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POPULAR INC
Form 10-Q
August 09, 2007

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

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Form 10-Q
p Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
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## For the quarterly period ended June 30, 2007

```
Commission File Number: 000-13818
POPULAR, INC.
(Exact name of registrant as specified in its charter)
```


## Puerto Rico

(State or other jurisdiction of incorporation or organization)

## Popular Center Building

209 Muñoz Rivera Avenue, Hato Rey San Juan, Puerto Rico
(Address of principal executive offices)

66-0667416
(IRS Employer Identification Number)
(
$\qquad$

```
00918
(787) 765-9800
(Registrant s telephone number, including area code)
NOT APPLICABLE
```

(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. p Yes o No Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer p Accelerated filer o Non-accelerated filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes p No
Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: Common Stock $\$ 6.00$ par value 279,629,000 shares outstanding as of August 3, 2007.

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## Forward-Looking Information

The information included in this Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to the Corporation s financial condition, results of operations, plans, objectives, future performance and business, including, but not limited to, statements with respect to the adequacy of the allowance for loan losses, market risk and the impact of interest rate changes, capital adequacy and liquidity, and the effect of legal proceedings and new accounting standards on the Corporation sfinancial condition and results of operations. All statements contained herein that are not clearly historical in nature are forward-looking, and the words anticipate, believe, continues, expect, estimate, intend, and similar expressions and future or conditional verbs such as will, would, should, could, might, can, may, expressions are generally intended to identify forward-looking statements.
These statements are not guarantees of future performance and involve certain risks, uncertainties, estimates and assumptions by management that are difficult to predict. Various factors, some of which are beyond the Corporation s control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements. Factors that might cause such a difference include, but are not limited to: the rate of growth in the economy, as well as general business and economic conditions; changes in interest rates, as well as the magnitude of such changes; the fiscal and monetary policies of the federal government and its agencies; the relative strength or weakness of the consumer and commercial credit sectors and of the real estate markets; the performance of the stock and bond markets; competition in the financial services industry; possible legislative, tax or regulatory changes; and difficulties in combining the operations of acquired entities.
Moreover, the outcome of legal proceedings, as discussed in Part II, Item I. Legal Proceedings, is inherently uncertain and depends on judicial interpretations of law and the findings of regulators, judges and juries.
All forward-looking statements included in this document are based upon information available to the Corporation as of the date of this document, and we assume no obligation to update or revise any such forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

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## ITEM 1. FINANCIAL STATEMENTS <br> POPULAR, INC. <br> CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

(In thousands, except share information)
ASSETS
Cash and due from banks
Money market investments:
Federal funds sold
Securities purchased under agreements to resell
Time deposits with other banks

Pledged securities with creditors right to repledge
Other investment securities available-for-sale
3,421,716
3,743,924
6,112,628
Investment securities held-to-maturity, at amortized cost (market value at June 30,
2007-\$429,536; December 31, 2006 - \$92,764; June 30, 2006 \$420,172)

429,479
91,340
245,500

| 345,400 | 84,350 | 245,500 |
| ---: | ---: | ---: |
| 212,138 | 202,181 | 366,143 |
| 17,449 | 15,177 | 8,879 |

574,987
301,708
620,522

Other investment securities, at lower of cost or realizable value (realizable value at June 30, 2007-\$160,372;
December 31, 2006-\$412,593; June 30, 2006 \$422,163)
Trading account securities, at fair value:
Pledged securities with creditors right to repledge
Other trading securities
Loans held-for-sale, at lower of cost or market value
Loans held-in-portfolio:
Loans held-in-portfolio pledged with creditors right to
repledge

Other loans held-in-portfolio
Less Unearned income
Allowance for loan losses
195,66
$32,274,058$
323,864

$$
=-100
$$

564,847

31,581,008
31,494,785
67,381

Premises and equipment, ne
-587,505

| 595,140 | 592,704 |
| ---: | ---: |
| 84,816 | 83,658 |
| 248,240 | 245,998 |
| $1,611,890$ | $1,515,682$ |
| 667,853 | 656,189 |
| 107,554 | 105,044 |

$$
\$ 46,985,363 \quad \$ 47,403,987 \quad \$ 48,399,514
$$

LIABILITIES AND STOCKHOLDERS EQUITY
Liabilities:
Deposits:
Non-interest bearing
Interest bearing

Federal funds purchased and assets sold under agreements to repurchase
Other short-term borrowings
Notes payable
Other liabilities

| $\$ 4,280,195$ | $\$ 4,222,133$ | $\$ 4,370,437$ |
| ---: | ---: | ---: |
| $21,105,800$ | $20,216,198$ | $19,079,083$ |
|  |  |  |
| $25,385,995$ | $24,438,331$ | $23,449,520$ |
|  |  |  |
| $5,655,936$ | $5,762,445$ | $7,926,731$ |
| $3,384,105$ | $4,034,125$ | $2,656,936$ |
| $8,068,638$ | $8,737,246$ | $10,198,675$ |
| 793,500 | 811,424 | 704,547 |
|  |  |  |
| $43,288,174$ | $43,783,571$ | $44,936,409$ |

Commitments and contingencies (See Note 12)
Minority interest in consolidated subsidiaries
109
110
Stockholders equity:
Preferred stock, $\$ 25$ liquidation value; 30,000,000 shares authorized; $7,475,000$ shares issued and outstanding in all periods presented
Common stock, $\$ 6$ par value; $470,000,000$ shares authorized in all periods presented; 292,722,761 shares issued (December 31, 2006 292,190,924; June 30, 2006 $291,718,358$ ) and 279,326,816 outstanding (December 31, 2006 278,741,547. June 30, $2006 \quad 278,293,561$ )

Surplus
Retained earnings
Accumulated other comprehensive loss, net of tax of (\$96,065) (December 31, 2006 (\$84,143); June 30, 2006 (\$110,267))
Treasury stock at cost, 13,395,945 shares (December 31, 2006 13,449,377; June 30, 2006 13,424,797)

| $1,756,337$ | $1,753,146$ | $1,750,310$ |
| ---: | ---: | ---: |
| 533,152 | 526,856 | 490,631 |
| $1,701,100$ | $1,594,144$ | $1,576,499$ |
|  |  |  |
| $(274,817)$ | $(233,728)$ | $(334,789)$ |
| $(205,567)$ | $(206,987)$ | $(206,533)$ |
| $3,697,080$ | $3,620,306$ | $3,462,993$ |
|  | $\$ 47,403,987$ | $\$ 48,399,514$ |

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

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## POPULAR, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(In thousands, except per share information)
INTEREST INCOME:
Loans
Money market investments
Investment securities
Trading account securities

## INTEREST EXPENSE:

Deposits
Short-term borrowings

Long-term debt

Net interest income
Provision for loan losses
Net interest income after provision for loan losses
Service charges on deposit accounts
Other service fees (See Note 13)
Net gain (loss) on sale and valuation adjustments of investment securities
Trading account profit (loss)
Gain on sale of loans and valuation adjustments on loans held-for-sale
Other operating income

| 182,730 | 135,961 | 355,832 | 260,372 |
| ---: | ---: | ---: | ---: |
| 119,466 | 127,074 | 244,275 | 251,877 |
| 111,298 | 133,223 | 232,000 | 266,455 |
|  |  |  |  |
| 413,494 | 396,258 | 832,107 | 778,704 |
|  |  |  |  |
| 371,417 | 365,779 | 726,399 | 725,543 |
| 115,167 | 67,096 | 211,513 | 116,043 |
| 256,250 | 298,683 | 514,886 | 609,500 |
| 48,392 | 47,324 | 96,863 | 94,793 |
| 89,590 | 80,017 | 177,439 | 160,363 |
|  |  |  |  |
| 1,175 | $(14,424)$ | 82,946 | $(2,084)$ |
| 10,377 | 1,830 | $(3,787)$ | 13,305 |
|  |  |  |  |
| 28,294 | 29,054 | 31,728 | 76,315 |
| 25,547 | 40,185 | 70,362 | 70,127 |
|  |  |  |  |
| 459,625 | 482,669 | 970,437 | $1,022,319$ |

## OPERATING EXPENSES:

Personnel costs:

| Salaries | 126,950 | 126,700 | 263,429 | 262,232 |
| :--- | ---: | ---: | ---: | ---: |
| Pension, profit sharing and other benefits | 37,338 | 39,783 | 79,234 | 82,303 |
|  |  |  |  | 344,535 |
| Net occupancy expenses | 164,288 | 166,483 | 342,663 | 37,267 |
| Equipment expenses | 26,501 | 28,629 | 58,515 | 67,170 |
| Other taxes | 32,245 | 33,973 | 64,641 | 21,170 |
| Professional fees | 11,835 | 10,929 | 23,682 | 75,566 |
| Communications | 38,642 | 38,488 | 74,629 | 34,593 |

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| Business promotion | 30,369 | 31,991 | 58,741 | 64,814 |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Printing and supplies | 4,549 | 4,291 | 8,825 | 8,923 |  |
| Other operating expenses | 32,838 | 28,072 | 64,854 | 56,903 |  |
| Impact of change in fiscal period of certain <br> subsidiaries |  |  |  |  | 9,741 |
| Amortization of intangibles | 2,813 | 2,831 | 5,796 | 5,552 |  |
|  | 361,053 | 362,980 | 736,381 | 746,234 |  |
|  |  | 98,572 | 119,689 | 234,056 | 276,085 |
|  | 23,622 | 22,308 | 40,459 | 60,201 |  |
| Income before income tax | $\$ 74,950$ | $\$ 97,381$ | $\$ 193,597$ | $\$ 215,884$ |  |
| Income tax |  |  |  |  |  |
| NET INCOME | $\$ 71,972$ | $\$ 94,403$ | $\$$ | 187,641 | $\$$ |

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

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## POPULAR, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

| (In thousands) | Six months ended June 30, |  |
| :---: | :---: | :---: |
|  | 2007 | 2006 |
| Preferred stock: |  |  |
| Balance at beginning and end of year | \$ 186,875 | \$ 186,875 |
| Common stock: |  |  |
| Balance at beginning of year | 1,753,146 | 1,736,443 |
| Common stock issued under the Dividend Reinvestment Plan | 3,131 | 2,475 |
| Issuance of common stock |  | 11,312 |
| Stock options exercised | 60 | 80 |
| Balance at end of period | 1,756,337 | 1,750,310 |
| Surplus: |  |  |
| Balance at beginning of year | 526,856 | 452,398 |
| Common stock issued under the Dividend Reinvestment Plan | 5,290 | 5,733 |
| Issuance of common stock |  | 28,281 |
| Issuance cost of common stock |  | 1,502 |
| Stock options expense on unexercised options, net of forfeitures | 857 | 1,525 |
| Stock options exercised | 149 | 192 |
| Transfer from retained earnings |  | 1,000 |
| Balance at end of period | 533,152 | 490,631 |
| Retained earnings: |  |  |
| Balance at beginning of year | 1,594,144 | 1,456,612 |
| Net income | 193,597 | 215,884 |
| Cumulative effect of accounting change (adoption of SFAS No. 156 and |  |  |
| EITF 06-5) | 8,667 |  |
| Cash dividends declared on common stock | $(89,352)$ | $(89,041)$ |
| Cash dividends declared on preferred stock | $(5,956)$ | $(5,956)$ |
| Transfer to surplus |  | $(1,000)$ |
| Balance at end of period | 1,701,100 | 1,576,499 |
| Accumulated other comprehensive loss: |  |  |
| Balance at beginning of year | $(233,728)$ | $(176,000)$ |
| Other comprehensive loss, net of tax | $(41,089)$ | $(158,789)$ |
| Balance at end of period | $(274,817)$ | $(334,789)$ |
| Treasury stock at cost: |  |  |
| Balance at beginning of year | $(206,987)$ | $(207,081)$ |


| Purchase of common stock | $(352)$ |  |
| :--- | ---: | ---: |
| Reissuance of common stock | 1,772 | 548 |
| Balance at end of period | $(205,567)$ | $(206,533)$ |
| Total stockholders equity | $\$ 3,697,080$ | $\$ 3,462,993$ |

## Disclosure of changes in number of shares:

|  | June 30, 2007 | December 31, <br> 2006 | June 30, 2006 |
| :--- | ---: | ---: | ---: |
| Preferred Stock: |  |  |  |
| Balance at beginning and end of period | $7,475,000$ | $7,475,000$ | $7,475,000$ |
| Common Stock Issued: |  |  |  |
| Balance at beginning of year | $292,190,924$ | $289,407,190$ | $289,407,190$ |
| Issued under the Dividend Reinvestment Plan | 521,773 | 858,905 | 412,445 |
| Issuance of common stock | 10,064 | $1,885,380$ | $1,885,380$ |
| Stock options exercised | 39,449 | 13,343 |  |
| Balance at end of period | $292,722,761$ | $292,190,924$ | $291,718,358$ |
| Treasury stock | $(13,395,945)$ | $(13,449,377)$ | $(13,424,797)$ |
|  |  |  |  |
| Common Stock | $279,326,816$ | $278,741,547$ | $278,293,561$ |

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

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## POPULAR, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

| (In thousands) | Quarter ended June 30, |  |  | Six months ended June 30, |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2007 |  | 2006 | 2007 | 2006 |
| Net income | \$ 74,950 |  | \$ 97,381 | \$ 193,597 | \$ 215,884 |
| Other comprehensive loss, before tax: |  |  |  |  |  |
| Foreign currency translation adjustment | 1,200 |  | 369 | 2,980 | (317) |
| Adjustment of pension and postretirement benefit plans |  |  |  | (519) |  |
| Unrealized holding losses on securities available-for-sale arising during the period | $(95,452)$ |  | $(123,859)$ | $(55,969)$ | $(215,824)$ |
| Reclassification adjustment for (gains) losses included in net income | (1) |  | 14,424 | (83) | 2,084 |
| Net gain on cash flow hedges | 1,840 |  | 2,710 | 948 | 3,910 |
| Reclassification adjustment for gains included in net income | (286) |  | (778) | (125) | (617) |
| Cumulative effect of accounting change | (243) |  |  | (243) |  |
|  | $(92,942)$ |  | $(107,134)$ | $(53,011)$ | $(210,764)$ |
| Income tax benefit | 22,060 |  | 27,610 | 11,922 | 51,975 |
| Total other comprehensive loss, net of tax | $(70,882)$ |  | $(79,524)$ | $(41,089)$ | $(158,789)$ |
| Comprehensive income | \$ 4,068 |  | \$ 17,857 | \$152,508 | \$ 57,095 |
| Disclosure of accumulated other comprehensive loss: |  |  |  |  |  |
| (In thousands) |  |  | $\begin{aligned} & \text { une 30, } \\ & 2007 \end{aligned}$ | $\begin{gathered} \text { December 31, } \\ 2006 \end{gathered}$ | June 30, $2006$ |
| Foreign currency translation adjustment |  |  | $(33,721)$ | \$ $(36,701)$ | \$ (36,632) |
| Minimum pension liability adjustment |  |  |  | $(3,893)$ | $(2,354)$ |
| Tax effect |  |  |  | 1,518 | 918 |
| Adoption of SFAS No. 158 |  |  |  | 3,893 |  |
| Tax effect |  |  |  | $(1,518)$ |  |
| Net of tax amount |  |  |  |  | $(1,436)$ |
| Underfunding of pension and postretirement | it plans |  | $(69,779)$ | $(69,260)$ |  |
| Tax effect |  |  | 27,214 | 27,034 |  |
| Net of tax amount |  |  | $(42,565)$ | $(42,226)$ |  |

