

Wholesale borrowings — Oriental uses interest rate swaps to hedge the variability of interest cash flows of certain advances from the FHLB-NY that are tied to a variable rate index. The interest rate swaps effectively fix Oriental’s interest payments on these borrowings. As of December 31, 2018, Oriental had $34.0 million in interest rate swaps at an average rate of 2.4% designated as cash flow hedges for $34.0 million in advances from the FHLB-NY that reprice or are being rolled over on a monthly basis.

Credit Risk

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

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

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

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

Liquidity Risk

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

Oriental's business requires continuous access to various funding sources. While Oriental is able to fund its operations through deposits as well as through advances from the FHLB-NY and other alternative sources, Oriental's business is dependent upon other external wholesale funding sources. Oriental has selectively reduced its use of certain wholesale funding sources, such as repurchase agreements and brokered deposits. As of December 31, 2018, Oriental had $454.7 million in repurchase agreements, excluding accrued interest, and $525.1 million in brokered deposits.

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

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

As of December 31, 2018, Oriental had approximately $447.0 million in unrestricted cash and cash equivalents, $637.5 million in investment securities that are not pledged as collateral, and $762.0 million in borrowing capacity at the FHLB-NY.

Operational Risk

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

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

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

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

Concentration Risk

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

ITEM 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

OFG Bancorp

FORM 10-K

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OFG Bancorp

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and stockholders of OFG Bancorp:

The management of OFG Bancorp ("Oriental") is responsible for establishing and maintaining effective internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, and for the assessment of internal control over financial reporting. Oriental's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Oriental's internal control over financial reporting includes those policies and procedures that:

(1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Oriental;

(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of Oriental are being made only in accordance with authorization of management and directors of Oriental; and

(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Oriental's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As called for by Section 404 of the Sarbanes-Oxley Act of 2002, management has assessed the effectiveness of Oriental's internal control over financial reporting as of December 31, 2018. Management made its assessment using the criteria set forth in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Criteria").

Based on its assessment, management has concluded that Oriental maintained effective internal control over financial reporting as of December 31, 2018 based on the COSO Criteria.

The effectiveness of Oriental's internal control over financial reporting as of December 31, 2018, has been audited by KPMG LLP, Oriental's independent registered public accounting firm, as stated in their report dated March 8, 2019.

By: */s/ José Rafael Fernández*
José Rafael Fernández
President and Chief Executive Officer

Date: March 8, 2019

By: */s/ Maritza Arizmendi*
Maritza Arizmendi
Executive Vice President and Chief Financial Officer

Date: March 8, 2019

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
OFG Bancorp:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements and the related notes (collectively, the consolidated financial statements) of OFG Bancorp and subsidiaries as listed in the accompanying index. In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 8, 2019 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company’s auditor since 2005.

/s/ KPMG LLP

San Juan, Puerto Rico
March 8, 2019

Stamp No. E363705 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
OFG Bancorp:

Opinion on Internal Control Over Financial Reporting

We have audited OFG Bancorp and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated statements of financial condition of the Company as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements), and our report dated March 8, 2019 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP

San Juan, Puerto Rico

March 8, 2019

Stamp No. E363704 of the Puerto Rico

Society of Certified Public Accountants

was affixed to the record copy of this report

OFG BANCORP

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF DECEMBER 31, 2018 AND 2017

