Turning Point Brands, Inc.
Form DEF 14A
April 06, 2017
TABLE OF CONTENTS

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

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material under §240.14a-12

Turning Point Brands, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the

Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

TABLE OF CONTENTS

April 7, 2017

To our Stockholders:

You are cordially invited to attend the 2017 Annual Meeting of Stockholders of Turning Point Brands, Inc. on Wednesday, May 17, 2017. The meeting will be held at the offices of Frost Brown Todd LLC, 400 West Market Street, 32nd Floor, Louisville, Kentucky 40202 at 9:30 a.m. eastern daylight time.

The official Notice of Annual Meeting, Proxy Statement and Proxy Card are enclosed with this letter.

Please take the time to read carefully each of the proposals for stockholder action described in the accompanying proxy materials. Whether or not you plan to attend, you can ensure that your shares are represented at the meeting by promptly completing, signing and dating your proxy card and returning it in the enclosed postage-paid envelope. Stockholders of record can also vote by touch-tone telephone from the United States, using the toll-free number on the proxy card, or by the Internet, using the instructions on the proxy card. If you attend the meeting, you may revoke your proxy and vote your shares in person.

Your interest and participation in the affairs of the Company are greatly appreciated. Thank you for your continued support.

Sincerely,

/s/ Lawrence S. Wexler

Lawrence S. Wexler

President and Chief Executive Officer

TABLE OF CONTENTS

TURNING POINT BRANDS, INC.
5201 Interchange Way
Louisville, Kentucky 40229

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD MAY 17, 2017

To the Stockholders:

The Annual Meeting of Stockholders (the Annual Meeting) of Turning Point Brands, Inc. (the Company) will be held at the offices of Frost Brown Todd LLC, 400 West Market Street, 32nd Floor, Louisville, Kentucky 40202 on Wednesday, May 17, 2017 at 9:30 a.m. eastern daylight time.

At the Annual Meeting you will be asked to:

- elect seven directors to the Board of Directors, each for a term of one year;
- ratify the appointment of RSM US LLP as the Company's independent auditors; and
- transact such other business as may properly come before the meeting.

A Proxy Statement describing matters to be considered at the Annual Meeting is attached to this notice. Only stockholders of record at the close of business on March 31, 2017 are entitled to receive notice of and to vote at the meeting.

By Order of the Board of Directors,

/s/ James W. Dobbins
James W. Dobbins
General Counsel and Corporate Secretary

Louisville, Kentucky
April 7, 2017

IMPORTANT

WHETHER OR NOT YOU EXPECT TO BE PRESENT AT THE MEETING, PLEASE SUBMIT YOUR VOTE USING ONE OF THE VOTING METHODS DESCRIBED IN THE ATTACHED MATERIALS. IF YOU ATTEND THE MEETING, YOU MAY REVOKE YOUR PROXY AND VOTE YOUR SHARES IN PERSON.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE 2017 ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON MAY 17, 2017: Our Proxy Statement related to our 2017 Annual Meeting of Stockholders, our Annual Report on Form 10-K for the fiscal year ended on December 31, 2016 and our Annual Report to Stockholders for the fiscal year ended on December 31, 2016 are available on our website at *www.turningpointbrands.com* in the Investor Relations section.

TABLE OF CONTENTS

Table of Contents

SUMMARY OF MATTERS REQUIRING STOCKHOLDER ACTION	1
Proposal 1—Election of Directors	1
Proposal 2—Ratification of the Appointment of the Company's Independent Auditors	1
Other Matters	1
INFORMATION ABOUT PROXIES AND VOTING	2
Record Date and Voting Securities	2
Solicitation of Proxies	2
How to Vote	2
Changing Your Vote	3
CORPORATE GOVERNANCE AND OUR BOARD	4
Director Biographies	4
Meetings of the Board of Directors	5
Corporate Governance	6
Committees of the Board	7
Consideration of Candidates for Director	8
Compensation of Directors	9
Code of Business Conduct and Ethics	9
Corporate Governance Guidelines	9
SECURITY OWNERSHIP OF BENEFICIAL OWNERS AND MANAGEMENT	10
Section 16(a) Beneficial Ownership Reporting Compliance	11
EXECUTIVE COMPENSATION	12
Executive Compensation Objectives and Philosophy	12
Summary Compensation Table	12
Narrative Disclosure to Summary Compensation Table	13
Outstanding Equity Awards at Fiscal Year-End	18
Equity Compensation Plan Information	18
AUDIT COMMITTEE REPORT	19
CERTAIN RELATIONSHIPS AND TRANSACTIONS	20
PRESENTATION OF PROPOSALS	23
Proposal 1—Election of Directors	23
Proposal 2—Ratification of Independent Auditors	23
STOCKHOLDER PROPOSALS	25
STOCKHOLDERS' COMMUNICATIONS WITH THE BOARD	25
FORM 10-K	25
OTHER BUSINESS	26

TABLE OF CONTENTS

TURNING POINT BRANDS, INC.
5201 Interchange Way
Louisville, Kentucky 40229

PROXY STATEMENT
ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD MAY 17, 2017

This proxy statement and accompanying proxy card are being furnished in connection with the solicitation of proxies by the board of directors (the Board) of Turning Point Brands, Inc., a Delaware corporation, to be voted at the Annual Meeting of Stockholders (the Annual Meeting) and any adjournments thereof. In this proxy statement, references to the Company, we, us or our refer to Turning Point Brands, Inc. This proxy statement and accompanying proxy card are first being mailed to stockholders on or about April 7, 2017.

The Annual Meeting will be held at the offices of Frost Brown Todd LLC, 400 West Market Street, 32nd Floor, Louisville, Kentucky 40202 on Wednesday, May 17, 2017 at 9:30 a.m. eastern daylight time, for the purposes set forth in this proxy statement and the accompanying notice of Annual Meeting.

SUMMARY OF MATTERS REQUIRING STOCKHOLDER ACTION

Proposal 1—Election of Directors

The affirmative vote of a plurality of the votes entitled to be cast by the holders of the Company s common stock present in person or represented by proxy is required to elect each nominee. Election by a plurality means that the director nominee with the most votes for the available slot is elected for that slot. You may vote FOR each nominee or you may WITHHOLD AUTHORITY to vote for each nominee. Unless you WITHHOLD AUTHORITY to vote for a nominee, your proxy will be voted FOR the election of the individuals nominated as directors.

The Board recommends that you vote FOR the nominees.

Proposal 2—Ratification of the Appointment of the Company s Independent Auditors

The proposal to ratify the appointment of RSM US LLP as the Company s independent auditors for the fiscal year ending December 31, 2017 will be approved if more shares present (in person or by proxy) and entitled to vote at the Annual Meeting are voted FOR ratification than are voted AGAINST ratification. You may vote FOR or AGAINST ratification, or you may ABSTAIN from voting on this proposal. A vote to ABSTAIN will have no effect on the outcome of this proposal.

The Board recommends that you vote FOR this proposal.

Other Matters

As of the date of this proxy statement, the Board knows of no matters that will be presented for consideration at the Annual Meeting other than those matters discussed in this proxy statement. If any other matters should properly come before the Annual Meeting and call for a vote of stockholders, validly executed proxies in the enclosed form returned to us will be voted in accordance with the recommendation of the Board, or, in the absence of such a recommendation, in accordance with the judgment of the proxy holders. Any such additional matter will be approved if more shares present (in person or by proxy) and entitled to vote at the Annual Meeting are voted in favor of such matters than are voted against.

1

TABLE OF CONTENTS

INFORMATION ABOUT PROXIES AND VOTING

Record Date and Voting Securities

The Board has fixed the record date (the Record Date) for the Annual Meeting as the close of business on March 31, 2017. Only stockholders of record at the close of business on the Record Date will be entitled to vote at the Annual Meeting and at any adjournment or postponement thereof. At the close of business on the Record Date, there were outstanding 18,823,935 shares of common stock, each of which is entitled to one vote per share on all matters to be considered at the Annual Meeting.

The presence in person or by proxy of the holders of a majority of the outstanding shares of common stock will constitute a quorum for the transaction of business at the Annual Meeting. Shares of common stock represented by properly executed proxies received before the close of voting at the Annual Meeting will be voted as directed by such stockholders, unless revoked as described below.

Solicitation of Proxies

The cost of solicitation of proxies being solicited on behalf of the Board will be borne by us. In addition to solicitation by mail, proxies may be solicited personally, by telephone or other means by our directors, officers or employees, who receive no additional compensation for these solicitation activities. We will, upon request, reimburse brokerage houses and persons holding common stock in the names of their nominees for their reasonable out-of-pocket expenses in sending materials to their principals.

How to Vote

Stockholders of Record

If you are a stockholder and your shares are registered directly in your name with our stock transfer agent, Wells Fargo Shareowner Services, you are considered the stockholder of record of those shares. If you are a stockholder of record, you can give a proxy to be voted at the meeting:

- over the telephone by calling a toll-free number (1-866-883-3382);
- online *(*www.proxypush.com/tpb*)*; or
- by completing, signing, dating, and mailing the enclosed proxy card in the envelope provided.

Even if you plan to attend the meeting, we encourage you to submit a proxy. If you do give a proxy, we must receive it by 11:59 p.m., Central Daylight Time, on May 16, 2017, or your vote will not be recorded. If you prefer, you may instead vote in person at the meeting.

The telephone and online voting procedures have been set up for your convenience and are designed to authenticate your identity, enable you to give voting instructions, and confirm that those instructions are recorded properly. If you are a stockholder of record and you would like to vote by telephone or online, please refer to the instructions set forth on the enclosed proxy card.

By giving your proxy, you authorize the individuals named on the proxy card to vote your shares in accordance with your instructions. These individuals will also have the obligation and authority to vote your shares as they see fit on any other matter properly presented for a vote at the Annual Meeting. If for any reason a director nominee is not available to serve, the individuals named as proxy holders may vote your shares at the Annual Meeting for another nominee. The proxy holders for this year s Annual Meeting are James Dobbins and Brian Wigginton.

If you are a stockholder of record and you sign and return your proxy card (or give your proxy by telephone or online) without specifying how you want your shares to be voted with respect to both proposals, our proxy holders will vote your shares FOR the election of each of the nominees to the Board, and FOR the ratification of the appointment of RSM US LLP as the Company s independent auditors for the fiscal year ending December 31, 2017. With respect to any other matter that properly comes before the Annual Meeting, the proxy holders will vote your shares as recommended by the Board or, if no recommendation is given, using their own discretion.

2

TABLE OF CONTENTS

Street Name Stockholders

If your shares are held in a stock brokerage account or by a bank (known as holding shares in street name), you have the right to instruct your broker or bank how to vote your shares, and the broker or bank is required to vote in accordance with your instructions. To provide those instructions by mail, please complete, sign, date, and return your voting instruction card in the postage-paid envelope provided by your broker or bank. Alternatively, if the broker or bank that holds your shares offers online or telephone voting, you will receive information from your broker or bank about how to submit your voting instructions by those methods. Alternatively, you may vote in person at the meeting, but only if you obtain a legal proxy from the broker or bank that holds your shares.

If you are a street name stockholder and you do not instruct your broker or bank how to vote, your broker or bank is not permitted to vote your shares on the election of directors (known as a broker non-vote). Broker non-votes will have no effect on the outcome of the election of directors. Your broker will, however, have discretionary authority to vote your shares on the proposal regarding the ratification of the appointment of RSM US LLP as the Company s independent auditors for the fiscal year ending December 31, 2017.

Changing Your Vote

If you are a stockholder of record, you may change your vote by submitting another proxy by telephone or online, by mailing another properly signed proxy card bearing a later date than your original one, or by attending the Annual Meeting and casting your vote in person. You also may revoke a proxy that you previously provided by delivering timely written notice of revocation of your proxy to our Corporate Secretary at 5201 Interchange Way, Louisville, Kentucky 40229.

If you hold your shares in street name and you wish to change or revoke your voting instructions, you will need to follow the instructions in the materials your broker or bank provided to you.

TABLE OF CONTENTS

CORPORATE GOVERNANCE AND OUR BOARD

Director Biographies

Thomas F. Helms, Jr. Thomas F. Helms, Jr. has been a director of our company since 1997, serving as our Non-Executive Chairman since May 2016. Mr. Helms previously served as our Executive Chairman from May 2006 to May 2016. Before that, Mr. Helms served as Non-Executive Chairman of the Board from June 1997 to May 2006. Mr. Helms has also formerly served as our President. In 1988, Mr. Helms formed our predecessor to acquire certain loose leaf chewing tobacco assets of Lorillard, Inc. Mr. Helms served as President and Chief Executive Officer of Culbro Corporation s smokeless tobacco division from 1983 until shortly before its sale to American Maize-Products Company in 1986. From 1979 to 1982, Mr. Helms was General Manager of the Etherea Cosmetics and Designer Fragrances Division of Revlon, Inc. From 1964 to 1979, Mr. Helms was employed in marketing and sales positions in various divisions of Revlon, Inc.

We believe Mr. Helms is well-qualified to serve as a director due to his many years of experience in the tobacco industry, and in particular with our company, as well as his role in forming our predecessor. This experience provides him with a deep knowledge of both our industry and our company, which provides valuable insight to our Board.

Lawrence S. Wexler. Mr. Wexler has served as our President and CEO since June 2009 and as President and Chief Operating Officer of North Atlantic Trading Company, Inc. (NATC), our primary operating subsidiary, since June 2006. Before June 2006, Mr. Wexler had been the Chief Operating Officer of NATC since June 2005, and before that, the President and Chief Operating Officer of one of our other subsidiaries beginning December 2003. Mr. Wexler was a consultant to a number of emerging marketing, communication and financial companies, advising them on financial, marketing and strategic matters, at times in an operating role from 1998 to 2003. From 1977 to 1998, he was employed by Philip Morris, USA in various positions in the Sales, Marketing and Finance Departments. As Group Director, Discount Brands, his group introduced the *Basic* and *Alpine* brands. He served as Senior Vice President of Marketing from 1992 to 1993 and Senior Vice President Finance, Planning and Information Services from 1993 until his departure in 1998. Mr. Wexler holds a bachelor of science in administrative science from Yale and a master of business administration from Stanford.

We believe Mr. Wexler is well-qualified to serve as a director of our company because of his many years of experience at our company and his prior leadership positions at other companies, both within and outside of our industry. In addition, as Chief Executive Officer, Mr. Wexler provides valuable insight to the Board on our day-to-day operations.

Gregory H. A. Baxter. Gregory H. A. Baxter has served as a director of our company since April 2006. In October 2015, Mr. Baxter was elected to serve on the board of directors of Special Diversified Opportunities, Inc. (SDOI). Mr. Baxter has been an independent corporate finance consultant primarily for middle-market corporations and closely held businesses since 2005. Previously, from 2003 to 2005, he was Managing Director and Head, Hedge Fund Sales and Marketing at Diaz & Altschul Capital Management, where his primary focus was bringing its investment products to prospective corporate and institutional clients. He was also a member of the Investment Committee. Immediately before joining Diaz & Altschul, he was Managing Director and Head of Generalist/Cross-Border Mergers & Acquisitions at SG Cowen Securities Corporation, the U.S. investment bank of French bank, Société Générale from 2000 to 2002. There, he re-established the cross-border effort and worked globally in industries such as food, retail, consumer products, transportation and oil and gas. He was also a member of the SG Cowen Fairness Opinion Review Committee. Before SG Cowen, he was at Rothschild Inc. for almost six years, from 1994 to 2000, where he specialized in advising on industrial/engineering companies, including automotive, domestic and cross-border mergers, acquisitions and divestitures. He was also a founding member of SW Capital, an M&A boutique that specialized in middle-market transactions for Fortune 500 companies. Before that, he was a Vice President of Irving

Trust Company s Corporate Financial Counseling Department, providing M&A and other corporate finance advice to the bank s clients. Mr. Baxter holds a bachelor of arts from the University of Victoria in Canada and a master of business administration from the Ivey Business School in London.

We believe Mr. Baxter is well-qualified to serve as a director of our company because of his significant experience as a financial consultant and his experience with corporate investments, mergers and acquisitions.

H. C. Charles Diao. H. C. Charles Diao has served as a director of our company since November 2012. Mr. Diao is Senior Vice President of Finance and Corporate Development and Corporate Treasurer of DXC

4

TABLE OF CONTENTS

Technology Company and previously Vice President and Corporate Treasurer of its predecessor, Computer Science Corp since 2012, with responsibility for and management of global treasury operations, corporate finance and capital markets, corporate development and M&A, pension plans and risk management/insurance. From 2008 to 2012, Mr. Diao was Managing Director and founder of Diao & Co., LLC, a firm that provided M&A and strategic advisory services to corporate clients, and the Chief Investment Officer of Diao Capital Management LLC, an affiliate that managed alternative investments on behalf of institutional family offices. Mr. Diao was formerly a Senior Managing Director at Bear Stearns where he was the Group Head for Special Situations Credit, a partner within the firm s TMT investment banking practice and a member of the firm s Investment Banking Committee and IPO Committee. Mr. Diao served as a member of the board of directors of Media General Inc., the successor via merger to New Young Broadcasting Holdings Inc., from August 2012 until January 2017. He was Chairman of its Nominating and Governance Committee and a member of both its Audit Committee and its Finance Committee. He holds a B.S.E. from Princeton University and a masters of business administration from Harvard Business School.

We believe Mr. Diao is well-qualified to serve as a director of our company because of his prior directorships and senior management experience, as well as his corporate leadership, financial and operational management experience.

David Glazek. David Glazek has served as a director of our company since November 2012. Mr. Glazek is a Partner of Standard General L.P. and has been with Standard General since 2008. He was formerly an investment banker at Lazard Frères & Co. from 2000 to 2003 and from 2006 to 2008. Mr. Glazek holds a bachelor of arts from the University of Michigan and a J.D. from Columbia Law School.

We believe Mr. Glazek is well-qualified to serve as a director of our company because of his significant finance and private equity experience, which provides depth to the Board s analysis of financing considerations.

George W. Hebard III. George W. Hebard III has served as a director of our company since May 2015. Mr. Hebard has been a Managing Director of Barington Capital Group, a New York investment firm, since January 2014. Mr. Hebard is currently a director of Ebix, Inc. (NASDAQ: EBIX). Mr. Hebard served as Interim Principal Executive Officer and Interim Chief Operating Officer of Enzon Pharmaceuticals, Inc., a position he held as an employee from May 2012 to December 2013 and as a consultant from January 2014 to March 2016. From September 2011 to April 2012, Mr. Hebard was a Managing Director at Icahn Capital L.P., the entity through which Carl C. Icahn manages investment funds. Before joining Icahn Capital, from 2005 to 2011, Mr. Hebard served as a Managing Director at Blue Harbour Group, an investment firm in Greenwich, Connecticut. Before Blue Harbour Group, Mr. Hebard served as a Managing Director at Ranger Partners from 2002 to 2003, and before Ranger Partners, Mr. Hebard was an Associate at Icahn Associates Corp. from 1998 to 2002. Mr. Hebard was a director of Enzon Pharmaceuticals, Inc., from February 2012 to November 2013. He has a masters of business administration from INSEAD and an A.B. in Economics from Princeton University.

We believe Mr. Hebard is well-qualified to serve as a director of our company because of his management experience and his extensive experience with public equity investments, providing additional depth to the Board s analysis of investment and acquisition opportunities.

Arnold Zimmerman. Arnold Zimmerman has served as a director of our company since January 2013. Since 2007, he has been President of Catchers Mitt LLC, a marketing consulting company focused on personal care products. From 2002 to 2007, Mr. Zimmerman was the Chairman and CEO of 291 Digital LLC, a graphics imaging and printing company, and from 1999 to 2002 he was Chairman, President and CEO of AM Products Company. He has also held senior executive positions at Revlon-North America and the L Oreal Retail Hair Products Division from 1967 to 1992. Mr. Zimmerman holds a bachelor of arts from the University of Miami.

We believe Mr. Zimmerman is well-qualified to serve as a director of our company because of his significant directorship experience and experiences leading a number of consumer product companies.

Meetings of the Board of Directors

The Board met on 11 occasions and its standing committees (Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee) met on 12 occasions during our fiscal year ended December 31, 2016. Each incumbent director attended at least 75% of the aggregate number of meetings of the Board and its committees on which such director served during his period of service. In addition, the Company expects all members of the Board to attend the Annual Meeting. The Company did not hold an annual meeting

of stockholders during 2016. Eight regular Board meetings are currently scheduled for the fiscal year 2017. Executive sessions of non-employee directors, without management directors or employees present, are typically scheduled in conjunction with each regularly scheduled Board meeting. The role of each standing committee is more fully discussed below.

Corporate Governance

Board Structure

Our Board oversees the management of our company, reviews our long-term strategic plans and exercises direct decision-making authority in key areas such as choosing the Chief Executive Officer, setting the scope of such officer s authority to manage our business day to day, and evaluating his or her performance.

Our Board consists of seven directors. In accordance with our certificate of incorporation and by-laws, the number of directors on our Board will be determined from time to time by vote of the Board. Thomas Helms, Jr., who served as our Executive Chairman until May 2016, continues to serve as our Non-Executive Chairman. We believe that the Company and its stockholders are best served by having Mr. Helms serve in this position because he is the person most familiar with our history, business model, and the challenges we face in our industry. Mr. Helms s wealth of knowledge regarding Company operations and the industry in which we compete positions him to best identify matters for Board review and deliberation.

Each director is to hold office until his or her successor is duly elected and qualified or until his or her earlier death, resignation or removal. Vacancies and newly created directorships on the Board may be filled at any time by vote of the remaining directors.

Under our certificate of incorporation, for so long as we or one of our subsidiaries is party to certain distribution agreements with Bolloré, S.A. (Bolloré), no person who is a Bolloré competitor or who is an officer, director or representative of a Bolloré competitor or any entity that owns more than a 20% equity interest in a Bolloré competitor will be entitled to serve on the Board. We may require that any director or nominee for director certify that he or she is not disqualified from service on the Board pursuant to these provisions, and the Board is authorized to make such reasonable determinations as shall be necessary to implement the above limitation.

Risk Oversight

The Board is responsible for overseeing the Company s risk management strategies, including the Company s implementation of appropriate processes to administer day-to-day risk management. The Board is informed about risk management matters as part of its role in the general oversight and approval of corporate matters. The Board gives guidance to the Company s management on the risks it believes face the Company, such as the matters disclosed as risk factors in the Company s Annual Report on Form 10-K. Furthermore, the Board has delegated certain risk management responsibilities to its Audit and Compensation Committees.

Through the Audit Committee s charter, the Board has authorized it to oversee the Company s risk assessment and risk management policies. The Audit Committee, in fulfilling its oversight responsibilities, regularly and comprehensively (i) reviews and discusses with management and the independent auditor any significant risks or exposures and assesses the steps management has taken to minimize such risks, (ii) discusses with management and the independent auditor, and oversees the Company s underlying policies with respect to risk assessment and risk management, and (iii) reviews and discusses with the independent auditor any significant risks identified during the auditor s risk assessment procedures.

Through the Compensation Committee s charter, the Board has authorized it to oversee officer and director compensation programs. The Compensation Committee, in fulfilling its oversight responsibilities, designs the compensation packages applicable to the executive officers and Board members. The Compensation Committee also consults with management on the payments of bonuses and grants of equity awards to key employees on a quarterly basis.

The Audit Committee and the Compensation Committee jointly perform an annual risk assessment of our compensation programs for all employees to determine whether these programs encourage unnecessary or excessive risk taking. In conducting this review, each of our compensation programs is evaluated on a number of criteria aimed at identifying any incentive programs that deviate from our risk management objectives. Based on

TABLE OF CONTENTS

this review in 2016, the committees concluded that we have the right combination of rewards and incentives to drive company performance, without encouraging unnecessary or excessive risk taking by our employees.

The Board s oversight roles, including the roles of the Audit Committee and the Compensation Committee, combined with the leadership structure of the Board to include Company management, allow the Board to effectively administer risk management policies while also effectively and efficiently addressing Company objectives.

Director Independence

Our Board has determined that under NYSE Rules, Messrs. Baxter, Diao, Glazek, Hebard and Zimmerman are independent directors. The Board believes that these directors are also independent as that term is defined in the Exchange Act and the rules thereunder.

Committees of the Board

Our Board has three standing committees: an Audit Committee, a Compensation Committee and a Nominating and Corporate Governance Committee. Under the rules of NYSE, the membership of the Audit Committee is required to consist entirely of independent directors, subject to applicable phase-in periods. In addition, under applicable NYSE and SEC rules our Compensation Committee and Nominating and Corporate Governance Committee are required to consist entirely of independent directors. The following is a brief description of our committees.

Audit Committee

Our Audit Committee is composed of Messrs. Baxter, Diao and Hebard, each of whom satisfies the financial literacy requirements under the applicable rules and regulations of the SEC and listing standards of the NYSE. Mr. Baxter serves as chair of the Audit Committee. The Board has determined that Mr. Baxter qualifies as an audit committee financial expert as such term is defined under applicable rules of the SEC. The Audit Committee also satisfies the member independence and other requirements under current NYSE listing standards and SEC rules. Our Audit Committee, among other things, is responsible for:

- selecting a qualified firm to serve as the independent registered public accounting firm to audit our financial statements;
- the quality and integrity of our financial statements, our financial reporting process and our systems of internal accounting and financial records;
- helping to ensure the independence and performance of the independent registered public account firm;
- discussing the scope and results of the audit with the independent registered public accounting firm, and reviewing, with management the independent registered public accounting firm, our interim and year-end results of operations;
- developing procedures for employees to submit concerns anonymously about questionable accounting or audit matters;
- reviewing our policies on risk assessment and risk management;
- the performance of our internal audit function;
- reviewing related party transactions; and
- approving or, as required, pre-approving, all audit and all permissible non-audit services, other than de minimis non-audit services, to be performed by the independent registered public accounting firm.

Our Audit Committee operates under a written charter that satisfies the applicable rules and regulations of the SEC and the NYSE. Our Audit Committee charter may be found at our website, *www.turningpointbrands.com*. The Audit Committee met seven times during 2016.

7

Compensation Committee

Our Compensation Committee is composed of Messrs. Baxter, Glazek and Zimmerman. Mr. Glazek serves as the chair of the Compensation Committee. The Compensation Committee satisfies the member independence requirements under current NYSE listing standards and SEC rules. Our Compensation Committee, among other things, is responsible for:

- reviewing, approving and determining, or making recommendations to our Board regarding, the compensation of our executive officers;
- administering our equity compensation plans;
- reviewing, approving and making recommendations to our Board regarding incentive compensation and equity compensation plans; and
- establishing and reviewing general policies relating to compensation and benefits of our employees.

Our Compensation Committee operates under a written charter that satisfies the applicable rules and regulations of the SEC and the NYSE. Our Compensation Committee charter may be found at our website, *www.turningpointbrands.com*. The Compensation Committee met three times during 2016.

Nominating and Corporate Governance Committee

Our Nominating and Corporate Governance Committee is composed of Messrs. Diao, Glazek and Hebard. Mr. Hebard serves as the chair of the Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee satisfies the member independence requirements under current NYSE listing standards and SEC rules. Our Nominating and Corporate Governance Committee is, among other things, responsible for:

- identifying, evaluating and selecting, or making recommendations to our Board regarding, nominees for election to our Board and its committees;
- evaluating the performance of our Board and of individual directors;
- considering and making recommendations to our Board regarding the composition of our Board and its committees;
- reviewing developments in corporate governance practices;
- reviewing and recommending to the Board for approval any changes in the compensation of directors;
- evaluating the adequacy of our corporate governance practices and reporting; and
- developing and making recommendations to our Board regarding corporate governance guidelines and matters.

Our Nominating and Corporate Governance Committee operates under a written charter that satisfies the applicable rules and regulations of the SEC and the NYSE. Our Nominating and Corporate Governance Committee charter may be found at our website, *www.turningpointbrands.com*. The Nominating and Corporate Governance Committee met two times during 2016.

Consideration of Candidates for Director

Stockholder recommendations for Board membership should include, among other items, the name of the candidate, age, contact information, present principal occupation or employment, qualifications and skills, background, last five years employment and business experience, a description of current or previous service as director of any corporation or organization, other relevant biographical information, the nominee s consent to service on the Board, and all other information relating to such person as would be required to be disclosed in solicitations of proxies under Regulation 14A of the Exchange Act. A stockholder nominee will be requested to complete a detailed questionnaire in the form that current directors and officers complete.

TABLE OF CONTENTS

The Nominating and Corporate Governance Committee seeks to achieve a balance of knowledge, experience, and capability on the Board, and in assessessing nominees, considers such factors as it deems in the best interest of the Company and its stockholders. The manner in which the Nominating and Corporate Governance Committee evaluates a potential nominee will not differ based on whether the nominee is recommended by a stockholder of the Company.

Compensation of Directors

As described more fully below, the following table summarizes the total compensation earned for fiscal year 2016 for each of the non-employee directors.

Our non-employee directors (other than Mr. Glazek) currently receive an annual retainer of $50,000, but no meeting fees. The Chairman of the Audit Committee, which is currently Gregory H. A. Baxter, is paid an annual fee of $25,000 and Audit Committee members are paid an annual fee of $10,000. For services provided to us beyond those typically provided by corporate directors, the Board may approve compensation of up to $2,000 per day for outside directors on a case-by-case basis. Employees of ours on our Board do not receive cash compensation for service on our Board, but are eligible to receive stock option grants or restricted stock awards for service on our Board as part of their annual compensation.

The following table summarizes information about director compensation for the year ended December 31, 2016. Mr. Wexler was compensated as an officer and, therefore, did not receive any compensation for service on the Board in 2016. Mr. Glazek did not receive any compensation from us for serving on the Board in 2016.

Name	Fees earned or paid in cash ($)	Total ($)
Gregory H. A. Baxter[(1)]	75,000	75,000
H. C. Charles Diao[(2)]	60,000	60,000
George W. Hebard III[(3)]	55,833	55,833
Arnold Zimmerman[(4)]	50,000	50,000

(1) Mr. Baxter received $75,000, composed of Board member fees of $50,000 and an Audit Committee Chairman retainer of $25,000.

(2) Mr. Diao received $60,000, composed of Board member fees of $50,000 and Audit Committee member fees of $10,000.

(3) Mr. Hebard received $55,833, composed of Board member fees of $50,000 and Audit Committee member fees of $5,833.

(4) Mr. Zimmerman received $50,000, composed solely of Board member fees.

Code of Business Conduct and Ethics

Our Board has adopted a Code of Business Conduct and Ethics that applies to all of our directors and employees, including our executive officers. A copy of the Code of Business Conduct and Ethics is available on our website at www.turningpointbrands.com under the Investor Relations section. We intend to disclose any amendments to our Code of Business Conduct and Ethics, or waivers of its requirements, on our website or in filings under the Exchange Act.

Corporate Governance Guidelines

Our Board has adopted corporate governance guidelines that serve as a flexible framework within which our Board and its committees operate. These guidelines cover a number of areas including, the size and composition of the

Board, Board membership criteria and director qualifications, director responsibilities, meetings of independent directors, committee responsibilities and assignments, Board member access to management and independent advisors, director communications with third parties, director compensation, director orientation and continuing education, evaluation of senior management and management succession planning. A copy of our corporate governance guidelines is available on our website at www.turningpointbrands.com under the Investor Relations section.

TABLE OF CONTENTS

SECURITY OWNERSHIP OF BENEFICIAL OWNERS AND MANAGEMENT

The table below sets forth certain information regarding the beneficial ownership of our common stock by:

- Each person or entity known to us who beneficially owns five percent or more of the common stock;
- Each of our directors and named executive officers; and
- All of our directors and executive officers as a group.

Other than with respect to the common stock beneficially owned by Standard General, L.P., which is reported as of March 21, 2017, the table below states beneficial ownership as of March 6, 2017. The amounts and percentages of common stock beneficially owned are reported on the basis of the regulations of the SEC governing the determination of beneficial ownership of securities. Under these rules, a person is deemed to be a beneficial owner of a security if that person has or shares voting power, which includes the power to vote or to direct the voting of such security, or investment power, which includes the power to dispose of or to direct the disposition of such security. A person is also deemed to be a beneficial owner of any securities of which that person has a right to acquire beneficial ownership within 60 days. Under these rules, more than one person may be deemed to be a beneficial owner of the same securities. Included in the amount of common stock beneficially owned are shares of common stock subject to exercisable options or warrants or options or warrants that will become exercisable within 60 days of March 6, 2017. The calculation of percent owned by each person assumes that all vested options held by such person have been exercised. The calculation of percent owned by all directors and executive officers as a group assumes that all vested options beneficially held by them and warrants have been exercised.

Name of Beneficial Holder	Position or Title of Beneficial Holder	Shares Beneficially Owned	Percentage of Shares Beneficially Owned	
Helms Management Corp.(1)	Principal Stockholder	1,740,062	9.2	%
Standard General L.P.(2)	Principal Stockholder	11,069,442	58.8	%
Fort George Investments, LLC(2)(3)	Principal Stockholder	1,233,090	6.6	%
Thomas F. Helms, Jr.(4)	Director	1,742,562	9.3	%
Lawrence S. Wexler(5)	President & Chief Executive Officer; Director	535,584	2.8	%
Mark A. Stegeman(6)	Senior Vice President, Chief Financial Officer	27,139		*
James W. Dobbins(7)	Senior Vice President, General Counsel, Secretary	165,419		*
Gregory H.A. Baxter(8)	Director	48,090		*
H. C. Charles Diao(9)	Director	41,728		*
David Glazek(10)	Director	—		*
George W. Hebard III(11)	Director	10,432		*
Arnold Zimmerman(12)	Director	62,592		*
Directors and Executive Officers as a Group (10 persons)		**2,759,361**	**14.2**	**%**

* Indicates less than 1%

(1) The address of Helms Management Corp. is Attn: Thomas Helms, President, 75 Woods Lane, East Hampton, NY 11937.

(2) This information is based solely on a review of stock ownership reports on Schedule 13D that have been filed by this shareholder with the SEC as of March 21, 2017. The address of Standard General and Mr. Glazek is 767 Fifth Avenue, New York, NY 10153. Of the listed shares 7,403,966, 2,228,943, and 209,464 shares are held by Standard General Master Fund L.P., P Standard General Ltd. and Standard General Focus Fund L.P., respectively.

Standard General also has investment and voting control over 1,233,090 shares owned by Fort George Investments, LLC, for which Standard General acts as a sub-advisor.

Standard General serves as investment manager to each of Standard General Master Fund L.P., P Standard General Ltd. and Standard General Focus Fund L.P. (the Funds) and, in that capacity, exercises voting and investment control over the shares held by the Funds. Soohyung Kim is the Chief Executive Officer of Standard General and a director of the general partner of Standard General. By

10

virtue of the foregoing, Standard General and Mr. Kim may be deemed to beneficially own, and have shared voting and dispositive power over, all of the shares held by the Funds and by Fort George. Each of Mr. Kim, Standard General, the Funds and Fort George disclaims beneficial ownership of the shares reported except to the extent of its or his pecuniary interest in such shares.

(3) This information is based solely on a review of a stock ownership report on Schedule 13G filed by this shareholder with the SEC as of March 6, 2017. The address of Fort George Investments, LLC is c/o Corbin Capital Partners, L.P., 590 Madison Avenue, New York, NY 10022.

(4) All of the voting capital stock of Helms Management Corp. is owned by Mr. Helms, who serves as chairman of its board of directors, and all of the non-voting capital stock of Helms Management Corp. is owned by a trust established by Mr. Helms for the benefit of his children.

Pursuant to a loan and voting agreement among Mr. Helms, Helms Management Corp. and Standard General, on November 19, 2012, Helms Management Corp. pledged 1.46 million shares of common stock to secure a loan from Standard General. On November 23, 2016, Standard General and Mr. Helms entered into an amendment to the loan and voting agreement, pursuant to which Standard General Master Fund agreed to loan an additional $300,000 to Mr. Helms. Mr. Helms has agreed, at the request of Standard General at any time in its sole discretion and within two business days of the request, to repay a portion of the amounts loaned with 150,000 shares of our common stock owned by him, which for such purpose shall be valued at the 30 calendar day trailing volume weighted average price of our common stock on the date of the request. In addition, Mr. Helms provided Standard General, for nine months from the date of the amendment to the loan agreement, authority to exercise investment discretion on his behalf with respect to 500,000 of the shares of our common stock owned by him that have been previously pledged as collateral under the loan agreement. On March 17, 2017, Mr. Helms and Standard General further amended the loan agreement in order to provide that Standard General would loan an additional $700,000 ($1,000,000 in the aggregate) to Mr. Helms and that Mr. Helms, at the request of Standard General at any time in its sole discretion and within two business days of the request, would repay a portion of the amounts loaned by Standard General by delivering an additional 250,000 shares (400,000 shares in the aggregate) of the Company common stock owned by him, which for such purpose will be valued at the 30 calendar day trailing volume weighted average price of the Company common stock on the date of the request. In addition, Mr. Helms agreed to continue to provide Standard General, for nine months from the date of the second amendment, authority to exercise investment discretion on his behalf with respect to 500,000 of the shares of the Turning Point Common Stock owned by him that had been previously pledged as collateral under the loan agreement. See Certain Relationships and Transactions—Helms Promissory Notes and Loan and Voting Agreement with Standard General.