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| Unrealized losses on securities available-for-sale | $(268,295)$ | $(212,243)$ | $(409,430)$ |
| :--- | :---: | :---: | :---: |
| Tax effect | 69,182 | 57,146 | 110,440 |
| Net of tax amount | $(199,113)$ | $(155,097)$ | $(298,990)$ |
| Unrealized gains on cash flows hedges | 913 | 90 | 3,117 |
| Tax effect | $(331)$ | $(37)$ | $(1,091)$ |
| Net of tax amount | 582 | 53 | 2,026 |
| Cumulative effect of accounting change, net of tax |  | 243 | 243 |
| Accumulated other comprehensive loss, net of tax | $\$(274,817)$ | $\$(233,728)$ | $\$(334,789)$ |

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

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## POPULAR, INC. <br> CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| (In thousands) |  | Six months ended June 30, |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  | 2007 |  | 2006 |
| Cash flows from operating activities: |  |  |  |  |
| Net income | \$ | 193,597 | \$ | 215,884 |
| Less: Impact of change in fiscal period of certain subsidiaries, net of tax |  |  |  | $(6,129)$ |
| Net income before change in fiscal period |  | 193,597 |  | 222,013 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |  |
| Depreciation and amortization of premises and equipment |  | 39,973 |  | 42,506 |
| Provision for loan losses |  | 211,513 |  | 116,043 |
| Amortization of intangibles |  | 5,796 |  | 5,552 |
| Amortization and fair value adjustment of servicing assets |  | 22,606 |  | 28,290 |
| Net (gain) loss on sale and valuation adjustment of investment securities |  | $(82,946)$ |  | 2,084 |
| Net gain on disposition of premises and equipment |  | $(4,851)$ |  | $(2,269)$ |
| Net gain on sale of loans and valuation adjustments on loans |  |  |  |  |
| held-for-sale |  | $(31,728)$ |  | $(76,315)$ |
| Net amortization of premiums and accretion of discounts on investments |  | 11,235 |  | 14,358 |
| Net amortization of premiums and deferred loan origination fees and costs |  | 47,938 |  | 66,709 |
| Earnings from investments under the equity method |  | $(16,590)$ |  | $(6,163)$ |
| Stock options expense |  | 907 |  | 1,585 |
| Deferred income taxes |  | $(48,112)$ |  | $(28,381)$ |
| Net disbursements on loans held-for-sale |  | $(3,087,103)$ |  | $(3,559,262)$ |
| Acquisitions of loans held-for-sale |  | $(403,712)$ |  | $(846,117)$ |
| Proceeds from sale of loans held-for-sale |  | 2,833,030 |  | 3,834,624 |
| Net decrease in trading securities |  | 645,680 |  | 1,000,341 |
| Net increase in accrued income receivable |  | $(1,506)$ |  | $(1,966)$ |
| Net increase in other assets |  | $(16,261)$ |  | $(79,280)$ |
| Net (decrease) increase in interest payable |  | $(14,013)$ |  | 9,886 |
| Net increase in postretirement benefit obligation |  | 1,824 |  | 2,755 |
| Net decrease in other liabilities |  | $(52,071)$ |  | $(63,653)$ |
| Total adjustments |  | 61,609 |  | 461,327 |
| Net cash provided by operating activities |  | 255,206 |  | 683,340 |
| Cash flows from investing activities: |  |  |  |  |
| Net (increase) decrease in money market investments |  | $(206,843)$ |  | 129,048 |
| Purchases of investment securities: |  |  |  |  |
| Available-for-sale |  | $(65,385)$ |  | (211,139) |
| Held-to-maturity |  | $(12,293,611)$ |  | (16,847,432) |
| Other |  | $(16,935)$ |  | $(32,202)$ |

Proceeds from calls, paydowns, maturities and redemptions of investment securities:

| Available-for-sale | 810,710 | 761,858 |
| :---: | :---: | :---: |
| Held-to-maturity | 11,957,964 | 16,580,599 |
| Other | 5,445 | 39,263 |
| Proceeds from sale of investment securities available-for-sale | 28,981 | 44,474 |
| Proceeds from sale of other investment securities | 246,352 |  |
| Net disbursements on loans | $(362,569)$ | $(472,274)$ |
| Proceeds from sale of loans | 3,549 | 212,791 |
| Acquisition of loan portfolios | (784) | $(175,856)$ |
| Assets acquired, net of cash | $(1,633)$ | (418) |
| Mortgage servicing rights purchased | $(23,988)$ | $(9,599)$ |
| Acquisition of premises and equipment | $(49,652)$ | $(63,469)$ |
| Proceeds from sale of premises and equipment | 21,951 | 26,762 |
| Proceeds from sale of foreclosed assets | 80,278 | 66,685 |
| Net cash provided by investing activities | 133,830 | 49,091 |
| Cash flows from financing activities: |  |  |
| Net increase in deposits | 936,810 | 811,499 |
| Net decrease in federal funds purchased and assets sold under agreements to repurchase | $(106,509)$ | $(888,881)$ |
| Net decrease in other short-term borrowings | $(650,020)$ | $(150,183)$ |
| Payments of notes payable | $(773,731)$ | $(1,210,735)$ |
| Proceeds from issuance of notes payable | 103,249 | 682,406 |
| Dividends paid | $(95,223)$ | $(93,249)$ |
| Proceeds from issuance of common stock | 8,667 | 47,293 |
| Treasury stock acquired | (352) |  |
| Net cash used in financing activities | $(577,109)$ | $(801,850)$ |
| Cash effect of change in fiscal period of certain subsidiaries |  | 11,914 |
| Net decrease in cash and due from banks | $(188,073)$ | $(57,505)$ |
| Cash and due from banks at beginning of period | 950,158 | 906,397 |
| Cash and due from banks at end of period | \$ 762,085 | \$ 848,892 |

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

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## Notes to Unaudited Consolidated Financial Statements

## Note 1 Nature of Operations and Basis of Presentation

Popular, Inc. (the Corporation or Popular ) is a diversified, publicly-owned financial holding company subject to the supervision and regulation of the Board of Governors of the Federal Reserve System. The Corporation is a full service financial services provider with operations in Puerto Rico, the United States, the Caribbean and Latin America. As the leading financial institution based in Puerto Rico, the Corporation offers retail and commercial banking services through its principal banking subsidiary, Banco Popular de Puerto Rico ( BPPR ), as well as auto and equipment leasing and financing, mortgage loans, consumer lending, investment banking, broker-dealer and insurance services through specialized subsidiaries. In the United States, the Corporation has established a community banking franchise providing a broad range of financial services and products to the communities it serves. Banco Popular North America ( BPNA ) operates branches in California, Texas, Illinois, New York, New Jersey and Florida, while E-LOAN provides online consumer direct lending to obtain mortgage, auto and home equity loans, and provides an online platform to raise deposits for BPNA. Popular Financial Holdings ( PFH ) offers mortgage and personal loans and provides mortgage loan servicing. The Corporation also owns a financial transaction processing operation, EVERTEC, which strives to use its expertise in technology and electronic banking as a competitive advantage in its expansion throughout the United States, the Caribbean and Latin America, as well as internally servicing many of its subsidiaries system infrastructures and transactional processing businesses. Note 21 to the consolidated financial statements presents further information about the Corporation s business segments.
The unaudited consolidated financial statements include the accounts of Popular, Inc. and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The Corporation also consolidates the variable interest entities for which it is the primary beneficiary and, therefore, will absorb the majority of the entity s expected losses, receive a majority of the entity s expected returns, or both. These unaudited statements are, in the opinion of management, a fair statement of the results for the periods reported and include all necessary adjustments, all of a normal recurring nature, for a fair statement of such results. Certain reclassifications have been made to the prior period consolidated financial statements to conform to the 2007 presentation.
The statement of condition data as of December 31, 2006 were derived from audited financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted from the statements presented as of June 30, 2007, December 31, 2006 and June 30, 2006 pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, these financial statements should be read in conjunction with the audited consolidated financial statements of the Corporation for the year ended December 31, 2006, included in the Corporation s 2006 Annual Report. The Corporation s Form 10-K filed on March 1, 2007 incorporates by reference the 2006 Annual Report.

## Note 2 Recent Accounting Developments

SFAS No. 155 Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140
In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. SFAS No. 155 permits companies to elect, on a transaction-by-transaction basis, to apply a fair value measurement to hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation under SFAS No. 133. This statement also clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The adoption of SFAS No. 155 in 2007 did not have a material impact on the Corporation s consolidated financial statements during the six months ended June 30, 2007.

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SFAS No. 156 Accounting for Servicing of Financial Assets an amendment of FASB No. 140
SFAS No. 156 requires that all separately recognized servicing assets and liabilities be initially measured at fair value, if practicable. For subsequent measurements, SFAS No. 156 permits companies to choose between using an amortization method or a fair value measurement method for reporting purposes by class of servicing asset or liability. The Corporation adopted SFAS No. 156 in January 2007. The Corporation elected the fair value measurement for mortgage servicing rights ( MSRs ). Servicing rights associated with Small Business Administration ( SBA ) commercial loans will continue to be accounted at the lower of cost or market method. The initial impact of adoption of the fair value measurement for MSRs was included as a cumulative effect of a change in accounting principle directly in stockholders equity and resulted in a net increase in stockholders equity of approximately $\$ 9.6$ million, net of deferred taxes. Refer to Note 7 to the consolidated financial statements for required SFAS No. 156 disclosures. FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109 (FIN 48)
In 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition related to income taxes. The accounting provisions of FIN 48 were effective for the Corporation beginning in the first quarter of 2007. Based on management s assessment, there was no impact on retained earnings as of January 1, 2007 due to the initial application of the provisions of FIN 48. Also, as a result of the implementation, the Corporation did not recognize any change in the liability for unrecognized tax benefits. Refer to Note 14 to the consolidated financial statements for further information on the impact of FIN 48.
EITF Issue No. 06-03 How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation) (EITF 06-03)
EITF 06-03 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The Corporation s accounting policy is to account on a net basis for the taxes collected from customers and remitted to governmental authorities on a net basis. The corresponding amounts recognized in the consolidated financial statements are not significant.
EITF Issue No. 06-5 Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance (EITF 06-5) EITF 06-5 focuses on how an entity should determine the amount that could be realized under the insurance contract at the balance sheet date in applying FTB 85-4, and whether the determination should be on an individual or group policy basis. At the September 2006 meeting, the Task Force affirmed as a final consensus that the cash surrender value and any additional amounts provided by the contractual terms of the insurance policy that are realizable at the balance sheet date should be considered in determining the amount that could be realized under FTB 85-4, and any amounts that are not immediately payable in cash to the policyholder should be discounted to their present value. Additionally, the Task Force affirmed as a final consensus the tentative conclusion that in determining the amount that could be realized, companies should assume that policies will be surrendered on an individual-by-individual basis, rather than surrendering the entire group policy. Also, the Task Force reached a consensus that contractual limitations on the ability to surrender a policy do not affect the amount to be reflected under FTB 85-4, but, if significant, the nature of those restrictions should be disclosed. The Corporation adopted the EITF $06-5$ guidance in the first quarter of 2007 and as a result recorded a $\$ 0.9$ million cumulative effect adjustment to beginning retained earnings (reduction of capital) for the existing bank-owned life insurance arrangement.
SFAS No. 157 Fair Value Measurements
SFAS No. 157, issued in September 2006, defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy. The fair value hierarchy ranks the quality and

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reliability of the information used to determine fair values. Financial assets carried at fair value will be classified and disclosed in one of the three categories in accordance with the hierarchy. The three levels of the fair value hierarchy are: (1) quoted market prices for identical assets or liabilities in active markets; (2) observable market-based inputs or unobservable inputs that are corroborated by market data; and (3) unobservable inputs that are not corroborated by market data. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Corporation will adopt the provisions of SFAS No. 157 commencing with the first quarter of 2008. The Corporation is evaluating the impact that this accounting pronouncement may have in its consolidated financial statements and disclosures.

## SFAS No. 159 Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets

 and Financial LiabilitiesIn February 2007, the FASB issued SFAS No. 159, which provides companies with an option to report selected financial assets and liabilities at fair value. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, Fair Value Measurements, and No. 107, Disclosures about Fair Value of Financial Instrument. SFAS No. 159 is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. The Corporation will adopt the provisions of SFAS No. 159 commencing in January 2008. Management is evaluating the impact that this accounting standard may have on its consolidated financial statements.
FSP FIN No. 39-1 Amendment of FASB Interpretation No. 39
In April 2007, the FASB issued Staff Position FSP FIN 39-1 which defines right of setoff and specifies what conditions must be met for a derivative contract to qualify for this right of setoff. It also addresses the applicability of a right of setoff to derivative instruments and clarifies the circumstances in which it is appropriate to offset amounts recognized for those instruments in the statement of financial position. In addition, this FSP permits the offsetting of fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments. This interpretation is effective for fiscal years beginning after November 15, 2007, with early application permitted. The adoption of FSP FIN 39-1 is not expected to have a material impact on the Corporation s consolidated financial statements.
FSP FIN No. $46(R) 7$ Application of FASB Interpretation No. $46(R)$ to Investment Companies
In May 2007, the FASB issued Staff Position FSP FIN No. 46 (R), which amends the scope of the exception to FIN 46 $(\mathrm{R})$ to indicate that investments accounted for at fair value in accordance with the specialized accounting guidance in the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide for Investment Companies, are not subject to consolidation under FIN No. 46 (R). This interpretation is effective for fiscal years beginning on or after December 15, 2007. Management is evaluating the impact, if any, that the adoption of this interpretation may have on its consolidated financial statements.
SOP 07-01 Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies
The Statement of Position SOP 07-01 issued in June 2007 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide for Investment Companies ( AICPA Guide ). Additionally, it provides guidance as to whether a parent company or an equity method investor can apply the specialized industry accounting principles of the AICPA Guide. SOP 07-01 is effective for fiscal years beginning on or after December 15, 2007, with early application encouraged. Management is evaluating the impact, if any, that the adoption of SOP 07-1 may have on its consolidated financial statements.