	December 31,			
		2018		2017
	(In thousands)			
ASSETS				
Cash and cash equivalents:				
Cash and due from banks	$	442,103	$	478,182
Money market investments		4,930		7,021
Total cash and cash equivalents		**447,033**		**485,203**
Restricted cash		3,030		3,030
Investments:				
Trading securities, at fair value, with amortized cost of $647 (December 31, 2017 - $647)		360		191
Investment securities available-for-sale, at fair value, with amortized cost of $854,511 (December 31, 2017 - $648,800)		841,857		645,797
Investment securities held-to-maturity, at amortized cost, with fair value of $410,353 (December 31, 2017 - $497,681)		424,740		506,064
Federal Home Loan Bank (FHLB) stock, at cost		12,644		13,995
Other investments		3		3
Total investments		**1,279,604**		**1,166,050**
Loans:				
Loans held-for-sale, at lower of cost or fair value		10,368		12,272
Loans held for investment, net of allowance for loan and lease losses of $164,231 (December 31, 2017 - $167,509)		4,421,226		4,044,057
Total loans		**4,431,594**		**4,056,329**
Other assets:				
Foreclosed real estate		33,768		44,174
Accrued interest receivable		34,254		49,969
Deferred tax asset, net		113,763		127,421
Premises and equipment, net		68,892		67,860
Customers' liability on acceptances		16,937		27,663
Servicing assets		10,716		9,821
Derivative assets		347		771
Goodwill		86,069		86,069
Other assets		57,345		64,693
Total assets	$	**6,583,352**	$	**6,189,053**

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

OFG BANCORP

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF DECEMBER 31, 2018 AND 2017 (CONTINUED)

	December 31, 2018		December 31, 2017	
	(In thousands)			
LIABILITIES AND STOCKHOLDERS' EQUITY				
Deposits:				
Demand deposits	$	2,191,802	$	2,039,126
Savings accounts		1,212,259		1,251,398
Time deposits		1,504,054		1,508,958
Total deposits		**4,908,115**		**4,799,482**
Borrowings:				
Securities sold under agreements to repurchase		455,508		192,869
Advances from FHLB		77,620		99,643
Subordinated capital notes		36,083		36,083
Other borrowings		1,214		153
Total borrowings		**570,425**		**328,748**
Other liabilities:				
Derivative liabilities		333		1,281
Acceptances executed and outstanding		16,937		27,644
Accrued expenses and other liabilities		87,665		86,791
Total liabilities		**5,583,475**		**5,243,946**
Commitments and contingencies (See Note 26)				
Stockholders' equity:				
Preferred stock; 10,000,000 shares authorized; 1,340,000 shares of Series A, 1,380,000 shares of Series B, and 960,000 shares of Series D issued and outstanding (December 31, 2017 - 1,340,000 shares; 1,380,000 shares; and 960,000 shares) $25 liquidation value		92,000		92,000
84,000 shares of Series C issued and outstanding at December 31, 2017 $1,000 liquidation value		-		84,000
Common stock, $1 par value; 100,000,000 shares authorized; 59,885,234 shares issued: 51,293,924 shares outstanding (December 31, 2017 - 52,625,869; 43,947,442)		59,885		52,626
Additional paid-in capital		619,381		541,600

Legal surplus		90,167		81,454
Retained earnings		253,040		200,878
Treasury stock, at cost, 8,591,310 shares (December 31, 2017 - 8,678,427 shares)		(103,633)		(104,502)
Accumulated other comprehensive (loss), net of tax of $1,677 (December 31, 2017 - $564)		(10,963)		(2,949)
Total stockholders' equity		**999,877**		**945,107**
Total liabilities and stockholders' equity	$	**6,583,352**	$	**6,189,053**

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

OFG BANCORP

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	Year Ended December 31,		
	2018	2017	2016
	(In thousands, except per share data)		
Interest income:			
Loans	$ 321,381	$ 312,421	$ 321,945
Mortgage-backed securities	31,190	26,994	30,522
Investment securities and other	7,848	6,232	4,125
Total interest income	**360,419**	**345,647**	**356,592**
Interest expense:			
Deposits	32,953	30,298	29,253
Securities sold under agreements to repurchase	7,794	7,223	18,805
Advances from FHLB and other borrowings	1,875	2,398	6,186
Subordinated capital notes	1,903	1,556	2,921
Total interest expense	**44,525**	**41,475**	**57,165**
Net interest income	**315,894**	**304,172**	**299,427**
Provision for loan and lease losses, net	56,108	113,139	65,076
Net interest income after provision for loan and lease losses	**259,786**	**191,033**	**234,351**
Non-interest income:			
Banking service revenue	43,638	39,468	41,647
Wealth management revenue	25,934	25,790	27,433
Mortgage banking activities	4,767	4,050	5,021
Total banking and financial service revenues	**74,339**	**69,308**	**74,101**
FDIC shared-loss benefit, net	-	1,403	(13,581)
Net gain on:			
Sale of securities	-	6,896	12,207
Derivatives	-	132	(71)
Early extinguishment of debt	-	(80)	(12,000)
Other non-interest income	5,756	1,028	6,163
Total non-interest income, net	**80,095**	**78,687**	**66,819**