(5) Includes 264,113 shares subject to exercisable stock options. The amount included in the table above includes 56,334 shares held by Mr. Wexler’s children, including shares they hold as custodians for Mr. Wexler’s grandchildren.

(6) Includes 26,998 shares subject to exercisable stock options.

(7) Includes 81,378 shares subject to exercisable stock options

(8) Includes 48,090 shares subject to exercisable stock options.

(9) Includes 41,728 shares subject to exercisable stock options.

(10) Mr. Glazek is a Partner of Standard General L.P., which manages Standard General Master Fund L.P., P Standard General Ltd. and Standard General Focus Fund L.P. Mr. Glazek is a Standard General designee on our Board. See footnote 2.

(11) Includes 10,432 shares subject to exercisable stock options.

(12) Includes 41,728 shares subject to exercisable stock options.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the Company s directors and officers, and persons who beneficially own more than 10% of a registered class of the Company s equity securities, to file with the SEC initial reports of stock

ownership and reports of changes in stock ownership and to provide the Company with copies of all such filed forms. Based solely on its review of such copies or written representations from reporting persons, the Company believes that all reports were filed on a timely basis during the fiscal year ended December 31, 2016, with the exception of the following: (i) Mark A. Stegeman filed a late Form 4 on August 29, 2016 to reflect both a grant of restricted stock to him on May 11, 2016 and a grant of stock options to him on August 10, 2016, and (ii) James M. Murray filed a late Form 4 on November 28, 2016 to report both a grant of restricted stock to him on May 11, 2016 and his exercise of a stock option on November 23, 2016.

TABLE OF CONTENTS

EXECUTIVE COMPENSATION

This section addresses our executive compensation program for our named executive officers. It includes a discussion of our compensation objectives and philosophy and the material elements of compensation earned by, or awarded or paid to, our named executive officers, which include our principal executive officer and our two other most highly compensated executive officers. This section also describes the compensation actions taken during 2016 and is intended to provide a further understanding of the amounts displayed in the required tabular disclosures. The information set forth in this section is presented pursuant to the reduced disclosure rules applicable to Emerging Growth Companies.

Our named executive officers for 2016 were:

- Thomas F. Helms, Jr., our Executive Chairman until May 2016;
- Lawrence S. Wexler, our President & Chief Executive Officer;
- James W. Dobbins, our Senior Vice President, General Counsel & Secretary; and
- Mark A. Stegeman, our Senior Vice President & Chief Financial Officer.

Executive Compensation Objectives and Philosophy

One objective of our executive compensation program is to attract and retain qualified, energetic employees who are enthusiastic about our mission and culture. A further objective is to provide incentives and reward each senior executive for his or her contribution to our growth and operating and financial improvement. In addition, we strive to promote an ownership mentality among key leadership executives.

Our Compensation Committee is solely responsible for authorizing the compensation of our named executive officers. In doing so, the Compensation Committee may consult from time to time with the named executive officers. However, the Compensation Committee will at all times retain full responsibility for determining the compensation of our named executive officers, and no named executive officer will participate in the Compensation Committee s approval of his or her compensation.

Summary Compensation Table

The following table shows information regarding the compensation of our named executive officers for services performed in the years ended December 31, 2016 and December 31, 2015.

Name and Principal Position	Year	Salary ($)	Option Awards ($)[1]	Non-Equity Incentive Plan Compensation ($)[2]	All Other Compensation ($)[3]	Total ($)
Thomas F. Helms, Jr.	2016	145,673	—	—	644,322	789,995
Executive Chairman	2015	378,750	—	189,375	35,750	603,875
Lawrence S. Wexler	2016	695,488	—	883,218	30,616	1,609,322
President & Chief Executive Officer	2015	641,892	—	646,135	59,587	1,347,614
James W. Dobbins	2016	358,382	—	225,899	20,337	604,618
Senior Vice President,	2015	342,392	—	175,327	27,750	545,469

General Counsel & Secretary						
Mark A. Stegeman *Senior Vice President, Chief Financial Officer*	2016	331,464	127,971	192,500	14,203	666,138

(1) Option Awards reflect the grant date fair value of each award, determined in accordance with FASB ASC Topic 718. Pursuant to SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. For additional information on the assumptions made in the valuation for the awards reflected in this column, please see Notes 14 and 15 to our Consolidated Financial Statements as of and for the year ended December 31, 2016 in our Annual Report on Form 10-K.

(2) Performance bonuses in respect of a given year were generally determined in March of the following year and paid shortly thereafter.

12

(3) Mr. Helms served as our Executive Chairman until May 2016. During 2016, as our Executive Chairman, Mr. Helms received a car allowance of $8,018, a matching contribution under our 401(k) defined contribution plan (including a discretionary contribution equal to 1% of base salary) of $6,146, a parking allowance of $3,665, payment of non-qualified deferred compensation of $700 and severance payments totaling $596,625. Following his termination as our Executive Chairman, Mr. Helms became or Non-Executive Chairman, at which time he began receiving the same retainer paid to our other non-employee directors. This column also includes those fees, totaling $29,167 for 2016.

For 2016, Messrs. Wexler and Dobbins received a car allowance through May of $6,600 and $4,400, respectively, and non-qualified deferred compensation of $10,766 and $2,687, respectively, and they each received a matching contribution under our 401(k) defined contribution plan (including a discretionary contribution equal to 1% of base salary) of $13,250. For 2016, Mr. Stegeman received a matching contribution under our 401(k) defined contribution plan (including a discretionary contribution equal to 1% of base salary) of $12,788 and non-qualified deferred compensation of $1,415.

Narrative Disclosure to Summary Compensation Table

Elements of Executive Compensation

Elements of executive compensation include: salary, bonus, equity-based compensation, welfare benefits and perquisites, a Company match to our 401(k) defined contribution plan (including contributions to our Restoration Plan (discussed below), where applicable) and other retirement benefits. Each of the named executive officers is party to an individual employment agreement with us. Effective December 31, 2003, we froze our defined benefit retirement plan for our salaried employees, although Messrs. Helms and Dobbins retain benefits under this plan. Individual elements of compensation and the applicable compensation arrangements are described in more detail below.

Salary

The named executive officers receive a fixed annual salary to compensate them for services they render. Until May 2016, Mr. Helms s base salary remained unchanged from his 2015 base salary of $378,750. Effective April 15, 2016, the base salaries for each of Messrs. Wexler and Dobbins were increased by 2.5% from their 2015 level, to $662,288 and $353,271, respectively, and Mr. Stegeman s base salary was increased by 1.5% from his 2015 level to $304,500. Pursuant to employment agreements dated November 23, 2015, and effective as of May 10, 2016, the base salaries for each of Messrs. Wexler, Dobbins and Stegeman were increased to $722,925, $365,271 and $350,000, respectively.

Bonus

Our executive compensation program is designed to reward business success and each senior executive s contribution to our operating and financial performance. In measuring a senior executive s contribution to us, our Board considers our growth and various financial metrics. We also consider an executive s performance in managing us in light of general economic conditions, as well as specific company, industry and competitive conditions. Our senior executives participate in a discretionary incentive bonus payment under our Management Bonus Program based on the Board s assessment of our financial performance and individual performance. The incentive bonus compensation paid to the named executive officers in 2016 for fiscal year 2015 was based upon final financial performance as assessed by the Board based upon our audited 2015 financial statements and such officer s individual performance in 2015. The incentive bonus compensation paid to the named executive officers in 2017 for fiscal year 2016 was based on similar performance criteria with respect to 2016.

Equity-Based Compensation - 2015 Plan

In April 2015, we adopted the Turning Point Brands, Inc. 2015 Equity Incentive Plan (the 2015 Plan). The 2015 Plan authorizes the Compensation Committee to provide equity-based or other incentive-based compensation for the purpose of attracting and retaining directors, employees and certain consultants and providing our directors, employees and such consultants incentives and rewards for superior performance. The 2015 Plan is designed to comply with the requirements of applicable federal and state securities laws, and the Code, including allowing us to issue awards that may comply with the performance-based exclusion from the deduction limitations under Section 162(m) of the Code.

Shares Subject to the 2015 Plan. The 2015 Plan authorizes the issuance of 1,400,000 shares of our common stock in connection with awards pursuant to the 2015 Plan. No more than 1,400,000 of the total number of shares available for issuance under the 2015 Plan may be issued upon the exercise of incentive stock options (ISOs). The number of shares with respect to awards (including options and stock appreciation rights

(SARs)) that may be granted under the 2015 Plan to any individual participant in any single fiscal year may not exceed 210,000 shares (with grants to non-employee directors limited to 70,000 shares), and the maximum number of shares that may be paid to any individual participant in connection with awards intended to qualify as performance-based compensation under Section 162(m) of the Code in respect of a single calendar year (including as a portion of the applicable performance period) may not exceed 210,000 shares (or the cash equivalent of such shares), each as subject to potential adjustment as described in the 2015 Plan.

Any shares of our common stock covered by an award granted under the 2015 Plan, which for any reason are canceled or forfeited, or are settled in cash, will again be available for awards under the 2015 Plan. However, (i) shares not issued or delivered as a result of the net settlement of an outstanding stock option or SAR, (ii) shares used to pay the exercise price or withholding taxes related to an outstanding award and (iii) shares repurchased by us using proceeds realized by us in connection with a participant s exercise of an option or SAR will not again become available for grant.

Subject to the 2015 Plan s share counting rules, common stock covered by awards granted under the 2015 Plan will not be counted as used unless and until the shares are actually issued or transferred. However, shares issued or transferred under awards granted under the 2015 Plan in substitution for or conversion of, or in connection with an assumption of, stock options, SARs, restricted stock, restricted stock units (RSUs) or other stock or stock-based awards held by awardees of an entity engaging in a corporate acquisition or merger transaction with us or any of our subsidiaries will not count against (or be added back to) the aggregate share limit or other 2015 Plan limits described above. Additionally, shares available under certain plans that we or our subsidiaries may assume in connection with corporate transactions from another entity may be available for certain awards under the 2015 Plan, under circumstances further described in the 2015 Plan, but will not count against the aggregate share limit or other limits described above. The various limits described above are subject to potential adjustment as described in the 2015 Plan.

Administration. The 2015 Plan is administered by the Compensation Committee. The Compensation Committee generally may select eligible employees to whom awards are granted, determine the types of awards to be granted and the number of shares covered by awards and set the terms and conditions of awards. The Compensation Committee s determinations and interpretations under the 2015 Plan are binding on all interested parties. The Compensation Committee may delegate to a subcommittee or to officers certain authority with respect to the granting of awards other than awards to certain officers and directors as specified in the 2015 Plan.

Eligibility. Certain of our senior executives are eligible to receive grants of stock options, RSUs, SARs and restricted stock under the 2015 Plan, and certain of our senior executives were eligible to receive grants of non-qualified stock options and restricted stock under the 2006 Equity Incentive Plan. No stock options were granted to the named executive officers in 2015. In connection with our IPO, we issued 141 shares of restricted stock to Mr. Stegeman, and in August 2016, in connection with his employment agreement, we granted Mr. Stegeman options to purchase 53,996 shares of our common stock at an exercise price of $9.26, 50% of which were vested immediately and 25% of which will vest on each of the first and second anniversaries of their grant date.

In 2017, the Company established a new performance-based equity incentive program, pursuant to which certain key employees, including our named executive officers, were granted performance-based restricted stock units under the 2015 Plan. There awards are eligible to vest based upon the Company s return on invested capital achievement during a five-year performance period beginning in 2017.

Equity-Based Compensation - 2006 Plan

As of March 6, 2017, there remained outstanding 1,084,138 unexercised stock options under our 2006 Equity Incentive Plan (the 2006 Plan). No additional awards may be granted under the 2006 Plan.

Welfare Benefits & Perquisites

We provide the named executive officers with health, dental and vision insurance plans, term life and disability insurance, and certain perquisites. Except with respect to specific perquisites, senior executives may generally elect to participate in these plans on the same basis and terms as all employees.

TABLE OF CONTENTS

401(k) Matching Contributions

We provide a company match to the 401(k) defined contribution plan to all eligible employees. For the 2015 and 2016 401(k) plan years, we contributed 4% of the participant s annual base salary to those eligible salaried employees contributing 4% or greater of their salary. For those eligible salaried employees contributing less than 4% of annual base salary, we matched the contribution by 100%. In each of 2015 and 2016, we also made a discretionary contribution equal to 1% of the participant s annual base salary to those eligible salaried employees.

Restoration Plan

We adopted a Restoration Plan in 2013 (the Restoration Plan), to give parity in benefits to executives with those benefits offered to employees generally via our 401(k) defined contribution plan. The Restoration Plan credits bookkeeping liability accounts for selected executives each year in amounts equal to amounts those executives would otherwise have been credited under the 401(k) plan. The Internal Revenue Code of 1986, as amended (the Code), allowed only up to $265,000 (in 2016; indexed each year) in total compensation to be considered in allocating contributions to a tax-qualified plan, so credits will be made to the non-qualified Restoration Plan for selected executives on compensation paid above that level, at the same percentage rate as applies to employees generally on pay below that level through the 401(k) plan. Amounts credited to the Restoration Plan grow based on the S&P 500 equity index returns each year. Benefits accrued under the Restoration Plan are not set aside in a trust account, and cannot be paid to the covered executive officer until the seventh month after termination of employment, at which time benefits are forfeited if the termination is deemed for cause. Notwithstanding the foregoing restriction on acceleration of payment, we may elect, in our sole discretion and without the covered executive s consent, to pay the balance of an executive s benefits to the executive in a lump sum at any time so long as the payment results in the termination and liquidation of the executive s entire account under the Restoration Plan and the payment does not exceed applicable dollar amounts under Code Section 402(g)(1)(B). Each of the named executive officers participates in the Restoration Plan.

Retirement Plan

We have a noncontributory, defined benefit retirement plan (the Retirement Plan), which originally covered all full-time employees, including officers, upon completing one year of service. Effective December 31, 2003, we froze the Retirement Plan for our salaried employees. Messrs. Helms and Dobbins are the only named executive officers who participated in the Retirement Plan during 2016 and 2015.

A participant in the Retirement Plan becomes fully vested before normal retirement at age 65 upon the completion of five years of service. Based on years of service, Messrs. Helms and Dobbins are fully vested under the Retirement Plan. Benefits are also provided under the Retirement Plan in the event of early retirement at or after age 55 and the completion of at least ten years of service (or special early retirement after completion of 30 years of service) and in the event of retirement for disability after completion of five years of service. The amount of the contribution, payment or accrual with respect to a specified person is not and cannot readily be separately or individually calculated by the actuaries for the Retirement Plan. Benefits under the Retirement Plan are based upon application of a formula to the specified average compensation and years of credited service at normal retirement age. Compensation covered by the Retirement Plan consists of the average annual salary during any five consecutive calendar years in the last ten years of an employee s service, which affords the highest salary, or, if employed for less than five years, the average annual salary for the years employed. The Retirement Plan benefits are not subject to any deduction for social security payments.

Prior Employment Agreements

Thomas F. Helms, Jr.

We and Mr. Helms were parties to an Amended and Restated Employment Agreement (the 2008 Agreement), whereby Mr. Helms served as Executive Chairman of our Board. On December 4, 2015, we and Mr. Helms entered into an amendment to the 2008 Agreement (the Amendment). Pursuant to the Amendment, upon the closing of our IPO, Mr. Helms employment and the 2008 Agreement both terminated effective immediately. Following the termination of the 2008 Agreement, neither we nor Mr. Helms have any further rights, obligations or duties under the 2008 Agreement, except for certain rights Mr. Helms has to indemnification by us that survived the termination of the 2008 Agreement. In consideration of the Amendment, we paid Mr. Helms $298,312.50 following the closing of our IPO and an additional $298,312.50 on the three-month anniversary of the closing of the IPO.

15

TABLE OF CONTENTS

Lawrence S. Wexler

Under a prior employment agreement with Mr. Wexler, our President and Chief Executive Officer, he received: (i) an annual base salary ($646,135 for 2015 and $662,288 as of May 2016), subject to adjustment, and was eligible for a target potential management bonus (75% of salary originally, and subsequently increased to 100% of salary for 2015); (ii) a monthly vehicle allowance; and (iii) four weeks annual paid vacation. We also provided Mr. Wexler an amount ($18,205 in 2015) to purchase life insurance. He was also entitled to participate in our group benefit and stock incentive plans.

James W. Dobbins

Under a prior employment agreement with Mr. Dobbins, our Senior Vice President and General Counsel, he received: (i) an annual base salary ($344,654 for 2015 and $353,271 as of May 2016), subject to adjustment, and was eligible for a target potential management bonus of 50% of salary; (ii) a monthly vehicle allowance; and (iii) four weeks annual paid vacation. He was also entitled to participate in our group benefit and stock incentive plans.

Mark A. Stegeman

Under a prior employment agreement with Mr. Stegeman, our Senior Vice President and Chief Financial Officer, he received (i) an annual base salary ($300,000 for 2015 and $304,500 as of May 2016), subject to adjustment, and was eligible for a target potential management bonus of 50% of salary, and (ii) three weeks annual paid vacation. He was also entitled to participate in our group benefit and stock incentive plans. Mr. Stegeman s prior employment agreement also provided Mr. Stegeman the right to receive options to purchase Company stock worth $500,000; however, no stock options were issued to Mr. Stegeman under that employment agreement.

Current Employment Agreements

In November 2015, we entered into new employment agreements with each of Messrs. Wexler, Dobbins and Stegeman which became effective and replaced their prior employment agreements upon the completion of our IPO in May 2016 (collectively, the 2016 Employment Agreements).

Upon a termination of employment by us without cause or by the applicable executive for good reason (each as defined in the applicable executive s 2016 Employment Agreement), each of Messrs. Wexler, Dobbins and Stegeman would be entitled to severance payments comprised of the following: (1) accrued compensation and benefits; (2) continuation of then-current base salary for 12 months, to be paid in accordance with our normal payroll practices; (3) a cash severance bonus equal to the average annual cash bonus received by the applicable executive for the 24-month period before the termination date; and (4) a lump sum payment equal to the cost of COBRA continuation coverage for the executive and his eligible dependents for 12 months.

In the event of a termination of employment by us without cause or by the applicable executive for good reason within one year following a change of control (as such term is defined in the applicable executive s 2016 Employment Agreement), or within 12 months of the effective date of his 2016 Employment Agreement, each of Messrs. Wexler, Dobbins and Stegeman would be entitled to severance payments comprised of the following (in lieu of any other severance payments under the 2016 Employment Agreements): (1) the accrued compensation and benefits; (2) continuation of then-current base salary for 24 months, to be paid in accordance with our normal payroll practices; (3) a cash severance bonus equal to two-times the average annual cash bonus received by the applicable executive for the 24-month period before the termination date; and (4) a lump sum payment equal to the cost of COBRA continuation coverage for the executive and his eligible dependents for 12 months.

In general, the foregoing severance payments and other benefits are subject to the applicable executive executing and delivering a release of claims to us. Pursuant to their respective 2016 Employment Agreements, Messrs. Wexler, Dobbins and Stegeman are each subject to certain restrictive covenants, including non-competition and non-solicitation restrictions during the employment term, and for a post-termination period equal to the number of months the executive is entitled to receive salary continuation pursuant to the severance provisions described above.

In addition, if any payment made to Messrs. Wexler, Dobbins or Stegeman would be subject to the excise tax under Section 4999 of the Internal Revenue Code, then the amounts payable to the applicable executive will

16

TABLE OF CONTENTS

be reduced to the maximum amount that does not trigger the excise tax, unless the executive would be better off (on an after-tax basis) receiving all such payments and benefits and paying all applicable income and excise taxes.

Lawrence S. Wexler

Mr. Wexler s 2016 Employment Agreement provides for an initial term of one year, subject to automatic extensions for successive one-year terms unless earlier terminated, or unless either party provides notice of non-renewal at least 60 days before the end of the applicable term. Pursuant to his 2016 Employment Agreement, Mr. Wexler is entitled to receive an annual base salary of $722,925, subject to adjustment by the Board. Mr. Wexler is eligible to receive an annual cash bonus award, with a target bonus opportunity equal to 100% of base salary. The annual bonus is payable upon the achievement of designated performance metrics pursuant to our annual bonus award program, as determined by the Board.

James W. Dobbins

Mr. Dobbins s 2016 Employment Agreement provides for an initial term of one year, subject to automatic extensions for successive one-year terms unless earlier terminated, or unless either party provides notice of non-renewal at least 60 days before the end of the applicable term. Pursuant to his 2016 Employment Agreement, Mr. Mr. Dobbins is entitled to receive an annual base salary of $365,271, subject to adjustment by the Board. Mr. Dobbins is eligible to receive an annual cash bonus award, with a target bonus opportunity equal to 50% of base salary. The annual bonus is payable upon the achievement of designated performance metrics pursuant to our annual bonus award program, as determined by the Board.

Mark A. Stegeman

Mr. Stegeman s 2016 Employment Agreement provides for an initial term of one year, subject to automatic extensions for successive one-year terms unless earlier terminated, or unless either party provides notice of non-renewal at least 60 days prior to the end of the applicable term. Under his employment agreement, Mr. Stegeman is entitled to receive an annual base salary of $350,000, subject to adjustment by the Board. Mr. Stegeman is eligible to receive an annual cash bonus award, with a target bonus opportunity equal to 50% of his base salary. The annual bonus is payable upon the achievement of designated performance metrics pursuant to our annual bonus award program, as determined by the Board. Pursuant to his 2016 Employment Agreement, during 2016, Mr. Stegeman was issued options to purchase 53,996 shares of Company stock at an exercise price of $9.26 per share.

TABLE OF CONTENTS

Outstanding Equity Awards at Fiscal Year-End

The following table sets forth specified information concerning equity awards held by each of the named executive officers as of December 31, 2016.

		Option Awards				Stock Awards	
Name	**Date of grant**	**Number of securities underlying unexercised options (#) exercisable**	**Number of securities underlying unexercised options (#) unexercisable**	**Option exercise price ($)**	**Option expiration date**	**Equity incentive plan awards: Number of unearned shares, units or other rights that have not vested (#)**	**Equity incentive plan awards: Market or payout value of unearned shares, units or other rights that have not vested ($)**
Thomas F. Helms, Jr.	—	—	—	—	—	—	—
Lawrence S. Wexler	9/18/2007 (1)	228,122	—	1.06	9/18/2017	—	—
	11/4/2008 (1)	31,296	—	1.06	11/4/2018		
	8/8/2014 (1)	4,695	—	3.83	8/8/2024		
James W. Dobbins	9/18/2007 (1)	36,512	—	1.06	9/18/2017	—	—
	11/4/2008 (1)	20,864	—	1.06	11/4/2018		
	8/25/2011 (1)	31,296	—	3.83	8/25/2021		
	8/8/2014 (1)	5,216	—	3.83	8/8/2024		
Mark A. Stegeman	5/11/2016 (2)	—	—	—	—	141	1,727
	8/10/2016 (3)	26,998	26,998	9.26	8/10/2026	—	—

(1) Options to purchase shares of our stock granted pursuant to the 2006 Plan.

(2) Restricted stock granted under our 2015 Plan in connection with our IPO that will vest in three annual installments on the first, second and third anniversaries of the grant date.

(3) Options to purchase shares of our stock granted under the 2015 Plan pursuant to his 2016 Employment Agreement. 50% vested at grant and 25% vesting on the first two anniversaries of the date of grant, August 10, 2016.

Equity Compensation Plan Information

The following table contains information about our equity compensation plans as of December 31, 2016:

Plan Category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)**	**Weighted-average exercise price of outstanding options, warrants and rights (b)**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)**
Equity compensation plans approved by security holders	1,637,762	$ 2.41	1,320,060
Equity compensation plans not approved by security holders	—	—	—
Total	1,637,762	—	1,320,060

TABLE OF CONTENTS

AUDIT COMMITTEE REPORT

The Audit Committee has met and reviewed and discussed the Company s audited financial statements for the fiscal year ended December 31, 2016 with the Company s management, which has the primary responsibility for the Company s financial statements, as well as with the Company s independent auditor, RSM US LLP, who is responsible for performing an independent audit of the Company s consolidated financial statements in accordance with auditing standards of the Public Company Accounting Oversight Board. The Audit Committee is not providing any expert or special assurance as to the Company s financial statements or providing any professional certification with respect to the independent auditor s work product.

The Audit Committee has discussed with RSM US LLP the matters required to be discussed by Auditing Standard No. 16, *Communications With Audit Committees,* as adopted by the Public Company Accounting Oversight Board. The Audit Committee has received and reviewed the written disclosures and the letter from RSM US LLP required by the applicable requirements of the Public Company Accounting Oversight Board regarding RSM US LLP communications with the Audit Committee concerning independence. The Audit Committee also considered whether RSM US LLP non-audit services to the Company were compatible with the independence requirements and concluded their independence was not compromised by the provision of these services.

Taking all of these reviews and discussions into account, the Audit Committee recommended to the Board that the Company s audited financial statements be included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2016 for filing with the SEC.

All members of the Audit Committee of the Company listed below submit the foregoing report.

AUDIT COMMITTEE:

Gregory H. A. Baxter (Chair)
H. C. Charles Diao
George W. Hebard III

TABLE OF CONTENTS

CERTAIN RELATIONSHIPS AND TRANSACTIONS

Policies Regarding Related Party Transactions

Our Board has adopted a written statement of policy regarding transactions with related persons, which we refer to as our related person policy. Our related person policy requires that a related person (as defined as in paragraph (a) of Item 404 of Regulation S-K) must promptly disclose to our senior legal officer any related person transaction (defined as any transaction that is anticipated would be reportable by us under Item 404(a) of Regulation S-K in which we were or are to be a participant and the amount involved exceeds $120,000 and in which any related person had or will have a direct or indirect material interest) and all material facts with respect thereto. The senior legal officer will then promptly communicate that information to the Audit Committee of our Board. Following our IPO, no related person transaction may be executed without the approval or ratification of the Audit Committee. In general, the Audit Committee will approve or ratify only related person transactions that we believe are at least as favorable to us as those we would obtain from an unrelated party. Except as indicated otherwise, all of the relationships and transactions disclosed under this item Certain Relationships and Transactions, occurred before our IPO and the implementationof our related person policy.

Helms Promissory Notes and Loan and Voting Agreement with Standard General

On November 19, 2012, Thomas Helms, Jr., Helms Management Corp. and Standard General entered into a Loan and Voting Agreement. Mr. Helms pledged approximately 1.46 million shares of his Company stock to Standard General as collateral for the loan. Pursuant to the Loan and Voting Agreement, Standard General holds a first priority lien on the pledged shares. In connection with the IPO, the parties amended the Loan and Voting Agreement to remove the provisions related to Board size and the provisions requiring each of the parties to vote for the other parties Board designee.

Issuance of Non-Voting Stock to Standard General; Conversion of Non-Voting Stock

At the request of Standard General, on September 25, 2015, we exchanged 938,857 shares of our common stock for 938,857 shares of non-voting common stock. The exchange was made in connection with the restructuring of the funds through which Standard General maintains its interest in us. In June 2016, our Board elected to convert each outstanding share of our non-voting common stock into one share of our voting common stock, and effective as of June 28, 2016, we issued to Standard General 938,857 shares of our voting common stock in exchange for an equivalent number of shares of our non-voting common stock. As of the date of this proxy statement, there are no issued and outstanding shares of our non-voting common stock.

IPO Proceeds

7% Senior Notes and Intrepid Warrants

In November 2013, we issued to certain of our stockholders that qualified as accredited investors as defined in Rule 501 under the Securities Act rights to purchase their proportionate share of units consisting of our 7% Senior Notes and warrants to purchase membership units of our subsidiary Intrepid Brands. In connection with the rights offering we entered into a backstop agreement with Standard General pursuant to which Standard General agreed to purchase, immediately following consummation of the rights offering, all units that were not subscribed for and purchased by our stockholders. The rights offering expired in January 2014, and we issued a total of $11,000,000 aggregate principal of our 7% Senior Notes and warrants to purchase 11,000,000 membership units of Intrepid Brands upon exercise of the rights issued in the rights offering. In addition to Standard General, Lawrence Wexler, James Dobbins and Helms Management Corp. exercised the rights they received in the rights offering. Standard General, Lawrence

Wexler, James Dobbins and Helms Management Corp exchanged an aggregate of $11.2 million (including unpaid interest) of our 7% Senior Notes for 1,124,193 shares of our common stock in the IPO. We also redeemed all of the Intrepid warrants. In connection with the exchange of the 7% Senior Notes and the redemption of the Intrepid Warrants, Standard General, Lawrence Wexler, James Dobbins and Helms Management Corp. received 869,794 shares, 21,106 shares, 587 shares and 232,706 shares of our common stock, respectively, and $2,290,901, $90,000, $2,500 and $992,299, respectively.

PIK Toggle Notes

In January 2014 we issued to Standard General PIK Toggle Notes in an aggregate principal amount of $45 million. The PIK Toggle Note bore interest at a rate equal to LIBOR in effect at that time (not less than 1.25%), plus 13.75%, reset quarterly, and were scheduled to mature in January 2021.

20

TABLE OF CONTENTS

In connection with our IPO, Standard General exchanged approximately 46% of the outstanding aggregate principal amount (plus accrued and unpaid interest thereon from December 31, 2015) of the PIK Toggle Notes for 3,168,438 shares of our common stock (of which 440,176 shares of our common stock is owned by Fort George).

Intrepid Options

In August 2014, we adopted the Intrepid Option Plan for units of ownership in Intrepid Brands. Pursuant to the Intrepid Option Plan, on August 8, 2014, we granted to Messrs. Wexler, Dobbins and Murray Intrepid Options to purchase 322,211, 120,479 and 175,903 units, respectively, of Intrepid Brands, with an exercise price of $1.00 per unit. Each option was vested with respect to 50% of the units at the date of grant, with the remaining 50% vesting in two equal annual installments beginning on August 8, 2015. We used a portion of the proceeds from our IPO to repurchase all vested Intrepid Options in accordance with the terms of the Intrepid Option Plan. Messrs. Wexler, Dobbins and Murray received $161,106, $60,240 and $87,952, respectively, for their Intrepid Options.

The following table sets forth the cash proceeds as well as the number of shares of our common stock received by Standard General and each of our executive officers and directors in connection with the IPO:

Principal Stockholders		**Total**		**Common Stock**	
Standard General	$	37,708,964	(1)	4,038,232	(2)
Helms Management Corp.	$	992,299		232,706	
Executive Officers					
Lawrence Wexler	$	251,106		21,106	
James Dobbins	$	62,740		587	
James Murray	$	87,952		—	

(1) Includes $6.1 million paid to Fort George for its exchange of Intrepid Warrants and PIK Toggle Notes.

(2) Includes 869,794 shares issued with respect to the 7% Senior Notes and 3,168,438 shares with respect to the PIK Toggle Notes (of which 440,176 shares are owned by Fort George).

Anchor Order

Standard General and Fort George purchased an aggregate of $34 million of our common stock in our IPO.

Other Arrangements

Thomas F. Helms, III, son of our Executive Chairman Thomas F. Helms, Jr., is employed by us as Director of Trade Marketing. During the year ended December 31, 2016, he received aggregate compensation of $162,382.

Credit Line with Standard General

During 2016, we were parties to an agreement with Standard General for a credit line of up to $50 million, which was available to finance acquisitions approved by Standard General. The line of credit terminated by its terms in December 2016. Borrowings under the line were to mature on the fifth anniversary of the IPO. Borrowings under the line of credit would have borne interest at a floating rate equal to LIBOR plus a margin of 6.5% with a LIBOR floor of 1.0%. We did not draw on this line of credit before its termination.

Stockholders Agreement

Until November 2016, we and certain of our stockholders were parties to a Stockholders Agreement, setting forth among other things, the manner in which our directors were to be selected. Pursuant to the Stockholders Agreement, Mr. Helms had the right to vote a number of shares of common stock in respect of the election of directors sufficient to elect all our directors. Mr. Helms also had the right to vote a number of shares of common stock in respect of the election of directors pursuant to transfer agreements that preceded the Stockholders Agreement. The Stockholders Agreement also set forth certain restrictions on the transfer of shares of our common stock by stockholders and on the acquisition by existing stockholders of investments in competitors of Bolloré.

21

TABLE OF CONTENTS

In connection with the IPO, we amended the Stockholders Agreement to include a six month lock-up provision applicable to any shares held by the parties to the agreement that mirrored the lock-up agreements signed by our directors and executive officers in connection with the IPO. All other substantive provisions of the Stockholders Agreement terminated upon the consummation of the IPO, and the Stockholders Agreement terminated in its entirety upon the expiration of the six month lock-up period.

Registration Rights Agreement

In connection with the completion of the IPO, we entered into a registration rights agreement with Standard General, Mr. Helms and certain other stockholders.

Under the registration rights agreement, each of Standard General and the Helms Parties can require that we register for resale their shares of our common stock. If we become eligible to register the sale of our securities on Form S-3 under the Securities Act, each of Standard General, Thomas Helms, Jr. and Helms Management Corp. can require us to register the sale of the registrable securities held by them on Form S-3, subject to offering size and other restrictions.

The registration rights agreement includes customary piggyback rights for parties to the agreement in connection with registrations by us, including registrations filed in connection with a demand registration. Piggyback registration rights will be subject to customary underwriter cutback provisions, except with respect to shares offered by us.

In connection with the registrations described above, we will indemnify any selling stockholders, or contribute to payments the selling stockholders may be required to make, and we will bear all fees, costs and expenses (except underwriting commissions and discounts and fees and expenses of financial advisors of the selling stockholders and their internal and similar costs).

Indemnification of Directors, Officers and Standard General

In connection with the IPO, we entered into an indemnification agreement with each of our executive officers and directors and with Standard General that provides, in general, that we will indemnify them to the fullest extent permitted by law in connection with their service to us or on our behalf.

TABLE OF CONTENTS

PRESENTATION OF PROPOSALS

Proposal 1 – Election of Directors

The Company s by-laws provide that the number of directors on our Board will be determined from time to time by a vote of the Board. Our Board currently consists of seven (7) directors. At the Annual Meeting, we are electing seven (7) directors for a term of one year each.

Nominees for Election as a Director

Set forth below are the Board members who will stand for re-election at the Annual Meeting, together with their age, all Company positions and offices they currently hold, and the year in which they joined the Board. Although it is not anticipated that any of the nominees listed below will decline or be unable to serve, if that should occur, the proxy holders may, in their discretion, vote for a substitute nominee.

Name	Age	Position or Office	Director Since
Thomas F. Helms, Jr.	76	Non-Executive Chairman	1997
Lawrence S. Wexler	64	President & CEO; Director	2013
Gregory H. A. Baxter	63	Director	2006
H.C. Charles Diao	59	Director	2012
David Glazek	39	Director	2012
George W. Hebard	43	Director	2014
Arnold Zimmerman	79	Director	2013

Recommendation

THE BOARD RECOMMENDS THAT STOCKHOLDERS VOTE FOR THE ELECTION OF THE NOMINEES FOR THE DIRECTORS OF THE COMPANY SET FORTH ABOVE FOR ONE YEAR EACH.

Proposal 2 – Ratification of Independent Auditors

As more particularly described in this proxy statement, the Audit Committee is directly responsible for managing the Company s independent auditors, which includes, without limitation, (i) pre-approving all audit and permitted non-audit services provided by our independent auditors, and (ii) the appointment, compensation, retention and oversight of the Company s independent auditors. In connection with the same and pursuant to its charter, the Audit Committee has appointed the firm of RSM US LLP to serve as the independent auditors to audit the consolidated financial statements and the internal control over financial reporting of the Company for the fiscal year which ends on December 31, 2017. The Board and the Audit Committee jointly agree that the continued retention of RSM US LLP is in the best interest of the Company and its stockholders. Accordingly, a resolution will be presented at the Annual Meeting to ratify the appointment of RSM US LLP. If the stockholders fail to ratify the appointment of RSM US LLP, the Audit Committee will take this result into account when appointing an independent auditor for fiscal year 2017. Even if the appointment is ratified, the Audit Committee in its discretion may direct the appointment of a different independent registered public accounting firm as the Company s independent auditors at any time during the year if the Audit Committee believes that such a change would be in the best interests of the Company and its stockholders. One or more representatives of RSM US LLP are expected to be present at the Annual Meeting, will have the opportunity to make a statement if they desire to do so and will be available to respond to appropriate questions.