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## Note 3 Restrictions on Cash and Due from Banks and Highly Liquid Securities

The Corporation s subsidiary banks are required by federal and state regulatory agencies to maintain average reserve balances with the Federal Reserve Bank or with a correspondent bank. Those required average reserve balances were approximately $\$ 603$ million at June 30, 2007 (December 31, 2006 \$621 million; June 30, 2006 \$583 million). Cash and due from banks as well as other short-term, highly liquid securities are used to cover the required average reserve balances.
In compliance with rules and regulations of the Securities and Exchange Commission, at June 30, 2007, December 31, 2006, and June 30, 2006, the Corporation had securities with a market value of $\$ 445$ thousand segregated in a special reserve bank account for the benefit of brokerage customers of its broker-dealer subsidiary. These securities are classified in the consolidated statement of condition within the other trading securities category.
As required by the Puerto Rico International Banking Center Law, at June 30, 2007, December 31, 2006, and June 30, 2006, the Corporation maintained separately for its two international banking entities ( IBEs ), \$600 thousand in time deposits, equally split for the two IBEs, which were considered restricted assets.
As part of a line of credit facility with a financial institution, at June 30, 2007, December 31, 2006, and June 30, 2006, the Corporation maintained restricted cash of $\$ 1.9$ million as collateral. The cash is being held in certificates of deposits which mature in less than 90 days. The line of credit is used to support letters of credit.

## Note 4 Pledged Assets

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

|  | June 30, | December 31, | June 30, |
| :--- | ---: | ---: | ---: |
| (In thousands) | 2006 |  |  |
| Investment securities available-for-sale | $\$ 3,264,299$ | $\$ 2,645,272$ | $\$ 2,799,279$ |
| Investment securities held-to-maturity | 501 | 658 | 808 |
| Loans held-for-sale |  | 332,058 | 56,898 |
| Loans held-in-portfolio | $9,062,900$ | $10,260,198$ | $11,440,294$ |
|  | $\$ 12,327,700$ | $\$ 13,238,186$ | $\$ 14,297,279$ |

Pledged securities and loans in which the creditor has the right by custom or contract to repledge are presented separately in the consolidated statements of condition.

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## Note 5 Investment Securities Available-For-Sale

The amortized cost, gross unrealized gains and losses and approximate market value (or fair value for certain investment securities where no market quotations are available) of investment securities available-for-sale as of June 30, 2007, December 31, 2006 and June 30, 2006 were as follows:
(In thousands)
U.S. Treasury securities

Obligations of U.S. Government sponsored entities
Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations
Mortgage-backed securities
Equity securities
Others
(In thousands)
U.S. Treasury securities

Obligations of U.S. Government sponsored entities
Obligations of Puerto Rico, States and political subdivisions
Mortgage-backed securities
Equity securities
Others
(In thousands)
U.S. Treasury securities
Obligations of U.S. Government sponsored
entities

| Amortized | AS OF JUNE 30, 2006 |  | Market |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Gross | Gross |  |  |
|  | Unrealized Gains | Unrealized Losses |  |  |
| \$ 524,093 |  | \$ 46,330 | \$ | 477,763 |
| 7,440,298 |  | 288,943 |  | 7,151,355 |

AS OF JUNE 30, 2007
Amortized
Cost
\$ 500,193

| $6,016,206$ |  | 174,448 | $5,841,758$ |
| ---: | ---: | ---: | ---: |
| 117,372 | $\$ 170$ | 3,754 | 113,788 |
| $1,544,362$ | 6,122 | 18,435 | $1,532,049$ |
| 991,440 | 1,529 | 32,771 | 960,198 |
| 55,250 | 1,173 | 11,074 | 45,349 |
| 17,940 | 809 |  | 18,749 |
|  |  |  |  |
| $\$ 9,242,763$ | $\$ 9,803$ | $\$ 278,098$ | $\$ 8,974,468$ |


| AS OF DECEMBER 31, 2006 |  |  |
| :---: | :---: | :---: |
| Gross <br> Unrealized <br> Gains | Gross <br> Unrealized <br> Losses | Market <br> Value |
|  | $\$ 29,818$ | $\$ 474,835$ |

\$ 504,653
6,603,252
118,214
$1,657,613$
$1,061,850$
70,954
46,326
\$10,062,862
\$16,463
\$228,463
\$9,850,862

AS OF JUNE 30, 2006

| Gross <br> Unrealized <br> Gains | Gross <br> Unrealized <br> Losses | Market <br> Value |
| :---: | :---: | ---: |
|  | $\$ 37,616$ | $\$ 462,577$ |
|  | 174,448 | $5,841,758$ |
|  |  |  |
| $\$ 170$ | 3,754 | 113,788 |
| 6,122 | 18,435 | $1,532,049$ |
| 1,529 | 32,771 | 960,198 |
| 1,173 | 11,074 | 45,349 |
| 809 |  | 18,749 |
|  |  |  |
| $\$ 9,803$ | $\$ 278,098$ | $\$ 8,974,468$ |

Amortized
Cost
57

147,524 6,455,785
114,942
1,645,326
1,036,816
73,745
49,413

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Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations
Mortgage-backed securities
Equity securities
Others

| 120,410 | $\$$ | 70 | 5,801 |
| ---: | ---: | ---: | ---: |
| $1,790,277$ | 6,762 | 28,898 | $114,679,141$ |
| $1,285,786$ | 2,464 | 50,331 | $1,237,919$ |
| 68,294 | 2,748 | 925 | 70,117 |
| 69,327 | 698 | 701 | 69,324 |
|  |  |  |  |
| $\$ 11,298,485$ | $\$ 12,742$ | $\$ 421,929$ | $\$ 10,889,298$ |

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The table below shows the Corporation s gross unrealized losses and market value of investment securities available-for-sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2007, December 31, 2006 and June 30, 2006.

|  | Gross <br> Anrealized <br> Losses |  |  |
| :--- | ---: | ---: | ---: |
| (In thousands) | Market <br> Value |  |  |
| Obligations of U.S. Government sponsored entities | $\$ 475,542$ | $\$ 13,283$ | $\$ 462,259$ |
| Obligations of Puerto Rico, States and political subdivisions | 21,652 | 473 | 21,179 |
| Collateralized mortgage obligations | 189,570 | 2,077 | 187,493 |
| Mortgage-backed securities | 39,132 | 873 | 38,259 |
| Equity securities | 53,683 | 11,047 | 42,636 |
|  |  |  |  |
|  | $\$ 779,579$ | $\$ 27,753$ | $\$ 751,826$ |

## 12 months or more

Gross

(In thousands) | Amortized |
| :---: |
| Cost |

| U.S. Treasury securities | $\$ 500,193$ |
| :--- | ---: |
| Obligations of U.S. Government sponsored entities | $5,540,664$ |
| Obligations of Puerto Rico, States and political |  |
| subdivisions | 69,136 |
| Collateralized mortgage obligations | 647,337 |
| Mortgage-backed securities | 869,343 |
| Equity securities | 310 |


|  | \$7,626,983 | \$250,345 | \$7,376,638 |
| :---: | :---: | :---: | :---: |
|  |  | Total |  |
| (In thousands) | Amortized Cost | Gross <br> Unrealized Losses | Market <br> Value |
| U.S. Treasury securities | \$ 500,193 | \$ 37,616 | \$ 462,577 |
| Obligations of U.S. Government sponsored entities | 6,016,206 | 174,448 | 5,841,758 |
| Obligations of Puerto Rico, States and political subdivisions | 90,788 | 3,754 | 87,034 |
| Collateralized mortgage obligations | 836,907 | 18,435 | 818,472 |
| Mortgage-backed securities | 908,475 | 32,771 | 875,704 |

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| Equity securities | 53,993 | 11,074 | 42,919 |
| :--- | ---: | ---: | ---: |
|  | $\$ 8,406,562$ | $\$ 278,098$ | $\$ 8,128,464$ |

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AS OF DECEMBER 31, 2006
Less than 12 Months

|  | Amortized <br> Cost |  |  | Gross <br> Unrealized <br> Losses |
| :--- | ---: | ---: | ---: | ---: |
| (In thousands) |  | Market <br> Value |  |  |
| U.S. Treasury securities | 19,421 | $\$ 134$ | $\$ 19,287$ |  |
| Obligations of U.S. Government sponsored entities | 425,076 | 4,345 | 420,731 |  |
| Obligations of Puerto Rico, States and political subdivisions | 21,426 | 259 | 21,167 |  |
| Collateralized mortgage obligations | 501,705 | 4,299 | 497,406 |  |
| Mortgage-backed securities | 28,958 | 484 | 28,474 |  |
| Equity securities | 11,180 | 3,699 | 7,481 |  |
|  |  |  | $\$ 13,220$ | $\$ 994,546$ |

12 months or more

Gross

| Amortized | Unrealized | Market |
| :---: | :---: | :---: |
| Cost | Losses | Value |

U.S. Treasury securities
Obligations of U.S. Government sponsored entities

| $\$ 485,232$ | $\$ 29,684$ | $\$ 455,548$ |
| ---: | ---: | ---: |
| $6,097,274$ | 143,179 | $5,954,095$ |
|  |  |  |
| 55,238 | 3,278 | 51,960 |
| 564,217 | 12,892 | 551,325 |
| 954,293 | 26,008 | 928,285 |
| 300 | 202 | 98 |

$\$ 8,156,554 \quad \$ 215,243 \quad \$ 7,941,311$

Total
Gross
Amortized
(In thousands)
U.S. Treasury securities

Obligations of U.S. Government sponsored entities
Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations
Mortgage-backed securities
Equity securities

| $\$ 504,653$ | $\$ 29,818$ | $\$ 474,835$ |
| ---: | ---: | ---: |
| $6,522,350$ | 147,524 | $6,374,826$ |
|  |  |  |
| 76,664 | 3,537 | 73,127 |
| $1,065,922$ | 17,191 | $1,048,731$ |
| 983,251 | 26,492 | 956,759 |
| 11,480 | 3,901 | 7,579 |

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(In thousands) | Amortized |
| :---: |
| Cost |

U.S. Treasury securities
Obligations of U.S. Government sponsored entities
Obligations of Puerto Rico, States and political
subdivisions
Collateralized mortgage obligations

Mortgage-backed securities
\$
$3,519,418$
3

Equity securities
Others
44,386
732,872
205,765
35,716
14,261
\$4,571,767
\$206,409
\$4,365,358

12 months or more
Gross
Amortized
Cost
U.S. Treasury securities
Obligations of U.S. Government sponsored entities

Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations
Mortgage-backed securities

| $\$ 504,675$ | $\$ 45,988$ | $\$ 458,687$ |
| ---: | ---: | ---: |
| $3,920,949$ | 131,187 | $3,789,762$ |
|  |  |  |
| 55,232 | 4,777 | 50,455 |
| 313,094 | 12,558 | 300,536 |
| 957,443 | 21,010 | 936,433 |
|  |  |  |
| $\$ 5,751,393$ | $\$ 215,520$ | $\$ 5,535,873$ |

(In thousands)
U.S. Treasury securities

Obligations of U.S. Government sponsored entities
Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations
Mortgage-backed securities
Equity securities

| Others | 14,261 | 701 | 13,560 |
| :--- | ---: | ---: | ---: |
|  | $\$ 10,323,160$ | $\$ 421,929$ | $\$ 9,901,231$ |

At June 30, 2007, Obligations of Puerto Rico, States and political subdivisions include approximately $\$ 59$ million in Commonwealth of Puerto Rico Appropriation Bonds (Appropriation Bonds ) the rating on which was downgraded in May 2006 by Moody s Investors Service ( Moody s ) to Ba1, one notch below investment grade. Standard \& Poor s ( $\mathrm{S} \& \mathrm{P}$ ), another nationally-recognized credit rating agency, rated the Appropriation Bonds BBB-, which is still considered investment grade. As of June 30, 2007, these Appropriation Bonds represented approximately $\$ 2.9$ million in unrealized losses in the Corporation s available-for-sale investment securities portfolio. The Corporation is closely monitoring the political and economic situation of the Island as part of its evaluation of its available-for-sale portfolio for any declines in value that management may consider being other-than-temporary. Management has the intent and ability to hold these investments for a reasonable period of time for a forecasted recovery of fair value up to (or beyond) the cost of these investments.

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The unrealized loss positions of available-for-sale securities at June 30, 2007, except for the obligations of the Puerto Rico government described above, are primarily associated with U.S. government sponsored entities and Treasury obligations, and to a lesser extent, U.S. Agency and government sponsored-issued mortgage-backed securities and collateralized mortgage obligations. The vast majority of these securities are rated the equivalent of AAA by the major rating agencies. The investment portfolio is structured primarily with highly-liquid securities, which possess a large and efficient secondary market. Valuations are performed at least on a quarterly basis using third party providers and dealer quotes. Management believes that the unrealized losses in these available-for-sale securities at June 30, 2007 are temporary and are substantially related to market interest rate fluctuations and not to the deterioration in the creditworthiness of the issuers. Also, management has the intent and ability to hold these investments for a reasonable period of time for a forecasted recovery of fair value up to (or beyond) the cost of these investments.
During the six months ended June 30, 2007, the Corporation recognized through earnings approximately $\$ 30.7$ million in losses in residual interests classified as available-for-sale and $\$ 7.6$ million in losses in equity securities that management considered to be other-than-temporarily impaired. The equity securities that generated this other-than-temporary impairment in the first quarter of 2007 were sold in the second quarter of 2007.
The following table states the name of issuers and the aggregate amortized cost and market value of the securities of such issuer (includes available-for-sale and held-to-maturity securities), when the aggregate amortized cost of such securities exceeds $10 \%$ of stockholders equity. This information excludes securities of the U.S. Government agencies and corporations. Investments in obligations issued by a state of the U.S. and its political subdivisions and agencies, which are payable and secured by the same source of revenue or taxing authority, other than the U.S. Government, are considered securities of a single issuer.