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

OFG BANCORP

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016 (CONTINUED)

	Year Ended December 31,		
	2018	2017	2016
	(In thousands, except per share data)		
Non-interest expense:			
Compensation and employee benefits	76,524	79,751	76,761
Occupancy and equipment	33,084	32,557	30,300
Electronic banking charges	21,234	19,322	20,707
Professional and service fees	12,442	12,406	12,235
Taxes, other than payroll and income taxes	9,017	9,187	9,782
Credit related expenses	8,890	7,992	10,267
Information technology expenses	8,227	8,010	7,116
Insurance	6,249	5,223	9,109
Advertising, business promotion, and strategic initiatives	5,084	5,616	5,485
Loan servicing and clearing expenses	4,810	4,693	8,247
Loss on sale of foreclosed real estate and other repossessed assets	4,662	4,634	10,282
Communication	3,447	3,415	3,379
Printing, postage, stationary and supplies	2,217	2,437	2,558
Director and investor relations	1,089	1,072	1,087
Other	10,105	5,316	8,675
Total non-interest expense	**207,081**	**201,631**	**215,990**
Income before income taxes	**132,800**	**68,089**	**85,180**
Income tax expense	48,390	15,443	25,994
Net income	**84,410**	**52,646**	**59,186**
Less: dividends on preferred stock	(12,024)	(13,862)	(13,862)
Income (loss) available to common shareholders	**$ 72,386**	**$ 38,784**	**$ 45,324**
Earnings per common share:			
Basic	**$ 1.59**	**$ 0.88**	**$ 1.03**
Diluted	**$ 1.52**	**$ 0.88**	**$ 1.03**
Average common shares outstanding and equivalents	**51,349**	**51,096**	**51,088**
Cash dividends per share of common stock	**$ 0.25**	**$ 0.24**	**$ 0.24**

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

OFG BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	Year Ended December 31, 2018	2017 (In thousands)	2016
Net income	**$ 84,410**	**$ 52,646**	**$ 59,186**
Other comprehensive loss before tax:			
Unrealized (loss) gain on securities available-for-sale	(9,651)	2,276	(5,023)
Realized gain on investment securities included in net income	-	(6,896)	(12,207)
Other-than-temporary impairment included in net income	-	-	-
Unrealized gain on cash flow hedges	524	494	3,303
Other comprehensive loss before taxes	**(9,127)**	**(4,126)**	**(13,927)**
Income tax effect	1,113	(419)	1,526
Other comprehensive loss after taxes	**(8,014)**	**(4,545)**	**(12,401)**
Comprehensive income	**$ 76,396**	**$ 48,101**	**$ 46,785**

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

OFG BANCORP

CONSOLIDATED STATEMENTS OF CHANGES

IN STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	Year Ended December 31,		
	2018	2017	2016
		(In thousands)	
Preferred stock:			
Balance at beginning of year	$ 176,000	$ 176,000	$ 176,000
Conversion of convertible preferred stock into common stock	(84,000)	$ -	$ -
Balance at end of year	**92,000**	**176,000**	**176,000**
Common stock:			
Balance at beginning of year	52,626	52,626	52,626
Conversion of convertible preferred stock into common stock	7,259	-	-
Balance at end of year	**59,885**	**52,626**	**52,626**
Additional paid-in capital:			
Balance at beginning of year	541,600	540,948	540,512
Stock-based compensation expense	1,401	1,109	1,270
Stock-based compensation excess tax benefit recognized in income	-	(99)	-
Lapsed restricted stock units	(361)	(358)	(834)
Conversion of convertible preferred stock into common stock	76,741	-	-
Balance at end of year	**619,381**	**541,600**	**540,948**
Legal surplus:			
Balance at beginning of year	81,454	76,293	70,435
Transfer from retained earnings	8,713	5,161	5,858
Balance at end of year	**90,167**	**81,454**	**76,293**
Retained earnings:			
Balance at beginning of year	200,878	177,808	148,886
Net income	84,410	52,646	59,186
Cash dividends declared on common stock	(11,511)	(10,553)	(10,544)
Cash dividends declared on preferred stock	(12,024)	(13,862)	(13,862)
Transfer to legal surplus	(8,713)	(5,161)	(5,858)
Balance at end of year	**253,040**	**200,878**	**177,808**
Treasury stock:			
Balance at beginning of year	(104,502)	(104,860)	(105,379)
Lapsed restricted stock units	869	358	519
Balance at end of year	**(103,633)**	**(104,502)**	**(104,860)**
Accumulated other comprehensive loss, net of tax:			
Balance at beginning of year	(2,949)	1,596	13,997