Fees Paid to the Independent Auditors

We paid the following fees to RSM LLP for fiscal years 2016 and 2015:

	2016	2015
Audit Fees	$ 489,391	$ 420,160
Audit-related Fees	$ 265,779	$ 358,565
Tax Fees	0	0
All Other Fees	0	0
	$ 755,170	$ 778,725

23

Audit Fees

RSM US LLP charged $489,391 in fiscal year 2016 and $420,160 in fiscal year 2015 for audit fees. These include professional services in connection with the audit of the Company s annual financial statements and its internal control over financial reporting. They also include reviews of the Company s financial statements included in the Company s Quarterly and Annual Reports on Form 10-Q and Form 10-K and for services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for the fiscal years shown.

Audit-related Fees

RSM US LLP charged $265,779 in fiscal year 2016 and $358,725 in fiscal year 2015 for audit-related fees. Fees in 2016 and 2015 relate to our IPO. Fees in 2016 also relate to consummated acquisitions.

Tax Fees

RSM US LLP did not charge the Company for any tax services in fiscal years 2016 or 2015.

All Other Fees

RSM US LLP did not charge the Company for any non-audit services in fiscal year 2016 or 2015.

Pre-approval Policies and Procedures

The Audit Committee pre-approved all audit and audit-related services provided to the Company by RSM US LLP before management engaged the auditors for those purposes. The policy of the committee is to review all engagement letters for accounting firms for non-audit services.

Recommendation

THE BOARD RECOMMENDS A VOTE FOR THE RATIFICATION OF RSM US LLP AS THE COMPANY S INDEPENDENT AUDITORS FOR THE FISCAL YEAR ENDING DECEMBER 31, 2017.

TABLE OF CONTENTS

STOCKHOLDER PROPOSALS

In order for stockholder proposals submitted pursuant to Rule 14a-8 of the Exchange Act to be presented at the Company s 2018 annual meeting of stockholders and included in the Company s proxy statement and form of proxy relating to such meeting, such proposals must be submitted to the Corporate Secretary of the Company at the Company s principal executive offices no later than December 7, 2017. Stockholder proposals should be submitted to the Corporate Secretary of the Company at 5201 Interchange Way, Louisville, Kentucky 40229. Such proposals must also comply with the additional requirements of Rule 14a-8 of the Exchange Act (or any successor rule) to be eligible for inclusion in the proxy statement for the 2018 annual meeting. The rules of the SEC set forth standards for what stockholder proposals the Company is required to include in a proxy statement for an annual meeting of stockholders.

In addition, the Company s by-laws, a copy of which is available upon request, provide that only such business which is properly brought before a stockholder meeting will be conducted. For business to be properly brought before a meeting or nominations of persons for election to the Board to be properly made at a meeting by a stockholder, notice must be received by the Corporate Secretary of the Company at the Company s offices not less 45 or more than 75 days before the one-year anniversary of the date on which the Company first mailed proxy materials for the preceding year s annual meeting of stockholders; provided, however, if the meeting is convened more than 30 days before or delayed by more than 30 days after the anniversary of the preceding year s annual meeting, or if no annual meeting was held in the preceding year, to be timely, notice must be recived not later than the close of business on the later of (i) the 90th day before such annual meeting, or (ii) the 10th day following the day on which public announcement of the date of such meeting is made. To be in proper written form, a stockholder s notice to the Company s Corporate Secretary must, among other things, set forth as to each matter such stockholder proposes to bring before the annual meeting (i) a brief description of the business proposed to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (ii) the name and record address of such stockholder, (iii) the class or series and number of shares of the Company s capital stock which are owned beneficially or of record by such stockholder, and (iv) any other information relating to such stockholder and beneficial owner, if any, that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for, as applicable, the proposal and/or for the election of directors in a contested election pursuant to Section 14 of the Exchange Act.

Accordingly, a stockholder who intends to raise a proposal to be acted upon at the 2018 Annual Meeting, but who does not desire to include the proposal in the Company s 2018 proxy statement, must inform the Company by sending written notice to the Company s Corporate Secretary at 5201 Interchange Way, Louisville, Kentucky 40229, no earlier than January 21, 2018 nor later than February 20, 2018. The persons named as proxies in the Company s proxy for the 2018 annual meeting may exercise their discretionary authority to act upon any proposal which is properly brought before a stockholder meeting.

STOCKHOLDERS COMMUNICATIONS WITH THE BOARD

Stockholders that want to communicate in writing with the Board, or specific directors individually, may send proposed communications to the Company s Corporate Secretary at 5201 Interchange Way, Louisville, Kentucky 40229. The proposed communication will be reviewed by Mr. Dobbins and by the Audit Committee. If the communication is appropriate and serves to advance or improve the Company or its performance, it will be forwarded to the Board or the appropriate director.

FORM 10-K

The Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2016, accompanies this proxy statement. The Company s Annual Report does not form any part of the material for solicitation of proxies.

Any stockholder who wishes to obtain, without charge, a copy of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2016, which includes financial statements, and is required to be filed with the SEC, may access it at www.turningpointbrands.com **in the Investor Relations section or may send a written request to James Dobbins, General Counsel and Corporate Secretary, Turning Point Brands, Inc., 5201 Interchange Way, Louisville, Kentucky 40229.**

TABLE OF CONTENTS

OTHER BUSINESS

The Board is not aware of any other matters to be presented at the Annual Meeting other than those set forth herein and routine matters incident to the conduct of the meeting. If any other matters should properly come before the Annual Meeting or any adjournment or postponement thereof, the persons named in the proxy, or their substitutes, intend to vote on such matters in accordance with their best judgment.

By Order of the Board of Directors,
/s/ James Dobbins
James Dobbins
Corporate Secretary

Louisville, Kentucky

April 7, 2017

Please vote your shares through any of the methods described on the proxy card as promptly as possible, whether or not you plan to attend the Annual Meeting in person. If you do attend the Annual Meeting, you may still vote in person, since the proxy may be revoked at any time before its exercise by delivering a written revocation of the proxy to the Company s Corporate Secretary.

26

TABLE OF CONTENTS

o the early repayment, on the third quarter of 2013, of $233.2 million in senior notes at an average cost of 7.77%.

These positive variances were partially offset by lower volume and yield on mortgage loans resulting in lower interest income by approximately $6.4 million as compared to the same quarter in 2013 mostly due to lower volume by $328 million.

155

Table of Contents

Table 2 Analysis of Levels & Yields on a Taxable Equivalent Basis for Continuing Operations

Quarters ended June 30,

										Varianc	
verage Volume			Average Yields / Costs					Interest		Attributab	
	2013	Variance	2014	2013	Variance		2014	2013	Variance	Rate	V
$ in millions)								(In thousands)			
3	$ 980	$ 398	0.33 %	0.34 %	(0.01)%	Money market investments	$ 1,131	$ 829	$ 302	$ 67	$
3	5,535	493	2.75	3.04	(0.29)	Investment securities	41,376	42,017	(641)	(1,567)	
3	428	5	5.59	6.20	(0.61)	Trading securities	6,024	6,614	(590)	(658)	
9	6,943	896	2.48	2.85	(0.37)	Total money market, investment and trading securities	48,531	49,460	(929)	(2,158)	
						Loans:					
6	8,206	240	5.08	5.03	0.05	Commercial	107,041	102,851	4,190	1,157	
5	312	(137)	5.55	4.52	1.03	Construction	2,416	3,512	(1,096)	680	
6	542	4	7.43	8.02	(0.59)	Leasing	10,151	10,880	(729)	(805)	
1	7,019	(328)	5.34	5.45	(0.11)	Mortgage	89,314	95,699	(6,385)	(1,979)	
4	3,720	174	10.44	10.56	(0.12)	Consumer	101,350	97,901	3,449	(603)	
2	19,799	(47)	6.30	6.29	0.01	Sub-total loans	310,272	310,843	(571)	(1,550)	
1	3,269	(458)	11.83	8.60	3.23	Covered loans	82,975	70,136	12,839	20,715	
3	23,068	(505)	6.99	6.62	0.37	Total loans	393,247	380,979	12,268	19,165	
2	$ 30,011	$ 391	5.82 %	5.75 %	0.07 %	Total earning assets	$ 441,778	$ 430,439	$ 11,339	$ 17,007	$
						Interest bearing deposits:					
7	$ 4,736	$ 161	0.32 %	0.35 %	(0.03)%	NOW and money market [1]	$ 3,847	$ 4,158	$ (311)	$ (447)	$
3	6,538	175	0.22	0.25	(0.03)	Savings	3,628	4,020	(392)	(481)	
9	8,073	(364)	0.98	1.21	(0.23)	Time deposits	18,748	24,267	(5,519)	(3,930)	
9	19,347	(28)	0.54	0.67	(0.13)	Total deposits	26,223	32,445	(6,222)	(4,858)	
9	2,722	(623)	1.70	1.44	0.26	Short-term borrowings [3]	8,892	9,767	(875)	(443)	
6	511	25	15.92	15.95	(0.03)	TARP funds [2]	21,342	20,374	968	(48)	
9	1,253	(274)	4.21	5.01	(0.80)	Other medium and long-term debt [3]	10,306	15,692	(5,386)	(561)	
3	23,833	(900)	1.17	1.32	(0.15)	Total interest bearing liabilities	66,763	78,278	(11,515)	(5,910)	

	5,388	63				Non-interest bearing demand deposits					
3	790	1,228				Other sources of funds					
2	$ 30,011	$ 391	0.88 %	1.04 %	(0.16)%	Total source of funds	66,763	78,278	(11,515)	(5,910)	
			4.94 %	4.71 %	0.23 %	Net interest margin					
						Net interest income on a taxable equivalent basis	375,015	352,161	22,854	$ 22,917	$
			4.65 %	4.43 %	0.22 %	Net interest spread					
						Accelerated amortization TARP discount and related deferred costs	414,068		414,068		
						Taxable equivalent adjustment	20,328	17,750	2,578		
						Net interest income	$ (59,381)	$ 334,411	$ (393,792)		
			(0.51)%			Net interest margin including accelerated amortization of TARP discount and related costs					

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

[1] Includes interest bearing demand deposits corresponding to certain government entities in Puerto Rico.
[2] Junior subordinated deferrable interest debentures.
[3] Cost of borrowings excludes the impact of the accelerated amortization. Total cost of borrowings for the second quarter of 2014 including the accelerated amortization of TARP discount would have been 50.31%.

Table of Contents

The results for the six-month period ended June 30, 2014 were impacted by the same factors described in the quarterly results, being the most significant the increase in the covered loan portfolio yield.

Table 3 Analysis of Levels & Yields on a Taxable Equivalent Basis for Continuing Operations

Six Months ended June 30,

Average Volume			Average Yields / Costs				Interest			Variance Attributable to	
014	2013	Variance	2014	2013	Variance		2014	2013	Variance	Rate	Volum
(In millions)							(In thousands)				
1,347	$ 1,041	$ 306	0.32 %	0.35 %	(0.03)%	Money market investments	$ 2,104	$ 1,784	$ 320	$ 48	$ 27
5,933	5,488	445	2.78	3.11	(0.33)	Investment securities	82,493	85,230	(2,737)	(4,842)	2,10
423	428	(5)	5.73	6.23	(0.50)	Trading securities	12,022	13,206	(1,184)	(1,049)	(13
7,703	6,957	746	2.51	2.88	(0.37)	Total money market, investment and trading securities	96,619	100,220	(3,601)	(5,843)	2,24
						Loans:					
8,467	8,224	243	5.05	4.93	0.12	Commercial	212,172	201,058	11,114	5,098	6,01
180	338	(158)	8.11	4.18	3.93	Construction	7,252	7,008	244	4,536	(4,29
545	542	3	7.50	8.19	(0.69)	Leasing	20,455	22,213	(1,758)	(1,870)	11
6,691	6,716	(25)	5.39	5.44	(0.05)	Mortgage	180,497	182,581	(2,084)	(1,407)	(67
3,828	3,723	105	10.42	10.57	(0.15)	Consumer	197,783	195,068	2,715	(2,086)	4,80
9,711	19,543	168	6.31	6.26	0.05	Sub-total loans	618,159	607,928	10,231	4,271	5,96
2,872	3,391	(519)	11.50	8.45	3.05	Covered loans	164,073	142,320	21,753	40,073	(18,32
2,583	22,934	(351)	6.97	6.58	0.39	Total loans	782,232	750,248	31,984	44,344	(12,36
0,286	$ 29,891	$ 395	5.83 %	5.72 %	0.11 %	Total earning assets	$ 878,851	$ 850,468	$ 28,383	$ 38,501	$ (10,11
						Interest bearing deposits:					
4,817	$ 4,666	$ 151	0.32 %	0.37 %	(0.05)%	NOW and money market [1]	$ 7,625	$ 8,592	$ (967)	$ (1,234)	$ 26

6,702	6,530	172	0.22	0.25	(0.03)	Savings	7,187	8,140	(953)	(1,117)	16
7,624	8,172	(548)	1.01	1.24	(0.23)	Time deposits	38,269	50,329	(12,060)	(8,206)	(3,85
9,143	19,368	(225)	0.56	0.70	(0.14)	Total deposits	53,081	67,061	(13,980)	(10,557)	(3,42
2,201	2,722	(521)	1.64	1.45	0.19	Short-term borrowings [3]	17,932	19,548	(1,616)	177	(1,79
534	507	27	15.98	15.95	0.03	TARP funds [2]	42,673	40,407	2,266	93	2,17
1,005	1,260	(255)	4.16	5.00	(0.84)	Other medium and long-term debt [3]	20,865	31,426	(10,561)	(1,139)	(9,42
2,883	23,857	(974)	1.18	1.33	(0.15)	Total interest bearing liabilities	134,551	158,442	(23,891)	(11,426)	(12,46
5,517	5,315	202				Non-interest bearing demand deposits					
1,886	719	1,167				Other sources of funds					
0,286	$ 29,891	$ 395	0.89 %	1.07 %	(0.18)%	Total source of funds	134,551	158,442	(23,891)	(11,426)	(12,46
			4.94 %	4.65 %	0.29 %	Net interest margin					
						Net interest income on a taxable equivalent basis	744,300	692,026	52,274	$ 49,927	$ 2,34
			4.65 %	4.39 %	0.26 %	Net interest spread					
						Accelerated amortization TARP discount and related deferred costs	414,068		414,068		
						Taxable equivalent adjustment	38,442	32,971	5,471		
						Net interest income	$ 291,790	$ 659,055	$ (367,265)		

2.20 %	Net interest margin including accelerated amortization of TARP discount and related costs

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

[1] Includes interest bearing demand deposits corresponding to certain government entities in Puerto Rico.
[2] Junior subordinated deferrable interest debentures.
[3] Cost of borrowings excludes the impact of the accelerated amortization. Total cost of borrowings for the six months ended June 30, 2014 including the accelerated amortization of TARP discount would have been 26.51%.

157

Provision for Loan Losses

The Corporation s total provision for loan losses totaled $61.7 million for the quarter ended June 30, 2014 compared with $254.5 million for the quarter ended June 30, 2013.

The provision for loan losses for the non-covered loan portfolio totaled $50.1 million, compared with $229.0 million for the same quarter in 2013, reflecting a decrease of $178.9 million, mostly due to an incremental provision of $169.2 million as a result of the bulk sale of non-performing residential mortgage loans completed during the second quarter of 2013. Excluding the impact of the sale, the provision for loans losses declined by $9.7 million. In addition, the Corporation recorded a reserve release of $18.7 million during the second quarter of 2014 due to the annual recalibration and enhancements to the allowance for loan losses methodology, compared to a reserve increase of $11.8 million for the second quarter of 2013 due to enhancements completed in that quarter. Net charge-offs, excluding write-downs related to the bulk sale in 2013, decreased by $32.9 million from the same quarter prior year, driven by improvements in the credit performance of most portfolios.

The provision for the Puerto Rico non-covered portfolio amounted to $74.9 million, compared to $230.5 million in the second quarter of 2013, reflecting the aforementioned impact of the bulk loan sale. Excluding the impact of the sale, the provision for loan losses increased by $13.6 million, when compared to the quarter ended June 30, 2013, predominantly driven by environmental factors accounting for prevailing macroeconomic conditions in Puerto Rico and the effect of downgrades in the internal risk ratings of certain large corporate and public sector relationships. These increases were partially offset by a $14.9 million reserve release as part of the annual recalibration and enhancements to the allowance for loan losses methodology. Refer to the Critical Accounting Policies section of this MD&A for further details of these revisions.

The U.S. operations recorded a provision release of $24.8 million for the second quarter of 2014, compared to a provision release of $1.5 million for the same quarter in 2013 prompted by continued improvements in credit quality trends and the effect of a $3.8 million reserve release as part of the annual recalibration and enhancements of the ALLL models.

Table of Contents

The provision for covered loans totaled $11.6 million in the second quarter of 2014, compared with $25.5 million for the same quarter in 2013, reflecting a decrease of $13.9 million. This decrease is due to lower impairment losses on commercial loan pools accounted for under ASC 310-30 and the impact of a $7.5 million reserve increase related to recalibration and enhancements to the allowance for loan losses methodology implemented during the second quarter of 2013. Overall expected loss estimates for pools accounted for under ASC Subtopic 310-30 continue to be lower than originally estimated. In addition, as part of the annual recalibration and enhancements of the ALLL models, the Corporation recorded a $0.8 million reserve increase during the second quarter of 2014.

For the six months ended June 30, 2014, the Corporation s total provision for loan losses totaled $141.5 million, compared with $481.1 million for the same period in 2013, decreasing by $339.6 million, mostly due to the impact of $318.1 million related to the bulk loan sales completed during 2013. Excluding the impact of the sales, the provision reflects a decrease of $21.5 million from the six month period ended June 30, 2013, mostly driven by continued credit quality improvements in the US operations. The results for the six months ended June 30, 2014 include a $17.9 million reserve release as part of the annual recalibration and enhancements of the ALLL models, compared to a reserve increase of $19.3 million for the same period of 2013 due to enhancements to the allowance for loan losses methodology.

For the six months period ended June 30, 2014 the provision for loan losses for the non-covered loan portfolio decreased by $333.9 million when compared to the same period of 2013, mainly due to the $318.1 million impact of the loan sales during 2013. Excluding the impact of the sales, the provision would have declined by $15.8 million, led by a decrease of $27.9 million in the US operations, offset by an increase of $12.1 million in the BPPR segment primarily due to challenging economic conditions in Puerto Rico, as stated above.

The provision for the covered portfolio was $37.3 million for the six month period ended June 30, 2014, compared to $43.1 million for same period of last year. This decrease is due to lower impairment losses on commercial loan pools accounted for under ASC 310-30 and the impact of a $7.5 million reserve increase related to the recalibration and enhancements to the allowance for loan losses methodology implemented during the second quarter of 2013.

Refer to the Credit Risk Management and Loan Quality sections of this MD&A for a detailed analysis of net charge-offs, non-performing assets, the allowance for loan losses and selected loan losses statistics.

NON-INTEREST INCOME

Refer to Table 4 for a breakdown on non-interest income by major categories for the quarters and six months ended June 30, 2014 and 2013.

Table 4 Non-Interest Income

	Quarters ended June 30,			Six months ended June 30,		
(In thousands)	2014	2013	Variance	2014	2013	Variance
Service charges on deposit accounts	$ 39,237	$ 41,378	$ (2,141)	$ 78,596	$ 82,539	$ (3,943)
Other service fees:						
Debit card fees	11,000	10,395	605	21,544	20,460	1,084
Insurance fees	12,406	11,550	856	24,125	23,157	968
Credit card fees	16,985	16,265	720	33,068	31,819	1,249

Sale and administration of investment products	7,456	10,243	(2,787)	13,913	18,960	(5,047)
Trust fees	4,566	4,154	412	9,029	8,612	417
Other fees	4,055	4,672	(617)	7,607	9,215	(1,608)
Total other service fees	56,468	57,279	(811)	109,286	112,223	(2,937)
Mortgage banking activities	3,788	18,081	(14,293)	7,466	38,378	(30,912)
Net gain (loss) and valuation adjustments of investment securities		5,856	(5,856)		5,856	(5,856)
Trading account profit (loss)	1,055	(4,345)	5,400	3,032	(5,329)	8,361
Net gain (loss) on sale of loans, including valuation adjustment on loans held-for-sale	9,659	4,291	5,368	14,052	(58,428)	72,480
Adjustment (expense) to indemnity reserves on loans sold	(7,454)	(11,632)	4,178	(17,801)	(27,775)	9,974
FDIC loss share (expense) income	(55,261)	(3,755)	(51,506)	(79,467)	(30,021)	(49,446)
Other operating income	15,297	181,565	(166,268)	43,657	201,585	(157,928)
Total non-interest income	$ 62,789	$ 288,718	$ (225,929)	$ 158,821	$ 319,028	$ (160,207)

159

Table of Contents

Table 5 Mortgage Banking Activities

	Quarters ended June 30,			Six months ended June 30,		
(In thousands)	2014	2013	Variance	2014	2013	Variance
Mortgage servicing fees, net of fair value adjustments:						
Mortgage servicing fees	$ 10,558	$ 11,313	$ (755)	$ 21,306	$ 22,556	$ (1,250)
Mortgage servicing rights fair value adjustments	(7,740)	(5,126)	(2,614)	(15,836)	(10,741)	(5,095)
Total mortgage servicing fees, net of fair value adjustments	2,818	6,187	(3,369)	5,470	11,815	(6,345)
Net gain (loss) on sale of loans, including valuation on loans held-for-sale	8,189	(351)	8,540	15,365	13,409	1,956
Trading account (loss) profit:						
Unrealized gains (losses) on outstanding derivative positions	22	622	(600)	(738)	600	(1,338)
Realized (losses) gains on closed derivative positions	(7,241)	11,623	(18,864)	(12,631)	12,554	(25,185)
Total trading account (loss) profit	(7,219)	12,245	(19,464)	(13,369)	13,154	(26,523)
Total mortgage banking activities	$ 3,788	$ 18,081	$ (14,293)	$ 7,466	$ 38,378	$ (30,912)

Non-interest income decreased by $225.9 million during the quarter ended June 30, 2014, compared with the same quarter of the previous year. During the second quarter of 2013, BPPR completed the sale of a portfolio of non-performing residential mortgage loans with a loss of $3.9 million and reserve for indemnification claims of $3.0 million. In addition, in connection with the EVERTEC IPO completed during the second quarter of 2013, the Corporation recognized other operating income of $162.1 million and a prepayment penalty fee of $5.9 million from EVERTEC s early repayment of its debt security. Excluding the impact of these transactions completed during the second quarter of 2013, non-interest income decreased $64.9 million.

The decrease in non-interest income was principally due to:

- Lower other operating income by $166.3 million mostly due to the gain of $162.1 million during the second quarter of 2013 from EVERTEC s IPO;

- Unfavorable variance in FDIC loss share (expense) income of $51.5 million due mainly to a higher amortization of the indemnification asset by $33.5 million. During the second quarter, the Corporation revised its analysis of expected cash flows which resulted in a net decrease of approximately $102.9 million in estimated credit losses, which was driven mainly by commercial loan pools. Though this will have a

positive impact on the Corporation s interest accretion in future periods, the carrying value of the indemnification asset was amortized to reflect lower levels of expected losses. This amortization is recognized over the shorter of the remaining life of the loan pools, which had an average life of approximately six years, or the indemnification asset, which as of June 30, 2014 is one year for commercial, construction and consumer loans and of six years for single-family residential mortgage loans. Additionally, lower mirror accounting of credit impairment losses by $15.0 million also contributed to the higher expense. Refer to Table 6 for a breakdown of FDIC loss share (expenses) income by major categories;

Lower mortgage banking activities revenues by $14.3 million due to an unfavorable variance of $18.9 million in realized gains / (losses) on closed derivative positions and higher unfavorable valuation adjustments on mortgage servicing rights at BPPR segment. Refer to Table 5 for details of mortgage banking activities; and

Lower gains on investment securities by $5.9 million due to EVERTEC s prepayment penalty fee resulting from the early repayment of its debt security.

These unfavorable variances were partially offset by:

Higher trading account profit by $5.4 million mainly at BPPR segment due to higher volume of MBS outstanding at higher market prices;

Higher net gains on sale of loans by $5.4 million principally at the BPNA segment due to a higher volume of loans sold; and

Lower adjustments to the indemnity reserves by $4.2 million mostly due to the indemnity reserve of $3.0 million recorded during the second quarter of 2013 at BPPR in connection to the sale of non-performing loans and a partial reserve release at BPNA during this quarter, partially offset by higher provision for loans subject to credit recourse at BPPR.

Table of Contents

For the six months ended June 30, 2014 non-interest income decreased $160.2 million. Excluding the two significant transactions discussed above and the bulk sale of non-performing assets during the first quarter of 2013, which had a negative impact in non-interest income of $72.2 million, the non-interest income decreased by $71.3 million.

Lower other operating income by $157.9 million primarily due to the gain of $162.1 million during the second quarter of 2013 from EVERTEC s IPO;

Unfavorable variance in FDIC loss share (expense) income of $49.4 million due mainly to the same factors described above for the quarterly results. The amortization of the indemnification asset increased by $42.3 million when compared to the same period of 2013, driven by an increase in expected cash flows. Additionally, lower mirror accounting of credit impairment losses by $13.9 million partially offset by a favorable variance in the fair value adjustment of the true-up payment obligation of $7.2 million also contributed to the higher expense. Refer to Table 6 for a breakdown of FDIC loss share (expenses) income by major categories; and

Lower mortgage banking activities revenues by $30.9 million mainly due to the unfavorable variance in realized gains / (losses) on closed derivative positions and higher unfavorable valuation adjustments on mortgage servicing rights at BPPR segment. Refer to Table 5 for details of mortgage banking activities.

These unfavorable variances were partially offset by:

Positive variance of $72.5 million in net gain (loss) on sale of loans held-for-sale, net of valuation adjustment, that was mainly due to effect of the $61.4 million loss at BPPR resulting from the bulk sale of non-performing commercial and construction loans during the first quarter of 2013, which included an unfavorable valuation adjustment on loans held-for-sale transferred to held-in-portfolio of approximately $8.8 million;

Lower provision for indemnity reserves on loans sold by $10.0 million mainly due to the effect of the $13.7 million reserves established at BPPR in connection with the previously mentioned bulk sales of non-performing assets completed during the first and second quarters of 2013, of which $2.0 million was reversed during the first quarter of 2014, in addition to the reserve release of $1.2 million at BPNA during this quarter; and

Net positive change in trading account profit / (loss) by $8.4 million at BPPR segment due to higher volume of MBS outstanding at higher market values.

Table of Contents

The following table provides a summary of the revenues and expenses derived from the assets acquired in the FDIC-assisted transaction during the quarters and six month periods ended June 30, 2014 and 2013:

Table 6 Financial Information Westernbank FDIC-Assisted Transaction

	Quarters ended June 30,			Six months ended June 30,		
(In thousands)	2014	2013	Variance	2014	2013	Variance
Interest income on covered loans	$ 82,975	$ 70,136	$ 12,839	$ 164,073	$ 142,320	$ 21,753
FDIC loss share (expense) income :						
Amortization of loss share indemnification asset	(72,095)	(38,557)	(33,538)	(121,041)	(78,761)	(42,280)
80% mirror accounting on credit impairment losses[1]	10,372	25,338	(14,966)	25,462	39,383	(13,921)
80% mirror accounting on reimbursable expenses	11,085	12,131	(1,046)	23,830	19,914	3,916
80% mirror accounting on recoveries on covered assets, including rental income on OREOs, subject to reimbursement to the FDIC	(3,557)	(2,168)	(1,389)	(7,949)	(3,269)	(4,680)
80% mirror accounting on amortization of contingent liability on unfunded commitments		(193)	193		(386)	386
Change in true-up payment obligation	(1,206)	(476)	(730)	(38)	(7,251)	7,213
Other	140	170	(30)	269	349	(80)
Total FDIC loss share (expense) income	(55,261)	(3,755)	(51,506)	(79,467)	(30,021)	(49,446)
Amortization of contingent liability on unfunded commitments (included in other operating income)		242	(242)		484	(484)
Total revenues	27,714	66,623	(38,909)	84,606	112,783	(28,177)
Provision for loan losses	11,604	25,500	(13,896)	37,318	43,056	(5,738)
Total revenues less provision for loan losses	$ 16,110	$ 41,123	$ (25,013)	$ 47,288	$ 69,727	$ (22,439)

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

Average balances

(In millions)	Quarters ended June 30, 2014	2013	Variance	Six months ended June 30, 2014	2013	Variance
Covered loans	$ 2,811	$ 3,269	$ (458)	$ 2,872	$ 3,391	$ (519)
FDIC loss share asset	792	1,376	(584)	846	1,385	(539)

Operating Expenses

Refer to Table 7 for a breakdown of operating expenses by major categories. Operating expenses decreased by $18.4 million when compared to the same quarter of 2013 due to the following factors:

Lower FDIC deposit insurances expenses by $8.1 million resulting from improvements in assets quality and earnings trends.

Lower personnel costs by $7.3 million mainly at BPPR mostly related to lower pension and postretirement expenses due to actuarial revisions, and lower hospital and life insurance expenses.

Lower other real estate (OREO) expenses by $4.2 million due to lower maintenance expenses and lower rental income as a result of OREO properties sold, partially offset by higher subsequent write-downs during this quarter.

Lower other operating expenses by $2.3 million due to a sundry reserve release of approximately $1.4 million at BPNA during the second quarter of 2014.

These decreases were partially offset by higher restructuring costs by $4.6 million related to the PCB reorganization. Refer to Note 4 for a detail of restructuring charges.

162

Table of Contents

Operating expenses decreased by $56.1 million for the six months ended June 30, 2014 when compared to the same period in 2013, due to the following main factors:

Lower OREO expenses by $43.7 million mainly at BPPR due to the loss of $37.0 million from the bulk sale of commercial and single family real estate owned recognized during the first quarter of 2013.

Lower personnel costs by $10.5 million mostly at BPPR driven by lower pension and postretirement expenses due to actuarial revisions, partially offset by higher 401K savings plan expenses due to the restoration of the Corporation s matching contribution to the plan in April 2013.

Lower FDIC deposit insurance expense by $5.5 million resulting from improvements in assets quality and earnings trends.

These decreases were partially offset by higher restructuring costs by $4.6 million related to the PCB reorganization.

Table 7 Operating Expenses

	Quarters ended June 30,			Six months ended June 30,		
(In thousands)	2014	2013	Variance	2014	2013	Variance
Personnel costs:						
Salaries	$ 69,149	$ 68,585	$ 564	$ 138,187	$ 136,207	$ 1,980
Commissions, incentives and other bonuses	12,862	14,704	(1,842)	25,961	29,477	(3,516)
Pension, postretirement and medical insurance	7,532	13,911	(6,379)	16,233	28,224	(11,991)
Other personnel costs, including payroll taxes	9,557	9,159	398	23,020	20,032	2,988
Total personnel costs	99,100	106,359	(7,259)	203,401	213,940	(10,539)
Net occupancy expenses	20,267	21,059	(792)	41,627	41,551	76
Equipment expenses	12,044	11,485	559	23,456	23,105	351
Other taxes	13,543	15,225	(1,682)	27,206	26,753	453
Professional fees:						
Collections, appraisals and other credit related fees	6,652	7,915	(1,263)	12,972	17,629	(4,657)
Programming, processing and other technology services	43,533	42,872	661	86,218	85,521	697
Other professional fees	16,839	16,228	611	34,833	31,602	3,231
Total professional fees	67,024	67,015	9	134,023	134,752	- 729
Communications	6,425	6,395	30	13,110	12,946	164

Business promotion	16,038	15,357	681	27,424	27,942	(518)
FDIC deposit insurance	10,480	18,557	(8,077)	21,458	26,913	(5,455)
Other real estate owned (OREO) expenses	3,410	7,657	(4,247)	9,850	53,524	(43,674)
Other operating expenses:						
Credit and debit card processing, volume and interchange expenses	5,640	5,096	544	10,836	9,801	1,035
Transportation and travel	1,586	1,756	(170)	3,176	3,165	11
Printing and supplies	955	1,035	(80)	1,645	1,815	(170)
Operational losses	1,945	3,577	(1,632)	7,480	7,095	385
All other	10,383	11,302	(919)	19,721	21,808	(2,087)
Total other operating expenses	20,509	22,766	(2,257)	42,858	43,684	(826)
Amortization of intangibles	2,025	1,989	36	4,051	3,979	72
Restructuring costs	4,574		4,574	4,574		4,574
Total operating expenses	$ 275,439	$ 293,864	$ (18,425)	$ 553,038	$ 609,089	$ (56,051)

INCOME TAXES

Income tax benefit amounted to $4.1 million for the quarter ended June 30, 2014, compared with $237.4 million for the same quarter of 2013. The decrease in income tax benefit was primarily due to the recognition during the second quarter of 2013 of $215.6 million in income tax benefit and a corresponding increase in the net deferred tax asset of the Puerto Rico operations as the result of the increase in the marginal tax rate from 30% to 39% per Act Number 40 of the Puerto Rico Internal Revenue Code applicable to taxable years beginning after December 31, 2012.

During the second quarter of 2014 the Corporation entered into a Closing Agreement with the Puerto Rico Department of Treasury. The Agreement, among other matters, was related to the income tax treatment of certain charge-offs related to the loans acquired from Westernbank as part of the FDIC assisted transaction in the year 2010. As a result of the Agreement, the Corporation recorded a tax benefit of $23.4 million due to a reduction in the deferred tax liability associated with the Westernbank loan portfolio. Additionally, in connection with this Closing, the Corporation made an estimated tax payment of $45 million which will be used as a credit to offset future income tax liabilities.

Table of Contents

This benefit was partially offset by the negative impact of the deferred tax asset valuation allowance of $9.2 million recorded at the Holding Company, due to the difference in the tax treatment of the interest expense related to the TARP funds and the newly issued $450 million senior notes, bearing interest at 7%. The previous interest expense on the TARP funds was not deductible for purposes of calculating taxable income. However, interest expense on the $450 million term notes will be deductible for purposes of the calculation; increasing the loss in the Holding Company on a stand-alone basis. The Holding Company s lack of taxable income exclusive of reversing temporary differences after deducting the interest expense generated on the notes represents strong negative evidence within management s evaluation of the realizability of that entity s deferred tax asset. After weighting of all positive and negative evidence management concluded, as of the reporting date, that it is more likely that not that the Holding Company will not be able to realize any portion of the deferred tax asset, considering the criteria of ASC Topic 740, therefore recorded a full valuation allowance against it.

On July1, 2014, the Government of Puerto Rico approved an amendment to the Internal Revenue Code, which among other things, changed the income tax rate for capital gains from 15% to 20%. As a result, the Corporation expects to recognize an income tax expense of approximately $20.0 million during the third quarter of 2014, mainly related to the deferred tax liability associated with the portfolio acquired from Westernbank.

The components of income tax benefit for the quarters ended June 30, 2014 and 2013 are included in the following table:

Table 8 Components of Income Tax Benefit Quarter

	Quarters ended			
	June 30, 2014		June 30, 2013	
(In thousands)	Amount	% of pre-tax income	Amount	% of pre-tax income
Computed income tax at statutory rates	$ (130,147)	39 %	$ 29,168	39 %
Net benefit of net tax exempt interest income	(13,558)	4	(10,325)	(14)
Deferred tax asset valuation allowance	(7,211)	2	(2,958)	(4)
Non-deductible expenses	169,810	(50)	7,946	11
Difference in tax rates due to multiple jurisdictions	(4,293)	1	(2,588)	(3)
Initial adjustment in deferred tax due to change in tax rate			(215,600)	(288)
Effect of income subject to preferential tax rate[1]	(20,833)	6	(47,322)	(63)
Others	2,108	(1)	4,299	5
Income tax benefit	$ (4,124)	1%	$ (237,380)	(317)%

[1] For 2014, includes the impact of the Closing Agreement with the P.R. Treasury signed in June 2014.

Income tax expense amounted to $19.1 million for the six months ended June 30, 2014, compared with an income tax benefit of $294.3 million for the same period of 2013. The increase in income tax expense was primarily due to the

recognition during the year 2013 of a tax benefit and a corresponding increase in the net deferred tax asset of the Puerto Rico operations as result of the increase in the marginal tax rate from 30% to 39% as mention above. In addition, during 2013 the income tax benefit increased due to the loss generated on the Puerto Rico operations by the sale of non-performing assets net of the gain realized on the sale of EVERTEC s common stock.