June 30, 2007
December 31, 2006
June 30, 2006

| (In thousands) | Amortized Cost | Market Value | Amortized Cost | Market Value | Amortized Cost | Market Value |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| FNMA | \$1,261,541 | \$1,238,499 | \$1,539,651 | \$ 1,517,525 | \$1,797,323 | \$1,758,590 |
| FHLB | 6,069,496 | 5,897,748 | 6,230,841 | 6,086,885 | 7,354,827 | 7,073,831 |
| Freddie Mac | 1,011,125 | 996,046 | 1,149,185 | 1,134,853 | 1,243,039 | 1,212,853 |

Note 6 Investment Securities Held-to-Maturity
The amortized cost, gross unrealized gains and losses and approximate market value (or fair value for certain investment securities where no market quotations are available) of investment securities held-to-maturity as of June 30, 2007, December 31, 2006 and June 30, 2006 were as follows:
(In thousands)
Obligations of U.S. Government sponsored entities
Obligations of Puerto Rico, States and political subdivisions
Collateralized mortgage obligations Others

AS OF JUNE 30, 2007

| (In thousands) | AS OF JUNE 30, 2007 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Gross <br> Unrealized Gains | Gross Unrealized Losses | Market <br> Value |
| Obligations of U.S. Government sponsored entities | \$340,323 | \$ 13 | \$ 36 | \$340,300 |
| Obligations of Puerto Rico, States and political subdivisions | 72,406 | 441 | 374 | 72,473 |
| Collateralized mortgage obligations | 354 |  | 19 | 335 |
| Others | 16,396 | 39 | 7 | 16,428 |
|  | \$429,479 | \$493 | \$436 | \$429,536 |

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| (In thousands) | AS OF DECEMBER 31, 2006 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Market <br> Value |
| Obligations of U.S. Government sponsored entities | \$ 3,017 |  |  | \$ 3,017 |
| Obligations of Puerto Rico, States and political subdivisions | 72,152 | \$ 1,559 | \$ 161 | 73,550 |
| Collateralized mortgage obligations | 381 |  | 21 | 360 |
| Others | 15,790 | 60 | 13 | 15,837 |
|  | \$91,340 | \$1,619 | \$195 | \$92,764 |
|  | AS OF JUNE 30, 2006 |  |  |  |
|  |  | Gross | Gross |  |
|  | Amortized Cost | Unrealized Gains | Unrealized Losses | Market <br> Value |
| Obligations of U.S. Government sponsored entities | \$314,408 |  | \$ 64 | \$314,344 |
| Obligations of Puerto Rico, States and political subdivisions | 73,043 | \$367 | 527 | 72,883 |
| Collateralized mortgage obligations | 433 |  | 24 | 409 |
| Others | 32,514 | 50 | 28 | 32,536 |
|  | \$420,398 | \$417 | \$643 | \$420,172 |

The following table shows the Corporation s gross unrealized losses and fair value of investment securities held-to-maturity, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2007, December 31, 2006 and June 30, 2006:

AS OF JUNE 30, 2007
Less than 12 months

|  | $\begin{array}{c}\text { Gross } \\ \text { Amortized } \\ \text { Cost }\end{array}$ |  |  |
| :--- | ---: | ---: | ---: | \(\left.\begin{array}{c}Unrealized <br>


Losses\end{array}\right)\)| Market |
| :---: |
| Value |


|  | Gross <br> Anrealized <br> Losses |  |  |
| :--- | ---: | ---: | ---: |
| (In thousands) | Cost | Market <br> Value |  |
| Obligations of Puerto Rico, States and political subdivisions | $\$ 24,545$ | $\$ 151$ | $\$ 24,394$ |
| Collateralized mortgage obligations | 354 | 19 | 335 |
| Others | 1,250 | 5 | 1,245 |
|  | $\$ 26,149$ | $\$ 175$ | $\$ 25,974$ |

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|  | Total |  |  |
| :--- | :---: | ---: | ---: |
|  | Amortized |  |  |
| Cost |  |  |  | \(\left.\begin{array}{c}Gross <br>

Unrealized <br>

Losses\end{array}\right)\)| Market |
| :---: |
| Value |


| (In thousands) | Cost | Losses | Value |
| :--- | ---: | ---: | ---: |
| Obligations of Puerto Rico, States and political subdivisions | $\$ 26,623$ | $\$ 161$ | $\$ 26,462$ |
| Collateralized mortgage obligations | 381 | 21 | 360 |
| Others | 1,250 | 13 | 1,237 |
|  |  |  | $\$ 28,254$ |
|  |  | $\$ 195$ | $\$ 28,059$ |

AS OF JUNE 30, 2006
Less than 12 months


| Obligations of U.S. Government sponsored entities | $\$ 6,948$ | $\$ 3$ | $\$ 6,945$ |
| :--- | ---: | ---: | ---: |
| Obligations of Puerto Rico, States and political subdivisions | 25,993 | 199 | 25,794 |
| Collateralized mortgage obligations | 433 | 24 | 409 |
| Others | 250 |  | 250 |
|  | $\$ 33,624$ | $\$ 226$ | $\$ 33,398$ |


| (In thousands) | Cost | Losses | Value |
| :--- | ---: | ---: | ---: |
| Obligations of U.S. Government sponsored entities | $\$ 314,408$ | $\$ 64$ | $\$ 314,344$ |
| Obligations of Puerto Rico, States and political subdivisions | 51,823 | 527 | 51,296 |
| Collateralized mortgage obligations | 433 | 24 | 409 |
| Others | 7,886 | 28 | 7,858 |
|  |  |  | $\$ 374,550$ |
|  |  | $\$ 643$ | $\$ 373,907$ |

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Management believes that the unrealized losses in the held-to-maturity portfolio at June 30, 2007 are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuers. Management has the intent and ability to hold these investments until maturity.

## Note 7 Mortgage Servicing Rights

The Corporation recognizes as assets the rights to service loans for others, whether these rights are purchased or result from asset transfers (sales and securitizations). Commencing in 2007 and in accordance with SFAS No. 156, the Corporation no longer records servicing rights in connection with on-balance sheet mortgage loan securitizations. Effective January 1, 2007, under SFAS No. 156, the Corporation identified servicing rights related to residential mortgage loans as a class of servicing rights and elected to apply fair value accounting to these mortgage servicing rights ( MSRs ). These MSRs are segregated between loans serviced by PFH and by the Corporation s banking subsidiaries. Fair value determination is performed on a subsidiary basis, with assumptions varying in accordance with the types of assets or markets served (i.e. PFH primarily subprime mortgage loans vs. banking subsidiaries primarily conforming loans). Servicing rights associated with Small Business Administration (SBA ) commercial loans, the other class of servicing assets held by the Corporation, will continue to be accounted at the lower of cost or market method. Classes of servicing rights were determined based on the different markets or types of assets served. Management also considered trends in the markets and elections by other major participants in the industries served in determining the accounting methodology to be followed for the different types of servicing rights.
Under the fair value accounting method of SFAS No. 156, purchased MSRs and MSRs resulting from asset transfers are capitalized and carried at fair value. Prior to the adoption of SFAS No. 156, the Corporation capitalized purchased residential MSRs at cost, and MSRs from asset transfers based on the relative fair value of the servicing right and the residential mortgage loan at the time of sale. Prior to SFAS No. 156, both purchased MSRs and MSRs from asset transfers were accounted at quarter-end at the lower of cost or market value.
Effective January 1, 2007, upon the remeasurement of the MSRs at fair value in accordance with SFAS No. 156, the Corporation recorded a cumulative effect adjustment to increase the 2007 beginning balance of retained earnings in stockholders equity. The table below reconciles the balance of MSRs as of December 31, 2006 and January 1, 2007.

|  | Banking subsidiaries |  | PFH |  |
| :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Residential MSRs |  | esidential <br> MSRs | Total |
| Balance at December 31, 2006 | \$ 77,801 | \$ | 82,338 | \$ 160,139 |
| Remeasurement upon adoption of SFAS No. 156 (a) | 13,630 |  | 1,700 | 15,330 |
| Balance at January 1, 2007 | \$ 91,431 |  | 84,038 | \$ 175,469 |

(a) The
remeasurement
effect, net of
deferred taxes,
amounted to
$\$ 9.6$ million on
a consolidated
basis.
At the end of each quarter, the Corporation uses a discounted cash flow model to estimate the fair value of MSRs, which is benchmarked against third party opinions of value. The discounted cash flow model incorporates assumptions that market participants would use in estimating future net servicing income, including estimates of
prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, prepayment and late fees, among other considerations. The Corporation uses assumptions in the model that it believes are comparable to those used by brokers or other service providers. Refer to Note 8 Retained Interests on Mortgage Loan Sales / Securitizations for information on assumptions used in the valuation model of MSRs as of June 30, 2007.

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The change in MSRs measured using the fair value method for the six months ended June 30, 2007 was:

|  | Banking subsidiaries |  | PFH |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Residential MSRs |  | Residential MSRs |  | Total |
| Fair value at January 1, 2007 | \$ | 91,431 | \$ | 84,038 | \$ 175,469 |
| Purchases |  | 2,030 |  | 21,958 | 23,988 |
| Servicing from securitizations or asset transfers |  | 11,968 |  | 8,040 | 20,008 |
| Changes due to payments on loans (1) |  | $(4,561)$ |  | $(16,837)$ | $(21,398)$ |
| Changes in fair value due to changes in valuation model inputs or assumptions |  | 3,887 |  | $(4,015)$ | (128) |
| Other changes |  |  |  | (66) | (66) |
| Fair value at June 30, 2007 |  | 04,755 | \$ | 93,118 | \$ 197,873 |

(1) Represents
changes due to
collection /
realization of
expected cash
flows over time.
The changes in amortized MSRs for the six months ended June 30, 2006 were:

| (In thousands) | Residential <br> MSRs |  |
| :--- | ---: | ---: |
| Balance at January 1, 2006 | 137,701 <br> Rights originated <br> Rights purchased <br> Amortization <br> Balance at June 30, 2006 <br> Less: Valuation allowance <br> Balance at June 30, 2006, net of valuation allowance <br> Fair value at June 30, 2006 | 155,593 |

Residential mortgage loans serviced for others were $\$ 15.4$ billion at June 30, 2007 (December 31, 2006 \$13.3 billion; June 30, 2006 \$11.0 billion).
Net mortgage servicing fees, a component of other service fees in the consolidated statement of income, include the changes from period to period in fair value of the MSRs, which may result from changes in the valuation model inputs or assumptions (principally reflecting changes in discount rates and prepayment speed assumptions) and other changes, representing changes due to collection / realization of expected cash flows. Prior to the adoption of SFAS No. 156, the Corporation carried residential MSRs at the lower of cost or market, with amortization of MSRs and
changes in the MSRs valuation allowance recognized in net mortgage servicing fees.
Note 8 Retained Interests on Sales of Mortgage Loans
Popular Financial Holdings
The Corporation, through its consumer lending subsidiary PFH, has retained mortgage servicing rights and residual interests (also referred to as interest-only securities or IOs ) in connection with securitizations of subprime mortgage loans.
Residual interests retained as part of off-balance sheet securitizations of subprime mortgage loans prior to 2006 are classified as investment securities available-for-sale and are presented at fair value in the unaudited consolidated statements of condition. PFH s residual interests classified as available-for-sale as of June 30, 2007 amounted to $\$ 19$ million. In the quarter and six-month periods ended June 30, 2007, the Corporation recognized other-than-temporary impairment losses of $\$ 1.3$ million and $\$ 30.7$ million, respectively, on these residual interests. Commencing in January 2006, the residual interests derived from newly-issued PFH s off-balance sheet securitizations are accounted for as trading securities. As such, any valuation adjustment related to these particular residual interests is being recorded as part of trading account profit (loss) in the consolidated statements of income. Residual interests accounted for as trading securities from PFH s securitizations approximated $\$ 17$ million at June 30, 2007. For the second quarter and six-month periods ended June 30, 2007, the Corporation recognized trading losses of $\$ 0.8$ million and $\$ 24.3$ million, respectively, on these residual interests.

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During 2007, the Corporation conducted one off-balance sheet asset securitization that involved the transfer of mortgage loans to a qualifying special purpose entity (QSPE), which in turn transferred these assets and their tittles to a different trust, thus isolating those loans from the Corporation s assets. Approximately, $\$ 461$ million in adjustable ( ARM ) and fixed-rate loans were securitized and sold by PFH as part of this transaction, with a gain on sale of approximately $\$ 13.5$ million. As part of this transaction, the Corporation recognized MSRs of $\$ 8$ million and IOs of $\$ 4.7$ million.
Key economic assumptions used in measuring the retained interests at the date of this off-balance sheet securitization were:


Key economic assumptions used to estimate the fair value of residual interests and MSRs derived from PFH s securitizations and the sensitivity of residual cash flows to immediate changes in those assumptions were as follows:

| (In thousands) | June 30, 2007 |  |  | December 31, 2006 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | MSRs |  |  |  | MSRs |  |
|  | Residual Interests | Fixed-rate loans | ARM loans | Residual Interests | Fixed-rate loans | ARM loans |
| Carrying amount of retained interests | \$ 36,013 | \$34,081 | \$25,544 | \$85,965 | \$38,017 | \$29,838 |
| Fair value of retained interests | \$ 36,013 | \$34,081 | \$25,544 | \$85,965 | \$37,815 | \$32,212 |
| Weighted average life of collateral (in years) | 2.8 years | 3.2 years | 2.0 years | 3.2 years | 3.1 years | 2.1 years |
| Weighted average | 28\% |  |  | 28\% |  |  |
| prepayment speed | (Fixed-rate |  |  | (Fixed-rate |  |  |
| (annual rate) | loans) |  |  | loans) |  |  |
|  | 35\% |  |  | 35\% |  |  |
|  | (ARM |  |  | (ARM |  |  |
|  | loans) | 28\% | 35\% | loans) | 28\% | 35\% |
| Impact on fair value of $10 \%$ increase in |  |  |  |  |  |  |
|  | \$ $(1,405)$ | \$ 263 | \$ (120) | \$ $(5,543)$ | \$ 210 | \$ (149) |

Impact on fair value of $20 \%$ increase in

| prepayment rate | $\$(2,235)$ | $\$ 404$ | $\$(165)$ | $\$(9,284)$ | $\$$ | 234 | $\$(200)$ |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Weighted average <br> discount rate (annual |  | $25 \%$ |  | $17 \%$ |  | $17 \%$ |  | $17 \%$ |  | $16 \%$ |
| rate) |  |  |  |  |  |  |  |  |  |  |

PFH, as servicer, collects prepayment penalties on a substantial portion of the underlying serviced loans; as such, an adverse change in the prepayment assumptions with respect to the MSRs could be partially offset by the benefit derived from the prepayment penalties estimated to be collected.

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The amounts included in the tables above exclude any purchased MSRs since these assets were not derived from securitizations or loan sales executed by the Corporation.