Other comprehensive loss, net of tax		(8,014)		(4,545)	(12,401)
Balance at end of year		**(10,963)**		**(2,949)**	**1,596**
Total stockholders' equity	**$**	**999,877**	**$**	**945,107$**	**920,411**

The accompanying nots are an integral part of these consolidated financial statements

OFG BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Cash flows from operating activities:			
Net income	$ **84,410**	$ **52,646**	$ **59,186**
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of deferred loan origination fees and fair value premiums on acquired loans	4,605	3,537	3,548
Amortization of investment securities premiums, net of accretion of discounts	5,753	7,865	8,540
Amortization of core deposit and customer relationship intangibles	1,319	1,473	1,677
Amortization of fair value premiums on acquired deposits	-	-	340
FDIC shared-loss (benefit) expense	-	(1,403)	13,581
Depreciation and amortization of premises and equipment	8,898	8,986	9,420
Deferred income tax expense, net	14,772	(3,658)	23,226
Provision for loan and lease losses	56,108	113,139	65,076
Stock-based compensation	1,401	1,109	1,270
Stock-based compensation excess tax benefit recognized in income	-	(99)	-
(Gain) loss on:			
Sale of loans	(301)	(955)	(1,570)
Derivatives	-	(103)	181
Sale of securities	-	(6,896)	(12,207)
Early extinguishment of debt	-	80	12,000
Foreclosed real estate and other repossessed assets	3,405	4,964	11,934
Sale of other assets	(107)	(539)	12
Sale of other repossesed assets	1,257	57	(1,623)
Originations of loans held-for-sale	(95,520)	(116,020)	(179,430)
Proceeds from sale of loans held-for-sale	27,757	75,637	69,862
Net (increase) decrease in:			
Trading securities	(169)	156	(59)
Accrued interest receivable	15,715	(29,742)	410
Servicing assets	(895)	37	(2,403)
Other assets	5,486	13,675	(7,941)
Net (decrease) in:			
Accrued interest on deposits and borrowings	1,489	(937)	(862)
Accrued expenses and other liabilities	(2,028)	28,431	4,344
Net cash provided by operating activities	**133,355**	**151,440**	**78,512**

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

OFG BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016 (CONTINUED)

	Year Ended December 31,		
	2018	2017	2016
		(In thousands)	
Cash flows from investing activities:			
Purchases of:			
Investment securities available-for-sale	(271,639)	(182,054)	(119,544)
Investment securities held-to-maturity	-	-	(86,478)
FHLB stock	(113,731)	(31,950)	(20,421)
Maturities and redemptions of:			
Investment securities available-for-sale	120,709	105,169	145,512
Investment securities held-to-maturity	77,583	88,726	101,965
FHLB stock	115,082	28,748	30,411
Proceeds from sales of:			
Investment securities available-for-sale	17,837	256,996	300,483
Foreclosed real estate and other repossessed assets, including write-offs	51,057	40,051	47,507
Proceeds from sale of loans held-for-sale	-	-	123,137
Premises and equipment	1,668	569	48
Origination and purchase of loans, excluding loans held-for-sale	(1,315,906)	(801,766)	(768,353)
Principal repayment of loans	840,064		