Table of Contents

Table 9 Components of Income Tax Expense (Benefit) Year-to-Date

	Six months ended			
	June 30, 2014		June 30, 2013	
(In thousands)	Amount	% of pre-tax income	Amount	% of pre-tax income
Computed income tax at statutory rates	$ (95,138)	39 %	$ (43,731)	39 %
Net benefit of net tax exempt interest income	(24,944)	10	(19,876)	18
Deferred tax asset valuation allowance	(14,183)	6	(2,975)	3
Non-deductible expenses	178,129	(73)	15,759	(14)
Difference in tax rates due to multiple jurisdictions	(10,488)	4	(5,948)	5
Initial adjustment in deferred tax due to change in tax rate			(197,467)	176
Effect of income subject to preferential tax rate[1]	(18,555)	8	(45,313)	40
Others	4,319	(2)	5,294	(5)
Income tax expense (benefit)	$ 19,140	(8)%	$ (294,257)	262 %

[1] For 2014, includes the impact of the Closing Agreement with the P.R. Treasury signed in June 2014.
Refer to Note 34 to the consolidated financial statements for a breakdown of the Corporation s deferred tax assets as of June 30, 2014.

REPORTABLE SEGMENT RESULTS

The Corporation s reportable segments for managerial reporting purposes consist of Banco Popular de Puerto Rico and Banco Popular North America. These reportable segments pertain only to the continuing operations of Popular, Inc. As previously indicated in Note 3 to the consolidated financial statements, the regional operations in California, Illinois and Central Florida were classified as discontinued operations in the second quarter of 2014. A Corporate group has been defined to support the reportable segments. For managerial reporting purposes, the costs incurred by the Corporate group are not allocated to the reportable segments.

For a description of the Corporation s reportable segments, including additional financial information and the underlying management accounting process, refer to Note 36 to the consolidated financial statements.

The Corporate group reported a net loss of $451.4 million for the second quarter and $471.4 million for the six months ended June 30, 2014, compared with a net income of $137.0 million for the second quarter and $107.8 million for the six months ended June 30, 2013. The unfavorable variance at the Corporate group was mainly due to the accelerated amortization of $414.1 million of the discount and deferred costs associated with the TARP funds, which were repaid in July 2, 2014 and the after-tax gain of approximately $156.6 million recognized during the second quarter of 2013, in connection with EVERTEC s IPO.

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

Banco Popular de Puerto Rico

The Banco Popular de Puerto Rico reportable segment s net income amounted to $71.3 million for the quarter ended June 30, 2014, compared with a net income of $160.1 million for the same quarter of the previous year. The principal factors that contributed to the variance in the financial results included the following:

- higher net interest income by $19.3 million, or 24 basis points, mostly due to:
  - an increase of $12.8 million in income from the covered portfolio due to loan resolutions and higher expected cash flows, partially offset by lower levels due to the continued resolution of that portfolio;
  - higher income from commercial loans of $4.4 million due to higher volumes and higher yields after the bulk sale of non-performing commercial loans during the first quarter of 2013;
  - an increase of $3.1 million on income from consumer loans due to the loan purchase of $90.0 million completed during the first quarter of 2014 and higher volume of auto loans;
  - lower interest expense from deposits by $3.8 million, or a lower cost of 10 basis points, mainly from individual retirement accounts and brokered CD s related to renewal of maturities at lower prevailing rates and to lower volume of deposits; and
  - lower cost of borrowings by $4.7 million mainly due to the conversion into shares of common stock of $185 million in subordinated notes due to Popular, Inc. during the fourth quarter of 2013.

Partially offsetting the favorable variances in net interest income was a reduction of approximately $6.0 million in interest income from mortgage loans due to lower volumes and $1.8 million on investment securities also caused by lower volumes of mortgage backed securities. The net interest margin was 5.50% for the quarter ended June 30, 2014, compared to 5.26% for the same period in 2013;

- lower provision for loan losses by $169.5 million, or 66%, mostly due to the decrease in the provision for loan losses on the non-covered loan portfolio of $155.6 million, mainly related to the $169.2 million impact of the bulk sale of non-performing mortgage loans during the second quarter of 2013. Excluding the impact of the sale, the provision for loan losses for the non-covered portfolio increased by $13.6 million, due to macro-economic conditions in Puerto Rico and reserves for commercial and public sector exposures, offset by the reserve releases due to the annual review of the components of the allowance for loan losses. The provision for the covered portfolio declined by $13.9 million driven by lower impairment losses on loan pools accounted for under ASC 310-30;
- lower non-interest income by $64.8 million, or 63%, mainly due to:

higher FDIC loss share expense by $51.5 million (refer to Table 6 for components of this variance). During the second quarter of 2014, the Corporation revised its analysis of expected cash flows which resulted in a net decrease of approximately $102.9 million in estimated credit losses, driven mainly by certain commercial loan pools. Although this is expected to have a positive impact on the Corporation s interest accretion in future periods, the carrying value of the indemnification asset was amortized to reflect lower levels of expected losses. Lower mirror accounting on credit impairment losses during the quarter also contributed to higher FDIC loss share expense, and

lower income from mortgage banking activities by $ 14.3 million mainly due to higher losses on closed derivative positions and unfavorable fair value adjustments on mortgage servicing rights, offset by higher gains on securitization transactions.

The negative variances in non-interest income detailed above were partially offset by:

higher trading account income by $ 5.3 million due to higher volume of mortgage backed securities at higher market values, and

lower provisions for indemnity reserves by $2.2 million due to the $3.0 million provision recorded during the second quarter of 2013 related to the bulk sale of non-performing mortgage loans,

166

lower operating expenses by $15.0 million, or 6%, mainly due to lower personnel costs by $6.8 million mostly due to lower pension and postretirement expenses due to changes to actuarial assumptions in pension obligations, and medical and life insurance expenses; and lower FDIC deposit insurance expense by $8.0 million due to improved asset quality and earnings trends

lower income tax benefit by $227.8 million, mainly due to the change in statutory tax rate from 30% to 39% during the second quarter of 2013, resulting in a tax benefit of $214.2 million, as compared to a benefit of $23.4 million recognized during the second quarter of 2014, in connection with a Closing Agreement with the Puerto Rico Department of Treasury

Net income for the six months ended June 30, 2014 amounted to $136.3 million, compared to $51.3 million for the same period of the previous year. The principal factors that contributed to the variance in the financial results included the following:

higher net interest income by $42.2 million, or 28 basis points, mostly due to:

an increase of $21.8 million in income from the covered portfolio due to loan resolutions and higher expected cash flows, partially offset by lower levels due to the continued resolution of that portfolio;

higher income from commercial loans of $10.9 million due to higher volumes and higher yields after the bulk sale of non-performing commercial loans during the first quarter of 2013;

an increase of $3.1 million on income from consumer loans due to the loan purchase of $90 million in consumer loans during the first quarter of 2014 and higher volume of auto loans;

lower interest expense from deposits by $8.9 million, or a lower cost of 11 basis points, mainly from individual retirement accounts and brokered CD s related to renewal of maturities at lower prevailing rates and to lower volume of deposits; and

lower cost of borrowings by $9.0 million mainly due to the conversion into shares of common stock of $185 million in subordinated notes due to Popular, Inc. during the fourth quarter of 2013.

Partially offsetting the favorable variances in net interest income was a reduction of approximately $2.2 million and $3.2 million in construction and mortgage loans income, respectively, due to lower volumes and $4.3 million lower income on investment securities also caused by lower volumes of mortgage backed securities and US Government Agencies. The net interest margin was 5.50% for the six months ended June 30, 2014, compared to 5.22% for the same period in 2013;

lower provision for loan losses by $311.6 million, or 65%, mostly due to the decrease in the provision for loan losses on the non-covered loan portfolio of $306.0 million, mainly related to the incremental provision

of $148.8 million and $169.2 million related to the bulk sales of non-performing loans during the first and second quarters of 2013. Excluding the impact of the sales, the provision for loan losses for the non-covered portfolio increased by $6.4 million, due to macro-economic conditions in Puerto Rico and reserves for commercial and public sector exposures, offset by the reserve releases due to the annual review of the components of the allowance for loan losses. The provision for the covered portfolio declined by $5.7 million driven by lower impairment losses on loan pools accounted for under ASC 310-30; and

lower non-interest income by $13.1 million, or 11%, mainly due to:

Higher FDIC loss share expense by $49.4 million mainly due to higher amortization of the indemnification asset and lower mirror accounting on credit impairment losses, as discussed above; and

Lower income from mortgage banking activities by $ 30.9 million mainly due to higher losses on closed derivative positions and unfavorable fair value adjustments on mortgage servicing rights, offset by higher gains on securitization transactions.

The negative variances in non-interest income detailed above were partially offset by:

Lower losses on sale of loans by $59.6 million due to the impact of the sales of non performing loans completed during 2013;

167

Higher trading account income by $8.4 million due to higher volume of mortgage backed securities at higher market values;

Lower provisions for indemnity reserves by $6.8 million due to the $13.7 million aggregate provision recorded during the first and second quarters of 2013 related to the bulk sale of non-performing assets

Lower operating expenses by $55.0 million, or 11%, mainly due to lower OREO expenses due to the $37.0 million write down recorded in connection with the sale of non-performing assets during the first quarter of 2013, lower personnel costs by $10.5 million mostly due to lower pension and postretirement expenses due to changes to actuarial assumptions in pension obligations, and medical and life insurance expenses; and lower FDIC deposit insurance expense by $5.5 million due to improved asset quality and earnings trends.

Income tax expense was $21.9 million, compared to an income tax benefit of $288.6 million. The unfavorable variance of $310.5 million was mainly due higher income during 2014 and the change in statutory tax rate from 30% to 39% during the second quarter of 2013, resulting in a tax benefit of $214.2 million, as compared to a benefit of $23.4 million recognized during the second quarter of 2014, in connection with a Closing Agreement with the Puerto Rico Department of Treasury.

Banco Popular North America

For the quarter ended June 30, 2014, the reportable segment of Banco Popular North America reported net income from continuing operations of $50.9 million, compared with $15.4 million for the same quarter of the previous year. The principal factors that contributed to the variance in the financial results included the following:

higher net interest income by $2.2 million, or 5%, mainly impacted by lower interest expense from deposits by $2.4 million, or a lower cost of 27 basis points, driven by the renewal of maturities from time deposits at lower prevailing rates. The BPNA reportable segment s net interest margin was 3.25% for the quarter ended June 30, 2014, compared with 3.12% for the same period in 2013;

higher reversal of provision for loan losses by $23.3 million, principally as a result of improved credit performance. Refer to the Credit Risk Management and Loan Quality section of this MD&A for certain quality indicators and further explanations corresponding to the BPNA reportable segment;

higher non-interest income by $10.1 million, mostly due to higher gains on sale of loans by $8.4 million related to a higher volume of sales of non-performing commercial loans; and lower provision for indemnity reserves by $2.0 million.

higher operating expenses by $0.1 million, reflecting $4.6 million in restructuring charges incurred during the second quarter of 2014, related to the reorganization of PCB, partially offset by a favorable variance of $3.1 million in OREO expense due to sales of commercial OREOs.

Net income from continuing operations for the six months ended June 30, 2014 amounted to $72.0 million, compared to $23.0 million for the same period of the previous year. The principal factors that contributed to the variance in the financial results included the following:

higher net interest income by $7.2 million, or 8%, mainly impacted by lower interest expense from deposits by $5.1 million, or a lower cost of 29 basis points, driven by the renewal of maturities from time deposits at lower prevailing rates and higher income from collection of construction loans which were in non-accrual status by $2.5 million. The BPNA reportable segment s net interest margin was 3.33% for the six months ended June 30, 2014, compared with 3.14% for the same period in 2013;

168

favorable variance in the provision for loan losses by $27.9 million, principally as a result of improved credit performance, as mentioned above.

higher non-interest income by $14.4 million, mostly due to higher gains on sale of loans by $12.9 million related to a higher volume of sales of non-performing commercial loans; and lower provision for indemnity reserves for $3.2 million, partially offset by lower service charges on deposits by $1.9 million

higher operating expenses by $0.7 million, reflecting $4.6 million in restructuring charges incurred during the second quarter of 2014, related to the reorganization of PCB, partially offset by a favorable variance of $2.5 million in OREO expense due to sales of commercial OREOs and lower personnel costs by $1.4 million.

FINANCIAL CONDITION ANALYSIS

Assets

During the quarter ended June 30, 2014, the Corporation reclassified $1.8 billion in assets and $2.1 billion in liabilities to discontinued operations in the statement of financial condition as part of the reorganization of PCB. Refer to Note 3 for details of discontinued operations.

The Corporation s total assets were $36.6 billion at June 30, 2014 and $35.7 billion at December 31, 2013. Refer to the consolidated financial statements included in this report for the Corporation s consolidated statements of financial condition as of such dates.

Money market investments, trading and investment securities

Money market investments totaled $1.7 billion at June 30, 2014, compared to $858.5 million at December 31, 2013. The increase was mainly due to liquidity held in anticipation of the TARP repayment.

Trading account securities amounted to $346 million at June 30, 2014, compared to $340 million at December 31, 2013. Refer to the Market Risk section of this MD&A for a table that provides a breakdown of the trading portfolio by security type.

Investment securities available-for-sale and held-to-maturity amounted to $5.8 billion at June 30, 2014, compared with $5.4 billion at December 31, 2013. The increase in investment securities available-for-sale is mainly reflected in the categories of Obligations of US Government sponsored entities. At June 30, 2014, the investment securities available-for-sale portfolio was in unrealized net gain position of $4.3 million, compared with an unrealized net loss position of $51.1 million at December 31, 2013.

169

Table 10 provides a breakdown of the Corporation s portfolio of investment securities available-for-sale (AFS) and held-to-maturity (HTM) on a combined basis. Also, Notes 7 and 8 to the consolidated financial statements provide additional information with respect to the Corporation s investment securities AFS and HTM. The portfolio of Obligations of the Puerto Rico Government is comprised of securities with specific sources of income or revenues identified for repayments. The Corporation performs periodic credit quality review on these issuers.

Table 10 Breakdown of Investment Securities Available-for-Sale and Held-to-Maturity

(In thousands)	June 30, 2014	December 31, 2013	Variance
U.S. Treasury securities	$ 27,729	$ 28,482	$ (753)
Obligations of U.S. Government sponsored entities	2,217,230	1,629,205	588,025
Obligations of Puerto Rico, States and political subdivisions	181,846	180,258	1,588
Collateralized mortgage obligations	2,303,707	2,418,924	(115,217)
Mortgage-backed securities	1,020,048	1,135,641	(115,593)
Equity securities	4,343	4,116	227
Others	13,369	38,670	(25,301)
Total investment securities AFS and HTM	$ 5,768,272	$ 5,435,296	$ 332,976

Loans

Refer to Table 11, for a breakdown of the Corporation s loan portfolio, the principal category of earning assets. Loans covered under the FDIC loss sharing agreements are presented separately in Table 11. The risks on covered loans are significantly different as a result of the loss protection provided by the FDIC. The loss share agreement applicable to commercial (including construction) and consumer loans provides for FDIC loss sharing for five years expiring at the end of the quarter ended June 30, 2015. Also, refer to Note 9 for detailed information about the Corporation s loan portfolio composition and loan purchases and sales.

The Corporation s total loan portfolio amounted to $22.5 billion at June 30, 2014 compared to $24.7 billion at December 31, 2013. Excluding the reclassification of $1.8 billion in loans to discontinued operations, the total loan portfolio decreased by $454 million mainly in the covered loan portfolio due to the continuation of loan resolutions and the normal portfolio run-off.

Table of Contents

Table 11 Loans Ending Balances

(In thousands)	June 30, 2014	December 31, 2013	Variance
Loans not covered under FDIC loss sharing agreements:			
Commercial	$ 8,155,547	$ 10,037,184	$ (1,881,637)
Construction	179,059	206,084	(27,025)
Legacy[1]	162,941	211,135	(48,194)
Lease financing	546,868	543,761	3,107
Mortgage	6,664,448	6,681,476	(17,028)
Consumer	3,926,361	3,932,226	(5,865)
Total non-covered loans held-in-portfolio	19,635,224	21,611,866	(1,976,642)
Loans covered under FDIC loss sharing agreements:			
Commercial	1,745,967	1,812,804	(66,837)
Construction	82,763	190,127	(107,364)
Mortgage	867,075	934,373	(67,298)
Consumer	40,297	47,123	(6,826)
Total covered loans held-in-portfolio	2,736,102	2,984,427	(248,325)
Total loans held-in-portfolio	22,371,326	24,596,293	(2,224,967)
Loans held-for-sale:			
Commercial	2,895	603	2,292
Construction	949		949
Mortgage	93,166	109,823	(16,657)
Total loans held-for-sale	97,010	110,426	(13,416)
Total loans	$ 22,468,336	$ 24,706,719	$ (2,238,383)

[1] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

Non-covered loans

The non-covered loans held-in-portfolio decreased to $19.6 billion at June 30, 2014 compared to $21.6 billion at December 31, 2013. Excluding the $1.8 billion loans reclassified to discontinued operations, non-covered loans held-in-portfolio decreased by $192.6 million, mainly in the BPPR commercial loan portfolio primarily as a result of a reduction in the public sector.

The loans held-for-sale portfolio reflected a decrease of $13.4 million from December 31, 2013 to June 30, 2014; the decrease was mostly at BPPR segment driven by mortgage loans securitized and sold during the quarter.

Covered loans

The covered loans portfolio amounted to $2.7 billion at June 30, 2014, compared to $3.0 billion at December 31, 2013. The decrease of $248.3 million was mainly due to loan resolutions and the normal portfolio run-off. Refer to Table 11 for a breakdown of the covered loans by major loan type categories. Tables 12 and 13 provide the activity in the carrying amount and outstanding discount on the covered loans accounted for under ASC 310-30. The outstanding accretable discount is impacted by increases in cash flow expectations on the loan pool based on quarterly revisions of the portfolio. The increase in the accretable discount is recognized as interest income using the effective yield method over the estimated life of each applicable loan pool.

Table of Contents

Table 12 Activity in the Carrying Amount of Covered Loans Accounted for Under ASC 310-30

	Quarter ended June 30,		Six months ended June 30,	
(In thousands)	2014	2013	2014	2013
Beginning balance	$ 2,733,122	$ 3,157,663	$ 2,827,947	$ 3,491,759
Accretion	79,863	62,536	158,981	127,526
Collections / charge-offs	(202,321)	(207,333)	(376,264)	(606,419)
Ending balance	$ 2,610,664	$ 3,012,866	$ 2,610,664	$ 3,012,866
Allowance for loan losses (ALLL)	(90,892)	(91,195)	(90,892)	(91,195)
Ending balance, net of ALLL	$ 2,519,772	$ 2,921,671	$ 2,519,772	$ 2,921,671

Table 13 Activity in the Accretable Yield on Covered Loans Accounted for Under ASC 310-30

	Quarter ended June 30,		Six months ended June 30,	
(In thousands)	2014	2013	2014	2013
Beginning balance	$ 1,218,212	$ 1,372,135	$ 1,309,205	$ 1,451,669
Accretion [1]	(79,863)	(62,536)	(158,981)	(127,526)
Change in expected cash flows	142,409	70,013	130,534	55,469
Ending balance	$ 1,280,758	$ 1,379,612	$ 1,280,758	$ 1,379,612

[1] Positive to earnings, which is included in interest income.

FDIC loss share asset

Table 14 sets forth the activity in the FDIC loss share asset for the quarters and six months ended June 30, 2014 and 2013.

Table 14 Activity of Loss Share Asset

	Quarters ended June 30,		Six months ended June 30,	
(In thousands)	2014	2013	2014	2013
Balance at beginning of period	$ 833,721	$ 1,380,592	$ 948,608	$ 1,399,098
Amortization of loss share indemnification asset	(72,095)	(38,557)	(121,041)	(78,761)
Credit impairment losses to be covered under loss sharing agreements	10,372	25,338	25,462	39,383
		(193)		(386)

Decrease due to reciprocal accounting on amortization of contingent liability on unfunded commitments				
Reimbursable expenses	11,085	12,131	23,830	19,914
Payments to (from) FDIC under loss sharing agreements	(31,530)		(112,857)	107
Other adjustments attributable to FDIC loss sharing agreements		31	(12,449)	(13)
Balance at end of period	$ 751,553	$ 1,379,342	$ 751,553	$ 1,379,342

The FDIC loss share indemnification asset is recognized on the same basis as the assets subject to the loss share protection from the FDIC, except that the amortization / accretion terms differ. Decreases in expected reimbursements from the FDIC due to improvements in expected cash flows to be received from borrowers, as compared with the initial estimates, are recognized as a reduction to non-interest income prospectively over the life of the loss share agreements. This is because the indemnification asset balance is being reduced to the expected reimbursement amount from the FDIC. Table 15 presents the activity associated with the outstanding balance of the FDIC loss share asset amortization (or negative discount) for the periods presented.

Table 15 Activity in the Remaining FDIC Loss Share Asset Discount

	Quarter ended June 30,		Six months ended June 30,	
(In thousands)	2014	2013	2014	2013
Balance at beginning of period[1]	$ 71,634	$ 128,682	$ 103,691	$ 141,800
Amortization of negative discount[2]	(72,095)	(38,557)	(121,041)	(78,761)
Impact of lower projected losses	106,400	31,999	123,289	59,085
Balance at end of period	$ 105,939	$ 122,124	$ 105,939	$ 122,124

[1] Positive balance represents negative discount (debit to assets), while a negative balance represents a discount (credit to assets).

[2] Amortization results in a negative impact to non-interest income, while a positive balance results in a positive impact to non-interest income, particularly FDIC loss share (expense) income.

During the second quarter, the Corporation revised its analysis of expected cash flow which resulted in a net decrease of approximately $102.9 million in estimated credit losses, which was driven mainly by commercial loan pools. The lowered loss estimates requires the Corporation to amortize the loss share asset to its currently lower expected collectible balance, thus resulting in negative accretion. Due to the shorter life of the indemnity asset compared with the expected life of the covered loans, this negative accretion temporarily offsets the benefit of higher cash flows accounted through the accretable yield on the loans.

Other real estate owned

Other real estate owned (OREO) represents real estate property received in satisfaction of debt. At June 30, 2014, OREO decreased to $295 million from $304 million at December 31, 2013. Refer to Table 16 for the activity in other real estate owned. The amounts included as covered other real estate are subject to the FDIC loss sharing agreements.

Table 16 Other Real Estate Owned Activity

	For the quarter ended June 30, 2014				
(In thousands)	Non-covered OREO Commercial/ Construction	Non-covered OREO Mortgage	Covered OREO Commercial/ Construction	Covered OREO Mortgage	Total
Balance at beginning of period	$ 48,141	$ 88,824	$ 110,333	$ 48,414	$ 295,712
Write-downs in value	(571)	(439)	(6,635)	(940)	(8,585)
Additions	6,303	15,400	22,260	4,103	48,066
Sales	(5,372)	(12,203)	(14,792)	(3,777)	(36,144)
Other adjustments	1,286	(1,949)	(3,261)	100	(3,824)
Ending balance	$ 49,787	$ 89,633	$ 107,905	$ 47,900	$ 295,225

	For the six months ended June 30, 2014				
(In thousands)	Non-covered OREO Commercial/ Construction	Non-covered OREO Mortgage	Covered OREO Commercial/ Construction	Covered OREO Mortgage	Total
Balance at beginning of period	$ 48,649	$ 86,852	$ 120,215	$ 47,792	$ 303,508
Write-downs in value	(785)	(1,108)	(11,198)	(1,147)	(14,238)
Additions	10,971	30,283	35,454	8,594	85,302
Sales	(10,334)	(24,266)	(33,213)	(6,154)	(73,967)
Other adjustments	1,286	(2,128)	(3,353)	(1,185)	(5,380)
Ending balance	$ 49,787	$ 89,633	$ 107,905	$ 47,900	$ 295,225

	For the quarter ended June 30, 2013				
(In thousands)	Non-covered OREO	Non-covered OREO Mortgage	Covered OREO	Covered OREO Mortgage	Total

	Commercial/ Construction		Commercial/ Construction		
Balance at beginning of period	$ 79,146	$ 75,553	$ 129,413	$ 42,965	$ 327,077
Write-downs in value	(987)	(462)	(3,568)	(1,482)	(6,499)
Additions	3,940	30,337	16,879	8,064	59,220
Sales	(17,264)	(13,154)	(3,839)	(5,208)	(39,465)
Other adjustments	290	1,521		1	1,812
Ending balance	$ 65,125	$ 93,795	$ 138,885	$ 44,340	$ 342,145

	For the six months ended June 30, 2013				
	Non-covered OREO	Non-covered OREO	Covered OREO	Covered OREO	
(In thousands)	Commercial/ Construction	Mortgage	Commercial/ Construction	Mortgage	Total
Balance at beginning of period	$ 135,862	$ 130,982	$ 99,398	$ 39,660	$ 405,902
Write-downs in value	(5,886)	(7,820)	(6,673)	(1,785)	(22,164)
Additions	22,258	55,185	51,674	17,037	146,154
Sales	(87,399)	(85,171)	(5,514)	(10,464)	(188,548)
Other adjustments	290	619		(108)	801
Ending balance	$ 65,125	$ 93,795	$ 138,885	$ 44,340	$ 342,145

173

Table of Contents

Other assets

Table 17 provides a breakdown of the principal categories that comprise the caption of Other assets in the consolidated statements of financial condition at June 30, 2014 and December 31, 2013.

Table 17 Breakdown of Other Assets

(In thousands)	June 30, 2014	December 31, 2013	Variance
Net deferred tax assets (net of valuation allowance)	$ 788,732	$ 761,768	$ 26,964
Investments under the equity method	214,452	197,006	17,446
Bank-owned life insurance program	230,570	228,805	1,765
Prepaid FDIC insurance assessment	379	383	(4)
Prepaid taxes	210,079	91,504	118,575
Other prepaid expenses	73,886	67,108	6,778
Derivative assets	27,559	34,710	(7,151)
Trades receivable from brokers and counterparties	519,495	71,680	447,815
Others	227,208	234,594	(7,386)
Total other assets	$ 2,292,360	$ 1,687,558	$ 604,802

The increase in other assets from December 31, 2013 to June 30, 2014 of $604.8 million was mainly due to $450.0 million on trade receivables due to the issuance of senior notes raised near the end of the second quarter with a settlement date of July 1, 2014, to partially fund the repayment of the $935 million in trust preferred securities under TARP.

Also, prepaid taxes increased by $118.6 million mostly due to the payment of $45 million in income taxes in connection with the Closing Agreement signed with the Puerto Rico Department of Treasury on June 30, 2014, and $37.8 million of corporate personal property tax and municipal tax paid during the quarter, to be amortized over the next twelve months.

Goodwill

The decrease in goodwill from December 31, 2013 to June 30, 2014 of $187 million was the result of the non-cash write-down of the goodwill allocated, on a relative fair value basis, to the discontinued U.S. businesses. Refer to Note 16 for detailed information about the Corporation s goodwill and other intangible assets and Note 3 for more information about the discontinued U.S businesses.

Table of Contents

Deposits and Borrowings

The composition of the Corporation s financing sources to total assets at June 30, 2014 and December 31, 2013 is included in Table 18.

Table 18 Financing to Total Assets

(In millions)	June 30, 2014	December 31, 2013	% increase (decrease) from 2013 to 2014	% of total assets 2014	2013
Non-interest bearing deposits	$ 5,667	$ 5,923	(4.3)%	15.5%	16.6%
Interest-bearing core deposits	14,778	16,026	(7.8)	40.4	44.8
Other interest-bearing deposits	4,456	4,762	(6.4)	12.2	13.3
Fed funds purchased and repurchase agreements	2,075	1,659	25.1	5.7	4.6
Other short-term borrowings	31	401	(92.3)	0.1	1.1
Notes payable	2,360	1,585	48.9	6.4	4.4
Other liabilities	881	767	14.9	2.4	2.2
Liabilities from discontinued operations	2,080			5.7	
Stockholders equity	4,260	4,626	(7.9)	11.6	13.0

Deposits

The Corporation s deposits totaled $24.9 billion at June 30, 2014 compared to $26.7 billion at December 31, 2013. Excluding the reclassification of $2.1 billion in deposits to discontinued operations, deposits increased by $248.3 million mainly in demand deposit. Refer to Table 19 for a breakdown of the Corporation s deposits at June 30, 2014 and December 31, 2013.

Table 19 Deposits Ending Balances

(In thousands)	June 30, 2014	December 31, 2013	Variance
Demand deposits [1]	$ 6,412,632	$ 6,590,963	$ (178,331)
Savings, NOW and money market deposits (non-brokered)	10,276,715	11,255,309	(978,594)
Savings, NOW and money market deposits (brokered)	543,032	553,521	(10,489)
Time deposits (non-brokered)	5,790,324	6,478,103	(687,779)
Time deposits (brokered CDs)	1,878,449	1,833,249	45,200
Total deposits	$ 24,901,152	$ 26,711,145	$ (1,809,993)

[1] Includes interest and non-interest bearing demand deposits.

Borrowings

The Corporation s borrowings amounted to $4.5 billion at June 30, 2014, compared with $3.6 billion at December 31, 2013. The increase is mainly the result of the accelerated amortization of the $414.1 million discount and deferred cost of the TARP related trust preferred securities, as well as the issuance of $450.0 million in senior notes. Refer to Note 18 to the consolidated financial statements for detailed information on the Corporation s borrowings. Also, refer to the Liquidity section in this MD&A for additional information on the Corporation s funding sources.

175

Table of Contents

Other liabilities

Other liabilities increased from $766.8 million at December 31, 2013 to $880.6 million at June 30, 2014. The increase was principally driven by unsettled trades payable at the end of the period accompanied by higher income tax payable at the BPPR segment.

Stockholders Equity

Stockholders equity totaled $4.3 billion at June 30, 2014, compared with $4.6 billion at December 31, 2013. The decrease resulted from the Corporation s net loss of $424.9 million for the six months ended June 30, 2014, principally triggered by the acceleration of the amortization of discount and deferred costs related to the TARP securities, partially offset by a decrease of $58.5 million in accumulated other comprehensive loss due to net unrealized gain (losses) in the portfolio of investments securities available-for-sale. Refer to the consolidated statements of financial condition, comprehensive income and of changes in stockholders equity for information on the composition of stockholders equity.

REGULATORY CAPITAL

The Corporation continues to exceed the well-capitalized guidelines under the federal banking regulations. The regulatory capital ratios and amounts of total risk-based capital, Tier 1 risk-based capital and Tier 1 leverage at June 30, 2014 and December 31, 2013 are presented on Table 20. As of such dates, BPPR and BPNA were well-capitalized.

Table 20 Capital Adequacy Data

(Dollars in thousands)	June 30, 2014	December 31, 2013
Risk-based capital:		
Tier I capital	$ 4,591,753	$ 4,464,742
Supplementary (Tier II) capital	348,485	296,813
Total capital	$ 4,940,238	$ 4,761,555
Minimum Total capital requirement to be well capitalized	2,387,307	2,331,867
Excess Total capital	$ 2,552,931	$ 2,429,688
Risk-weighted assets:		
Balance sheet items	$ 22,083,255	$ 21,409,548
Off-balance sheet items	1,789,813	1,909,126
Total risk-weighted assets	$ 23,873,068	$ 23,318,674
Adjusted quarterly average assets	$ 35,132,145	$ 34,746,137
Ratios [1]:		

Tier I capital (minimum required 4.00%)	19.23%	19.15%
Total capital (minimum required 8.00%)	20.69	20.42
Leverage ratio [2]	13.07	12.85

[1] The well-capitalized requirement for a bank holding company under existing rules is a minimum ratio of Tier I capital to risk-weighted assets of 6% and Total capital to risk-weighted assets of 10%.

[2] All banks are required to have a minimum Tier 1 Leverage ratio of 3% or 4% of adjusted quarterly average assets, depending on the bank s classification. At June 30, 2014, the capital adequacy minimum requirement for Popular, Inc. was (in thousands): Total capital of $ 1,909,845; Tier 1 capital of $ 954,923; and Tier 1 Leverage of $ 1,053,964, based on a 3% ratio, or $ 1,405,286, based on a 4% ratio, according to the entity s classification.

The increase in the regulatory capital ratios from December 31, 2013 was driven mainly by the impact of the current six months period earnings, excluding the effect of the non-cash goodwill impairment charge which had no impact in total capital for regulatory capital purposes and the acceleration of the unamortized discount of the TARP funds. This favorable impact was partially offset by a net increase in risk-weighted assets, which included the trade receivable booked as of June 30, 2014 as part of the senior note issuance trade date accounting, which was subject to a 100% risk-weight assignment.

176

In accordance with the Federal Reserve Board guidance under its existing general risk-based capital rules, the trust preferred securities represent restricted core capital elements and qualify as Tier 1 capital, subject to certain quantitative limits. The aggregate amount of restricted core capital elements that may be included in the Tier 1 capital of a banking organization must not exceed 25% of the sum of all core capital elements (including cumulative perpetual preferred stock and trust preferred securities). Amounts of restricted core capital elements in excess of this limit generally may be included in Tier 2 capital, subject to further limitations. At June 30, 2014, the Corporation s restricted core capital elements exceeded the 25% limitation as a result of the acceleration of the unamortized discount of the TARP funds and, as a result $45 million of the outstanding trust preferred securities were included as Tier 2 capital. At December 31, 2013, the Corporation s restricted core capital elements did not exceed the 25% limitation.

Non-GAAP financial measures

The tangible common equity ratio, tangible assets and tangible book value per common share, which are presented in the table that follows, are non-GAAP measures. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase accounting method of accounting for mergers and acquisitions. Neither tangible common equity nor tangible assets or related measures should be considered in isolation or as a substitute for stockholders equity, total assets or any other measure calculated in accordance with generally accepted accounting principles in the United States of America (GAAP). Moreover, the manner in which the Corporation calculates its tangible common equity, tangible assets and any other related measures may differ from that of other companies reporting measures with similar names.

Table 21 provides a reconciliation of total stockholders equity to tangible common equity and total assets to tangible assets at June 30, 2014 and December 31, 2013.

Table 21 Reconciliation of Tangible Common Equity and Tangible Assets

(In thousands, except share or per share information)	June 30, 2014	December 31, 2013
Total stockholders equity	$ 4,260,441	$ 4,626,150
Less: Preferred stock	(50,160)	(50,160)
Less: Goodwill	(461,246)	(647,757)
Less: Other intangibles	(40,122)	(45,132)
Total tangible common equity	$ 3,708,913	$ 3,883,101
Total assets	$ 36,587,902	$ 35,749,333
Less: Goodwill	(461,246)	(647,757)
Less: Other intangibles	(40,122)	(45,132)
Total tangible assets	$ 36,086,534	$ 35,056,444
Tangible common equity to tangible assets	10.28%	11.08%
Common shares outstanding at end of period	103,472,979	103,397,699
Tangible book value per common share	$ 35.84	$ 37.56

The Tier 1 common equity to risk-weighted assets ratio is another non-GAAP measure. Ratios calculated based upon Tier 1 common equity have become a focus of regulators and investors, and management believes ratios based on Tier 1 common equity assist investors in analyzing the Corporation s capital position.

Because Tier 1 common equity is not formally defined by GAAP or, unlike Tier 1 capital, codified in the federal banking regulations currently in place as of June 30, 2014, this measure is considered to be a non-GAAP financial measure. Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied and are not audited. To mitigate these limitations, the Corporation has procedures in place to calculate these measures using the appropriate GAAP or regulatory components. Although these non-GAAP financial measures are frequently used by stakeholders in the evaluation of a company, they have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP.

Table of Contents

Table 22 provides a reconciliation of the Corporation s total common stockholders equity (GAAP) to Tier 1 common equity at June 30, 2014 and December 31, 2013 (non-GAAP).

Table 22 Reconciliation Tier 1 Common Equity

(In thousands)	June 30, 2014	December 31, 2013
Common stockholders equity	$ 4,210,281	$ 4,575,990
Less: Unrealized losses (gains) on available-for-sale securities, net of tax[1]	(4,071)	48,344
Less: Disallowed deferred tax assets[2]	(636,081)	(626,570)
Less: Disallowed goodwill and other intangible assets, net of deferred tax liability	(447,182)	(643,185)
Less: Aggregate adjusted carrying value of non-financial equity investments	(1,381)	(1,442)
Add: Adjustment of pension and postretirement benefit plans and unrealized gains (losses) on cash flow hedges, net of tax[1]	103,263	104,302
Total Tier 1 common equity	$ 3,224,829	$ 3,457,439
Tier 1 common equity to risk-weighted assets	13.51%	14.83%

[1] Under the current general risk-based capital rules, the effects of accumulated other comprehensive income or loss (AOCI) items included in shareholders equity (for example, mark-to-market adjustments to the value of securities held in the available for sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios.