## Banking subsidiaries

The Corporation s banking subsidiaries also retain servicing responsibilities in connection with the sale of mortgage loans to third parties. Also, servicing responsibilities are retained under pooling / selling arrangements of mortgage loans into mortgage-backed securities, primarily GNMA and FNMA securities. Substantially all mortgage loans securitized by the Corporation s banking subsidiaries, in which the Corporation retains a servicing right, have fixed rates. Under the servicing agreements, the banking subsidiaries do not earn significant prepayment penalties on the underlying loans serviced.
Key economic assumptions used in measuring the MSRs at the date of the securitizations and whole loan sales by the banking subsidiaries performed during the quarter ended June 30, 2007 were:

|  | MSRs |
| :--- | :---: |
| Prepayment speed | $13.1 \%$ |
| Weighted average life (in years) | 7.7 |
| Discount rate (annual rate) | years |

Key economic assumptions used to estimate the fair value of MSRs derived from transactions performed by the banking subsidiaries and the sensitivity of residual cash flows to immediate changes in those assumptions were as follows:

|  | June 30, | December 31, |
| :--- | :---: | :---: |
| (In thousands) | 2007 | 2006 |
|  | MSRs | MSRs |
| Fair value of retained interests | $\$ 83,171$ | $\$ 73,332$ |
| Weighted average life (in years) | 11.3 years | 9.2 years |
| Weighted average prepayment speed (annual rate) | $8.8 \%$ | $14.0 \%$ |
| Impact on fair value of 10\% adverse change | $\$(2,903)$ | $\$(1,868)$ |
| Impact on fair value of $20 \%$ adverse change | $10.9 \%$ | $\$(4,151)$ |
| Weighted average discount rate (annual rate) | $\$(3,714)$ | $10.3 \%$ |
| Impact on fair value of $10 \%$ adverse change | $\$(6,542)$ | $\$(2,142)$ |
| Impact on fair value of $20 \%$ adverse change |  | $(4,200)$ |

The amounts of MSRs presented in the table above exclude purchased MSRs.
The expected credit losses for the residential mortgage loans serviced by the Corporation s banking subsidiaries, including securitizations serviced on a recourse basis, are minimal.
The sensitivity analyses presented above for IOs and MSRs are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 and 20 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in the sensitivity tables included herein, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

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## Note 9 Derivative Instruments and Hedging Activities

Refer to Note 28 to the consolidated financial statements included in the 2006 Annual Report for a complete description of the Corporation s derivative activities. The following represents the major changes that occurred in the Corporation s derivative activities in the second quarter of 2007:

## Cash Flow Hedges

Derivative financial instruments designated as cash flow hedges outstanding as of June 30, 2007 and December 31, 2006 were as follows:

As of June 30, 2007

|  | Notional <br> amount | Derivative <br> assets | Derivative | Equity <br> liabilities | OCI |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Ineffectiveness |  |  |  |  |

## Liability Hedges

Interest rate swaps
\$ 390,000
\$ 853
\$ 554

As of December 31, 2006

|  | Notional <br> amount | Derivative <br> assets | Derivative <br> (In thousands) | Equity <br> OCI |
| :--- | :---: | :---: | :---: | :---: |
| Asset Hedges <br> Forward commitments | $\$ 190,000$ | $\$ 175$ | $\$ 2$ | $\$ 106$ |
| Liability Hedges <br> Interest rate swaps | $\$ 390,000$ | $\$ 887$ | $\$ 523$ | $\$ 237$ |

The Corporation utilizes forward contracts to hedge the sale of mortgage-backed securities with duration terms over one month. Interest rate forward contracts are contracts for the delayed delivery of securities which the seller agrees to deliver on a specified future date at a specified price or yield. These forward contracts are used to hedge a forecasted transaction and thus qualify for cash flow hedge accounting in accordance with SFAS No. 133, as amended. Changes in the fair value of the derivatives are recorded in other comprehensive income. The amount included in accumulated other comprehensive income corresponding to these forward contracts is expected to be reclassified to earnings in the next twelve months. The contracts outstanding at June 30, 2007 have a maximum remaining maturity of 80 days. The Corporation also has designated as cash flow hedges, interest rate swap contracts that convert floating rate debt into fixed rate debt by minimizing the exposure to changes in cash flows due to higher interest rates. These interest rate swap contracts have a maximum remaining maturity of 1.8 years.

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## Non-Hedging Activities

Financial instruments designated as non-hedging derivatives outstanding at June 30, 2007 and December 31, 2006 were as follows:

June 30, 2007

| (In thousands) | Notional amount |  | Fair Values |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Derivative assets |  | Derivative liabilities |  |
| Forward contracts | \$ | 634,365 |  | 3,732 | \$ | 683 |
| Futures contracts |  | 4,000 |  |  |  | 29 |
| Call options and put options |  | 98,000 |  | 94 |  | 164 |
| Interest rate swaps associated with: - short-term borrowings |  | 400,000 |  | 1,989 |  |  |
| - bond certificates offered in an on-balance sheet securitization |  | 441,555 |  | 855 |  |  |
| - financing of auto loans held-in-portfolio |  | 385,872 |  | 1,564 |  |  |
| - swaps with corporate clients |  | 509,607 |  |  |  | 8,252 |
| - swaps offsetting position of corporate client swaps |  | 509,607 |  | 8,252 |  |  |
| - investment securities |  | 79,385 |  | 160 |  | 483 |
| Credit default swap |  | 33,463 |  |  |  |  |
| Interest rate caps |  | 818,365 |  | 2,996 |  |  |
| Interest rate caps for benefit of corporate clients |  | 50,000 |  |  |  | 77 |
| Indexed options on deposits |  | 212,192 |  | 50,309 |  |  |
| Index options on S\&P Notes |  | 31,152 |  | 7,523 |  |  |
| Bifurcated embedded options |  | 237,861 |  |  |  | 56,412 |
| Mortgage rate lock commitments |  | 254,092 |  | 6 |  | 2,147 |
| Total |  | ,699,516 |  | 77,480 |  | 68,247 |

As of December 31, 2006

| (In thousands) | Notional amount |  | Fair Values |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Derivative assets |  | Derivative liabilities |  |
| Forward contracts | \$ | 400,572 |  | 1,277 | \$ | 125 |
| Call options and put options |  | 37,500 |  | 83 |  | 46 |
| Interest rate swaps associated with: |  |  |  |  |  |  |
| - short-term borrowings |  | 400,000 |  | 2,153 |  |  |
| - bond certificates offered in an on-balance sheet securitization |  | 516,495 |  | 90 |  | 1,168 |
| - financing of auto loan portfolio held-in-portfolio |  | 470,146 |  | 728 |  |  |
| - auto loans approvals locked interest rates |  | 17,442 |  | 22 |  |  |
| - swaps with corporate clients |  | 410,533 |  |  |  | 2,146 |
| - swaps offsetting position of corporate client swaps |  | 410,533 |  | 2,146 |  |  |
| - investment securities |  | 89,385 |  |  |  | 1,645 |
| - mortgage loan portfolio prior to securitization |  | 75,000 |  | 302 |  |  |
| Credit default swap |  | 33,463 |  |  |  |  |


| Foreign currency and exchange rate commitments w/ |  |  |  |
| :--- | ---: | ---: | ---: |
| clients | 103 |  |  |
| Foreign currency and exchange rate commitments w/ | 103 | 2 |  |
| counterparty | 889,417 | 4,099 |  |
| Interest rate caps | 50,000 | 38 |  |
| Interest rate caps for benefit of corporate clients | 204,946 | 38,323 |  |
| Indexed options on deposits | 31,152 | 5,648 | 43,844 |
| Indexed options on S\&P Notes | 229,455 |  | 635 |
| Bifurcated embedded options | 215,676 | 13 | 49,701 |
| Mortgage rate lock commitments | $\$ 4,481,921$ | $\$ 54,886$ |  |
|  |  |  |  |
| Total |  |  |  |
|  |  |  |  |
| Interest Rates Swaps |  |  |  |
| The Corporation has an interest rate swap outstanding to economically hedge the payments of certificates issued as |  |  |  |
| part of a securitization. This swap is marked-to-market quarterly and recognized as part of interest expense. The |  |  |  |

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Corporation recognized gains of $\$ 1.7$ million for the second quarter and $\$ 1.9$ million for the six months ended June 30, 2007 due to changes in its fair value. There was no impact in interest expense associated with these swaps during the quarter and six-month periods ended June 30, 2006.
The Corporation has interest rate swaps to economically hedge the cost of short-term debt. For the second quarter of 2007, the Corporation recognized a gain of $\$ 634$ thousand, and for the six months ended June 30, 2007, recognized losses of $\$ 164$ thousand due to changes in their fair value, which were included as part of short-term interest expense. During the quarter and six-month periods ended June 30, 2006, the Corporation recognized gains of $\$ 4.0$ million and $\$ 5.4$ million, respectively, associated with changes in the fair value of these interest rate swaps.
Additionally, the Corporation entered into amortizing swap contracts to economically convert to a fixed rate the cost of funds associated with auto loans held-in-portfolio. Gains of $\$ 1.8$ million and $\$ 836$ thousand for the quarter and six months ended June 30, 2007, respectively, were recognized as part of long-term interest expense. During the quarter and six-month periods ended June 30, 2006, the Corporation recognized gains of $\$ 1.4$ million and $\$ 2.9$ million, respectively, associated with changes in the fair value of these swaps.
The Corporation had interest rate swaps to economically hedge the changes in fair value of loans acquired and originated prior to securitization. These swaps were unwound during the second quarter of 2007 as a result of the completion of an off-balance sheet securitization. Changes in the fair value of these swaps were reported as part of interest income. Gains of $\$ 1.5$ million and $\$ 107$ thousand were recorded in the quarter and six-month periods ended June 30, 2007, respectively, as part of long-term interest expense.

## Interest Rate Caps

The Corporation has interest rate caps in conjunction with a series of mortgage loans securitizations that are used to limit the interest rate payable to the security holders. These interest rate caps are designated as non-hedging derivative instruments and are marked-to-market currently in the consolidated statements of income.
During the quarter ended June 30,2007 , the Corporation entered into a $\$ 100$ million interest rate cap to mitigate its exposure to rising interest rates on short-term borrowings.
Losses of $\$ 125$ thousand and $\$ 1.3$ million for the quarter and six months ended June 30, 2007, respectively, were recognized as part of long-term interest expense related to these interest rate cap contracts. For the quarter and six months ended June 30, 2006, these losses amounted to $\$ 0.7$ million and $\$ 3.1$ million.

## Forward Contracts

The Corporation has loan sales commitments to economically hedge the changes in fair value of mortgage loans held-for-sale associated with interest rate lock commitments through both mandatory and best efforts forward sales agreements. These contracts are entered into in order to optimize the gain on sales of loans. These contracts are recognized at fair market value with changes directly reported in income as part of gain on sale of loans. For the quarter and six months ended June 30 , 2007, gains of $\$ 2.3$ million and $\$ 1.6$ million, respectively, were recognized due to changes in fair value of these forward sales commitments. During the second quarter and six months ended June 30, 2006, the Corporation recognized losses of $\$ 0.5$ million and gains of $\$ 1.8$ million, respectively, related to these forward contracts.

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## Note 10 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the six months ended June 30, 2007 and 2006, allocated by reportable segment, were as follows (refer to Note 21 for the definition of the Corporation s reportable segments):

| (In thousands) | 2007 <br> Balance at January 1, 2007 | Goodwill acquired | Other | Balance at June 30, 2007 |
| :---: | :---: | :---: | :---: | :---: |
| Banco Popular de Puerto Rico: |  |  |  |  |
| P.R. Commercial Banking | \$ 14,674 |  |  | \$ 14,674 |
| P.R. Consumer and Retail Banking | 34,999 |  |  | 34,999 |
| P.R. Other Financial Services | 4,391 | \$ 24 |  | 4,415 |
| Popular North America: |  |  |  |  |
| Banco Popular North America | 568,647 |  |  | 568,647 |
| Popular Financial Holdings |  |  |  |  |
| EVERTEC | 45,142 | 775 | \$(183) | 45,734 |
| Total Popular, Inc. | \$ 667,853 | \$799 | \$(183) | \$668,469 |
|  | 2006 |  |  |  |
| (In thousands) | Balance at January 1, 2006 | Purchase accounting <br> adjustments | Other | Balance at June 30, 2006 |
| Banco Popular de Puerto Rico: |  |  |  |  |
| P.R. Commercial Banking | \$ 14,674 |  |  | \$ 14,674 |
| P.R. Consumer and Retail Banking | 34,999 |  |  | 34,999 |
| P.R. Other Financial Services | 4,110 |  |  | 4,110 |
| Popular North America: |  |  |  |  |
| Banco Popular North America | 542,834 | \$2,412 | \$(210) | 545,036 |
| Popular Financial Holdings | 14,236 | 3 |  | 14,239 |
| EVERTEC | 43,131 |  |  | 43,131 |
| Total Popular, Inc. | \$ 653,984 | \$2,415 | \$(210) | \$656,189 |

Purchase accounting adjustments consist of adjustments to the value of the assets acquired and liabilities assumed resulting from the completion of appraisals or other valuations, adjustments to initial estimates recorded for transaction costs, if any, and contingent consideration paid during a contractual contingency period. The purchase accounting adjustments during the first six months of 2006 at the PNA reportable segment were mostly related to the E-LOAN acquisition.
At June 30, 2007 and December 31, 2006, other than goodwill, the Corporation had $\$ 65$ million of identifiable intangibles with indefinite useful lives, mostly associated with E-LOAN s trademark (June 30, $2006 \$ 59$ million). The following table reflects the components of other intangible assets subject to amortization:

June 30, 2007
Gross Accumulated Gross Accumulate
Gross Accumulated
June 30, 2006
Gross Accumulated

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| (In thousands) | Amount | Amortization | Amount | Amortization | Amount | Amortization |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Core deposits | $\$ 71,629$ | $\$ 46,982$ | $\$ 76,708$ | $\$ 48,367$ | $\$ 76,956$ | $\$ 44,741$ |
| Other customer <br> relationships | 11,543 | 3,113 | 11,156 | 2,171 | 8,593 | 1,273 |
| Other intangibles | 9,146 | 4,534 | 9,099 | 3,426 | 9,320 | 2,729 |
| Total | $\$ 92,318$ | $\$ 54,629$ | $\$ 96,963$ | $\$ 53,964$ | $\$ 94,869$ | $\$ 48,743$ |

During the quarter and six months ended June 30, 2007, the Corporation recognized $\$ 2.8$ million and $\$ 5.8$ million,

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respectively, in amortization expense related to other intangible assets with definite lives (June 30, $2006 \quad \$ 2.8$ million and $\$ 5.6$ million, respectively).
The following table presents the estimated aggregate annual amortization expense of the intangible assets with definite lives for each of the following fiscal years:

|  | (In |
| :---: | :---: |
| 2007 | thousands) |
| 2008 | $\$ 10,067$ |
| 2009 | 8,368 |
| 2010 | 6,546 |
| 2011 | 5,588 |

No significant events or circumstances have occurred that would reduce the fair value of any reporting unit below its carrying amount.