[2] Approximately $159 million of the Corporation s $789 million of net deferred tax assets included as Other assets in the consolidated statement of financial condition at June 30, 2014 ($167 million and $762 million, respectively, at December 31, 2013), were included without limitation in regulatory capital pursuant to the risk-based capital guidelines, while approximately $636 million of such assets at June 30, 2014 ($627 million at December 31, 2013) exceeded the limitation imposed by these guidelines and, as disallowed deferred tax assets , were deducted in arriving at Tier 1 capital. The remaining $(6) million of the Corporation s other net deferred tax assets at June 30, 2014 ($(32) million at December 31, 2013) represented primarily the following items: (a) the deferred tax effects of unrealized gains and losses on available-for-sale debt securities, which are permitted to be excluded prior to deriving the amount of net deferred tax assets subject to limitation under the guidelines; (b) the deferred tax asset corresponding to the pension liability adjustment recorded as part of accumulated other comprehensive income; and (c) certain deferred tax liabilities associated with goodwill and other intangibles.

Table of Contents

As indicated previously, in July 2014, the Corporation completed the repayment of $935 million in TARP funds to the U.S. Treasury, as well as repurchased the warrant owned by the U.S. Treasury at a price of $3 million. The associated $935 million of capital securities (trust preferred securities) qualify for regulatory capital treatment under the federal agencies risk-based standards. The Corporation s pro-forma regulatory capital ratios and capital amounts assuming the repayment of the TARP funds had occurred as of June 30, 2014 are the following:

Table 23 Capital Adequacy Data Pro-forma with TARP Repayment

(Dollars in thousands)	Actual June 30, 2014	Pro-forma effect	Pro-forma June 30, 2014
Risk-based capital:			
Tier I common equity [1]	$ 3,224,829	$ (3,000)	$ 3,221,829
Additional Tier I capital	1,366,924	(890,162)	476,762
Total Tier I capital	$ 4,591,753	$ (893,162)	$ 3,698,591
Supplementary (Tier II) capital	348,485	(50,350)	298,135
Total capital [2]	$ 4,940,238	$ (943,512)	$ 3,996,726
Minimum Total capital requirement to be well capitalized	$ 2,387,307	$ (44,651)	$ 2,342,656
Excess Total capital	$ 2,552,931	$ (898,861)	$ 1,654,070
Risk-weighted assets:			
Balance sheet items [3]	$ 22,083,255	$ (446,512)	$ 21,636,743
Off-balance sheet items	1,789,813		1,789,813
Total risk-weighted assets	$ 23,873,068	$ (446,512)	$ 23,426,556
Adjusted quarterly average assets	$ 35,132,145	$ (24,231)	$ 35,107,914
Ratios:			
Tier I capital (minimum required 4.00%)	19.23%	(3.44)	15.79%
Total capital (minimum required 8.00%)	20.69	(3.63)	17.06
Leverage ratio	13.07	(2.54)	10.53
Tier 1 common equity [4]	13.51	0.24	13.75

[1] Refer to Table 22 for a reconciliation of Tier I common equity.

[2] Pro-forma effect includes the repurchase of the $935 million in capital securities and the repurchase of the warrant for $3 million.

[3] As of June 30, 2014, the Corporation had recorded a trade receivable for $441 million in other assets associated with the senior note issuance which settled in July 1st, 2014. The funds were used to repay the TARP funds. The trade receivable was risk-weighted at 100%, while the remaining funds used to repay TARP had 0% risk weight.

[4] Actual and pro-forma Common Tier I capital includes $414.1 million of accelerated discount amortization related to the subsequent $935 million TARP repayment. The Tier 1 common equity ratio on a pro-forma basis was impacted by the warrant and the trade receivable. The ratio is computed by dividing Tier 1 common equity by risk-weighted assets.

New Capital Rules to Implement Basel III Capital Requirements

In July 2013, the Board of Governors of the Federal Reserve System (the Board), the Office of the Comptroller of the Currency (the OCC) and the Federal Deposit Insurance Corporation (the FDIC) and together with the Board and the OCC (the Agencies) approved new rules (New Capital Rules) to establish a revised comprehensive regulatory capital framework for all U.S. banking organizations. On July 9, 2013, the New Capital Rules were approved by the Office of the Comptroller of the Currency (OCC) and (as interim final rules) by the Federal Deposit Insurance Corporation (FDIC) (together with the Board, the Agencies).

The New Capital Rules generally implement the Basel Committee on Banking Supervision s (the Basel Committee) December 2010 final capital framework referred to as Basel III for strengthening international capital standards. The New Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including Popular, BPPR and BPNA, as compared to the current U.S. general risk-based capital rules. The New Capital Rules revise the definitions and the components of regulatory capital, as well as address other issues affecting the numerator in banking institutions regulatory capital ratios. The New Capital Rules also address asset risk weights and other matters

affecting the denominator in banking institutions regulatory capital ratios and replace the existing general risk-weighting approach, which was derived from the Basel Committee s 1988 Basel I capital accords, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee s 2004 Basel II capital accords. In addition, the New Capital Rules implement certain provisions of Dodd-Frank Act, including the requirements of Section 939A to remove references to credit ratings from the federal agencies rules. The New Capital Rules are effective for Popular, BPPR and BPNA on January 1, 2015, subject to phase-in periods for certain of their components and other provisions.

Among other matters, the New Capital Rules: (i) introduce a new capital measure called Common Equity Tier 1 (CET1) and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and Additional Tier 1 capital instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to existing regulations. Under the New Capital Rules, for most banking organizations, including the Corporation, the most common form of Additional Tier 1 capital is non-cumulative perpetual preferred stock and the most common form of Tier 2 capital is subordinated notes and a portion of the allocation for loan and lease losses, in each case, subject to the New Capital Rules specific requirements.

Pursuant to the New Capital Rules, the minimum capital ratios as of January 1, 2015 will be as follows:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (that is, CET1 *plus* Additional Tier 1 capital) to risk-weighted assets;
- 8.0% Total capital (that is, Tier 1 capital *plus* Tier 2 capital) to risk-weighted assets; and
- 4% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the leverage ratio).

The New Capital Rules also introduce a new 2.5% capital conservation buffer , composed entirely of CET1, on top of the three minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. Thus, when fully phased-in on January 1, 2019, Popular, BPPR and BPNA will be required to maintain such an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) Total capital to risk-weighted assets of at least 10.5%.

The New Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1.

In addition (as noted above), under the current general risk-based capital rules, the effects of AOCI items included in shareholders equity (for example, mark-to-market adjustments to the value of securities held in the available for sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios. Pursuant to the New Capital Rules, the effects of certain AOCI items are not excluded; however, non-advanced approach banking organizations, including Popular, BPPR and BPNA, may make a one-time permanent election to continue to exclude these items. This election must be made concurrently with the first filing of certain of the Popular s, BPPR s and BPNA s periodic regulatory reports in the beginning of 2015. Popular, BPPR and BPNA expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of their securities portfolio. The New Capital Rules also preclude certain hybrid securities, such as trust preferred securities, from inclusion in bank holding companies Tier 1 capital, subject to phase-out in the case of bank holding companies that had $15 billion or more in total consolidated assets as of December 31, 2009. The Corporation s Tier I capital level at June 30, 2014, included $ 427 million of trust preferred securities that are subject to the phase-out provisions of the New Capital Rules. The Corporation would be allowed to include only 25 percent of such trust preferred securities in Tier 1 capital as of January 1, 2015 and 0 percent as of January 1, 2016, and thereafter. Trust preferred securities no longer included in Popular s Tier 1 capital may nonetheless be included as a component of Tier 2 capital on a permanent basis without phase-out and irrespective of whether such securities otherwise meet the revised definition of Tier 2 capital set forth in the New Capital Rules. The Corporation s trust preferred securities issued to the U.S. Treasury pursuant to the Emergency Economic Stabilization Act of 2008 were exempt from the phase-out provision. However, these were repurchased by the Corporation on July 2, 2014.

Implementation of the deductions and other adjustments to CET1 will begin on January 1, 2015 and will be phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer will begin on January 1, 2016 at the 0.625% level and increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019.

With respect to BPPR and BPNA, the New Capital Rules revise the prompt corrective action (PCA) regulations adopted pursuant to Section 38 of the Federal Deposit Insurance Act, by: (i) introducing a CET1 ratio requirement at each PCA category (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the current 6%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3% leverage ratio and still be adequately capitalized. The New Capital Rules do not change the total risk-based capital requirement for any PCA category.

The New Capital Rules prescribe a new standardized approach for risk weightings that expand the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a larger and more risk-sensitive number of categories, depending on the nature of the assets, and resulting in higher risk weights for a variety of asset classes.

The Corporation has evaluated the impact of the New Capital Rules on our regulatory capital ratios and estimates a reduction of approximately 103 basis points to our Basel I Tier I Common risk-based capital ratio based on our June 30, 2014 balance sheet composition, assuming the TARP repayment and a full phase-in of the New Capital Rules. The following table presents a preliminary estimate of the computation of the Corporation s regulatory capital ratios and risk-weighted assets on a fully-phased in basis under the methodologies set forth in the New Capital Rules based on our current understanding of those Rules and subject to certain assumptions.

We believe that Popular, BPPR and BPNA will be able to meet the required well-capitalized capital ratios on a Basel III basis.

Table of Contents

Table 24 Estimated Regulatory Capital Ratios Under Basel III Rules Fully Phased-in-Basis

(Dollars in thousands)		June 30, 2014 adjusted to reflect the TARP repayment
Tier I common equity (Basel I)	$	3,221,829
Adjustment related to capital components		10,022
Estimated Tier I common equity under Basel III rules without AOCI	$	3,231,851
Additional Tier I equity (Basel I)	$	476,762
Adjustment related to capital components		(426,602)
Estimated additional Tier I equity under Basel III rules	$	50,160
Tier II capital (Basel I)	$	298,135
Adjustment related to capital components		450,441
Estimated Tier II capital under Basel III rules	$	748,576
Total capital (Basel I)	$	3,996,726
Adjustment related to capital components		33,861
Estimated total capital under Basel III rules	$	4,030,587
Risk-weighted assets under Basel I rules	$	23,426,556
Adjustment related to RWA components		1,973,497
Estimated risk-weighted assets under Basel III rules	$	25,400,053
Estimated ratios:		
Tier I capital		12.92%
Tier I common equity		12.72
Total capital		15.87
Leverage		9.34

Contractual Obligations and Commercial Commitments

The Corporation has various financial obligations, including contractual obligations and commercial commitments, which require future cash payments on debt and lease agreements. Also, in the normal course of business, the Corporation enters into contractual arrangements whereby it commits to future purchases of products or services from third parties. Obligations that are legally binding agreements, whereby the Corporation agrees to purchase products or services with a specific minimum quantity defined at a fixed, minimum or variable price over a specified period of

time, are defined as purchase obligations.

Purchase obligations include major legal and binding contractual obligations outstanding at June 30, 2014, primarily for services, equipment and real estate construction projects. Services include software licensing and maintenance, facilities maintenance, supplies purchasing, and other goods or services used in the operation of the business. Generally, these contracts are renewable or cancelable at least annually, although in some cases the Corporation has committed to contracts that may extend for several years to secure favorable pricing concessions. Purchase obligations amounted to $245 million at June 30, 2014 of which approximately 50% matures in 2014, 21% in 2015, 14% in 2016 and 15% thereafter.

182

The Corporation also enters into derivative contracts under which it is required either to receive or pay cash, depending on changes in interest rates. These contracts are carried at fair value on the consolidated statement of financial condition with the fair value representing the net present value of the expected future cash receipts and payments based on market rates of interest as of the statement of condition date. The fair value of the contract changes daily as interest rates change. The Corporation may also be required to post additional collateral on margin calls on the derivatives and repurchase transactions.

Refer to Note 18 for a breakdown of long-term borrowings by maturity.

The Corporation utilizes lending-related financial instruments in the normal course of business to accommodate the financial needs of its customers. The Corporation s exposure to credit losses in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit and commercial letters of credit is represented by the contractual notional amount of these instruments. The Corporation uses credit procedures and policies in making those commitments and conditional obligations as it does in extending loans to customers. Since many of the commitments may expire without being drawn upon, the total contractual amounts are not representative of the Corporation s actual future credit exposure or liquidity requirements for these commitments.

Table 25 presents the contractual amounts related to the Corporation s off-balance sheet lending and other activities at June 30, 2014.

Table 25 Off-Balance Sheet Lending and Other Activities

	Amount of commitment - Expiration Period				
(In millions)	Remaining 2014	Years 2015 - 2016	Years 2017 - 2018	Years 2019 - thereafter	Total
Commitments to extend credit	$ 5,592	$ 1,050	$ 198	$ 102	$ 6,942
Commercial letters of credit	5				5
Standby letters of credit	20	28			48
Commitments to originate or fund mortgage loans	20	13			33
Unfunded investment obligations	1	9			10
Total	$ 5,638	$ 1,100	$ 198	$ 102	$ 7,038

Note: Commitments to extend credit and standby letters of credit exclude $111.5 million from discontinued operations.

At June 30, 2014 and December 31, 2013, the Corporation maintained a reserve of approximately $4 million and $7 million, respectively, for probable losses associated with unfunded loan commitments related to commercial and consumer lines of credit. The estimated reserve is principally based on the expected draws on these facilities using historical trends and the application of the corresponding reserve factors determined under the Corporation s allowance for loan losses methodology. This reserve for unfunded loan commitments remains separate and distinct from the allowance for loan losses and is reported as part of other liabilities in the consolidated statement of financial condition.

Refer to Note 24 to the consolidated financial statements for additional information on credit commitments and contingencies.

Guarantees associated with loans sold / serviced

At June 30, 2014, the Corporation serviced $2.3 billion in residential mortgage loans subject to lifetime credit recourse provisions, principally loans associated with FNMA and FHLMC residential mortgage loan securitization programs, compared with $2.5 billion at December 31, 2013. The Corporation s last sale of mortgage loans subject to credit recourse was in 2009.

In the event of any customer default, pursuant to the credit recourse provided, the Corporation is required to repurchase the loan or reimburse the third party investor for the incurred loss. The maximum potential amount of future payments that the Corporation would be required to make under the recourse arrangements in the event of nonperformance by the borrowers is equivalent to the total outstanding balance of the residential mortgage loans serviced with recourse and interest, if applicable. In the event of nonperformance by the borrower, the Corporation has rights to the underlying collateral securing the mortgage loan. The

Table of Contents

Corporation suffers losses on these loans when the proceeds from a foreclosure sale of the property underlying a defaulted mortgage loan are less than the outstanding principal balance of the loan plus any uncollected interest advanced and the costs of holding and disposing the related property.

In the case of Puerto Rico, most claims are settled by repurchases of delinquent loans, the majority of which are greater than 90 days past due. The average time period to prepare an initial response to a repurchase request is from 30 to 120 days from the initial written notice depending on the type of repurchase request. Failure by the Corporation to respond to a request for repurchase on a timely basis could result in a deterioration of the seller/servicer relationship and the seller/servicer s overall standing. In certain instances, investors could require additional collateral to ensure compliance with the servicer s repurchase obligation or cancel the seller/servicer license and exercise their rights to transfer the servicing to an eligible seller/servicer.

Table 26 below presents the delinquency status of the residential mortgage loans serviced by the Corporation that are subject to lifetime credit recourse provisions.

Table 26 Delinquency of Residential Mortgage Loans Subject to Lifetime Credit Recourse

(In thousands)	June 30, 2014	December 31, 2013
Total portfolio	$ 2,304,197	$ 2,524,155
Days past due:		
30 days and over	$ 281,092	$ 347,046
90 days and over	$ 123,876	$ 138,018
As a percentage of total portfolio:		
30 days past due or more	12.20%	13.75%
90 days past due or more	5.38%	5.47%

During the second quarter and six months ended June 30, of 2014, the Corporation repurchased approximately $21 million and $48 million, respectively, (unpaid principal balance) in mortgage loans subject to the credit recourse provisions, compared with $36 million and $66 million, respectively, during the same periods of 2013. Based on historical repurchase experience, the loan delinquency status is the main factor which causes the repurchase request. Once the loans are repurchased, they are put through the Corporation s loss mitigation programs.

At June 30, 2014, there was ten outstanding unresolved claim related to the credit recourse portfolio with a principal balance outstanding of $1.2 million, compared with five claims with an outstanding balance of $769 thousand at December 31, 2013. The outstanding unresolved claims at June 30, 2014 pertain to FNMA and Freddie Mac and to FNMA at December 31, 2013.

At June 30, 2014, the Corporation s liability established to cover the estimated credit loss exposure related to loans sold or serviced with credit recourse amounted to $48 million, compared with $41 million at December 31, 2013.

The following table presents the changes in the Corporation s liability for estimated losses related to loans serviced with credit recourse provisions for the quarters and six months ended June 30, 2014 and 2013.

Table 27 Changes in Liability of Estimated Losses from Credit Recourse Agreements

(In thousands)	Quarters ended June 30, 2014	Quarters ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Balance as of beginning of period	$ 45,809	$ 47,983	$ 41,463	$ 51,673
Provision for recourse liability	7,984	6,688	19,026	10,785
Net charge-offs / terminations	(5,901)	(8,779)	(12,597)	(16,566)
Balance as of end of period	$ 47,892	$ 45,892	$ 47,892	$ 45,892

The provision for credit recourse liability increased by $8.2 million during the six months ended June 30 2014, when compared with the same period in 2013, due to certain enhancements in the estimated losses for credit recourse at BPPR.

The estimated losses to be absorbed under the credit recourse arrangements are recorded as a liability when the loans are sold or credit recourse is assumed as part of acquired servicing rights and are updated by accruing or reversing expense (categorized in the line item adjustments (expense) to indemnity reserves on loans sold in the consolidated statements of operations) throughout the life of the loan, as necessary, when additional relevant information becomes available. The methodology used to estimate the recourse liability is a function of the recourse arrangements given and considers a variety of factors, which include actual defaults and historical loss experience, foreclosure rate, estimated future defaults and the probability that a loan would be delinquent. Statistical methods are used to estimate the recourse liability. Expected loss rates are applied to different loan segmentations. The expected loss, which represents the amount expected to be lost on a given loan, considers the probability of default and loss severity. The probability of default represents the probability that a loan in good standing would become 90 days delinquent within the following twelve-month period. Regression analysis quantifies the relationship between the default event and loan-specific characteristics, including credit scores, loan-to-value ratios and loan aging, among others.

Servicing agreements relating to the mortgage-backed securities programs of FNMA and GNMA, and to mortgage loans sold or serviced to certain other investors, including FHLMC, require the Corporation to advance funds to make scheduled payments of principal, interest, taxes and insurance, if such payments have not been received from the borrowers. At June 30, 2014, the Corporation serviced $16.1 billion in mortgage loans for third-parties, including the loans serviced with credit recourse, compared with $16.3 billion at December 31, 2013. The Corporation generally recovers funds advanced pursuant to these arrangements from the mortgage borrower, from liquidation proceeds when the mortgage loan is foreclosed or, in the case of FHA/VA loans, under the applicable FHA and VA insurance and guarantees programs. However, in the meantime, the Corporation must absorb the cost of the funds it advances during the time the advance is outstanding. The Corporation must also bear the costs of attempting to collect on delinquent and defaulted mortgage loans. In addition, if a defaulted loan is not cured, the mortgage loan would be canceled as part of the foreclosure proceedings and the Corporation would not receive any future servicing income with respect to that loan. At June 30, 2014, the outstanding balance of funds advanced by the Corporation under such mortgage loan servicing agreements was approximately $24 million, compared with $29 million during 2013. To the extent the mortgage loans underlying the Corporation s servicing portfolio experience increased delinquencies, the Corporation would be required to dedicate additional cash resources to comply with its obligation to advance funds as well as incur additional administrative costs related to increases in collection efforts.

When the Corporation sells or securitizes mortgage loans, it generally makes customary representations and warranties regarding the characteristics of the loans sold. The Corporation s mortgage operations in Puerto Rico conform mortgage loans into pools which are exchanged for FNMA and GNMA mortgage-backed securities, which are generally sold to private investors, or are sold directly to FNMA for cash. As required under the government agency programs, quality review procedures are performed by the Corporation to ensure that asset guideline qualifications are met. To the extent the loans do not meet specified characteristics, the Corporation may be required to repurchase such loans or indemnify for losses and bear any subsequent loss related to the loans. Repurchases under representation and warranty arrangements in which the Corporation s Puerto Rico banking subsidiaries were required to repurchase the loans amounted to $2.2 million in unpaid principal balance with losses amounting to $1.6 million during the six months ended June 30, 2014. A substantial amount of these loans reinstate to performing status or have mortgage insurance, and thus the ultimate losses on the loans are not deemed significant.

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

from the purchaser, which are currently being evaluated.

During the quarter ended March 31, 2013, the Corporation established a reserve for certain specific representation and warranties made in connection with BPPR s sale of commercial and construction loans, and commercial and single family real estate owned. The purchaser s sole remedy under the indemnity clause is to seek monetary damages from BPPR, for a maximum of $18.0 million. BPPR is not required to repurchase any of the assets. BPPR recognized a reserve of approximately $10.7 million, representing its best estimate of the loss that would be incurred in connection with this indemnification. During the quarter ended March 31, 2014, the Corporation released $2.0 million of this reserve based on an evaluation of claims received under this clause.

The following table presents the changes in the Corporation s liability for estimated losses associated with indemnifications and customary representations and warranties related to loans sold by BPPR during the quarters and six months ended June 30, 2014 and 2013.

185

Table of Contents

Table 28 Changes in Liability of Estimated Losses from Indemnifications and Customary Representations and Warranties Agreements

	Quarters ended June 30,		Six months ended June 30,	
(In thousands)	2014	2013	2014	2013
Balance as of beginning of period	$ 23,731	$ 17,603	$ 26,261	$ 7,587
Additions for new sales		3,047		13,747
Provision (reversal) for representation and warranties	(1,647)	415	(2,663)	125
Net charge-offs / terminations	(504)	(106)	(2,018)	(500)
Balance as of end of period	$ 21,580	$ 20,959	$ 21,580	$ 20,959

In addition, at June 30, 2014, the Corporation has reserves for customary representations and warranties related to loans sold by its U.S. subsidiary E-LOAN prior to 2009. Loans were sold to investors on a servicing released basis subject to certain representations and warranties. Although the risk of loss or default was generally assumed by the investors, the Corporation made certain representations relating to borrower creditworthiness, loan documentation and collateral, which if not correct, may result in requiring the Corporation to repurchase the loans or indemnify investors for any related losses associated with these loans. At June 30, 2014 and December 31, 2013, the Corporation s reserve for estimated losses from such representation and warranty arrangements amounted to $5 million and $7 million, respectively. E-LOAN is no longer originating and selling loans since the subsidiary ceased these activities in 2008 and most of the outstanding agreements with major counterparties were settled during 2010 and 2011.

MARKET RISK

The financial results and capital levels of Popular, Inc. are constantly exposed to market risk. Market risk represents the risk of loss due to adverse movements in market rates or financial asset prices, which include interest rates, foreign exchange rates, and bond and equity security prices; the failure to meet financial obligations coming due because of the inability to liquidate assets or obtain adequate funding; and the inability to easily unwind or offset specific exposures without significantly lowering prices because of inadequate market depth or market disruptions.

While the Corporation is exposed to various business risks, the risks relating to interest rate risk and liquidity are major risks that can materially impact future results of operations and financial condition due to their complexity and dynamic nature.

The Asset Liability Management Committee (ALCO) and the Corporate Finance Group are responsible for planning and executing the Corporation s market, interest rate risk, funding activities and strategy, and for implementing the policies and procedures approved by the Corporation s Risk Management Committee. In addition, the Risk Management Group independently monitors and reports adherence with established market and liquidity policies and recommends actions to enhance and strengthen controls surrounding interest, liquidity, and market risks. The ALCO meets mostly on a weekly basis and reviews the Corporation s current and forecasted asset and liability positions as well as desired pricing strategies and other relevant topics. Also, on a monthly basis the ALCO reviews various interest rate risk metrics, ratios and portfolio information, including but not limited to, the Corporation s liquidity positions, projected sources and uses of funds, interest rate risk positions and economic conditions.

Interest rate risk (IRR), a component of market risk, is considered by management as a predominant market risk in terms of its potential impact on profitability or market value. Management utilizes various tools to assess IRR,

including simulation modeling, static gap analysis, and Economic Value of Equity (EVE). The three methodologies complement each other and are use jointly in the evaluation of the Corporation s IRR. Simulation modeling is prepared for a five year period, which in conjunction with the EVE analysis, provides Management a better view of long term IRR.

Net interest income simulation analysis performed by legal entity and on a consolidated basis is a tool used by the Corporation in estimating the potential change in future net interest income resulting from hypothetical changes in interest rates. Sensitivity analysis is calculated using a simulation model which incorporates actual balance sheet figures detailed by maturity and interest yields or costs. It also incorporates assumptions on balance sheet growth and expected changes in its composition, estimated prepayments in accordance with projected interest rates, pricing and maturity expectations on new volumes and other non-interest related data.

Management assesses interest rate risk using various interest rate scenarios that differ in magnitude and direction, the speed of change and the projected shape of the yield curve. For example, the types of interest rate scenarios processed include most likely economic scenarios, flat or unchanged rates, yield curve twists, + 200 and + 400 basis points parallel ramps and + 200 and + 400

186

basis points parallel shocks. Given the fact that some market interest rates are close to zero, management has focused on measuring the risk on net interest income in rising rate scenarios. Management also performs analyses to isolate and measure basis and prepayment risk exposures.

The asset and liability management group also evaluates the reasonableness of assumptions used and results obtained in the monthly sensitivity analyses. In addition, the model and processes used to assess IRR are subject to third-party validations according to the guidelines established in the Model Governance and Validation policy. Due to the importance of critical assumptions in measuring market risk, the risk models incorporate third-party developed data for critical assumptions such as prepayment speeds on mortgage loans and mortgage-backed securities, estimates on the duration of the Corporation s deposits and interest rate scenarios.

The Corporation runs net interest income simulations under interest rate scenarios in which the yield curve is assumed to rise gradually by the same amount. The rising rate scenarios considered in these market risk disclosures reflect gradual parallel changes of 200 and 400 basis points during the twelve-month period ending June 30, 2015. Under a 200 basis points rising rate scenario, projected net interest income increases by $33 million, while under a 400 basis points rising rate scenario, projected net interest income increases by $54 million, when compared against the Corporation s flat or unchanged interest rates forecast scenario. These interest rate simulations exclude the impact on loans accounted pursuant to ASC Subtopic 310-30, whose yields are based on management s current expectation of future cash flows.

Simulation analyses are based on many assumptions, including relative levels of market interest rates, interest rate spreads, loan prepayments and deposit decay. They should not be relied upon as indicative of actual results. Further, the estimates do not contemplate actions that management could take to respond to changes in interest rates. By their nature, these forward-looking computations are only estimates and may be different from what may actually occur in the future.

The Corporation estimates the sensitivity of economic value of equity to changes in interest rates. EVE is equal to the estimated present value of the Corporation s assets minus the estimated present value of the liabilities. This sensitivity analysis is a useful tool to measure long-term IRR because it captures the impact of rate changes in expected cash flows from all future periods, including principal and interest.

EVE sensitivity using interest rate shock scenarios is estimated on a quarterly basis. The current EVE sensitivity is focused on rising 200 and 400 basis point parallel shocks. Management has a defined limit for the increase in EVE sensitivity resulting from the shock scenario.

The Corporation maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in net interest income or market value that are caused by interest rate volatility. The market value of these derivatives is subject to interest rate fluctuations and counterparty credit risk adjustments which could have a positive or negative effect in the Corporation s earnings.

Trading

The Corporation engages in trading activities in the ordinary course of business at its subsidiaries, Banco Popular de Puerto Rico (BPPR) and Popular Securities. Popular Securities trading activities consist primarily of market-making activities to meet expected customers needs related to its retail brokerage business and purchases and sales of U.S. Government and government sponsored securities with the objective of realizing gains from expected short-term price movements. BPPR s trading activities consist primarily of holding U.S. Government sponsored mortgage-backed securities classified as trading and hedging the related market risk with TBA (to-be-announced) market transactions.

The objective is to derive spread income from the portfolio and not to benefit from short-term market movements. In addition, BPPR uses forward contracts or TBAs to hedge its securitization pipeline. Risks related to variations in interest rates and market volatility are hedged with TBAs that have characteristics similar to that of the forecasted security and its conversion timeline.

At June 30, 2014, the Corporation held trading securities with a fair value of $346 million, representing approximately 1.0% of the Corporation s total assets, compared with $340 million and 1.0% at December 31, 2013. As shown in Table 29, the trading portfolio consists principally of mortgage-backed securities, which at June 30, 2014 were investment grade securities. As of June 30, 2014, the trading portfolio also included $10.3 million in Puerto Rico government obligations and shares of Closed-end funds that invest primarily in Puerto Rico government obligations (December 31, 2013 - $11.1 million) held by Popular Securities. Trading instruments are recognized at fair value, with changes resulting from fluctuations in market prices, interest rates or exchange rates reported in current period earnings. The Corporation recognized a net trading account gain of $1.1 million for the quarter ended June 30, 2014 and a trading account loss of $4.3 million for the quarter ended June 30, 2013. Table 29 provides the composition of the trading portfolio at June 30, 2014 and December 31, 2013.

187

Table of Contents

Table 29 Trading Portfolio

	June 30, 2014		December 31, 2013	
(Dollars in thousands)	Amount	Weighted Average Yield [1]	Amount	Weighted Average Yield [1]
Mortgage-backed securities	$ 317,082	4.82%	$ 312,751	4.90%
Collateralized mortgage obligations	1,845	4.81	1,849	4.75
Puerto Rico obligations	8,197	5.14	7,586	5.15
Interest-only strips	842	12.16	915	12.01
Other (includes related trading derivatives)	17,857	2.63	16,642	3.14
Total	$ 345,823	4.73%	$ 339,743	4.84%

[1] Not on a taxable equivalent basis.

The Corporation s trading activities are limited by internal policies. For each of the two subsidiaries, the market risk assumed under trading activities is measured by the 5-day net value-at-risk (VAR), with a confidence level of 99%. The VAR measures the maximum estimated loss that may occur over a 5-day holding period, given a 99% probability. Under the Corporation s current policies, trading exposures cannot exceed 2% of the trading portfolio market value of each subsidiary, subject to a cap.

The Corporation s trading portfolio had a 5-day VAR of approximately $1.5 million, assuming a confidence level of 99%, for the last week in June 2014. There are numerous assumptions and estimates associated with VAR modeling, and actual results could differ from these assumptions and estimates. Backtesting is performed to compare actual results against maximum estimated losses, in order to evaluate model and assumptions accuracy.

In the opinion of management, the size and composition of the trading portfolio does not represent a significant source of market risk for the Corporation.

FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS

The Corporation currently measures at fair value on a recurring basis its trading assets, available-for-sale securities, derivatives, mortgage servicing rights and contingent consideration. Occasionally, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as loans held-for-sale, impaired loans held-in-portfolio that are collateral dependent and certain other assets. These nonrecurring fair value adjustments typically result from the application of lower of cost or fair value accounting or write-downs of individual assets.

The Corporation categorizes its assets and liabilities measured at fair value under the three-level hierarchy. The level within the hierarchy is based on whether the inputs to the valuation methodology used for fair value measurement are observable.

Refer to Note 27 to the consolidated financial statements for information on the Corporation s fair value measurement disclosures required by the applicable accounting standard. At June 30, 2014, approximately $ 6.0 billion, or 97%, of the assets measured at fair value on a recurring basis used market-based or market-derived valuation inputs in their

valuation methodology and, therefore, were classified as Level 1 or Level 2. The majority of instruments measured at fair value were classified as Level 2, including U.S. Treasury securities, obligations of U.S. Government sponsored entities, obligations of Puerto Rico, States and political subdivisions, most mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs), and derivative instruments.

At June 30, 2014, the remaining 3% of assets measured at fair value on a recurring basis were classified as Level 3 since their valuation methodology considered significant unobservable inputs. The financial assets measured as Level 3 included mostly tax-exempt GNMA mortgage-backed securities and mortgage servicing rights (MSRs). Additionally, the Corporation reported $77 million of financial assets that were measured at fair value on a nonrecurring basis at June 30, 2014, all of which were classified as Level 3 in the hierarchy.

Broker quotes used for fair value measurements inherently reflect any lack of liquidity in the market since they represent an exit price from the perspective of the market participants. Financial assets that were fair valued using broker quotes amounted to $ 29 million at June 30, 2014, of which $ 14 million were Level 3 assets and $ 15 million were Level 2 assets. Level 3 assets consisted principally of tax-exempt GNMA mortgage-backed securities. Fair value for these securities was based on an internally-prepared matrix derived from an average of two indicative local broker quotes. The main input used in the matrix pricing was non-binding local broker quotes obtained from limited trade activity. Therefore, these securities were classified as Level 3.

During the quarter and six months ended June 30, 2014, there were no transfers in and/or out of Level 1, Level 2 and Level 3 for financial instruments measured at fair value on a recurring basis. Refer to the Critical Accounting Policies / Estimates in the 2013 Annual Report for additional information on the accounting guidance and the Corporation s policies or procedures related to fair value measurements.

Trading Account Securities and Investment Securities Available-for-Sale

The majority of the values for trading account securities and investment securities available-for-sale are obtained from third-party pricing services and are validated with alternate pricing sources when available. Securities not priced by a secondary pricing source are documented and validated internally according to their significance to the Corporation s financial statements. Management has established materiality thresholds according to the investment class to monitor and investigate material deviations in prices obtained from the primary pricing service provider and the secondary pricing source used as support for the valuation results. During the quarter and six months ended June 30, 2014, the Corporation did not adjust any prices obtained from pricing service providers or broker dealers.

Inputs are evaluated to ascertain that they consider current market conditions, including the relative liquidity of the market. When a market quote for a specific security is not available, the pricing service provider generally uses observable data to derive an exit price for the instrument, such as benchmark yield curves and trade data for similar products. To the extent trading data is not available, the pricing service provider relies on specific information including dialogue with brokers, buy side clients, credit ratings, spreads to established benchmarks and transactions on similar securities, to draw correlations based on the characteristics of the evaluated instrument. If for any reason the pricing service provider cannot observe data required to feed its model, it discontinues pricing the instrument. During the quarter and six months ended June 30, 2014, none of the Corporation s investment securities were subject to pricing discontinuance by the pricing service providers. The pricing methodology and approach of our primary pricing service providers is concluded to be consistent with the fair value measurement guidance.

Furthermore, management assesses the fair value of its portfolio of investment securities at least on a quarterly basis, which includes analyzing changes in fair value that have resulted in losses that may be considered other-than-temporary. Factors considered include, for example, the nature of the investment, severity and duration of possible impairments, industry reports, sector credit ratings, economic environment, creditworthiness of the issuers and any guarantees.

Securities are classified in the fair value hierarchy according to product type, characteristics and market liquidity. At the end of each period, management assesses the valuation hierarchy for each asset or liability measured. The fair value measurement analysis performed by the Corporation includes validation procedures and review of market changes, pricing methodology, assumption and level hierarchy changes, and evaluation of distressed transactions.

At June 30, 2014, the Corporation s portfolio of trading and investment securities available-for-sale amounted to $ 6.0 billion and represented 97% of the Corporation s assets measured at fair value on a recurring basis. At June 30, 2014, net unrealized gains on the trading and available-for-sale investments securities portfolios approximated $11 million

and $4 million, respectively. Fair values for most of the Corporation s trading and investment securities available-for-sale were classified as Level 2. Trading and investment securities available-for-sale classified as Level 3, which were the securities that involved the highest degree of judgment, represented less than 1% of the Corporation s total portfolio of trading and investment securities available-for-sale.