## Note 11 Borrowings

The composition of federal funds purchased and assets sold under agreements to repurchase was as follows:
(In thousands)
Federal funds purchased
Assets sold under agreements to repurchase

| June 30, | December 31, <br> 2007 | June 30, <br> 2006 |
| :---: | :---: | :---: |
| $\$ 1,430,952$ | $\$ 1,276,818$ | $\$ 1,164,177$ |
| $4,224,984$ | $4,485,627$ | $6,762,554$ |
|  |  |  |
| $\$ 5,655,936$ | $\$ 5,762,445$ | $\$ 7,926,731$ |

Other short-term borrowings consisted of:
(In thousands)
Advances with FHLB paying interest at:
-fixed rates ranging from $5.24 \%$ to $5.44 \%$ (June 30, 2006 $5.24 \%$ to $5.39 \%$ )
-a floating rate of $0.06 \%$ over the fed funds rate (Fed
funds rate at June 30, 2006 was $5.00 \%$ )

| June 30, | December 31, | June 30, |
| :---: | :---: | :---: |
| 2007 | 2006 | 2006 |

Advances under credit facilities with other institutions at: -fixed rates ranging from $5.35 \%$ to $5.50 \%$ (June 30, 2006 $5.33 \%$ to $5.35 \%$ )
-floating rates ranging from $0.45 \%$ to $2.00 \%$ over the 1-month LIBOR rate (1-month LIBOR rate at June 30, 2006 was $5.33 \%$ )
\$ 305,000
\$ 230,000
\$ 400,000
105,000
-a floating rate of $0.20 \%$ over the 3 -month LIBOR rate
(3-month LIBOR rate at June 30, 2006 5.48\%)
Commercial paper at rates ranging from $4.75 \%$ to $5.37 \%$
(June 30, $2006 \quad 4.75 \%$ to $5.37 \%$ )
Term funds purchased at:
-fixed rates ranging from 5.28\% to 5.38\% (June 30, 2006
$5.02 \%$ to $5.36 \%) \quad 2,065,000 \quad 2,140,900 \quad 1,275,000$
-a floating rate of $0.08 \%$ (June 30, $20060.06 \%$ to $0.08 \%$ ) over the fed funds rate (Fed funds rate at June 30, 2007 was $5.38 \%$; June 30, $20065.00 \%$ )

| 400,000 | 500,000 | 647,200 |
| ---: | ---: | ---: |
| 87,191 | 92,780 | 9,640 |
| $\$ 3,384,105$ | $\$ 4,034,125$ | $\$ 2,656,936$ |

Note: Refer to the Corporation s Form 10-K for the year ended December 31, 2006, for rates and maturity information corresponding to the borrowings outstanding as of such date.

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Notes payable consisted of:
(In thousands)

Advances with FHLB:
-maturing from 2007 through 2016 paying interest at
fixed rates ranging from $3.07 \%$ to $6.98 \%$ (June 30, 2006 $2.51 \%$ to $6.98 \%$ )
-maturing in 2008 paying interest monthly at a floating rate of $0.0075 \%$ over the 1 -month LIBOR rate ( 1 -month LIBOR rate at June 30, 2007 was $5.32 \%$; June 30, 2006 5.33\%)
-maturing in 2007 paying interest quarterly at the
3-month LIBOR rate less $0.04 \%$
-maturing in 2007 paying interest monthly at the 1 -month LIBOR rate plus $0.02 \%$ (1-month LIBOR rate at June 30, 2006 5.33\%)

Advances under revolving lines of credit maturing in 2008 paying interest monthly at a floating rate of $0.90 \%$ over the 1-month LIBOR rate (1-month LIBOR rate at June 30, 2007 was $5.32 \%$; June 30, $20065.33 \%$ )

Advances under revolving lines of credit with maturities until 2009 paying interest quarterly at a floating rate of $0.20 \%$ to $0.35 \%$ (June 30, $20060.35 \%$ to $0.45 \%$ ) over the 3 -month LIBOR rate (3-month LIBOR rate at June 30, 2007 was $5.36 \%$ )

Term notes with maturities ranging from 2007 through 2011 paying interest semiannually at fixed rates ranging from 3.35\% to 5.65\% (June 30, $20063.25 \%$ to $6.39 \%$ )

Term notes with maturities ranging from 2007 until 2009 paying interest quarterly at floating rates ranging from $0.35 \%$ to $0.40 \%$ over the 3 -month LIBOR rate (3-month LIBOR rate at June 30, 2007 was $5.36 \%$; June 30, 2006 5.48\%)

Term notes with maturities until 2030 paying interest monthly at fixed rates ranging from $3.00 \%$ to $6.00 \%$

Term notes with maturities until 2013 paying interest monthly at a floating rate of $3.00 \%$ over the 10 -year US treasury notes rate (average 10-year US treasury notes rate at June 30, 2007 was $5.10 \%$; June 30, $20065.11 \%$ )

$$
349,504
$$

$\begin{array}{rrr}2,014,659 & 2,014,928 & \\ 349,504 & 349,295 & 469,074 \\ 3,100 & 3,100 & 3,100 \\ & & \\ & & \\ 8,168 & 10,428 & 11,589 \\ 2,489,329 & 2,695,916 & 3,093,397\end{array}$
$\begin{array}{rrr}2,014,659 & 2,014,928 & \\ 349,504 & 349,295 & 469,074 \\ 3,100 & 3,100 & 3,100 \\ & & \\ & & \\ 8,168 & 10,428 & 11,589 \\ 2,489,329 & 2,695,916 & 3,093,397\end{array}$

Secured borrowings with maturities until 2015 paying interest monthly at fixed rates ranging from $3.86 \%$ to 7.12\% (June 30, $20063.05 \%$ to $7.12 \%$ )

Secured borrowings with maturities until 2012 paying interest monthly at rates ranging from $0.05 \%$ to $3.50 \%$ over the 1-month LIBOR rate (1-month LIBOR rate at June 30, 2007 was $5.32 \%$; June 30, $20065.33 \%$ )

Notes linked to the S\&P 500 Index maturing in 2008
Junior subordinated deferrable interest debentures with maturities ranging from 2027 to 2034 with fixed interest rates ranging from $6.13 \%$ to $8.33 \%$ (Refer to Note 17)

Other

| $1,352,710$ | $1,708,650$ | $1,888,914$ |
| ---: | ---: | ---: |
| 38,118 | 36,112 | 34,014 |
|  |  |  |
| 849,672 | 849,672 | 849,672 |
| 21,399 | 21,583 | 511 |
| $\$ 8,068,638$ | $\$ 8,737,246$ | $\$ 10,198,675$ |

Note: Refer to the Corporation s Form 10-K for the year ended December 31, 2006, for rates and maturity information corresponding to the borrowings outstanding as of such date.

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## Note 12 Commitments and Contingencies

Commercial letters of credit and stand-by letters of credit amounted to $\$ 15$ million and $\$ 181$ million, respectively, at June 30, 2007 (December 31, $2006 \$ 21$ million and $\$ 181$ million; June 30, $2006 \quad \$ 18$ million and $\$ 161$ million). There were also other commitments outstanding and contingent liabilities, such as commitments to extend credit. At June 30, 2007, the Corporation recorded a liability of $\$ 753$ thousand (December 31, $2006 \$ 658$ thousand; June 30, $2006 \$ 696$ thousand), which represents the fair value of the obligations undertaken in issuing the guarantees under stand-by letters of credit. The fair value approximates the fee received from the customer for issuing such commitments. These fees are deferred and are recognized over the commitment period. The liability was included as part of other liabilities in the consolidated statements of condition. The stand-by letters of credit were issued to guarantee the performance of various customers to third parties. The contract amounts in stand-by letters of credit outstanding represent the maximum potential amount of future payments the Corporation could be required to make under the guarantees in the event of nonperformance by the customers. These stand-by letters of credit are used by the customer as a credit enhancement and typically expire without being drawn upon. The Corporation s stand-by letters of credit are generally secured, and in the event of nonperformance by the customers, the Corporation has rights to the underlying collateral provided, which normally includes cash and marketable securities, real estate, receivables and others. Management does not anticipate any material losses related to these instruments.
Popular, Inc. Holding Company ( PIHC ) fully and unconditionally guarantees certain borrowing obligations issued by certain of its wholly-owned consolidated subsidiaries, which aggregated to $\$ 3.4$ billion at June 30, 2007
(December 31, $2006 \$ 3.3$ billion and June 30, $2006 \$ 4.2$ billion). In addition, at June 30, 2007, PIHC fully and unconditionally guaranteed $\$ 824$ million of capital securities (December 31, 2006 and June 30, $2006 \quad \$ 824$ million) issued by four wholly-owned issuing trust entities that have been deconsolidated pursuant to FIN No. 46R.
The Corporation is a defendant in a number of legal proceedings arising in the normal course of business. Based on the opinion of legal counsel, management believes that the final disposition of these matters will not have a material adverse effect on the Corporation $s$ financial position or results of operations.
Note 13 Other Service Fees
The caption of other service fees in the consolidated statements of income consists of the following major categories:

|  | Quarter ended June 30, |  | Six months ended June 30, |  |
| :--- | :---: | :---: | ---: | :---: |
| (In thousands) | 2007 | 2006 | 2007 | 2006 |
|  |  |  |  |  |
| Credit card fees and discounts | $\$ 24,999$ | $\$ 22,371$ | $\$ 48,523$ | $\$ 44,944$ |
| Debit card fees | 16,855 | 15,085 | 32,956 | 30,004 |
| Insurance fees | 14,720 | 14,411 | 27,669 | 26,552 |
| Processing fees | 11,677 | 10,939 | 23,789 | 21,218 |
| Sale and administration of investment products | 7,311 | 6,649 | 14,571 | 14,106 |
| Mortgage servicing fees, net of amortization |  |  | $(919)$ | 10,869 |

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## Note 14 Income Taxes

As indicated in Note 2, the Corporation adopted FIN 48 effective January 1, 2007. The initial adoption of FIN 48 had no impact on the Corporation sfinancial statements since management determined that there was no need to recognize changes in the liability for unrecognized tax benefits.
The reconciliation of unrecognized tax benefits, including accrued interest, was as follows:

| (In millions) | Six months <br> ended June <br> 30,2007 |
| :--- | :---: |
| Balance as of January 1, 2007 |  |
| Additions for tax positions of current period | $\$ 20.4$ |
| Balance as of June 30, 2007 | 4.0 |

As of June 30, 2007, the related accrued interest approximated $\$ 2.8$ million. Management has determined that as of June 30, 2007 there is no need to accrue for the payment of penalties. The Corporation s policy is to report interest related to unrecognized tax benefits in income tax expense, while the penalties, if any, in other operating expenses in the consolidated statements of income.
After consideration of the effect on U.S. federal tax of unrecognized U.S. state tax benefits, the total amount of unrecognized tax benefits, including U.S. and Puerto Rico that, if recognized, would affect the Corporation s effective tax rate, was approximately $\$ 23.2$ million for the six months ended June 30, 2007.
The amount of unrecognized tax benefits may increase or decrease in the future for various reasons including adding amounts for current tax year positions, expiration of open income tax returns due to the statutes of limitation, changes in management s judgment about the level of uncertainty, status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions.
The Corporation and its subsidiaries file income tax returns in Puerto Rico, the U.S. federal jurisdiction, various U.S. states and political subdivisions, and foreign jurisdictions. As of June 30, 2007, the following years remain subject to examination: U.S. Federal jurisdiction 2005 and 2006 and Puerto Rico 2003 through 2006. The U.S. Internal Revenue Service ( IRS ) commenced its examination of the Corporation s U.S. operations tax return for 2005 that is anticipated to be finished by the end of 2007. As of June 30, 2007, the IRS has not proposed any adjustment as a result of the audit. Although the outcome of tax audits is uncertain, the Corporation believes that adequate amounts of tax, interest and penalties have been provided for any adjustments that are expected to result from open years. The Corporation does not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

## Note 15 Stock-Based Compensation

The Corporation maintained a Stock Option Plan (the Stock Option Plan ), which permitted the granting of incentive awards in the form of qualified stock options, incentive stock options, or non-statutory stock options of the Corporation. In April 2004, the Corporation s shareholders adopted the Popular, Inc. 2004 Omnibus Incentive Plan (the
Incentive Plan ), which replaced and superseded the Stock Option Plan. All outstanding award grants under the Stock Option Plan continue to remain outstanding at June 30, 2007 under the original terms of the Stock Option Plan.

## Stock Option Plan

Employees and directors of the Corporation or any of its subsidiaries were eligible to participate in the Stock Option Plan. The Board of Directors or the Compensation Committee of the Board had the absolute discretion to determine the individuals that were eligible to participate in the Stock Option Plan. This plan provides for the issuance of Popular, Inc. s common stock at a price equal to its fair market value at the grant date, subject to certain plan provisions. The shares are to be made available from authorized but unissued shares of common stock or treasury

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stock. The Corporation s policy has been to use authorized but unissued shares of common stock to cover each grant. The maximum option term is ten years from the date of grant. Unless an option agreement provides otherwise, all options granted are $20 \%$ exercisable after the first year and an additional $20 \%$ is exercisable after each subsequent year, subject to an acceleration clause at termination of employment due to retirement.
The following table presents information on stock options outstanding as of June 30, 2007:
(Not in thousands)

|  |  | Weighted <br> Average <br> Exercise <br> Price of | Weighted <br> Average <br> Remaining Life <br> of <br> Options | Options |
| :--- | :---: | :---: | :---: | :---: | :---: | | Exercisable |
| :---: | | Weighted |
| :---: |
| Average |
| Exercise |
| Price of |

The aggregate intrinsic value of options outstanding and options exercisable as of June 30,2007 was $\$ 12.6$ million and $\$ 1.0$ million, respectively.
The following table summarizes the stock option activity and related information:

| (Not in thousands) | Options <br> Outstanding | Weighted-Average <br> Exercise Price |
| :--- | ---: | :---: |
| Outstanding at January 1, 2006 | $3,223,703$ | 20.63 |
| Granted | $(39,449)$ | 15.78 |
| Exercised | $(37,818)$ | 23.75 |
| Forfeited | $(1,637)$ | 24.05 |
| Expired | $3,144,799$ | $\$ 20.65$ |
| Outstanding at December 31,2006 | $(10,064)$ | 15.83 |
| Granted | $(19,063)$ | 25.50 |
| Exercised | $(16,055)$ | 19.14 |
| Forfeited | $3,099,617$ | $\$ 20.65$ |

The stock options exercisable at June 30, 2007 totaled 2,380,590 (June 30, 2006 1,973,986). There were no stock options exercised during the quarter ended June 30, 2007. For the six months ended June 30, 2007, the cash received from stock options exercised amounted to $\$ 159$ thousand. The total intrinsic value of options exercised during the quarter ended June 30, 2006 was $\$ 26$ thousand. The total intrinsic value of options exercised during the six-month period ended June 30, 2007 was $\$ 28$ thousand (June 30, $2006 \$ 68$ thousand).
There were no new stock option grants issued by the Corporation under the Stock Option Plan during 2006 or 2007. The Corporation recognized $\$ 0.4$ million in stock option expense, with a tax benefit of $\$ 0.2$ million, for the quarter ended June 30, 2007 (June 30, $2006 \$ 0.8$ million, with a tax benefit of $\$ 0.3$ million). For the six months ended

June 30, 2007, the Corporation recognized $\$ 0.9$ million in stock option expense, with a tax benefit of $\$ 0.4$ million (June 30, $2006 \$ 1.6$ million, with a tax benefit of $\$ 0.6$ million). The total unrecognized compensation cost at June 30, 2007 related to non-vested stock option awards was $\$ 2.5$ million and is expected to be recognized over a weighted-average period of 1.4 years.

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## Incentive Plan

The Incentive Plan permits the granting of incentive awards in the form of an Annual Incentive Award, a Long-term Performance Unit Award, an Option, a Stock Appreciation Right, Restricted Stock, Restricted Unit or Performance Share. Participants in the Incentive Plan are designated by the Compensation Committee of the Board of Directors (or its delegate as determined by the Board). Employees and directors of the Corporation and / or any of its subsidiaries are eligible to participate in the Incentive Plan. The shares may be made available from common stock purchased by the Corporation for such purpose, authorized but unissued shares of common stock or treasury stock. The Corporation s policy with respect to the shares of restricted stock has been to purchase such shares in the open market to cover each grant.
Under the Incentive Plan, the Corporation has issued only restricted shares, which become vested based on the employees continued service with Popular. The compensation cost associated with the shares of restricted stock is estimated based on a two-prong vesting schedule, unless otherwise stated in an agreement. The first part is vested ratably over five years commencing at the date of grant and the second part is vested at termination of employment after attainment of 55 years of age and 10 years of service. The five-year vesting part is accelerated at termination of employment after attaining 55 years of age and 10 years of service.
Beginning in 2007, the Corporation authorized the issuance of performance shares in addition to restricted shares under a long-term incentive plan. The performance shares award consists of the opportunity to receive shares of Popular, Inc. s common stock provided the Corporation achieves certain performance goals during a 3-year performance cycle. The compensation cost associated with the performance shares will be recorded ratably over a three-year performance period. The performance shares will be granted at the end of the three-year period and will be vested at grant date. As of June 30, 2007, no shares have been granted under this plan.
The following table summarizes the restricted stock activity under the Incentive Plan and related information to members of management:

|  | Restricted | Weighted-Average <br> Grant Date Fair <br> Value |
| :--- | :---: | :---: |
| (Not in thousands) | Stock | (172,622 |
| Non-vested at January 1, 2006 <br> Granted <br> Vested <br> Forfeited | 444,036 | 27.65 |
| Non-vested at December 31, 2006 | $(5,188)$ | 19.95 |
| Granted <br> Vested <br> Forfeited | 611,470 | $\$ 22.55$ |
| Non-vested at June 30, 2007 | $(69,471)$ | 20.56 |

During the quarters ended June 30, 2007 and 2006, no shares of restricted stock were awarded to management under the Incentive Plan. During the six-month period ended June 30, 2007, no shares of restricted stock were awarded to management under the Incentive Plan (June 30, 2006 444,036).
During the quarter ended June 30, 2007, the Corporation recognized $\$ 0.5$ million (June 30, 2006 - $\$ 0.8$ million) of restricted stock expense related to management incentive awards, with an income tax benefit of $\$ 0.2$ million (June 30, $2006 \$ 0.3$ million). For the six-month period ended June 30, 2007, the Corporation recognized $\$ 1.8$ million (June 30, $2006 \$ 2.1$ million) of restricted stock expense related to management incentive awards, with an income tax benefit of $\$ 0.7$ million (June 30, 2006- $\$ 0.8$ million). The total unrecognized compensation cost related to non-vested restricted stock awards to members of management at June 30,2007 was $\$ 5.0$ million and is expected to be recognized over a
weighted-average period of 2.9 years.

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The following table summarizes the restricted stock under Incentive Award and related information to members of the Board of Directors:

| (Not in thousands) | Restricted Stock | Weighted-Average Grant Date Fair Value |  |
| :---: | :---: | :---: | :---: |
| Non-vested at January 1, 2006 | 46,948 | \$ | 23.61 |
| Granted | 32,267 |  | 19.82 |
| Vested | $(2,601)$ |  | 23.54 |
| Forfeited |  |  |  |
| Non-vested at December 31, 2006 | 76,614 | \$ | 22.02 |
| Granted | 29,363 |  | 17.35 |
| Vested | $(22,486)$ |  | 22.03 |
| Forfeited |  |  |  |
| Non-vested at June 30, 2007 | 83,491 | \$ | 20.37 |

During the quarter ended June 30, 2007, the Corporation granted 26,751 (June 30, 2006 28,583) shares of restricted stock to members of the Board of Directors of Popular, Inc. and BPPR. During this period, the Corporation recognized $\$ 0.1$ million, with a tax benefit of $\$ 0.06$ million (June 30, $2006 \quad \$ 0.1$ million, with a tax benefit of $\$ 0.05$ million), of restricted stock expense related to these restricted stock grants. For the six-month period ended June 30, 2007, the Corporation granted 29,363 (June 30, 2006 29,859) shares of restricted stock to members of the Board of Directors of Popular, Inc. and BPPR. During this period, the Corporation recognized $\$ 0.3$ million, with a tax benefit of $\$ 0.1$ million (June 30, $2006 \$ 0.3$ million, with a tax benefit of $\$ 0.1$ million), of restricted stock expense related to these restricted stock grants.

## Note 16 Pension and Other Benefits

The Corporation has noncontributory defined benefit pension plans and supplementary pension plans for regular employees of certain of its subsidiaries.
The components of net periodic pension cost for the quarters and six months ended June 30, 2007 and 2006 were as follows:

| (In thousands) | Pension Plans |  |  |  | Benefit Restoration Plans |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Quarters ended June 30, |  | Six months ended June 30, |  | Quarters ended June 30, |  | Six months ended June 30, |  |
|  | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Service cost | \$ 2,639 | \$ 3,135 | \$ 5,745 | \$ 6,270 | \$ 220 | \$ 262 | \$ 457 | \$ 524 |
| Interest cost | 7,959 | 7,641 | 15,932 | 15,282 | 419 | 400 | 839 | 800 |
| Expected return on plan assets | $(10,533)$ | $(9,931)$ | $(21,057)$ | $(19,909)$ | (368) | (264) | (736) | (528) |
| Amortization of prior service cost | 52 | 44 | 104 | 88 | (13) | (13) | (26) | (26) |
| Amortization of net loss |  | 488 |  | 976 | 247 | 276 | 495 | 552 |
| Net periodic cost Curtailment gain | 117 | 1,377 | $\begin{gathered} 724 \\ (246) \end{gathered}$ | 2,707 | 505 | 661 | $\begin{gathered} 1,029 \\ (258) \end{gathered}$ | 1,322 |

$\begin{array}{lllllllllllll}\text { Total cost } & \$ 117 & \$ 1,377 & \$ & 478 & \$ & 2,707 & \$ 505 & \$ 661 & \$ 771 & \$ 1,322\end{array}$
During the first quarter of 2007, the Corporation adopted an amendment to freeze the benefits for all employees under the U.S. Retirement and Restoration plans. These plans were remeasured at January 31, 2007 to account for the freeze. The discount rate of the U.S. Retirement plan was changed to $4.5 \%$ to reflect the expected plan termination. The remeasurement and curtailment effects were considered for these plans and are included as part of the June 30, 2007 disclosures.
For the six months ended June 30, 2007, contributions made to the pension and restoration plans approximated $\$ 1.6$ million. The total contributions expected to be paid during 2007 for the pension and restoration plans approximate $\$ 2.2$ million.

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The Corporation also provides certain health care benefits for retired employees of certain subsidiaries. The components of net periodic postretirement benefit cost for the quarters and six months ended June 30, 2007 and 2006 were as follows:

|  | Quarters ended |  | Six months ended |  |
| :--- | :---: | :---: | :---: | ---: |
|  | June 30, |  | June 30, |  |
| (In thousands) | 2007 | 2006 | 2007 | 2006 |
| Service cost | $\$ 578$ | $\$$ | 687 | $\$ 1,156$ |
| Interest cost | 1,889 | 1,927 | 3,778 | 31,399 |
| Amortization of prior service cost | $(261)$ | $(262)$ | $(523)$ | $(524)$ |
| Amortization of net loss |  | 240 |  | 480 |
| Total net periodic cost | $\$ 2,206$ | $\$ 2,592$ | $\$ 4,411$ | $\$ 5,209$ |

For the six months ended June 30, 2007, contributions made to the postretirement benefit plan approximated $\$ 3.3$ million. The total contributions expected to be paid during 2007 for the postretirement benefit plan approximate $\$ 6.4$ million.
Note 17 Trust Preferred Securities
At June 30, 2007 and 2006, the Corporation had established four trusts for the purpose of issuing trust preferred securities (the capital securities ) to the public. The proceeds from such issuances, together with the proceeds of the related issuances of common securities of the trusts (the common securities ), were used by the trusts to purchase junior subordinated deferrable interest debentures (the junior subordinated debentures ) issued by the Corporation. The sole assets of the trusts consisted of the junior subordinated debentures of the Corporation and the related accrued interest receivable. These trusts are not consolidated by the Corporation under the provisions of FIN No. 46(R). The junior subordinated debentures are included by the Corporation as notes payable in the consolidated statements of condition, while the common securities issued by the issuer trusts are included as other investment securities. The common securities of each trust are wholly-owned, or indirectly wholly-owned, by the Corporation. Financial data pertaining to the trusts follows:
(In thousands, including reference notes)

|  | Popular |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
|  |  | North |  |  |
|  |  | Popular | America | Popular |
| Issuer | BanPonce | Capital | Capital | Capital |
|  | Trust I | Trust I | Trust I | Trust II |


|  |  |  |  |  | September |  | November |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Issuance date | February 1997 |  | October 2003 |  |  | 2004 |  | 2004 |
| Capital securities | \$ | 144,000 | \$ | 300,000 | \$ | 250,000 | \$ | 130,000 |
| Distribution rate |  | 8.327\% |  | 6.700\% |  | 6.564\% |  | 6.125\% |
| Common securities | \$ | 4,640 | \$ | 9,279 | \$ | 7,732 | \$ | 4,021 |
| Junior subordinated debentures aggregate liquidation amount | \$ | 148,640 | \$ | 309,279 | \$ | 257,732 | \$ | 134,021 |
|  |  |  |  | November |  | September |  | December |
| Stated maturity date |  | February 2027 |  | 2033 |  | 2034 |  | 2034 |
| Reference notes |  | (a),(c),(e),(f),(g) |  | (b),(d),(f) |  | (a),(c),(f) |  | (b),(d),(f) |

## (a)

Statutory
business trust
that is
wholly-owned
by Popular
North America
(PNA) and
indirectly
wholly-owned
by the
Corporation.
(b) Statutory
business trust
that is
wholly-owned
by the
Corporation.
(c) The obligations
of PNA under
the junior
subordinated
debentures and
its guarantees of
the capital
securities under
the trust are
fully and
unconditionally
guaranteed on a subordinated
basis by the
Corporation to
the extent set
forth in the applicable guarantee agreement.
(d) These capital securities are fully and unconditionally guaranteed on a subordinated basis by the Corporation to the extent set forth in the applicable

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(e) The original issuance was for \$150,000. In 2003, the
Corporation reacquired $\$ 6,000$ of the 8.327\% capital securities.
(f) The Corporation has the right, subject to any required prior approval from the Federal Reserve, to redeem after certain dates or upon the occurrence of certain events mentioned below, the junior subordinated debentures at a redemption price equal to $100 \%$ of the principal amount, plus accrued and unpaid interest to the date of redemption. The maturity of the junior subordinated debentures may be shortened at the option of the Corporation prior to their stated maturity dates (i) on or after the stated optional redemption
dates stipulated
in the
agreements, in whole at any time or in part from time to time, or (ii) in whole, but not in part, at any time within 90 days
following the occurrence and during the continuation of a tax event, an investment
company event or a capital treatment event as set forth in the indentures relating to the capital
securities, in each case subject to regulatory approval. A capital treatment event would include a change in the regulatory capital treatment of the capital securities as a result of the recent accounting changes affecting the criteria for consolidation of variable interest entities such as the trust under FIN 46(R).
(g) Same as
(f) above,

## except that the

investment
company event
does not apply
for early
redemption.
The capital securities of Popular Capital Trust I and Popular Capital Trust II are traded on the NASDAQ under the symbols BPOPN and BPOPM, respectively.
Under the Federal Reserve Board s risk-based capital guidelines, the capital securities are included as part of the Corporation s Tier I capital.

## Note 18 -Stockholders Equity

During the fourth quarter of 2005, existing shareholders of record of the Corporation s common stock at November 7, 2005 fully subscribed to an offering of $10,500,000$ newly issued shares of Popular, Inc. s common stock at a price of $\$ 21.00$ per share under a subscription rights offering. This offering resulted in approximately $\$ 216$ million in additional capital, of which approximately $\$ 175$ million impacted stockholders equity at December 31, 2005 and the remainder impacted the Corporation s financial condition in the first quarter of 2006. As of December 31, 2005, this subscription rights offering resulted in $8,614,620$ newly issued shares of common stock; the remaining $1,885,380$ were issued during the first quarter of 2006.
The Corporation has a dividend reinvestment and stock purchase plan under which stockholders may reinvest their quarterly dividends in shares of common stock at a $5 \%$ discount from the average market price at the time of issuance, as well as purchase shares of common stock directly from the Corporation by making optional cash payments at prevailing market prices.
The Corporation $s$ authorized preferred stock may be issued in one or more series, and the shares of each series shall have such rights and preferences as shall be fixed by the Board of Directors when authorizing the issuance of that particular series. The Corporation s only outstanding class of preferred stock is its $6.375 \%$ noncumulative monthly income preferred stock, 2003 Series A. These shares of preferred stock are perpetual, nonconvertible and are redeemable solely at the option of the Corporation beginning on March 31, 2008. The redemption price per share is $\$ 25.50$ from March 31, 2008 through March 30, 2009, \$25.25 from March 31, 2009 through March 30, 2010 and \$25.00 from March 31, 2010 and thereafter.
The Banking Act of the Commonwealth of Puerto Rico requires that a minimum of $10 \%$ of BPPR s net income for the year be transferred to a statutory reserve account until such statutory reserve equals the total of paid-in capital on common and preferred stock. Any losses incurred by a bank must first be charged to retained earnings and then to the reserve fund. Amounts credited to the reserve fund may not be used to pay dividends without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The failure to maintain sufficient statutory reserves would preclude BPPR from paying dividends. BPPR s statutory reserve fund totaled $\$ 346$ million at June 30, 2007
(December 31, $2006 \$ 346$ million; June 30, $2006 \$ 317$ million). During the six months ended June 30, 2006, BPPR transferred $\$ 1$ million to the statutory reserve account. There were no transfers between the statutory reserve account and the retained earnings account during the six months ended June 30, 2007.