Mortgage Servicing Rights

Mortgage servicing rights (MSRs), which amounted to $ 152 million at June 30, 2014, do not trade in an active, open market with readily observable prices. Fair value is estimated based upon discounted net cash flows calculated from a combination of loan level data and market assumptions. The valuation model combines loans with common characteristics that impact servicing cash flows (e.g. investor, remittance cycle, interest rate, product type, etc.) in order to project net cash flows. Market valuation assumptions include prepayment speeds, discount rate, cost to service, escrow account earnings, and contractual servicing fee income, among other considerations. Prepayment speeds are derived from market data that is more relevant to the U.S. mainland loan portfolios and, thus, are adjusted for the Corporation s loan characteristics and portfolio behavior since prepayment rates in Puerto Rico have

189

been historically lower. Other assumptions are, in the most part, directly obtained from third-party providers. Disclosure of two of the key economic assumptions used to measure MSRs, which are prepayment speed and discount rate, and a sensitivity analysis to adverse changes to these assumptions, is included in Note 13 to the consolidated financial statements.

Derivatives

Derivatives, such as interest rate swaps and indexed options, are traded in over-the-counter active markets. These derivatives are indexed to an observable interest rate benchmark, such as LIBOR or equity indexes, and are priced using an income approach based on present value and option pricing models using observable inputs. Other derivatives are liquid and have quoted prices, such as forward contracts or to be announced securities (TBAs). All of these derivatives held by the Corporation were classified as Level 2. Valuations of derivative assets and liabilities reflect the values associated with counterparty risk and nonperformance risk, respectively. The non-performance risk, which measures the Corporation s own credit risk, is determined using internally-developed models that consider the net realizable value of the collateral posted, remaining term, and the creditworthiness or credit standing of the Corporation. The counterparty risk is also determined using internally-developed models which incorporate the creditworthiness of the entity that bears the risk, net realizable value of the collateral received, and available public data or internally-developed data to determine their probability of default. To manage the level of credit risk, the Corporation employs procedures for credit approvals and credit limits, monitors the counterparties credit condition, enters into master netting agreements whenever possible and, when appropriate, requests additional collateral. During the quarter ended June 30, 2014, inclusion of credit risk in the fair value of the derivatives resulted in a net gain of $0.4 million recorded in the other operating income and interest expense captions of the consolidated statement of operations, which consisted of a loss of $0.2 million from the assessment of the counterparties credit risk and a gain of $0.6 million resulting from the Corporation s own credit standing adjustment. During the six months ended June 30, 2014, inclusion of credit risk in the fair value of the derivatives resulted in a net gain of $1.5 million recorded in the other operating income and interest expense captions of the consolidated statement of operations, which consisted of a gain of $1.0 million resulting from assessment of the counterparties credit risk and a gain of $0.5 million resulting from the Corporation s own credit standing adjustment.

Loans held-in-portfolio considered impaired under ASC Section 310-10-35 that are collateral dependent

The impairment is based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations, size and supply and demand. Deterioration of the housing markets and the economy in general have adversely impacted and continue to affect the market activity related to real estate properties. These collateral dependent impaired loans are classified as Level 3 and are reported as a nonrecurring fair value measurement.

LIQUIDITY

The objective of effective liquidity management is to ensure that the Corporation has sufficient liquidity to meet all of its financial obligations, finance expected future growth and maintain a reasonable safety margin for cash commitments under both normal and stressed market conditions. The Board is responsible for establishing the Corporation s tolerance for liquidity risk, including approving relevant risk limits and policies. The Board has delegated the monitoring of these risks to the RMC and the ALCO. The management of liquidity risk, on a long-term and day-to-day basis, is the responsibility of the Corporate Treasury Division. The Corporation s Corporate Treasurer is responsible for implementing the policies and procedures approved by the Board and for monitoring the Corporation s liquidity position on an ongoing basis. Also, the Corporate Treasury Division coordinates corporate wide liquidity management strategies and activities with the reportable segments, oversees policy breaches and manages the escalation process. The Financial and Operational Risk Management Division is responsible for the independent monitoring and reporting of adherence with established policies.

An institution s liquidity may be pressured if, for example, its credit rating is downgraded, it experiences a sudden and unexpected substantial cash outflow, or some other event causes counterparties to avoid exposure to the institution. Factors that the Corporation does not control, such as the economic outlook, adverse ratings of its principal markets and regulatory changes, could also affect its ability to obtain funding.

Liquidity is managed by the Corporation at the level of the holding companies that own the banking and non-banking subsidiaries. It is also managed at the level of the banking and non-banking subsidiaries. The Corporation has adopted policies and limits to monitor more effectively the Corporation s liquidity position and that of the banking subsidiaries. Additionally, contingency funding plans are used to model various stress events of different magnitudes and affecting different time horizons that assist management in evaluating the size of the liquidity buffers needed if those stress events occur. However, such models may not predict accurately how the market and customers might react to every event, and are dependent on many assumptions.

Deposits, including customer deposits, brokered deposits and public funds deposits, continue to be the most significant source of funds for the Corporation, funding 68% of the Corporation s total assets at June 30, 2014, compared with 75% at December 31, 2013. The ratio of total ending loans to deposits was 90% at June 30, 2014, compared to 93% at December 31, 2013. In addition to traditional deposits, the Corporation maintains borrowing arrangements. At June 30, 2014, these borrowings consisted primarily of $ 1.8 billion in assets sold under agreement to repurchase, $541 million in advances with the FHLB, $1.4 billion in junior subordinated deferrable interest debentures related to trust preferred securities and $450 million in term notes issued to partially fund the repayment of TARP funds. A detailed description of the Corporation s borrowings, including their terms, is included in Note 18 to the consolidated financial statements. Also, the consolidated statements of cash flows in the accompanying consolidated financial statements provide information on the Corporation s cash inflows and outflows.

On April 22, 2014 the Corporation s U.S. bank subsidiary (PCB) declared a $250 million cash dividend to the Bank Holding Company (BHC), $100 million of which was contributed by the BHC to the Puerto Rico banking subsidiary (BPPR).

The following sections provide further information on the Corporation s major funding activities and needs, as well as the risks involved in these activities. A detailed description of the Corporation s borrowings and available lines of credit, including its terms, is included in Note 18 to the consolidated financial statements. Also, the consolidated statements of cash flows in the accompanying consolidated financial statements provide information on the Corporation s cash inflows and outflows.

Banking Subsidiaries

Primary sources of funding for the Corporation s banking subsidiaries (BPPR and BPNA), or the banking subsidiaries, include retail and commercial deposits, brokered deposits, unpledged investment securities, and, to a lesser extent, loan sales. In addition, the Corporation maintains borrowing facilities with the FHLB and at the discount window of the Fed, and has a considerable amount of collateral pledged that can be used to quickly raise funds under these facilities.

The principal uses of funds for the banking subsidiaries include loan originations, investment portfolio purchases, loan purchases and repurchases, repayment of outstanding obligations (including deposits), and operational expenses. Also, the banking subsidiaries assume liquidity risk related to collateral posting requirements for certain activities mainly in connection with contractual commitments, recourse provisions, servicing advances, derivatives, credit card licensing agreements and support to several mutual funds administered by BPPR.

Table of Contents

Note 38 to the consolidated financial statements provides a consolidating statement of cash flows which includes the Corporation s banking subsidiaries as part of the All other subsidiaries and eliminations column.

The banking subsidiaries maintain sufficient funding capacity to address large increases in funding requirements such as deposit outflows. This capacity is comprised mainly of available liquidity derived from secured funding sources, as well as on-balance sheet liquidity in the form of cash balances maintained at the Fed and unused secured lines held at the Fed and FHLB, in addition to liquid unpledged securities. The Corporation has established liquidity guidelines that require the banking subsidiaries to have sufficient liquidity to cover all short-term borrowings and a portion of deposits.

The Corporation s ability to compete successfully in the marketplace for deposits, excluding brokered deposits, depends on various factors, including pricing, service, convenience and financial stability as reflected by operating results, credit ratings (by nationally recognized credit rating agencies), and importantly, FDIC deposit insurance. Although a downgrade in the credit ratings of the Corporation s banking subsidiaries may impact their ability to raise retail and commercial deposits or the rate that it is required to pay on such deposits, management does not believe that the impact should be material. Deposits at all of the Corporation s banking subsidiaries are federally insured (subject to FDIC limits) and this is expected to mitigate the potential effect of a downgrade in the credit ratings.

Deposits are a key source of funding as they tend to be less volatile than institutional borrowings and their cost is less sensitive to changes in market rates. Refer to Table 19 for a breakdown of deposits by major types. Core deposits are generated from a large base of consumer, corporate and institutional customers. Core deposits include all non-interest bearing deposits, savings deposits and certificates of deposit under $100,000, excluding brokered deposits with denominations under $100,000. Core deposits have historically provided the Corporation with a sizable source of relatively stable and low-cost funds. Core deposits totaled $ 20.4 billion, or 82% of total deposits, at June 30, 2014, compared with $21.9 billion, or 82% of total deposits, at December 31, 2013. Core deposits financed 67% of the Corporation s earning assets at June 30, 2014, compared with 70% at December 31, 2013.

Certificates of deposit with denominations of $100,000 and over at June 30, 2014 totaled $3.0 billion, or 12% of total deposits (December 31, 2013 - $3.2 billion, or 12% of total deposits). Their distribution by maturity at June 30, 2014 is presented in the table that follows:

Table 30 Distribution by Maturity of Certificate of Deposits of $100,000 and Over

(In thousands)	
3 months or less	$ 1,557,130
3 to 6 months	437,155
6 to 12 months	421,364
Over 12 months	601,934
Total	$ 3,017,583

At June 30, 2014 and December 31, 2013, approximately 7% of the Corporation s assets were financed by brokered deposits. The Corporation had $2.4 billion in brokered deposits at June 30, 2014 and December 31, 2013. In the event that any of the Corporation s banking subsidiaries regulatory capital ratios fall below those required by a well-capitalized institution or are subject to capital restrictions by the regulators, that banking subsidiary faces the risk of not being able to raise or maintain brokered deposits and faces limitations on the rate paid on deposits, which may

hinder the Corporation s ability to effectively compete in its retail markets and could affect its deposit raising efforts.

To the extent that the banking subsidiaries are unable to obtain sufficient liquidity through core deposits, the Corporation may meet its liquidity needs through short-term borrowings by pledging securities for borrowings under repurchase agreements, by pledging additional loans and securities through the available secured lending facilities, or by selling liquid assets. These measures are subject to availability of collateral.

The Corporation s banking subsidiaries have the ability to borrow funds from the FHLB. At June 30, 2014 and December 31, 2013, the banking subsidiaries had credit facilities authorized with the FHLB aggregating to $3.3 billion and $3.0 billion, respectively, based on assets pledged with the FHLB at those dates. Outstanding borrowings under these credit facilities totaled $541 million at June 30, 2014 and $1.2 billion at December 31, 2013. Such advances are collateralized by loans held-in-portfolio, do not have restrictive covenants and do not have any callable features. At June 30, 2014 the credit facilities authorized with the FHLB were collateralized by $ 3.4 billion in loans held-in-portfolio and $4.5 billion at December 31, 2013. Refer to Note 18 to the consolidated financial statements for additional information on the terms of FHLB advances outstanding.

At June 30, 2014 and December 31, 2013, the Corporation s borrowing capacity at the Fed s Discount Window amounted to approximately $2.6 billion and $3.4 billion, respectively, which remained unused as of both dates. This facility is a collateralized source of credit that is highly reliable even under difficult market conditions. The amount available under this borrowing facility is dependent upon the balance of performing loans, securities pledged as collateral and the haircuts assigned to such collateral. At June 30, 2014 and December 31, 2013, this credit facility with the Fed was collateralized by $4.8 billion and $4.5 billion, respectively, in loans held-in-portfolio.

On July 25, 2011, Popular, Inc. and BPPR entered into a Memorandum of Understanding with the Federal Reserve Bank of New York and the Office of the Commissioner of Financial Institutions of Puerto Rico that requires the approval of these entities prior to the payment of any dividends by BPPR to PIHC. BPNA could not declare any dividends without the approval of the Federal Reserve Board.

As disclosed in Note 3, Discontinued Operations, in connection with the sale of the U.S. regional operations of California, Illinois and Central Florida, BPNA will be transferring the assets and liabilities of these regions which currently result in an aggregate net liability of $251.4 million. Upon the closing of these transactions, BPNA will need to fund this difference with its available liquid assets.

At June 30, 2014, management believes that the banking subsidiaries had sufficient current and projected liquidity sources to meet their anticipated cash flow obligations, as well as special needs and off-balance sheet commitments, in the ordinary course of business and have sufficient liquidity resources to address a stress event. Although the banking subsidiaries have historically been able to replace maturing deposits and advances if desired, no assurance can be given that they would be able to replace those funds in the future if the Corporation s financial condition or general market conditions were to deteriorate. The Corporation s financial flexibility will be severely constrained if its banking subsidiaries are unable to maintain access to funding or if adequate financing is not available to accommodate future financing needs at acceptable interest rates. The banking subsidiaries also are required to deposit cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines because of market changes, the Corporation will be required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity. Finally, if management is required to rely more heavily on more expensive funding sources to meet its future growth, revenues may not increase proportionately to cover costs. In this case, profitability would be adversely affected.

Westernbank FDIC-assisted Transaction and Impact on Liquidity

In the short-term, there may be a significant amount of the covered loans acquired in the FDIC-assisted transaction that will experience deterioration in payment performance, or will be determined to have inadequate collateral values to repay the loans. In such instances, the Corporation will likely no longer receive payments from the borrowers, which will impact cash flows. The loss sharing agreements will not fully offset the financial effects of such a situation. However, if a loan is subsequently charged-off or written down after the Corporation exhausts its best efforts at collection, the loss sharing agreements will cover 80% of the loss associated with the covered loans, offsetting most of any deterioration in the performance of the covered loans.

The effects of the loss sharing agreements on cash flows and operating results in the long-term will be similar to the short-term effects described above. The long-term effects that we may experience will depend primarily on the ability of the borrowers whose loans are covered by the loss sharing agreements to make payments over time. As the loss sharing agreements are in effect for a period of ten years for one-to-four family loans and five years for commercial, construction and consumer loans (with periods commencing on April 30, 2010), changing economic conditions will likely impact the timing of future charge-offs and the resulting reimbursements from the FDIC. Management believes that any recapture of interest income and recognition of cash flows from the borrowers or received from the FDIC on

the claims filed may be recognized unevenly over this period, as management exhausts its collection efforts under the Corporation s normal practices.

BPPR s liquidity may also be impacted by the loan payment performance and timing of claims made and receipt of reimbursements under the FDIC loss sharing agreements. Please refer to the Legal Proceedings section of Note 24 to the consolidated financial statements and to Part II, Item 1A- Risk factors herein for a description of an ongoing contractual dispute between BPPR and the FDIC which has impacted the timing of the payment of claims under the loss share agreements.

193

Bank Holding Companies

The principal sources of funding for the holding companies include cash on hand, investment securities, dividends received from banking and non-banking subsidiaries (subject to regulatory limits and authorizations) asset sales, credit facilities available from affiliate banking subsidiaries and proceeds from potential securities offerings.

The principal use of these funds include the repayment of debt, and interest payments to holders of senior debt and junior subordinated deferrable interest (related to trust preferred securities) and capitalizing its banking subsidiaries.

During the six months ended June 30, 2014, PIHC received $ 2.3 million in dividends from EVERTEC s parent company. PIHC also received $10.1 million in dividends from its investment in BHD.

On July 2, 2014, the Corporation completed the repayment of TARP funds to the U.S. Treasury through the repurchase of $935 million of trust capital securities issued to the U.S. Treasury under the TARP Capital Purchase Program. The Corporation funded the repurchase through a combination of available cash and approximately $400 million from the proceeds of the issuance of its $450 million aggregate principal amount of 7% Senior Notes due on 2019 which settled on July 1, 2014.

On July 23, 2014, the Corporation also completed the repurchase of the outstanding warrant initially issued to the U.S. Treasury under the TARP Capital Purchase Program in 2008. The warrant represented the right to purchase 2,093,284 shares of the Corporation s common stock at an exercise price of $67 per share with an original term of 10 years. The Corporation and the U.S. Treasury agreed upon a repurchase price of $3.0 million for the warrant. With the completion of this transaction, the Corporation completed its exit from the TARP Capital Purchase Program.

In connection with the repayment of TARP on July 2, 2014, the Corporation accelerated the related amortization of the discount and deferred costs amounting to $414.1 million during the second quarter of 2014, which is reflected as part of interest expense in the consolidated statement of operations.

Another use of liquidity at the parent holding company is the payment of dividends on preferred stock. At the end of 2010, the Corporation resumed paying dividends on its Series A and B preferred stock. The preferred stock dividends amounted to $1.9 million for the six months ended June 30, 2014. The preferred stock dividends paid were financed by issuing new shares of common stock to the participants of the Corporation s qualified employee savings plans. The Corporation is required to obtain approval from the Fed prior to declaring or paying dividends, incurring, increasing or guaranteeing debt or making any distributions on its trust preferred securities or subordinated debt. The Corporation anticipates that any future preferred stock dividend payments would continue to be financed with the issuance of new common stock in connection with its qualified employee savings plans. The Corporation is not paying dividends to holders of its common stock.

The BHC s have in the past borrowed in the money markets and in the corporate debt market primarily to finance their non-banking subsidiaries, however, the cash needs of the Corporation s non-banking subsidiaries other than to repay indebtedness and interest are now minimal. These sources of funding have become more costly due to the reductions in the Corporation s credit ratings. The Corporation s principal credit ratings are below investment grade which affects the Corporation s ability to raise funds in the capital markets. The Corporation has an automatic shelf registration statement filed and effective with the Securities and Exchange Commission, which permits the Corporation to issue an unspecified amount of debt or equity securities.

Note 38 to the consolidated financial statements provides a statement of condition, of operations and of cash flows for the two BHC s. The loans held-in-portfolio in such financial statements is principally associated with intercompany

transactions.

The outstanding balance of notes payable at the BHC s amounted to $1.8 billion at June 30, 2014 and to $972 million on December 31, 2013. These borrowings are principally junior subordinated debentures (related to trust preferred securities), including those issued to the U.S. Treasury as part of the TARP, and unsecured senior debt (term notes) which were repaid in full on July 2, 2014, as mentioned above. The repayment of the BHC s obligations represents a potential cash need which is expected to be met with a combination of internal liquidity resources stemming mainly from future dividend receipts and new borrowings. Increasing or guaranteeing new debt would be subject to the approval of the Fed.

194

The contractual maturities of the BHC s notes payable at June 30, 2014 are presented in Table 31.

Table 31 Distribution of BHC s Notes Payable by Contractual Maturity

Year	(In thousands)
2014	$ 675
2015	
2016	
2017	
2018	
Later years	889,800
No stated maturity	936,000
Total	1,826,475

The BHCs liquidity position continues to be adequate with sufficient cash on hand, investments and other sources of liquidity which are expected to be enough to meet all BHCs obligations during the foreseeable future.

Non-banking subsidiaries

The principal sources of funding for the non-banking subsidiaries include internally generated cash flows from operations, loan sales, repurchase agreements, and borrowed funds from their direct parent companies or the holding companies. The principal uses of funds for the non-banking subsidiaries include repayment of maturing debt, operational expenses and payment of dividends to the BHCs. The liquidity needs of the non-banking subsidiaries are minimal since most of them are funded internally from operating cash flows or from intercompany borrowings from their holding companies, BPPR or BPNA.

Obligations Subject to Rating Triggers or Collateral Requirements

The Corporation s banking subsidiaries currently do not use borrowings that are rated by the major rating agencies, as these banking subsidiaries are funded primarily with deposits and secured borrowings. The banking subsidiaries had $19 million in deposits at June 30, 2014 that are subject to rating triggers.

Some of the Corporation s derivative instruments include financial covenants tied to the bank s well-capitalized status and certain formal regulatory actions. These agreements could require exposure collateralization, early termination or both. The fair value of derivative instruments in a liability position subject to financial covenants approximated $12 million at June 30, 2014, with the Corporation providing collateral totaling $16 million to cover the net liability position with counterparties on these derivative instruments.

In addition, certain mortgage servicing and custodial agreements that BPPR has with third parties include rating covenants. In the event of a credit rating downgrade, the third parties have the right to require the institution to engage a substitute cash custodian for escrow deposits and/or increase collateral levels securing the recourse obligations. Also, as discussed in the Guarantees section of this MD&A, the Corporation services residential mortgage loans subject to credit recourse provisions. Certain contractual agreements require the Corporation to post collateral to secure such recourse obligations if the institution s required credit ratings are not maintained. Collateral pledged by the Corporation to secure recourse obligations amounted to approximately $105 million at June 30, 2014. The

Corporation could be required to post additional collateral under the agreements. Management expects that it would be able to meet additional collateral requirements if and when needed. The requirements to post collateral under certain agreements or the loss of escrow deposits could reduce the Corporation s liquidity resources and impact its operating results.

195

Table of Contents

CREDIT RISK MANAGEMENT AND LOAN QUALITY

Non-Performing Assets

Non-performing assets include primarily past-due loans that are no longer accruing interest, renegotiated loans, and real estate property acquired through foreclosure. A summary, including certain credit quality metrics, is presented in Table 29.

The Corporation s non-accruing and charge-off policies by major categories of loan portfolios are as follows:

Commercial and construction loans recognition of interest income on commercial and construction loans is discontinued when the loans are 90 days or more in arrears on payments of principal or interest or when other factors indicate that the collection of principal and interest is doubtful. The impaired portions of secured loans past due as to principal and interest is charged-off not later than 365 days past due. However, in the case of collateral dependent loans individually evaluated for impairment, the excess of the recorded investment over the fair value of the collateral (portion deemed uncollectible) is generally promptly charged-off, but in any event, not later than the quarter following the quarter in which such excess was first recognized. Commercial unsecured loans are charged-off no later than 180 days past due. Overdrafts are generally charged-off no later than 60 days past their due date.

Lease financing recognition of interest income for lease financing is ceased when loans are 90 days or more in arrears. Leases are charged-off when they are 120 days in arrears.

Mortgage loans recognition of interest income on mortgage loans is generally discontinued when loans are 90 days or more in arrears on payments of principal or interest. The impaired portion of a mortgage loan is charged-off when the loan is 180 days past due. The Corporation discontinues the recognition of interest income on residential mortgage loans insured by the Federal Housing Administration (FHA) or guaranteed by the U.S. Department of Veterans Affairs (VA) when 18 months delinquent as to principal or interest. The principal repayment on these loans is insured.

Consumer loans recognition of interest income on closed-end consumer loans and home-equity lines of credit is discontinued when the loans are 90 days or more in arrears on payments of principal or interest. Income is generally recognized on open-end consumer loans, except for home equity lines of credit, until the loans are charged-off. Closed-end consumer loans are charged-off when they are 120 days in arrears. Open-end consumer loans are charged-off when they are 180 days in arrears. Overdrafts in excess of 60 days are generally charged-off no later than 60 days past their due date.

Troubled debt restructurings (TDRs) loans classified as TDRs are typically in non-accrual status at the time of the modification. The TDR loan continues in non-accrual status until the borrower has demonstrated a willingness and ability to make the restructured loan payments (generally at least six months of sustained performance after the modification (or one year for loans providing for quarterly or semi-annual payments)) and management has concluded that it is probable that the borrower would not be in payment default in the

foreseeable future.

Loans accounted for under ASC Subtopic 310-30 by the Corporation, are not considered non-performing and will continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected.

Covered loans acquired in the Westernbank FDIC-assisted transaction, except for revolving lines of credit, are accounted for by the Corporation in accordance with ASC Subtopic 310-30. Under ASC Subtopic 310-30, the acquired loans were aggregated into pools based on similar characteristics. Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. The covered loans, which are accounted for under ASC Subtopic 310-30 by the Corporation, are not considered non-performing and will continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected. Also, loans charged-off against the non-accretable difference established in purchase accounting are not reported as charge-offs. Charge-offs will be recorded only to the extent that losses exceed the purchase accounting estimates.

Because of the application of ASC Subtopic 310-30 to the Westernbank acquired loans and the loss protection provided by the FDIC which limits the risks on the covered loans, the Corporation has determined to provide certain quality metrics in this MD&A that exclude such covered loans to facilitate the comparison between loan portfolios and across periods. Given the significant

amount of covered loans that are past due but still accruing due to the accounting under ASC Subtopic 310-30, the Corporation believes the inclusion of these loans in certain asset quality ratios in the numerator or denominator (or both) would result in a significant distortion to these ratios. In addition, because charge-offs related to the acquired loans are recorded against the non-accretable balance, the net charge-off ratio including the acquired loans is lower for portfolios that have significant amounts of covered loans. The inclusion of these loans in the asset quality ratios could result in a lack of comparability across periods, and could negatively impact comparability with other portfolios that were not impacted by acquisition accounting. The Corporation believes that the presentation of asset quality measures, excluding covered loans and related amounts from both the numerator and denominator, provides a better perspective into underlying trends related to the quality of its loan portfolio.

Total non-performing non-covered assets were $784 million at June 30, 2014, increasing by $49 million, or 7%, compared with December 31, 2013. Non-covered non-performing loans held-in-portfolio stand at $640 million, increasing by $42 million, or 7%, from December 31, 2013. This increase was driven by an increase of $127 million in the BPPR segment, offset in part by an improvement of $85 million in the BPNA segment. The ratio of non-performing loans to loans held-in-portfolio, excluding covered loans, increased to 3.26% at June 30, 2014 from 2.77% at December 31, 2013, also impacted by the reduction in loan balances from the reclassification to the discontinued operations.

At June 30, 2014, non-performing loans secured by real estate held-in-portfolio, excluding covered loans, amounted to $487 million in the Puerto Rico operations and $59 million in the U.S. mainland operations. These figures compare to $388 million in the Puerto Rico operations and $141 million in the U.S. mainland operations at December 31, 2013. In addition to the non-performing loans included in Table 32, at June 30, 2014, there were $104 million of non-covered performing loans, mostly commercial loans that, in management s opinion, are currently subject to potential future classification as non-performing and are considered impaired, compared with $103 million at December 31, 2013.

Table of Contents

Table 32 Non-Performing Assets

(Dollars in thousands)	June 30, 2014	As a % of loans HIP by category [5]	December 31, 2013	As a % of loans HIP by category [5]
Commercial	$ 278,133	3.4%	$ 279,053	2.8%
Construction	21,456	12.0	23,771	11.5
Legacy [1]	8,323	5.1	15,050	7.1
Leasing	2,873	0.5	3,495	0.6
Mortgage	286,320	4.3	232,681	3.5
Consumer	42,630	1.1	43,898	1.1
Total non-performing loans held-in-portfolio, excluding covered loans[2]	639,735	3.3%	597,948	2.8%
Non-performing loans held-for-sale [3]	4,426		1,092	
Other real estate owned (OREO), excluding covered OREO	139,420		135,501	
Total non-performing assets, excluding covered assets	$ 783,581		$ 734,541	
Covered loans and OREO [4]	171,955		197,388	
Total non-performing assets	$ 955,536		$ 931,929	
Accruing loans past due 90 days or more[6] [7]	$ 420,251		$ 418,028	
Ratios excluding covered loans:[8]				
Non-performing loans held-in-portfolio to loans held-in-portfolio	3.26%		2.77%	
Allowance for loan losses to loans held-in-portfolio	2.68		2.49	
Allowance for loan losses to non-performing loans, excluding held-for-sale	82.26		90.05	
Ratios including covered loans:				
Non-performing assets to total assets	2.61%		2.61%	
Non-performing loans held-in-portfolio to loans held-in-portfolio	2.93		2.55	
Allowance for loan losses to loans held-in-portfolio	2.79		2.60	
Allowance for loan losses to non-performing loans, excluding	95.28		102.11	

held-for-sale

HIP = held-in-portfolio

[1] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

[2] Total non-performing loans held-in-portfolio, excluding covered loans, excludes $9.5 million in discontinued operations as of June 30, 2014.

[3] Non-performing loans held-for-sale consist $582 thousand in mortgage loans, $3 million in commercial loans and $1 million in construction loans as of June 30, 2014 (December 31, 2013 - $603 thousand in commercial loans and $489 thousand in mortgage loans).

[4] The amount consists of $16 million in non-performing covered loans accounted for under ASC Subtopic 310-20 and $156 million in covered OREO as of June 30, 2014 (December 31, 2013 - $29 million and $168 million, respectively). It excludes covered loans accounted for under ASC Subtopic 310-30 as they are considered to be performing due to the application of the accretion method, in which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analyses.

[5] Loans held-in-portfolio used in the computation exclude $2.7 billion in covered loans at June 30, 2014 (December 31, 2013 $3.0 billion).

[6] The carrying value of covered loans accounted for under ASC Sub-topic 310-30 that are contractually 90 days or more past due was $0.6 billion at June 30, 2014 (December 31, 2013 - $0.7 billion). This amount is excluded from the above table as the covered loans accretable yield interest recognition is independent from the underlying contractual loan delinquency status.

[7] It is the Corporation s policy to report delinquent residential mortgage loans insured by FHA or guaranteed by the VA as accruing loans past due 90 days or more as opposed to non-performing since the principal repayment is insured. These balances include $124 million of residential mortgage loans insured by FHA or guaranteed by the VA that are no longer accruing interest as of June 30, 2014 (December 31, 2013 - $115 million). Furthermore, the Corporation has approximately $60 million in reverse mortgage loans which are guaranteed by FHA, but which are currently not accruing interest. Due to the guaranteed nature of the loans, it is the Corporation s policy to exclude these balances from non-performing assets (December 31, 2013 - $50 million).

Table of Contents

[8] These asset quality ratios have been adjusted to remove the impact of covered loans and covered foreclosed property. Appropriate adjustments to the numerator and denominator have been reflected in the calculation of these ratios. Management believes the inclusion of acquired loans in certain asset quality ratios that include non-performing assets, past due loans or net charge-offs in the numerator and denominator results in distortions of these ratios and they may not be comparable to other periods presented or to other portfolios that were not impacted by purchase accounting.

For the quarter ended June 30, 2014, total non-performing loans inflows, excluding consumer loan, amounted to $152 million, a decrease of $35 million, or 19%, when compared to inflows for the same period in 2013. Inflows of non-performing loans held-in-portfolio at the BPPR segment amounted to $136 million, a decrease of $22 million, or 14%, compared to inflows for 2013. Inflows of non-performing loans held-in-portfolio at the BPNA segment amounted to $16 million, a decrease of $13 million, or 45%, compared to inflows for 2013. These reductions are mostly concentrated in the commercial portfolio, reflective of credit quality improvements and proactive portfolio management processes. Refer to the following table for more information on non-performing loans held-in-portfolio inflows, excluding consumer loans.

Table 33 Activity in Non-Performing Loans Held-in-Portfolio (Excluding Covered Loans)

	For the quarter ended June 30, 2014		For the six months ended June 30, 2014	
(Dollars in thousands)	BPPR	BPNA	BPPR	BPNA
Beginning balance	$ 498,196	$ 94,826	$ 410,594	$ 139,961
Plus:				
New non-performing loans	136,133	14,604	319,280	37,418
Advances on existing non-performing loans		1,000		1,011
Less:				
Non-performing loans transferred to OREO	(6,948)	(661)	(12,399)	(1,856)
Non-performing loans charged-off	(22,685)	(6,935)	(40,072)	(14,462)
Loans returned to accrual status / loan collections	(67,332)	(19,325)	(140,039)	(48,469)
Loans transferred to held-for-sale		(17,402)		(47,496)
Non-performing loans transferred to discontinued operations		(9,239)		(9,239)
Ending balance NPLs	$ 537,364	$ 56,868	$ 537,364	$ 56,868

Table 34 Activity in Non-Performing Loans Held-in-Portfolio (Excluding Covered Loans)

	For the quarter ended June 30, 2013		For the six months ended June 30, 2013	
(Dollars in thousands)	BPPR	BPNA	BPPR	BPNA
Beginning balance	$ 804,575	$ 203,686	$ 1,156,229	$ 223,281
New non-performing loans	158,418	27,291	315,969	53,297
Advances on existing non-performing loans		1,230		1,234

Loans transferred from held-for-sale			14,942	400
Other		4,310		4,310
Non-performing loans transferred to OREO	(21,991)	(1,638)	(49,299)	(3,943)
Non-performing loans charged-off	(41,051)	(17,901)	(85,591)	(36,190)
Loans returned to accrual status / loan collections	(66,895)	(25,267)	(186,442)	(50,678)
Loans transferred to held-for-sale	(14,968)	(2,594)	(14,968)	(2,594)
Non-performing loans sold[1]	(434,607)		(767,359)	
Other		(4,309)		(4,309)
Ending balance NPLs	$ 383,481	$ 184,808	$ 383,481	$ 184,808

[1] Includes write-downs of loans sold during the quarters ended June 30, 2013 and March 31, 2013.

199

Table of Contents

Refer to Table 35 for a summary of the activity in the allowance for loan losses and selected loan losses statistics for the quarters ended June 30, 2014 and 2013.

Table 35 Allowance for Loan Losses and Selected Loan Losses Statistics Quarterly Activity

	Quarters ended June 30,					
	2014	2014	2014	2013	2013	2013
(Dollars in thousands)	Non-covered loans	Covered loans	Total	Non-covered loans	Covered loans	Total
Balance at beginning of period	$ 542,575	$ 97,773	$ 640,348	$ 583,501	$ 99,867	$ 683,368
Provision for loan losses Continuing operations	50,074	11,604	61,678	228,975	25,500	254,475
Provision for loan losses Discontinued operations				(5,067)		(5,067)
	592,649	109,377	702,026	807,409	125,367	932,776
Charged-offs:						
Commercial	21,890	5,993	27,883	42,386	1,150	43,536
Construction	42	6,427	6,469	2,191	16,024	18,215
Leases	1,754	2	1,756	1,843		1,843
Legacy[1]	1,347		1,347	3,743		3,743
Mortgage	10,997	2,262	13,259	16,127	2,255	18,382
Consumer	33,938	(677)	33,261	33,206	(106)	33,100
Discontinued operations				13,362		13,362
	69,968	14,007	83,975	112,858	19,323	132,181
Recoveries:						
Commercial	11,671	555	12,226	10,274	42	10,316
Construction	657	2,727	3,384	4,485	322	4,807
Leases	610	1	611	630		630
Legacy[1]	2,552		2,552	5,208		5,208
Mortgage	678	11	689	520		520
Consumer	7,599	1	7,600	8,135	49	8,184
Discontinued operations				4,461		4,461
	23,767	3,295	27,062	33,713	413	34,126
Net loans charged-offs (recovered):						
Commercial	10,219	5,438	15,657	32,112	1,108	33,220
Construction	(615)	3,700	3,085	(2,294)	15,702	13,408
Leases	1,144	1	1,145	1,213		1,213
Legacy[1]	(1,205)		(1,205)	(1,465)		(1,465)
Mortgage	10,319	2,251	12,570	15,607	2,255	17,862

Consumer	26,339	(678)	25,661	25,071	(155)	24,916
Discontinued operations				8,901		8,901
	46,201	10,712	56,913	79,145	18,910	98,055
Net write-downs[2]				(199,502)		(199,502)
Net write-downs related to loans transferred to discontinued operations	(20,202)		(20,202)			
Balance at end of period	$ 526,246	$ 98,665	$ 624,911	$ 528,762	$ 106,457	$ 635,219
Ratios:						
Annualized net charge-offs to average loans held-in-portfolio[3]	0.94%		1.01%	1.47%		1.58%
Provision for loan losses to net charge-offs[3]	1.08x		1.08x	0.69x		0.82x

200

[1] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.
[2] Net write-downs for the quarter ended June 30, 2013 are related to loans sold.
[3] Excluding provision for loan losses and the net write-down related to the asset sale during the quarter June 30, 2013.

Refer to Table 36 for a summary of the activity in the allowance for loan losses and selected loan losses statistics for the six months ended June 30, 2014 and 2013.

Table 36 Allowance for Loan Losses and Selected Loan Losses Statistics Year-to-date Activity

	Six months ended June 30,					
(Dollars in thousands)	2014 Non-covered loans	2014 Covered loans	2014 Total	2013 Non-covered loans	2013 Covered loans	2013 Total
Balance at beginning of period	$ 538,463	$ 102,092	$ 640,555	$ 621,701	$ 108,906	$ 730,607
Provision for loan losses Continuing operations	104,196	37,318	141,514	438,068	43,056	481,124
Provision for loan losses Discontinued operations	(6,764)		(6,764)	(7,860)		(7,860)
	635,895	139,410	775,305	1,051,909	151,962	1,203,871
Charged-offs:						
Commercial	48,998	13,961	62,959	82,023	11,715	93,738
Construction	458	29,408	29,866	3,820	25,783	29,603
Leases	2,721	2	2,723	3,386		3,386
Legacy[1]	4,331		4,331	10,036		10,036
Mortgage	21,261	3,918	25,179	37,903	4,317	42,220
Consumer	68,210	(972)	67,238	66,815	4,461	71,276
Discontinued operations	4,452		4,452	20,307		20,307
	150,431	46,317	196,748	224,290	46,276	270,566
Recoveries:						
Commercial	21,619	875	22,494	19,920	72	19,992
Construction	2,627	4,616	7,243	5,759	636	6,395
Leases	921	1	922	1,189		1,189
Legacy[1]	9,745		9,745	9,682		9,682
Mortgage	1,556	11	1,567	2,733	11	2,744
Consumer	14,519	69	14,588	16,361	52	16,413
Discontinued operations	9,997		9,997	8,144		8,144
	60,984	5,572	66,556	63,788	771	64,559

Net loans charged-off (recovered):						
Commercial	27,379	13,086	40,465	62,103	11,643	73,746
Construction	(2,169)	24,792	22,623	(1,939)	25,147	23,208
Leases	1,800	1	1,801	2,197		2,197
Legacy[1]	(5,414)		(5,414)	354		354
Mortgage	19,705	3,907	23,612	35,170	4,306	39,476
Consumer	53,691	(1,041)	52,650	50,454	4,409	54,863
Discontinued operations	(5,545)		(5,545)	12,163		12,163
	89,447	40,745	130,192	160,502	45,505	206,007
Net write-downs [2]				(362,645)		(362,645)
Net write-downs related to loans transferred to discontinued operations	(20,202)		(20,202)			
Balance at end of period	$ 526,246	$ 98,665	$ 624,911	$ 528,762	$ 106,457	$ 635,219
Ratios:						
Annualized net charge-offs to average loans held-in-portfolio[3]	0.87%		1.11%	1.51%		1.67%
Provision for loan losses to net charge-offs[3]	1.16x		1.09x	0.70x		0.75x

201

Table of Contents

[1] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.
[2] Net write-downs for June 30, 2013 are related to loans sold.
[3] Excluding provision for loan losses and the net write-downs related to the loans sales.
Refer to the Allowance for Loan Losses subsection in this MD&A for tables detailing the composition of the allowance for loan losses between general and specific reserves, and for qualitative information on the main factors driving the variances.

The following table presents annualized net charge-offs to average loans held-in-portfolio (HIP) for the non-covered portfolio by loan category for the quarters and six month period ended June 30, 2014 and 2013.

Table 37 Annualized Net Charge-offs (Recoveries) to Average Loans Held-in-Portfolio (Non-covered loans)

	Quarters ended June 30,		Six months ended June 30,	
	2014[2]	2013	2014	2013
Commercial [1]	0.49%	1.63%	0.47%	1.49%
Construction[1]	(1.55)	(3.31)	(2.61)	(1.43)
Leases	0.84	0.90	0.66	0.82
Legacy	(7.66)	(1.31)	(9.09)	0.14
Mortgage[1]	0.62	0.91	0.59	1.07
Consumer	2.71	2.68	2.79	2.70
Total annualized net charge-offs to average loans held-in-portfolio	0.94%	1.47%	0.87%	1.51%

[1] Excluding the net write-down related to the asset sales during the first and second quarters of 2013.
[2] Excluding net charge-offs from discontinued operations.
Note: Average loans held-in-portfolio excludes covered loans acquired in the Westernbank FDIC-assisted transaction which were recorded at fair value on date of acquisition, and thus, considered a credit discount component.

The Corporation s annualized net charge-offs to average non-covered loans held-in-portfolio ratio was 0.94% for the quarter ended June 30, 2014, down from 1.47% for the same period in 2013. Net charge-offs, excluding covered loans, for the quarter ended June 30, 2014 decreased by $32.9 million when compared to the quarter ended June 30, 2013. The decline is mostly driven by improvements in the credit performance of the loan portfolios and de-risking strategies taken by the Corporation to improve the risk profile of its portfolios.

During the second quarter of 2014, the Corporation s overall asset quality remained relatively stable. The BPNA segment continued to reflect strong credit quality led by the improved risk profile of its loan portfolios, further strengthened by the divesture of its regional operations in California, Illinois and Central Florida. Nevertheless, challenging economic and fiscal conditions in Puerto Rico continued to influence credit quality results in the BPPR segment.

The discussions in the sections that follow assess credit quality performance for the second quarter of 2014 for each of the Corporation s non-covered loan portfolios.

Commercial loans

Non-covered non-performing commercial loans held-in-portfolio remained flat at $278 million during June 30, 2014, compared with $279 million at December 31, 2013. The percentage of non-performing commercial loans held-in-portfolio to commercial loans held-in-portfolio increased to 3.41% at June 30, 2014 from 2.78% at December 31, 2013, primarily reflecting the reduction in loan balances from the reclassification to the discontinued operations.

Commercial non-covered non-performing loans held-in-portfolio at the BPPR segment increased by $67 million from December 31, 2013, mainly driven by a single $52 million credit relationship. Commercial non-performing loans held-in-portfolio at the BPNA segment decreased by $68 million from December 31, 2013, primarily reflecting the impact of loan resolutions and credit quality improvements, and $8 million attributed to the reclassification of the discontinued operations.

Table of Contents

Tables 38 and 39 present the changes in the non-performing commercial loans held-in-portfolio for the quarters and six months period ended June 30, 2014 and 2013 for the BPPR (excluding covered loans) and the BPNA segments.

For the quarter ended June 30, 2014, inflows of commercial non-performing loans held-in-portfolio at the BPPR segment amounted to $30 million, a decrease of $30 million, or 50%, when compared to inflows for the same period in 2013. Inflows of commercial non-performing loans held-in-portfolio at the BPNA segment amounted to $9 million, a decrease of $8 million, or 49%, compared to inflows for 2013. These reductions are mainly driven by improvements in the underlying quality of the portfolio and proactive portfolio management processes.

Table 38 provides information on commercial non-performing loans and net charge-offs for the BPPR (excluding the Westernbank covered loan portfolio) and the BPNA segments.

Table 38 Activity in Non-Performing Commercial Loans Held-in-Portfolio (Excluding Covered Loans)

	For the quarter ended June 30, 2014		For the six months ended June 30, 2014	
(Dollars in thousands)	BPPR	BPNA	BPPR	BPNA
Beginning balance	$ 245,931	$ 60,998	$ 186,097	$ 92,956
Plus:				
New non-performing loans	30,068	7,726	116,113	24,882
Advances on existing non-performing loans		951		957
Less:				
Non-performing loans transferred to OREO	(4,103)		(7,803)	
Non-performing loans charged-off	(14,377)	(5,470)	(24,655)	(9,562)
Loans returned to accrual status / loan collections	(3,967)	(15,475)	(16,200)	(30,409)
Loans transferred to held-for-sale		(16,130)		(46,224)
Non-performing loans transferred to discontinued operations		(8,019)		(8,019)
Ending balance NPLs	$ 253,552	$ 24,581	$ 253,552	$ 24,581

Table 39 Activity in Non-Performing Commercial Loans Held-in-Portfolio (Excluding Covered Loans)

	For the quarter ended June 30, 2013		For the six months ended June 30, 2013	
(Dollars in thousands)	BPPR	BPNA	BPPR	BPNA
Beginning balance	$ 186,808	$ 133,979	$ 522,733	$ 142,556
Plus:				
New non-performing loans	59,736	15,763	107,471	30,874
Advances on existing non-performing loans		1,226		1,226
Loans transferred from held-for-sale			790	
Other		4,310		4,310

Less:				
Non-performing loans transferred to OREO	(2,191)	(532)	(11,389)	(2,090)
Non-performing loans charged-off	(32,511)	(9,890)	(61,361)	(19,771)
Loans returned to accrual status / loan collections	(12,122)	(18,827)	(29,256)	(31,076)
Loans transferred to held-for-sale		(2,594)		(2,594)
Non-performing loans sold[1]			(329,268)	
Ending balance NPLs	$ 199,720	$ 123,435	$ 199,720	$ 123,435

[1] includes write-downs of $161,297 of loans sold at BPPR during the quarter ended March 31, 2013.

203

Table of Contents

Table 40 Non-Performing Commercial Loans and Net Charge-offs (Excluding Covered Loans)

	BPPR		BPNA		Popular, Inc.	
(Dollars in thousands)	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013
Non-performing commercial loans	$ 253,552	$ 186,097	$ 24,581	$ 92,956	$ 278,133	$ 279,053
Non-performing commercial loans to commercial loans HIP	4.03%	2.88%	1.32%	2.60%	3.41%	2.78%

	BPPR For the quarters ended		BPNA For the quarters ended		Popular, Inc. For the quarters ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Commercial loan net charge-offs[1]	$ 9,309	$ 29,968	$ 910	$ 9,808	$ 10,219	$ 39,776
Commercial loan net charge-offs (annualized) to average commercial loans HIP	0.58%	1.94%	0.18%	1.09%	0.49%	1.63%

	BPPR For the six months ended		BPNA For the six months ended		Popular, Inc. For the six months ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Commercial loan net charge-offs (recoveries)[1]	$ 24,482	$ 54,279	(2,781)	$ 18,670	$ 21,701	$ 72,949
Commercial loan net charge-offs (recoveries) (annualized) to average commercial loans HIP[1]	0.76%	1.76%	(0.20)%	1.04%	0.47%	1.49%

There are two commercial loan relationships greater than $10 million in non-accrual status with an outstanding aggregate balance of $65 million at June 30, 2014, compared with one commercial loan relationship with an outstanding aggregate balance of $15 million at December 31, 2013.

Commercial loan net charge-offs, excluding net charge-offs for covered loans, amounted to $10.2 million for the quarter ended June 30, 2014, compared to $39.8 million for the same period in 2013. Commercial loans annualized net charge-offs to average non-covered loans held-in-portfolio decreased to 0.49% for the quarter ended June 30, 2014 from 1.63% for the quarter ended June 30, 2013. Commercial loan net charge-offs, excluding net charge-offs for covered loans, decline of $29.6 million, or 74%, for the quarter ended June 30, 2014 when compared with the same quarter in 2013 was primarily due to improvements in credit quality and successful actions taken by the Corporation to de-risk the portfolio.

Commercial loan net charge-offs in the BPPR segment amounted to $9.3 million for the quarter ended June 30, 2014, compared to $30.0 million in June 30, 2013. Commercial loans annualized net charge-offs to average non-covered loans held-in-portfolio decreased to 0.58% for the quarter ended June 30, 2014 from 1.94% for the quarter ended June 30, 2013. Commercial loan net charge-offs declined by $20.7 million for the quarter ended June 30, 2014 when compared with the quarter ended June 30, 2013. For the quarter ended June 30, 2014, the charge-offs associated with collateral dependent commercial loans amounted to approximately $7.9 million in the BPPR segment.

Commercial loan net charge-offs in the BPNA segment amounted to $910 thousand for the quarter ended June 30, 2014, compared to $9.8 million in June 30, 2013. Commercial loans annualized net charge-offs to average non-covered loans held-in-portfolio decreased to 0.18% for the quarter ended June 30, 2014 from 1.09% for the quarter ended June 30, 2013. Commercial loan net charge-offs declined by $8.9 million for the quarter ended June 30, 2014 when compared with the same period in 2013. For the quarter ended June 30, 2014, there were no charge-offs associated with collateral dependent commercial loans from continuing operations at the BPNA segment.

The Corporation s commercial loan portfolio secured by real estate (CRE), excluding covered loans, amounted to $4.7 billion at June 30, 2014, of which $1.8 billion was secured with owner occupied properties, compared with $6.4 billion and $2.3 billion, respectively, at December 31, 2013. CRE non-performing loans, excluding covered loans, amounted to $188 million at June 30, 2014, compared with $221 million at December 31, 2013. The CRE non-performing loans ratios for the BPPR and BPNA segments were 4.71% and 1.71%, respectively, at June 30, 2014, compared with 3.80% and 3.10%, respectively, at December 31, 2013.

Table of Contents

Construction loans

Non-covered non-performing construction loans held-in-portfolio amounted to $21 million at June 30, 2014, compared to $24 million at December 31, 2013. Stable credit trends in the construction portfolio are the result of de-risking strategies executed by the Corporation over the past several years to downsize its construction loan portfolio. The percentage of non-performing construction loans to construction loans held-in-portfolio, excluding covered loans, remained stable at 11.98% at June 30, 2014 compared to 11.53% at December 31, 2013.

Construction non-covered non-performing loans held-in-portfolio at the BPPR segment increased to $21 million at June 30, 2014, from $18 million at December 31, 2013, driven by a single borrower. There are no construction non-performing loans held-in-portfolio at the BPNA segment for the quarter ended June 30, 2014, decreasing by $6 million at December 31, 2013.

Tables 41 and 42 present changes in non-performing construction loans held-in-portfolio for the quarters and six months period ended June 30, 2014 and 2013 for the BPPR (excluding covered loans) and the BPNA segments.

Table 41 Activity in Non-Performing Construction Loans Held-in-Portfolio (Excluding Covered Loans)

	For the quarter ended June 30, 2014		For the six months ended June 30, 2014	
(Dollars in thousands)	BPPR	BPNA	BPPR	BPNA
Beginning balance	$ 22,464	$	$ 18,108	$ 5,663
Plus:				
New non-performing loans	952		8,912	
Less:				
Non-performing loans charged-off	(42)		(458)	
Loans returned to accrual status / loan collections	(1,918)		(5,106)	(5,663)
Ending balance NPLs	$ 21,456	$	$ 21,456	$

Table 42 Activity in Non-Performing Construction Loans Held-in-Portfolio (Excluding Covered Loans)

	For the quarter ended June 30, 2013		For the six months ended June 30, 2013	
(Dollars in thousands)	BPPR	BPNA	BPPR	BPNA
Beginning balance	$ 45,036	$ 5,884	$ 37,390	$ 5,960
Plus:				
Advances on existing non-performing loans			14,152	
Less:				
Non-performing loans charged-off	(2,175)		(3,257)	
Loans returned to accrual status / loan collections	(3,817)	(50)	(5,757)	(126)
Non-performing loans sold[1]			(3,484)	

Ending balance NPLs	$ 39,044	$ 5,834	$ 39,044	$ 5,834

[1] Includes write-downs of $1,846 of loans sold at BPPR during the quarter ended March 31, 2013.
For the quarter ended June 30, 2014, inflows of construction non-performing loans held-in-portfolio at the BPPR segment increased to $952 thousand, when compared to additions for the same period in 2013. There were no additions of construction non-performing loans held-in-portfolio at the BPNA segment during the second quarter of 2014.

There were no construction loan relationships greater than $10 million in non-performing status at June 30, 2014 and December 31, 2013.

205

Table of Contents

Construction loan net charge-offs (recoveries), excluding net charge-offs for covered loans, amounted to recoveries of $615 thousand for the quarter ended June 30, 2014, compared to recoveries of $2 million at June 30, 2013. Construction loans annualized net charge-offs (recoveries) to average non-covered loans held-in-portfolio stand at (1.55%) for the quarter ended June 30, 2014, compared to (3.31%) for the quarter ended June 30, 2013. Construction loan net charge-offs, excluding covered loans, for the quarter ended June 30, 2014, increased by $1.7 million when compared with the quarter ended June 30, 2013 led by an increase in the BPPR segment. For the quarter ended June 30, 2014, the charge-offs associated with collateral dependent construction loans amounted to $103 thousand in the BPPR segment and none in the BPNA segment. Management identified construction loans considered impaired and charged-off specific reserves based on the value of the collateral.

Table 43 provides information on construction non-performing loans and net charge-offs for the BPPR (excluding the covered loan portfolio) and the BPNA segments.

Table 43 Non-Performing Construction Loans and Net Charge-offs (Excluding Covered Loans)

	BPPR		BPNA		Popular, Inc.	
(Dollars in thousands)	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013
Non-performing construction loans	$ 21,456	$ 18,108	$	$ 5,663	$ 21,456	$ 23,771
Non-performing construction loans to construction loans HIP	15.81%	11.24%	%	12.61%	11.98%	11.53%

	BPPR For the quarters ended		BPNA For the quarters ended		Popular, Inc. For the quarters ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Construction loan net charge-offs (recoveries) [1]	$ (615)	$ (2,294)	$	$	$ (615)	$ (2,294)
Construction loan net charge-offs (recoveries) (annualized) to average construction loans HIP	(1.86)%	(3.73)%	%	%	(1.55)%	(3.31)%

	BPPR For the six months ended		BPNA For the six months ended		Popular, Inc. For the six months ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Construction loan net charge-offs (recoveries) [1]	$ (1,993)	$ (1,939)	$ (176)	$	$ (2,169)	$ (1,939)

Construction loan net charge-offs (recoveries) (annualized) to average construction loans HIP[1]	(2.86)%	(1.65)%	(1.31)%	%	(2.61)%	(1.43)%

Legacy loans

The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

Legacy non-performing loans held-in-portfolio amounted to $8 million at June 30, 2014, compared with $15 million at December 31, 2013. The decrease of $7 million, or 45%, from December 31, 2013 was primarily driven by lower inflows to non-performing loans, loan resolutions and portfolio run-off. The percentage of non-performing legacy loans held-in-portfolio to legacy loans held-in-portfolio decreased to 5.11% at June 30, 2014 from 7.13% at December 31, 2013.

For the quarter ended June 30, 2014, additions to legacy loans in non-performing status amounted to $2 million, a decrease of $2 million, or 52%, when compared with the quarter ended June 30, 2013. The decrease in the inflows of non-performing legacy loans reflects improvements in overall loan credit performance.

Tables 44 and 45 present the changes in non-performing legacy loans held in-portfolio for the quarters and six months period ended June 30, 2014 and 2013.

Table of Contents

Table 44 Activity in Non-Performing Legacy Loans Held-in-Portfolio

(In thousands)	For the quarter ended June 30, 2014 BPNA	For the six months ended June 30, 2014 BPNA
Beginning balance	$ 11,608	$ 15,050
Plus:		
New non-performing loans	2,201	3,939
Advances on existing non-performing loans	49	54
Less:		
Non-performing loans charged-off	(816)	(3,384)
Loans returned to accrual status / loan collections	(2,227)	(4,844)
Loans transferred to held-for-sale	(1,272)	(1,272)
Non-performing loans transferred to discontinued operations	(1,220)	(1,220)
Ending balance NPLs	$ 8,323	$ 8,323

Table 45 Activity in Non-Performing Legacy Loans Held-in-Portfolio

(Dollars in thousands)	For the quarter ended June 30, 2013 BPNA	For the six months ended June 30, 2013 BPNA
Beginning balance	$ 35,830	$ 40,741
Plus:		
New non-performing loans	4,640	11,028
Advances on existing non-performing loans	4	8
Loans transferred from held-for-sale		400
Less:		
Non-performing loans charged-off	(5,358)	(10,673)
Loans returned to accrual status / loan collections	(2,373)	(8,761)
Other	(4,309)	(4,309)
Ending balance NPLs	$ 28,434	$ 28,434

In the loans held-in-portfolio, there was no legacy loan relationship greater than $10 million in non-accrual status at June 30, 2014 and December 31, 2013.

Legacy loan net charge-offs (recoveries) amounted to recoveries of $1.2 million for the quarter ended June 30, 2014, compared to recoveries of $917 thousand in June 30, 2013. Legacy loan net charge-offs (recoveries) to average

non-covered loans held-in-portfolio improved to (7.66%) for the quarter ended June 30, 2014 from (1.31%) for the quarter ended June 30, 2013.

Table of Contents

Table 46 provides information on legacy non-performing loans and net charge-offs.

Table 46 Non-Performing Legacy Loans and Net Charge-offs

	BPNA	
(Dollars in thousands)	June 30, 2014	December 31, 2013
Non-performing legacy loans	$ 8,323	$ 15,050
Non-performing legacy loans to legacy loans HIP	5.11%	7.13%

	BPNA For the quarters ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013
Legacy loan net charge-offs (recoveries)	$ (1,205)	$ (917)
Legacy loan net charge-offs (recoveries) (annualized) to average legacy loans HIP	(7.66)%	(1.31)%

	BPNA For the six months ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013
Legacy loan net charge-offs (recoveries)	$ (6,087)	$ 211
Legacy loan net charge-offs (recoveries) (annualized) to average legacy loans HIP	(9.09)%	0.14%

Mortgage loans

Non-covered non-performing mortgage loans held-in-portfolio were $286 million at June 30, 2014, compared to $233 million at December 31, 2013. The increase of $54 million from December 31, 2013 is mainly reflective of higher non-performing loans in the BPPR segment. The percentage of non-performing mortgage loans held-in-portfolio to mortgage loans held-in-portfolio increased to 4.30% at June 30, 2014 from 3.48% at December 31, 2013.

Mortgage non-covered non-performing loans held-in-portfolio at the BPPR segment increased by $56 million from December 31, 2013. While inflows continue relatively stable, reduced outflows are contributing to the net increase in non-performing loans balance. Mortgage non-performing loans held-in-portfolio at the BPNA segment remained stable, decreasing by $2 million from December 31, 2013.

Tables 47 and 48 present changes in non-performing mortgage loans held-in-portfolio for the quarters and six months period ended June 30, 2014 and 2013.

Table 47 Activity in Non-Performing Mortgage Loans Held-in-Portfolio (Excluding Covered Loans)

For the quarter ended June 30, 2014	For the six months ended

			June 30, 2014	
(Dollars in thousands)	BPPR	BPNA	BPPR	BPNA
Beginning balance	$ 229,801	$ 22,220	$ 206,389	$ 26,292
Plus:				
New non-performing loans	105,113	4,677	194,255	8,597
Less:				
Non-performing loans transferred to OREO	(2,845)	(661)	(4,596)	(1,856)
Non-performing loans charged-off	(8,266)	(649)	(14,959)	(1,516)
Loans returned to accrual status / loan collections	(61,447)	(1,623)	(118,733)	(7,553)
Ending balance NPLs	$ 262,356	$ 23,964	$ 262,356	$ 23,964

208

Table 48 Activity in Non-Performing Mortgage loans Held-in-Portfolio (Excluding Covered Loans)

	For the quarter ended June 30, 2013		For the six months ended June 30, 2013	
(Dollars in thousands)	BPPR	BPNA	BPPR	BPNA
Beginning balance	$ 572,731	$ 27,993	$ 596,106	$ 34,024
Plus:				
New non-performing loans	98,682	6,888	208,498	11,395
Less:				
Non-performing loans transferred to OREO	(19,800)	(1,106)	(37,910)	(1,853)
Non-performing loans charged-off	(6,365)	(2,653)	(20,973)	(5,746)
Loans returned to accrual status / loan collections	(50,956)	(4,017)	(151,429)	(10,715)
Loans transferred to held-for-sale	(14,968)		(14,968)	
Non-performing loans sold[1]	(434,607)		(434,607)	
Ending balance NPLs	$ 144,717	$ 27,105	$ 144,717	$ 27,105

[1] Includes write-downs of $199,502 of loans sold at BPPR during the quarter ended June 30, 2013.

For the quarter ended June 30, 2014, inflows of mortgage non-performing loans held-in-portfolio at the BPPR segment amounted to $105 million, an increase of $6 million, or 7%, when compared to inflows for the same period in 2013. Inflows of mortgage non-performing loans held-in-portfolio at the BPNA segment amounted to $5 million, a decrease of $2 million, or 32%, when compared to inflows for the same period in 2013.

Mortgage loan net charge-offs, excluding net charge-offs for covered loans, amounted to $10.3 million for the quarter ended June 30, 2014, compared to $15.6 million in June 30, 2013. Mortgage loan net charge-offs to average mortgage non-covered loans held-in-portfolio was 0.62% in June 30, 2014, compared to 0.91% for the quarter ended June 30, 2013. Mortgage loan net charge-offs, excluding covered loans, decrease of $5.3 million for the quarter ended June 30, 2014, when compared with the same period in 2013, was mainly related to the de-risking of the portfolio. Mortgage loan net charge-offs at the BPPR segment, excluding covered loans, amounted to $9.9 million, or 0.73% of average non-covered loans held-in-portfolio on an annualized basis, a decrease of $2.7 million when compared to same period in 2013. For the quarter ended June 30, 2014, charge-offs associated with mortgage loans individually evaluated for impairment amounted to $2.3 million in the BPPR segment.

Mortgage loan net charge-offs at the BPNA segment amounted to $393 thousand for the quarter ended June 30, 2014, a decrease of $2.6 million when compared to the same period in 2013. Mortgage loan net charge-offs to average mortgage non-covered loans held-in-portfolio decreased to 0.13% for the quarter ended June 30, 2014 from 1.00% for the quarter ended June 30, 2013. The net charge-offs for BPNA s non-conventional mortgage loan portfolio amounted to approximately $462 thousand, or 0.45% of average non-conventional mortgage loans held-in-portfolio, for the quarter ended June 30, 2014, compared with $2.4 million, or 2.22% of average loans for the same period last year.

Table 49 provides information on non-performing mortgage loans and net charge-offs for the BPPR, excluding the covered loan portfolio, and the BPNA segments.

Table 49 Non-Performing Mortgage Loans and Net Charge-offs (Excluding Covered Loans)

	BPPR		BPNA		Popular, Inc.	
(Dollars in thousands)	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013
Non-performing mortgage loans	$ 262,356	$ 206,389	$ 23,964	$ 26,292	$ 286,320	$ 232,681
Non-performing mortgage loans to mortgage loans HIP	4.81%	3.82%	1.99%	2.05%	4.30%	3.48%

209

Table of Contents

	BPPR		BPNA		Popular, Inc.	
	For the quarters ended		For the quarters ended		For the quarters ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Mortgage loan net charge-offs	$ 9,926	$ 12,589	$ 393	$ 3,018	$ 10,319	$ 15,607
Mortgage loan net charge-offs (annualized) to average mortgage loans HIP	0.73 %	0.89 %	0.13 %	1.00 %	0.62 %	0.91 %

	BPPR		BPNA		Popular, Inc.	
	For the six months ended		For the six months ended		For the six months ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Mortgage loan net charge-offs [1]	$ 18,442	$ 29,362	1,263	$ 5,808	$ 19,705	$ 35,170
Mortgage loan net charge-offs (annualized) to average mortgage loans HIP [1]	0.68 %	1.09 %	0.20 %	1.00 %	0.59 %	1.07 %

[1] Excludes write-downs of loans sold at BPPR.

Consumer loans

Non-covered non-performing consumer loans held-in-portfolio were $43 million at June 30, 2014, compared to $44 million at December 31, 2013. Consumer non-covered non-performing loans held-in-portfolio decreased by $1 million when compared to December 31, 2013, driven by a decrease of $2 million in the BPNA segment. The percentage of non-performing consumer loans held-in-portfolio to consumer loans held-in-portfolio decreased to 1.09% at June 30, 2014 from 1.12% at December 31, 2013.

For the quarter ended June 30, 2014, inflows of consumer non-performing loans held-in-portfolio at the BPPR segment amounted to $24 million, an increase of $3 million, or 15%, when compared to inflows for the same period of 2013. Inflows of consumer non-performing loans held-in-portfolio at the BPNA segment amounted to $6 million, a decrease of $2 million, or 26% compared to inflows for 2013.

The Corporation s consumer loan net charge-offs, excluding covered loans, amounted to $26.3 million for the quarter ended June 30, 2014, compared to $25.8 million in June 30, 2013. Consumer loan net charge-offs to average consumer non-covered loans held-in-portfolio increased to 2.71% for the quarter ended June 30, 2014 from 2.68% for June 30, 2013. Slight increase for the quarter ended June 30, 2014 was reflective of an increase of $3.6 million in the BPPR segment, offset by a decline of $3.1 million in the BPNA segment.

Table 50 provides information on consumer non-performing loans and net charge-offs by segments.

Table 50 Non-Performing Consumer Loans and Net Charge-offs (Excluding Covered Loans)

	BPPR		BPNA		Popular, Inc.	
(Dollars in thousands)	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013
Non-performing consumer loans	$ 33,570	$ 33,166	$ 9,060	$ 10,732	$ 42,630	$ 43,898
Non-performing consumer loans to consumer loans HIP	0.98 %	1.00 %	1.77 %	1.74 %	1.09 %	1.12 %

	BPPR For the quarters ended		BPNA For the quarters ended		Popular, Inc. For the quarters ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Consumer loan net charge-offs	$ 23,571	$ 19,928	$ 2,768	$ 5,832	$ 26,339	$ 25,760
Consumer loan net charge-offs (annualized) to average consumer loans HIP	2.76 %	2.46 %	2.30 %	3.80 %	2.71 %	2.68 %

	BPPR For the six months ended		BPNA For the six months ended		Popular, Inc. For the six months ended	
(Dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Consumer loan net charge-offs	$ 46,554	$ 39,929	$ 7,943	$ 11,985	$ 54,497	$ 51,914
Consumer loan net charge-offs (annualized) to average consumer loans HIP	2.77 %	2.47 %	2.92 %	3.86 %	2.79 %	2.70 %

Combined net charge-offs for E-LOAN s home equity lines of credit and closed-end second mortgages amounted to approximately $397 thousand, or 0.65% of those particular average loan portfolios, for the quarter ended June 30, 2014, compared with $3.0 million, or 4.06%, for the quarter ended June 30, 2013. With the downsizing of E-LOAN, this subsidiary ceased originating these types of loans in 2008. Home equity lending includes both home equity loans and lines of credit. This type of lending, which is secured by a first or second mortgage on the borrower s residence, allows customers to borrow against the equity in their home. Real estate market values at the time the loan or line is granted directly affect the amount of credit extended and, in addition, changes in these values impact the severity of losses. E-LOAN s portfolio of home equity lines of credit and closed-end second mortgages outstanding at June 30, 2014 totaled $240 million with a related allowance for loan losses of $6 million, representing 2.58% of that particular portfolio. E-LOAN s portfolio of home equity lines of credit and closed-end second mortgages outstanding at June 30, 2013 totaled $284 million with a related allowance for loan losses of $15 million, representing 5.32% of that particular portfolio. At June 30, 2014, home equity lines of credit and closed-end second mortgages in which E-LOAN holds both the first and second lien amounted to $47 thousand and $235 thousand, respectively, representing 0.01% and 0.05%, respectively, of the consumer loan portfolio of the BPNA segment. At June 30, 2014, 50% are

paying the minimum amount due on the home equity lines of credit. At June 30, 2014, all of the closed-end second mortgages in which E-LOAN holds the first lien mortgage were in performing status.

211

Table of Contents

Troubled debt restructurings

The following tables present the loans classified as TDRs according to their accruing status at June 30, 2014 and December 31, 2013. The Corporation s TDR loans totaled $1.0 billion at June 30, 2014, an increase of $77 million from December 31, 2013. TDRs in accruing status increased by $25 million from December 31, 2013, due to sustained borrower performance.

Table 51 TDRs Non-Covered Loans

	June 30, 2014		
(In thousands)	Accruing	Non-Accruing	Total
Commercial	$ 109,205	$ 113,148	$ 222,353
Construction	376	13,391	13,767
Mortgage	566,355	100,381	666,736
Leases	875	1,778	2,653
Consumer	110,066	11,681	121,747
Total	$ 786,877	$ 240,379	$ 1,027,256

Excludes TDRs from discontinued operations.

Table 52 TDRs Non-Covered Loans

	December 31, 2013		
(In thousands)	Accruing	Non-Accruing	Total
Commercial	$ 109,462	$ 80,140	$ 189,602
Construction	425	10,865	11,290
Legacy		949	949
Mortgage	535,357	82,786	618,143
Leases	270	2,623	2,893
Consumer	116,719	10,741	127,460
Total	$ 762,233	$ 188,104	$ 950,337

Table 53 TDRs Covered Loans

	June 30, 2014		
(In thousands)	Accruing	Non-Accruing	Total
Commercial	$ 14	$ 2,384	$ 2,398
Construction		2,962	2,962
Mortgage	2,804	592	3,396
Consumer	106	15	121

Total	$ 2,924	$ 5,953	$ 8,877

Table 54 TDRs Covered Loans

	December 31, 2013		
(In thousands)	Accruing	Non-Accruing	Total
Commercial	$ 7,389	$ 10,017	$ 17,406
Construction		3,464	3,464
Mortgage	146	189	335
Consumer	221	22	243
Total	$ 7,756	$ 13,692	$ 21,448

At June 30, 2014, the Corporation s commercial loan TDRs, excluding covered loans, for the BPPR and BPNA segments amounted to $219 million and $3 million, respectively, of which $111 million and $3 million, respectively, were in non-performing status. This compares with $172 million and $18 million, respectively, of which $63 million and $17 million were in non-performing status at December 31, 2013. The outstanding commitments for these commercial loan TDRs amounted to $4 million in the BPPR segment and no commitments outstanding in the BPNA segment at June 30, 2014. Commercial loans that have been modified as part of loss mitigation efforts were evaluated individually for impairment, resulting in a specific reserve of $26 million for the BPPR segment and none for the BPNA segment at June 30, 2014, compared with $13 million and none, respectively, at December 31, 2013.

At June 30, 2014, the Corporation s construction loan TDRs, excluding covered loans, for the BPPR segment amounted to $14 million, all of which were in non-performing status. The BPNA segment had no TDRs to report as of June 30, 2014. This compares with $6 million each, of which $5 million and $6 million, respectively, were in non-performing status at December 31, 2013. The outstanding commitments to lend additional funds to debtors owing loans whose terms have been modified in troubled debt restructurings for these construction loan TDRs amounted to $697 thousand in the BPPR segment and no commitments outstanding in the BPNA segment at June 30, 2014. These construction loan TDRs were individually evaluated for impairment resulting in a specific reserve of $883 thousand for the BPPR segment and none for the BPNA segment at June 30, 2014, compared to $177 thousand for the BPPR segment and none for the BPNA segment at December 31, 2013.

At June 30, 2014, the BPNA segment had no legacy TDRs to report as of June 30, 2014, compared to a total of $949 thousand of loan modifications at December 31, 2013. There were no commitments outstanding for these legacy loan TDRs at June 30, 2014. The legacy loan TDRs were evaluated for impairment requiring no specific reserves at June 30, 2014 and December 31, 2013.

At June 30, 2014, the mortgage loan TDRs for the BPPR and BPNA segments amounted to $615 million (including $269 million guaranteed by U.S. sponsored entities) and $52 million, respectively, of which $91 million and $9 million, respectively, were in non-performing status. This compares with $565 million (including $240 million guaranteed by U.S. sponsored entities) and $53 million, respectively, of which $73 million and $10 million were in non-performing status at December 31, 2013. These mortgage loan TDRs were evaluated for impairment resulting in a specific allowance for loan losses of $39 million and $14 million for the BPPR and BPNA segments, respectively, at June 30, 2014, compared to $38 million and $18 million, respectively, at December 31, 2013.

At June 30, 2014, the consumer loan TDRs for the BPPR and BPNA segments amounted to $119 million and $2 million, respectively, of which $11 million and $538 thousand, respectively, were in non-performing status, compared with $125 million and $2 million, respectively, of which $10 million and $587 thousand, respectively, were in non-performing status at December 31, 2013. These consumer loan TDRs were evaluated for impairment resulting in a specific allowance for loan losses of $28 million and $585 thousand for the BPPR and BPNA segments, respectively, at June 30, 2014, compared with $30 million and $280 thousand, respectively, at December 31, 2013.

Refer to Note 10 to the consolidated financial statements for additional information on modifications considered troubled debt restructurings, including certain qualitative and quantitative data about troubled debt restructurings performed in the past twelve months.

Other real estate

Other real estate represents real estate property acquired through foreclosure, part of the Corporation s continuous efforts to aggressively resolve non-performing loans. Other real estate not covered under loss sharing agreements with the FDIC increased by $3.9 million from December 31, 2013 to June 30, 2014.

Other real estate covered under loss sharing agreements with the FDIC, comprised principally of repossessed commercial real estate properties, amounted to $156 million at June 30, 2014, compared with $168 million at December 31, 2013. Generally, 80% of the write-downs taken on these properties based on appraisals or losses on the sale are covered under the loss sharing agreements.

During the second quarter of 2014, the Corporation transferred $48 million of loans to other real estate, sold $36 million of foreclosed properties and recorded write-downs and other adjustments of approximately $12 million.

Updated appraisals or third-party opinions of value (BPOs) are obtained to adjust the values of the other real estate assets. Commencing in 2011, the appraisal for a commercial or construction other real estate property with a book value greater than $1 million is updated annually and if lower than $1 million it is updated at least every two years. For residential other real estate property, the Corporation requests third-party BPOs or appraisals generally on an annual basis. Appraisals may be adjusted due to age, collateral inspections and property profiles or due to general marked conditions. The adjustments applied are based upon internal information like other appraisals for the type of properties and loss severity information that can provide historical trends in the real estate market, and may change from time to time based on market conditions.

For commercial and construction other real estate properties at the BPPR segment, depending on the type of property and/or the age of the appraisal, downward adjustments currently may range between 15% to 45%, including estimated cost to sell. For commercial and construction properties at the BPNA segment, the most typically applied collateral discount rate currently ranges from 10% to 40%, including cost to sell. This discount was determined based on an analysis of other real estate owned and loan sale transactions during the past year, comparing net proceeds received by the lender relative to the most recent appraised value of the properties. However, additional haircuts can be applied depending upon the age of appraisal, the region and the condition of the property or project.

Currently, in the case of the BPPR segment, appraisals of residential properties were subject to downward adjustments of up to approximately 15%, including cost to sell of 5%. In the case of the U.S. mainland residential properties, the downward adjustment approximated up to 30%, including cost to sell of 10%.

Table of Contents

Allowance for Loan Losses

Non-Covered Loan Portfolio

The allowance for loan losses, which represents management s estimate of credit losses inherent in the loan portfolio, is maintained at a sufficient level to provide for estimated credit losses on individually evaluated loans as well as estimated credit losses inherent in the remainder of the loan portfolio. The Corporation s management evaluates the adequacy of the allowance for loan losses on a quarterly basis. In this evaluation, management considers current economic conditions and the resulting impact on Popular Inc. s loan portfolio, the composition of the portfolio by loan type and risk characteristics, historical loss experience, results of periodic credit reviews of individual loans, regulatory requirements and loan impairment measurement, among other factors.

The Corporation must rely on estimates and exercise judgment regarding matters where the ultimate outcome is unknown, such as economic developments affecting specific customers, industries or markets. Other factors that can affect management s estimates are the years of historical data when estimating losses, changes in underwriting standards, financial accounting standards and loan impairment measurements, among others. Changes in the financial condition of individual borrowers, in economic conditions, in historical loss experience and in the condition of the various markets in which collateral may be sold may all affect the required level of the allowance for loan losses. Consequently, the business financial condition, liquidity, capital and results of operations could also be affected.

The Corporation s assessment of the allowance for loan losses is determined in accordance with accounting guidance, specifically guidance of loss contingencies in ASC Subtopic 450-20 (general reserve for inherent losses) and loan impairment guidance in ASC Section 310-10-35 (loans individually assessed for impairment). Decreases in expected cash flows after the acquisition date for loans (pools) accounted for under ASC Subtopic 310-30 are recognized by recording an allowance for loan losses in the current period. For purposes of loans accounted for under ASC Subtopic 310-20 and new loans originated as a result of loan commitments assumed, the Corporation s assessment of the allowance for loan losses is determined in accordance with the accounting guidance of loss contingencies in ASC Subtopic 450-20 (general reserve for inherent losses) and loan impairment guidance in ASC Section 310-10-35 for loans individually evaluated for impairment. Refer to the Critical Accounting Policies / Estimates section of this MD&A for a description of the Corporation s allowance for loan losses methodology.

The following tables set forth information concerning the composition of the Corporation s allowance for loan losses (ALLL) at June 30, 2014 and December 31, 2013 by loan category and by whether the allowance and related provisions were calculated individually pursuant to the requirements for specific impairment or through a general valuation allowance.

Table 55 Composition of ALLL

	June 30, 2014						
(Dollars in thousands)	Commercial	Construction	Legacy [3]	Leasing	Mortgage	Consumer	Total[2]
Specific ALLL	$ 36,597	$ 883	$	$ 688	$ 53,815	$ 29,043	$ 121,026
Impaired loans [1]	$ 317,746	$ 21,094	$ 2,536	$ 2,653	$ 466,243	$ 122,106	$ 932,378
Specific ALLL to impaired loans [1]	11.52%	4.19%	%	25.93%	11.54%	23.79%	12.98%
General ALLL	$ 165,912	$ 4,459	$ 9,343	$ 5,271	$ 84,113	$ 136,122	$ 405,220

Loans held-in-portfolio, excluding impaired loans [1]	$ 7,837,801	$ 157,965	$ 160,405	$ 544,215	$ 6,198,205	$ 3,804,255	$ 18,702,846
General ALLL to loans held-in-portfolio, excluding impaired loans [1]	2.12%	2.82%	5.82%	0.97%	1.36%	3.58%	2.17%
Total ALLL	$ 202,509	$ 5,342	$ 9,343	$ 5,959	$ 137,928	$ 165,165	$ 526,246
Total non-covered loans held-in-portfolio [1]	$ 8,155,547	$ 179,059	$ 162,941	$ 546,868	$ 6,664,448	$ 3,926,361	$ 19,635,224
ALLL to loans held-in-portfolio [1]	2.48%	2.98%	5.73%	1.09%	2.07%	4.21%	2.68%

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

[2] Excludes covered loans acquired on the Westernbank FDIC-assisted transaction. At June 30, 2014, the general allowance on the covered loans amounted to $98.7 million, while specific reserve amounted to $8 thousand.

[3] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

Table of Contents

Table 56 Composition of ALLL

	December 31, 2013						
(Dollars in thousands)	Commercial	Construction	Legacy[3]	Leasing	Mortgage	Consumer	Total[2]
Specific ALLL	$ 16,409	$ 177	$	$ 1,053	$ 55,667	$ 30,200	$ 103,506
Impaired loans [1]	$ 297,516	$ 22,486	$ 6,045	$ 2,893	$ 452,073	$ 127,703	$ 908,716
Specific ALLL to impaired loans [1]	5.52%	0.79%	%	36.40%	12.31%	23.65%	11.39%
General ALLL	$ 158,573	$ 5,165	$ 13,704	$ 9,569	$ 101,262	$ 146,684	$ 434,957
Loans held-in-portfolio, excluding impaired loans [1]	$ 9,739,669	$ 183,598	$ 205,090	$ 540,868	$ 6,229,403	$ 3,804,523	$ 20,703,151
General ALLL to loans held-in-portfolio, excluding impaired loans [1]	1.63%	2.81%	6.68%	1.77%	1.63%	3.86%	2.10%
Total ALLL	$ 174,982	$ 5,342	$ 13,704	$ 10,622	$ 156,929	$ 176,884	$ 538,463
Total non-covered loans held-in-portfolio [1]	$ 10,037,185	$ 206,084	$ 211,135	$ 543,761	$ 6,681,476	$ 3,932,226	$ 21,611,867
ALLL to loans held-in-portfolio [1]	1.74%	2.59%	6.49%	1.95%	2.35%	4.50%	2.49%

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

[2] Excludes covered loans acquired on the Westernbank FDIC-assisted transaction. At December 31, 2013, the general allowance on the covered loans amounted to $101.8 million while the specific reserve amounted to $0.3 million.

[3] The legacy portfolio is comprised of commercial loans, construction loans and lease financings related to certain lending products exited by the Corporation as part of restructuring efforts carried out in prior years at the BPNA segment.

At June 30, 2014, the allowance for loan losses, excluding covered loans, decreased by approximately $12 million when compared with December 31, 2013, mainly driven by a $52 million reserve release in BPNA prompted by continued improvements in credit quality trends and $20 million related to the transfer to LHFS of the discontinued operations, offset in part by higher reserves for the BPPR segment of $39 million. The general and specific reserves related to non-covered loans totaled $405 million and $121 million, respectively, at quarter-end, compared with $435 million and $104 million, respectively, as of December 31, 2013. The ratio of the allowance for loan losses to loans held-in-portfolio stood at 2.68% in the second quarter of 2014, compared to 2.49% in the quarter ended December 31, 2013. The ratio of allowance to non-performing loans held-in-portfolio was 82.26% at June 30, 2014, compared with 90.05% at December 31, 2013.

At June 30, 2014, the allowance for loan losses for non-covered loans at the BPPR segment totaled $466 million, or 2.94% of non-covered loans held-in-portfolio, compared with $427 million, or 2.69% of non-covered loans held-in-portfolio, at December 31, 2013. The increase in the allowance was mostly driven by: (1) environmental factors adjustments accounting for prevailing macroeconomic conditions in Puerto Rico and the public sector utilities exposures, (2) the effect of downgrades in the internal risk ratings of certain large corporate and public sector relationships, and (3) higher specific reserves, partially offset by a $15 million reserve release as part of the annual review of the components of the ALLL models. The allowance for loan losses at the BPNA segment totaled $60 million, or 1.59% of loans held-in-portfolio, compared with $112 million, or 1.95% of loans held-in-portfolio, at December 31, 2013, reflective of continued improvements in credit quality trend, the reclassification of $20.2 million attributable to the discontinued operation, and a $3.8 million reserve release as part of the annual review of the components of the ALLL models. The ratio of allowance to non-performing loans held-in portfolio was 81.26% and 90.98% for the BPPR and BPNA segments, respectively as of June 30, 2014, compared with 95.42% and 74.12% at December 31, 2013.

The allowance for loan losses for commercial loans held-in-portfolio, excluding covered loans, amounted to $203 million, or 2.48% of that portfolio, at June 30, 2014, compared with $175 million, or 1.74%, at December 31, 2013. The allowance for loan losses for the commercial loan portfolio in the BPPR segment, excluding the allowance for covered loans, totaled $184 million, or 2.92% of non-covered commercial loans held-in-portfolio, at June 30, 2014, compared with $128 million, or 1.98%, at December 31, 2013. The increase in the allowance was mostly driven by the previously mentioned factors. At the BPNA segment, the allowance for loan losses of the commercial loan portfolio totaled $18 million, or 0.98% of commercial loans held-in-portfolio, at June 30, 2014, compared with $47 million, or 1.31%, at December 31, 2013. The decrease in allowance for loan losses for the commercial loans held-in-portfolio is primarily reflective of the continued improvements in credit quality trends, the reclassification to LHFS of the discontinued operations, and a reserve release as part of the annual review of the components of the ALLL models.

The allowance for loan losses for construction loans held-in-portfolio, excluding covered loans, remained unchanged at $5 million, or 2.98% of that portfolio, at June 30, 2014, compared with $5 million, or 2.59%, at December 31, 2013. The allowance for loan losses corresponding to the construction loan portfolio for the BPPR segment, excluding the allowance for covered loans, totaled $5 million, or 3.83% of non-covered construction loans held-in-portfolio, at June 30, 2014, compared with $5 million, or 3.16%, at December 31, 2013. At the BPNA segment, the allowance for loan losses of the construction loan portfolio totaled $151 thousand, or 0.35% of construction loans held-in-portfolio, at June 30, 2014, compared with $247 thousand, or 0.55%, at December 31, 2013. The allowance levels in the construction portfolio are the result of de-risking strategies executed by the Corporation over the past several years to downsize its construction loan portfolio.

The allowance for loan losses for the legacy loans held-in-portfolio amounted to $9 million, or 5.73% of that portfolio, at June 30, 2014, compared with $14 million, or 6.49%, at December 31, 2013. The decrease in the allowance for loan losses is consistent with improved credit trends, lower loan balances and lower non-performing loans.

The allowance for loan losses for mortgage loans held-in-portfolio, excluding covered loans, amounted to $138 million, or 2.07% of that portfolio, at June 30, 2014, compared with $157 million, or 2.35%, at December 31, 2013. The allowance for loan losses corresponding to the mortgage loan portfolio at the BPPR segment totaled $120 million, or 2.21% of mortgage loans held-in-portfolio, excluding covered loans, at June 30, 2014 compared with $130 million, or 2.41%, respectively, at December 31, 2013. The decrease in the allowance was reflective of a lower environmental factors adjustment. At the BPNA segment, the allowance for loan losses corresponding to the mortgage loan portfolio totaled $18 million, or 1.45% of mortgage loans held-in-portfolio, at June 30, 2014, compared with $27 million, or 2.08%, at December 31, 2013. The decrease in the allowance is reflective of favorable credit trends and the run-off of the portfolio. The allowance for loan losses for BPNA s non-conventional mortgage loan portfolio amounted to $17 million, or 4.21% of that particular loan portfolio, compared with $23 million, or 5.57%, at December 31, 2013. The Corporation is no longer originating non-conventional mortgage loans at BPNA.

The allowance for loan losses for the consumer portfolio, excluding covered loans, amounted to $165 million, or 4.21% of that portfolio, at June 30, 2014, compared to $177 million, or 4.50%, at December 31, 2013. The allowance for loan losses of the non-covered consumer loan portfolio in the BPPR segment totaled $150 million, or 4.41% of that portfolio, at June 30, 2014, compared with $153 million, or 4.60%, at December 31, 2013. Overall consumer portfolios display stable trends, decreasing by $3 million when compared to December 31, 2013. At the BPNA segment, the allowance for loan losses of the consumer loan portfolio totaled $15 million, or 2.88% of consumer loans, at June 30, 2014, compared with $24 million, or 3.95%, at December 31, 2013. The decrease in the allowance for loan losses for the consumer loan portfolio was principally driven by lower loss trends, reflecting favorable credit trends.

The following table presents the Corporation s recorded investment in loans that were considered impaired and the related valuation allowance at June 30, 2014 and December 31, 2013.

Table 57 Impaired Loans (Non-Covered Loans) and the Related Valuation Allowance

	June 30, 2014		December 31, 2013	
(In millions)	Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance
Impaired loans:				
Valuation allowance	$ 754.0	$ 121.0	$ 642.6	$ 103.5

No valuation allowance required	178.4		266.1	
Total impaired loans	$ 932.4	$ 121.0	$ 908.7	$ 103.5

With respect to the $178 million non-covered portfolio of impaired loans for which no allowance for loan losses was required at June 30, 2014, management followed the guidance for specific impairment of a loan. When a loan is impaired, the measurement of the impairment may be based on: (1) the present value of the expected future cash flows of the impaired loan discounted at the loan s original effective interest rate; (2) the observable market price of the impaired loan; or (3) the fair value of the collateral, if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. Impaired loans with no valuation allowance were mostly collateral dependent loans for which management charged-off specific reserves based on the fair value of the collateral less estimated costs to sell.

216

Table of Contents

Average impaired loans, excluding covered loans, during the quarters ended June 30, 2014 and June 30, 2013 were $939.4 million and $1.0 billion, respectively. The Corporation recognized interest income on non-covered impaired loans of $8.8 million and $10.1 million for the quarters ended June 30, 2014 and June 30, 2013, respectively.

The following tables set forth the activity in the specific reserves for impaired loans for the quarters ended June 30, 2014 and June 30, 2013.

Table 58 Activity in Specific ALLL for the Quarter Ended June 30, 2014

(In thousands)	Commercial	Construction	Mortgage	Legacy	Consumer	Leasing	Total
Beginning balance	$ 30,892	$ 243	$ 53,916	$	$ 29,413	$ 672	$ 115,136
Provision for impaired loans	13,576	537	2,371		4,316	16	20,816
Less: Net charge-offs	(7,871)	103	(2,472)		(4,686)		(14,926)
Specific allowance for loan losses at June 30, 2014	$ 36,597	$ 883	$ 53,815	$	$ 29,043	$ 688	$ 121,026

Table 59 Activity in Specific ALLL for the Quarter Ended June 30, 2013

(In thousands)	Commercial	Construction	Mortgage	Legacy	Consumer	Leasing	Total
Beginning balance	$ 21,776	$ 135	$ 75,697	$	$ 24,472	$ 1,662	$ 123,742
Provision for impaired loans	16,693	2,349	55,358	603	9,310	(263)	84,050
Less: Net charge-offs	(19,750)	(1,083)	(2,109)	(603)	(2,528)		(26,073)
Net write-downs			(75,668)				(75,668)
Specific allowance for loan losses at June 30, 2013	$ 18,719	$ 1,401	$ 53,278	$	$ 31,254	$ 1,399	$ 106,051

For the quarter ended June 30, 2014, total net charge-offs for individually evaluated impaired loans amounted to approximately $14.9 million, of which $14.7 million pertained to the BPPR segment and $233 thousand to the BPNA segment. Most of these net charge-offs were related to the commercial loan portfolio.

The Corporation requests updated appraisal reports from pre-approved appraisers for loans that are considered impaired, and individually analyzes them following the Corporation s reappraisal policy. This policy requires updated appraisals for loans secured by real estate (including construction loans) either annually or every two years depending on the total exposure of the borrower. As a general procedure, the Corporation internally reviews appraisals as part of the underwriting and approval process and also for credits considered impaired. Generally, the specialized appraisal review unit of the Corporation s Credit Risk Management Division internally reviews appraisals following certain materiality benchmarks. In addition to evaluating the reasonability of the appraisal reports, these reviews monitor that appraisals are performed following the Uniform Standards of Professional Appraisal Practice (USPAP).

Appraisals may be adjusted due to age or general market conditions. The adjustments applied are based upon internal information, like other appraisals and/or loss severity information that can provide historical trends in the real estate market. Specifically, in commercial and construction impaired loans for the BPPR segment, and depending on the

type of property and/or the age of the appraisal, downward adjustments currently range from 15% to 45% (including costs to sell). At June 30, 2014, the weighted average discount rate for the BPPR segment was 18%.

For commercial and construction loans at the BPNA segment, downward adjustments to the collateral value currently range from 10% to 40% depending on the age of the appraisals and the type, location and condition of the property. This discount used was determined based on an analysis of other real estate owned and loan sale transactions during the past year, comparing net proceeds received by the bank relative to the most recent appraised value of the properties. However, additional haircuts can be applied depending upon the age of appraisal, the region and the condition of the project. Factors are based on appraisal changes and/or trends in loss severities. Discount rates discussed above include costs to sell and may change from time to time based on market conditions. At June 30, 2014, the weighted average discount rate for the BPNA segment was 31%.

Table of Contents

For mortgage loans secured by residential real estate properties, a current assessment of value is made not later than 180 days past the contractual due date. Any outstanding balance in excess of the estimated value of the collateral property, less estimated costs to sell, is charged-off. For this purpose, the Corporation requests third-party Broker Price Opinion of Value BPOs of the subject collateral property at least annually. In the case of the mortgage loan portfolio for the BPPR segment, BPOs of the subject collateral properties are currently subject to downward adjustment of up to approximately 26%, including cost to sell of 5%. In the case of the U.S. mortgage loan portfolio, a haircut up to 30% is taken, which includes costs to sell.

Discount rates discussed above include costs to sell and may change from time to time based on market conditions.

The table that follows presents the approximate amount and percentage of non-covered impaired loans for which the Corporation relied on appraisals dated more than one year old for purposes of impairment requirements at June 30, 2014 and December 31, 2013.

Table 60 Non-Covered Impaired Loans with Appraisals Dated 1 year or Older

	June 30, 2014		
	Total Impaired Loans Held-in-portfolio (HIP)		
(In thousands)	Loan Count	Outstanding Principal Balance	Impaired Loans with Appraisals Over One-Year Old [1]
Commercial	138	$ 263,091	6 %
Construction	7	19,039	40
Legacy	1	2,536	

[1] Based on outstanding balance of total impaired loans.

	December 31, 2013		
	Total Impaired Loans Held-in-portfolio (HIP)		
(In thousands)	Loan Count	Outstanding Principal Balance	Impaired Loans with Appraisals Over One-Year Old [1]
Commercial	174	$ 248,154	18 %
Construction	9	20,162	27
Legacy	4	6,045	

[1] Based on outstanding balance of total impaired loans.

The percentage of the Corporation s impaired construction loans that were relied upon as developed and as is for the periods ended June 30, 2014 and December 31, 2013 are presented in Table 61.

At June 30, 2014 and December 31, 2013, the Corporation accounted for $13 million and $6 million, respectively, impaired construction loans under the as developed value. This approach is used since the current plan is that the project will be completed and it reflects the best strategy to reduce potential losses based on the prospects of the project. The costs to complete the project and the related increase in debt are considered an integral part of the individual reserve determination.

Costs to complete are deducted from the subject as developed collateral value on impaired construction loans. Impairment determinations are calculated following the collateral dependent method, comparing the outstanding principal balance of the respective impaired construction loan against the expected realizable value of the subject collateral. Realizable values of subject collaterals have been defined as the as developed appraised value less costs to complete, costs to sell and discount factors. Costs to complete represent an estimate of the amount of money to be disbursed to complete a particular phase of a construction project. Costs to sell have been determined as a percentage of the subject collateral value, to cover related collateral disposition costs (e.g. legal and commission fees). As discussed previously, discount factors may be applied to the appraised amounts due to age or general market conditions.

Table of Contents

Table 61 Impaired Construction Loans Relied Upon As is or As Developed

	June 30, 2014						
	As is			As developed			
(In thousands)	Loan Count	Outstanding Principal Balance	As a % Of Total Construction Impaired Loans HIP	Loan Count	Outstanding Principal Balance	As a % Of Total Construction Impaired Loans HIP	Average % Of Completion
Loans held-in-portfolio	8	$ 8,168	39%	3	$ 12,926	61%	92%

	December 31, 2013						
	As is			As developed			
(In thousands)	Loan Count	Outstanding Principal Balance	As a % Of Total Construction Impaired Loans HIP	Loan Count	Outstanding Principal Balance	As a % Of Total Construction Impaired Loans HIP	Average % Of Completion
Loans held-in-portfolio [1]	12	$ 18,835	77%	2	$ 5,703	23%	90%

[1] Includes $2.1 million of construction loans from the BPNA legacy portfolio.

Allowance for loan losses Covered loan portfolio

The Corporation s allowance for loan losses for the covered loan portfolio acquired in the Westernbank FDIC-assisted transaction amounted to $99 million at June 30, 2014. This allowance covers the estimated credit loss exposure related to: (i) acquired loans accounted for under ASC Subtopic 310-30, which required an allowance for loan losses of $91 million at June 30, 2014, compared with $94 million at December 31, 2013; and (ii) acquired loans accounted for under ASC Subtopic 310-20, which required an allowance for loan losses of $8 million at June 30, 2014 and at December 31, 2013.

Decreases in expected cash flows after the acquisition date for loans (pools) accounted for under ASC Subtopic 310-30 are recognized by recording an allowance for loan losses in the current period. For purposes of loans accounted for under ASC Subtopic 310-20 and new loans originated as a result of loan commitments assumed, the Corporation s assessment of the allowance for loan losses is determined in accordance with the accounting guidance of loss contingencies in ASC Subtopic 450-20 (general reserve for inherent losses) and loan impairment guidance in ASC Section 310-10-35 for loans individually evaluated for impairment. Concurrently, the Corporation records an increase in the FDIC loss share asset for the expected reimbursement from the FDIC under the loss sharing agreements.

Geographic and government risk

The Corporation is exposed to geographical and government risk. The Corporation s assets and revenue composition by geographical area and by business segment reporting are presented in Note 36 to the consolidated financial statements. A significant portion of the Corporation s financial activities and credit exposure is concentrated in Puerto Rico, which has been going through a challenging economic cycle. Puerto Rico s fiscal and economic situation is expected to continue to be difficult.

In February 2014, the three principal rating agencies (Moody s, S&P and Fitch) lowered their ratings on the General obligation bonds of the Commonwealth of Puerto Rico and on the bonds of several other Commonwealth instrumentalities to non-investment grade ratings. In connection with their rating actions the rating agencies have noted various factors, including high levels of public debt, the lack of a clear economic growth catalyst, fiscal budget deficits, the financial condition of the public sector employee pension plans and, more recently liquidity concerns regarding the Commonwealth and Government Development Bank for Puerto Rico and concerns regarding access to market financing.

219

Table of Contents

In March 2014, the Commonwealth of Puerto Rico sold $3.5 billion in General Obligation bonds yielding 8.72% rated below investment grade, which should improve liquidity at the Government Development Bank for Puerto Rico and alleviate the short term liquidity situation. This financing is expected to provide liquidity to the Central Government through July 2015.

On June 28, 2014, Governor Alejandro García Padilla signed into law the Puerto Rico Public Corporations Debt Enforcement and Recovery Act (the Recovery Act) which provides a framework for certain public corporations, including the Puerto Rico Electric Power Authority, Puerto Rico Aqueduct & Sewer Authority and the Puerto Rico Highways and Transportation Authority, to restructure their debt obligations in order to ensure that the services they provide to the public are not interrupted. As explained in the legislation not all public corporations may use the Recovery Act. There are other governmental entities not included such as debt from the Commonwealth, the Government Development Bank for Puerto Rico (GDB) and its subsidiaries, affiliates and other ascribed entities, the seventy eight municipalities, the PR Sales Tax and Financing Corporation, and the Employees Retirement System, among others. Several institutional investors have filed lawsuits challenging the legality of the new law.

Given that the U.S. Bankruptcy code does not apply to municipal debt in Puerto Rico the Recovery Act aims to provide a process similar to U.S. Federal Bankruptcy in which certain Puerto Rico s public corporations may be able to restructure their debt obligations with their bondholders, creditors and other stakeholders. The primary objective is to make them self sufficient and not rely on the Commonwealth General fund or the Government Development Bank for financial support.

On July 1, 2014, Moody s, as a consequence to the enactment of the Recovery Act, downgraded the majority of the Puerto Rico central government and public instrumentalities obligations expressing its concern for all of Puerto Rico s municipal debt based on the deteriorating fiscal situation on the island and the possibility that application of the new law may further limit the Commonwealth s ability to access the capital markets. Both S&P and Fitch later issued ratings downgrades for various Puerto Rico Municipal issuers including Puerto Rico Electric Power Authority.

The PR Electric Power Authority faces significant fiscal and financial challenges that have to be addressed in the short term in order to stabilize its operations. They include a $696 million short term credit facility from various banks, the majority of which has been extended until August 14, 2014, pursuant to a forbearance agreement, significant recurring operational and budgetary shortfalls, high rates compared to US, high leverage, limited fuel diversification, significant CAPEX needs as well as burdensome environmental regulatory requirements.

In the case of the two other principal Public corporations subject to the Recovery Act, the Puerto Rico Aqueduct and Sewer Authority has been operating without relying on General fund or GDB s support as a significant rate increase in July 2013 has generated additional revenues that according to the Authority are expected to be sufficient to cover their operating expenses and financial obligations during the next three years. However, it also faces some challenges including the refinancing of $200 million in Bond Anticipation Notes due in March 2015 and complying with various regulatory requirements that require capital expenditures. The Highways and Transportation Authority challenges include, recurring operational and budgetary shortfall even after finding new sources of revenue through ACTS 30 and 31 and implementation of cost savings initiatives.

The latest GDB Economic Activity index published of June 2014 reflected a 1% year over year reduction after showing a 1.1% reduction year over year in May 2014.

The lingering effects of the prolonged recession are still reflected in limited loan demand, an increase in the rate of delinquency rates on mortgage loans granted in Puerto Rico and the financial condition of commercial borrowers. If the prices of crude oil increases and / or global or local economic conditions worsen it could result in a reduction in

consumer spending which could adversely impact our non-interest revenues.

At June 30, 2014, the Corporation s direct exposure to the Puerto Rico government and instrumentalities and municipalities amounted to $833 million, of which approximately $709 million is outstanding ($1.2 billion and $950 million at December 31, 2013). Of the amount outstanding, $570 million consists of loans and $139 million are securities ($789 million and $161 million at December 31, 2013). Of this amount, $272 million represents obligations from the Government of Puerto Rico and public corporations that are either collateralized loans or obligations that have a specific source of income or revenues identified for their repayment ($527 million at December 31, 2013). Some of these obligations consist of senior and subordinated loans to public corporations that obtain revenues from rates charged for services or products, such as public utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it. The remaining $437 million represents obligations from various municipalities in Puerto Rico for which, in most cases, the good faith, credit and unlimited taxing power of the applicable municipality has been pledged to their repayment ($423 million at December 31, 2013). These municipalities are required by law to levy special property taxes in such amounts as shall be required for the payment of all of its general obligation bonds and loans. These loans have seniority to the payment of operating cost and expenses of the municipality. Table 62 has a summary of the Corporation s direct exposure to the Puerto Rico Government.

Table of Contents

Table 62 Direct Exposure to the Puerto Rico Government

(In thousands)	Investment Portfolio	Loans	Total Outstanding	Total Exposure
Central Government	$ 68,971	$	$ 68,971	$ 99,244
Government Development Bank (GDB)	6,921		6,921	6,921
Public Corporations:				
Puerto Rico Aqueduct and Sewer Authority	448	100,000	100,448	130,819
Puerto Rico Electric Power Authority		74,997	74,997	93,800
Puerto Rico Highways and Transportation Authority	3		3	3
Other		20,750	20,750	25,500
Municipalities	62,155	374,318	436,473	476,381
Total Direct Government Exposure	$ 138,498	$ 570,065	$ 708,563	$ 832,668

In addition, at June 30, 2014, the Corporation had $360 million in indirect exposure to loans or securities that are payable by non-governmental entities, but which carry a government guarantee to cover any shortfall in collateral in the event of borrower default ($360 million at December 31, 2013). These included $279 million in residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority (December 31, 2013 - $274 million). These mortgage loans are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. Also, the Corporation had $48 million in Puerto Rico pass-through housing bonds backed by FNMA, GNMA or residential loans CMO s, and $33 million of industrial development notes ($52 million and $34 million, respectively, at December 31, 2013).

As further detailed in Notes 7 and 8 to the consolidated financial statements, a substantial portion of the Corporation s investment securities represented exposure to the U.S. Government in the form of U.S. Government sponsored entities, as well as agency mortgage-backed and U.S. Treasury securities. In addition, $937 million of residential mortgages and $131 million in commercial loans were insured or guaranteed by the U.S. Government or its agencies at June 30, 2014. The Corporation does not have any exposure to European sovereign debt.

ADOPTION OF NEW ACCOUNTING STANDARDS AND ISSUED BUT NOT YET EFFECTIVE ACCOUNTING STANDARDS

Refer to Note 2, New Accounting Pronouncements .

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and qualitative disclosures for the current period can be found in the Market Risk section of this report, which includes changes in market risk exposures from disclosures presented in the Corporation s 2013 Annual Report.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

Internal Control Over Financial Reporting

There have been no changes in the Corporation s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

Part II Other Information

Item 1. Legal Proceedings

For a discussion of Legal Proceedings, see Note 24, Commitments and Contingencies , to the Consolidated Financial Statements.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed under Part I Item 1A Risk Factors in our 2013 Annual Report. These factors could materially adversely affect our business, financial condition, liquidity, results of operations and capital position, and could cause our actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report. Also refer to the discussion in Part I Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations in this report for additional information that may supplement or update the discussion of risk factors in our 2013 Annual Report.

There have been no material changes to the risk factors previously disclosed under Item 1A of the Corporation s 2013 Annual Report, except for the risks described below.

The risks described in our 2013 Annual Report and in this report are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or results of operations.

Table of Contents

RISKS RELATED TO THE FDIC-ASSISTED TRANSACTION

Our ability to obtain reimbursement under the loss sharing agreements on covered assets depends on our compliance with the terms of the loss sharing agreements.

The loss share agreements contain specific terms and conditions regarding the management of the covered assets that BPPR must follow to receive reimbursement on losses from the FDIC. Under the loss share agreements, BPPR must:

- manage and administer the covered assets and collect and effect charge-offs and recoveries with respect to such covered assets in a manner consistent with its usual and prudent business and banking practices and, with respect to single family shared-loss loans, the procedures (including collection procedures) customarily employed by BPPR in servicing and administering mortgage loans for its own account and the servicing procedures established by FNMA or FHLMC, as in effect from time to time, and in accordance with accepted mortgage servicing practices of prudent lending institutions;

- exercise its best judgment in managing, administering and collecting amounts on covered assets and effecting charge-offs with respect to the covered assets;

- use commercially reasonable efforts to maximize recoveries with respect to losses on single family shared-loss assets and best efforts to maximize collections with respect to commercial shared-loss assets;

- retain sufficient staff to perform the duties under the loss share agreements;

- adopt and implement accounting, reporting, record-keeping and similar systems with respect to the commercial shared-loss assets;

- comply with the terms of the modification guidelines approved by the FDIC or another federal agency for any single-family shared loss loan;

- provide notice with respect to proposed transactions pursuant to which a third party or affiliate will manage, administer or collect any commercial shared-loss assets; and

- file monthly and quarterly certificates with the FDIC specifying the amount of losses, charge-offs and recoveries.

Under the loss share agreements, BPPR is also required to maintain books and records sufficient to ensure and document compliance with the terms of the loss share agreements.

Under the terms of the loss share agreements, BPPR is also required to deliver certain certificates regarding compliance with the terms of each of the loss share agreements and the computations required there under. The

required terms of the agreements are extensive and failure to comply with any of the guidelines could result in a specific asset or group of assets permanently losing their loss sharing coverage. BPPR believes that it has complied with the terms and conditions regarding the management of the covered assets. No assurances can be given that we will manage the covered assets in such a way as to always maintain loss share coverage on all such assets and fully recover the value of our loss share asset.

For the quarters ended June 30, 2010 through March 31, 2012, BPPR received reimbursement for loss-share claims submitted to the FDIC, including charge-offs for certain commercial late stage real-estate-collateral-dependent loans and OREO calculated in accordance with BPPR s charge-off policy for non-covered assets. When BPPR submitted its shared-loss claim in connection with the June 30, 2012 quarter, however, the FDIC refused to reimburse BPPR for a portion of the claim because of a difference related to the methodology for the computation of charge-offs for certain commercial late stage real-estate-collateral-dependent loans and OREO. In accordance with the terms of the commercial loss share agreement, BPPR applied a methodology for charge-offs for late stage real-estate-collateral-dependent loans that conforms to its regulatory supervisory criteria and is calculated in accordance with BPPR s charge-off policy for non-covered assets. The FDIC has stated that it believes that BPPR should use a different methodology for those charge-offs. Notwithstanding the FDIC s refusal to reimburse BPPR for certain shared-loss claims, BPPR has continued to calculate shared-loss claims for quarters subsequent to June 30, 2012 in accordance with its charge off policy for non-covered assets. As of June 30, 2014, BPPR had unreimbursed shared-loss claims of $369.4 million under the commercial loss share agreement with the FDIC. On July 25, 2014, BPPR received a payment of $66.3 million related to reimbursable shared-loss claims from the FDIC. After giving effect to this payment, BPPR has unreimbursed shared-loss claims amounting to $303.1 million. If the reimbursement amount for these claims were calculated in accordance with the FDIC s preferred methodology for late stage real-estate-collateral-dependent loans, the amount of such claims would be reduced by approximately $156.6 million.

Table of Contents

BPPR s loss share agreements with the FDIC specify that disputes can be submitted to arbitration before a review board under the commercial arbitration rules of the American Arbitration Association. On July 31, 2013, BPPR filed a statement of claim with the American Arbitration Association requesting that the review board determine certain matters relating to the loss-share claims under the commercial loss share agreement with the FDIC, including that the review board award BPPR the amounts owed under its unpaid quarterly certificates. The statement of claim includes requests for reimbursement of certain valuation adjustments for discounts to appraised values, costs to sell troubled assets and other items. The review board is comprised of one arbitrator appointed by BPPR, one arbitrator appointed by the FDIC and a third arbitrator selected by agreement of those arbitrators. The arbitration hearing date has been set for October 2014.

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

In April 2004, the Corporation s shareholders adopted the Popular, Inc. 2004 Omnibus Incentive Plan. The Corporation has to date used shares purchased in the market to make grants under the Plan. As of June 30, 2014 the maximum number of shares of common stock that may have been granted under this plan was 3,500,000.

In connection with the Corporation s participation in the Capital Purchase Program under the Troubled Asset Relief Program, the consent of the U.S. Department of the Treasury will be required for the Corporation to repurchase its common stock other than in connection with benefit plans consistent with past practice and certain other specified circumstances. The Corporation terminated its participation in the Troubled Asset Relief Program, after the repurchase on July 23, 2014, of the outstanding warrants issued to the U.S. Treasury.

The following table sets forth the details of purchases of Common Stock during the quarter ended June 30, 2014 under the 2004 Omnibus Incentive Plan.

Issuer Purchases of Equity Securities

Not in thousands

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
April 1 - April 30				
May 1 - May 31	144,977	$ 31.02		

June 1 - June 30			
Total June 30, 2014	144,977	$	31.02

224

Item 6. Exhibits

Exhibit No.	Exhibit Description
12.1	Computation of the ratios of earnings to fixed charges and preferred stock dividends[(1)]
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002[(1)]
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002[(1)]
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002[(1)]
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002[(1)]
101.INS	XBRL Instance Document[(1)]
101.SCH	XBRL Taxonomy Extension Schema Document[(1)]
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document[(1)]
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document[(1)]
101.LAB	XBRL Taxonomy Extension Label Linkbase Document[(1)]
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document[(1)]

(1) Included herewith

Table of Contents

SIGNATURES

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

	POPULAR, INC.
	(Registrant)
Date: August 8, 2014	By: /s/ Carlos J. Vázquez Carlos J. Vázquez Senior Executive Vice President & Chief Financial Officer
Date: August 8, 2014	By: /s/ Jorge J. García Jorge J. García Senior Vice President & Corporate Comptroller

226