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Note 19 Earnings per Common Share
The computation of earnings per common share ( EPS ) follows:

| (In thousands, except share information) | Quarter ended <br> June 30, |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2007 |  | 2006 |  | 2007 |  | 2006 |
| Net income | \$ | 74,950 | \$ | 97,381 | \$ | 193,597 | \$ | 215,884 |
| Less: Preferred stock dividends |  | 2,978 |  | 2,978 |  | 5,956 |  | 5,956 |
| Net income applicable to common stock | \$ | 71,972 | \$ | 94,403 | \$ | 187,641 | \$ | 209,928 |
| Average common shares outstanding |  | 279,355,701 |  | 278,354,043 |  | 79,218,147 |  | 278,220,693 |
| Average potential common shares |  | 88,158 |  | 282,176 |  | 117,671 |  | 305,794 |
| Average common shares outstanding assuming dilution |  | 279,443,859 |  | 278,636,219 |  | 79,335,818 |  | 278,526,487 |
| Basic and diluted EPS | \$ | 0.26 | \$ | 0.34 | \$ | 0.67 | \$ | 0.75 |

Potential common shares consist of common stock issuable under the assumed exercise of stock options and under restricted stock awards using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from exercise, in addition to the amount of compensation cost attributed to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect in earnings per share. For the quarter and six-month period ended June 30, 2007, there were 1,752,235 and 1,756,748 weighted average antidilutive stock options outstanding, respectively (June 30, 2006 $1,900,071$ and $1,899,458$ ). All shares of restricted stock are treated as outstanding for purposes of this computation.

## Note 20 Supplemental Disclosure on the Consolidated Statements of Cash Flows

As mentioned in Note 1 of the Corporation s 2006 Annual Report, as of the end of the first quarter of 2006, all subsidiaries of the Corporation had changed the reporting period to a December $31^{\text {st }}$ calendar period. The impact of this change corresponds to the financial results for the month of December 2005 for those subsidiaries which implemented the change in the first reporting period of 2006.
The following table reflects the effect in the Consolidated Statements of Cash Flows of the change in reporting period mentioned above.

|  | Six months <br> ended |
| :--- | ---: |
| (In thousands) | June 30,2006 |
| Net cash used in operating activities | $(80,906)$ |
| Net cash used in investing activities | $(104,732)$ |
| Net cash provided by financing activities | 197,552 |

Net increase in cash and due from banks
Loans receivable transferred to other real estate and other property for the six months ended June 30, 2007 amounted to $\$ 90$ million and $\$ 18$ million, respectively (June 30, $2006 \quad \$ 64$ million and $\$ 15$ million, respectively).
During the six months ended June 30, 2006, $\$ 464$ million in non-conforming loans classified as held-in-portfolio were pooled into trading securities and subsequently sold. The cash inflow from this sale was reflected as operating activities in the consolidated statement of cash flows. In addition, the consolidated statements of cash flows exclude the effect of $\$ 708$ million and $\$ 354$ million in non-cash reclassifications of loans held-for-sale securitized into trading securities for the six months ended June 30, 2007 and 2006, respectively.

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The Corporation recognized mortgage servicing rights of $\$ 20$ million during the six months ended June 30, 2007 as a result of the securitization and sale of mortgage loans with servicing retained (June 30, $2006 \quad \$ 40$ million).

## Note 21 Segment Reporting

Commencing in the first quarter of 2007, the Corporation s corporate structure consists of three reportable segments Banco Popular de Puerto Rico, Popular North America and EVERTEC. Also, a corporate group has been defined to support the reportable segments.
Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. The segments were determined based on the organizational structure, which focuses primarily on the markets the segments serve, as well as on the products and services offered by the segments. As indicated in the 2006 Annual Report, in January 2007, the Corporation announced a restructuring and integration plan (the Restructuring Plan ) for PFH s businesses. The Restructuring Plan, which is being implemented throughout 2007, has the following four basic components:
o exiting the wholesale subprime mortgage origination business during the first quarter of 2007, which entailed shutting down the wholesale broker, retail and call center business divisions;
o consolidating support activities at PFH (Finance, Credit Risk, Compliance, Human Resources, Facilities) within BPNA to reduce expenses;
o integrating PFH s existing commercial lending businesses (mortgage warehouse, mixed use, and construction lending) into BPNA s business lending groups; and
o focusing on the core Equity One network of 132 consumer finance branches in 15 states.
As part of the Restructuring Plan, the Corporation also executed an internal corporate reorganization of its U.S. subsidiaries. In January 2007, E-LOAN, as well as all of its direct and indirect subsidiaries, with the exception of E-LOAN Insurance Services, Inc. and E-LOAN International, Inc., became operating subsidiaries of BPNA. Prior to the consummation of this U.S. reorganization, E-LOAN was a direct wholly-owned subsidiary of PFH. E-LOAN continues to offer its broad range of products and conducts its direct activities through its online platform. Management will be leveraging the E-LOAN brand, technology and internet financial services platform over the next several years to complement BPNA s community banking growth strategy.
This reorganization and the Restructuring Plan led management to redefine its business reportable segments. Commencing in 2007, the U.S. operations are defined as one reportable segment defined as Popular North America . This segment includes the operations of BPNA and PFH, including all of its wholly-owned subsidiaries. The reportable segment disclosures for periods prior to 2007 were restated to reflect the new segmentation. Banco Popular de Puerto Rico:
Given that Banco Popular de Puerto Rico constitutes approximately $86 \%$ of the Corporation s net income for the six months ended June 30, 2007 and $55 \%$ of its total assets as of June 30,2007 , additional disclosures are provided for the business areas included in this reportable segment, as described below:

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

Consumer and retail banking represents the branch banking operations of BPPR which focus on retail clients. It includes the consumer lending business operations of BPPR, as well as the lending operations of Popular Auto, Popular Finance, and Popular Mortgage. These three subsidiaries focus respectively on auto and lease financing, small personal loans and mortgage loan originations. This area also incorporates income

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related with the investment of excess funds from the branch network, as well as a proportionate share of the investment function of BPPR.

Other financial services include the trust and asset management service units of BPPR, the brokerage and investment banking operations of Popular Securities, and the insurance agency and reinsurance businesses of Popular Insurance, Popular Insurance V.I. and Popular Life Re. Most of the services that are provided by these subsidiaries generate profits based on fee income.
Popular North America:
Popular North America, which includes the Corporation s U.S. operations, consists of:
BPNA, including its subsidiaries E-LOAN, Popular Leasing, U.S.A. (name being changed to Popular Equipment Finance, Inc.) and Popular Insurance Agency, U.S.A. BPNA operates through a branch network of over 135 branches in 6 states, while E-LOAN provides online consumer direct lending and supports BPNA s deposit gathering through its online platform. Popular Insurance Agency, U.S.A. offers investment and insurance services across the BPNA branch network. Popular Equipment Finance, Inc. provides mainly small to mid-ticket commercial and medical equipment financing. The U.S. operations also include the mortgage business unit of Banco Popular, National Association.

PFH, which activities are described above.
All of Popular s U.S. operations now report to the same president. The PNA segment is disaggregated for additional disclosures between BPNA and PFH. The results of E-LOAN are included as part of BPNA for the quarters ended June 30, 2007 and 2006. PNA Holding Company only is included as part of the Corporate group.

## EVERTEC:

This reportable segment includes the financial transaction processing and technology functions of the Corporation, including EVERTEC with offices in Puerto Rico, Florida, the Dominican Republic and Venezuela; EVERTEC USA, Inc. incorporated in the United States; and ATH Costa Rica, S.A., EVERTEC Centroamérica S.A. and T.I.I. Smart Solutions Inc. located in Costa Rica. In addition, this reportable segment includes the equity investments in CONTADO and Servicios Financieros, S.A. de C.V. ( Serfinsa ), which operate in the Dominican Republic and El Salvador, respectively. This segment provides processing and technology services to other units of the Corporation as well as to third parties, principally other financial institutions in Puerto Rico, the Caribbean and Central America. Corporate:
The Corporate group consists primarily of the holding companies: Popular, Inc., Popular North America and Popular International Bank, excluding the equity investments in CONTADO and Serfinsa, which due to the nature of their operations, are included as part of the processing segment. The holding companies obtain funding in the capital markets to finance the Corporation s growth, including acquisitions. The Corporate group also includes the expenses of the four administrative corporate areas that are identified as critical for the organization: Finance, Risk Management, Legal and People, Communications and Planning. These corporate administrative areas have the responsibility of establishing policy, setting up controls and coordinating the activities of their corresponding groups in each of the business circles.
The Corporation may periodically reclassify business segment results based on modifications to its management reporting and profitability measurement methodologies and changes in organizational alignment. The accounting policies of the individual operating segments are the same as those of the Corporation described in Note 1 .
Transactions between operating segments are primarily conducted at market rates, resulting in profits that are eliminated for reporting consolidated results of operations.

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2007
For the quarter ended June 30, 2007

| (In thousands) | Banco Popular de Puerto Rico |  | Popular North America |  | EVERTEC |  | Intersegment Eliminations | Total <br> Reportable Segments |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |  |  |
| Net interest income (expense) | \$ | 237,154 | \$ | 139,576 | \$ | (240) |  | \$ | 376,490 |
| Provision for loan losses |  | 63,482 |  | 51,685 |  |  |  |  | 115,167 |
| Non-interest income |  | 125,090 |  | 57,141 |  | 59,853 | \$ $(34,801)$ |  | 207,283 |
| Amortization of intangibles |  | 656 |  | 1,938 |  | 219 |  |  | 2,813 |
| Depreciation expense |  | 10,441 |  | 4,706 |  | 4,258 | (18) |  | 19,387 |
| Other operating expenses |  | 179,164 |  | 136,812 |  | 44,727 | $(34,832)$ |  | 325,871 |
| Income tax |  | 27,887 |  | 708 |  | 3,814 | 19 |  | 32,428 |
| Net income | \$ | 80,614 | \$ | 868 | \$ | 6,595 | \$ 30 | \$ | 88,107 |
| Segment Assets |  | ,863,421 |  | ,598,645 |  | 33,167 | \$ $(75,991)$ |  | 6,619,242 |

For the quarter ended June 30, 2007

| (In thousands) | Total Reportable Segments |  | Corporate |  | Eliminations |  | Total <br> Popular, Inc. |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income (expense) | \$ | 376,490 | \$ | $(5,373)$ | \$ | 300 | \$ | 371,417 |
| Provision for loan losses |  | 115,167 |  |  |  |  |  | 115,167 |
| Non-interest income (loss) |  | 207,283 |  | $(1,614)$ |  | $(2,294)$ |  | 203,375 |
| Amortization of intangibles |  | 2,813 |  |  |  |  |  | 2,813 |
| Depreciation expense |  | 19,387 |  | 594 |  |  |  | 19,981 |
| Other operating expenses |  | 325,871 |  | 14,218 |  | $(1,830)$ |  | 338,259 |
| Income tax |  | 32,428 |  | $(8,750)$ |  | (56) |  | 23,622 |
| Net income (loss) | \$ | 88,107 | \$ | $(13,049)$ | \$ | (108) | \$ | 74,950 |
| Segment Assets |  | ,619,242 |  | 471,299 |  | 05,178) |  | ,985,363 |

For the six months ended June 30, 2007

| (In thousands) | Banco Popular de Puerto Rico | Popular <br> North <br> America | EVERTEC |  | Intersegment Eliminations | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  | Reportable Segments |
| Net interest income (expense) | \$ 469,378 | \$271,671 | \$ | (473) |  |  | \$740,576 |
| Provision for loan losses | 110,480 | 101,026 |  |  |  | 211,506 |
| Non-interest income | 241,842 | 38,835 |  | 19,475 | \$ $(69,134)$ | 331,018 |

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|  | 1,318 | 4,011 | 467 |  | 5,796 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Amortization of intangibles | 21,165 | 9,342 | 8,320 | $(36)$ | 38,791 |
| Depreciation expense | 352,992 | 293,467 | 88,625 | $(69,196)$ | 665,888 |
| Other operating expenses | 58,382 | $(34,316)$ | 7,749 | 38 | 31,853 |
| Income tax |  |  |  |  |  |
|  | $\$ 166,883$ | $\$(63,024)$ | $\$ 13,841$ | $\$$ | 60 |$\$ \$ 117,760$

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|  | Total <br> Reportable <br> Segments | Corporate | Eliminations | Total <br> Popular, <br> Inc. |
| :--- | ---: | :---: | ---: | ---: |
| (In thousands) | $\$ 740,576$ | $\$(14,776)$ | $\$$ | 599 |
| Net interest income (expense) | 211,506 | 7 |  | $\$ 726,399$ |
| Provision for loan losses | 331,018 | 128,049 | $(3,516)$ | 211,513 |
| Non-interest income | 5,796 |  |  | 455,551 |
| Amortization of intangibles | 38,791 | 1,182 |  | 5,796 |
| Depreciation expense | 665,888 | 28,161 | $(3,437)$ | 690,973 |
| Other operating expenses | 31,853 | 8,386 | 220 | 40,459 |
| Income tax |  |  |  |  |
|  | $\$ 117,760$ | $\$ 75,537$ | $\$$ | 300 |
| Net income |  |  |  | $\$ 193,597$ |

2006
For the quarter ended June 30, 2006

| (In thousands) | Banco Popular de Puerto Rico |  | Popular North America |  | EVERTEC |  | Intersegment Eliminations |  | Total <br> Reportable Segments |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |  |  |  |
| Net interest income (expense) | \$ | 228,498 | \$ | 148,483 | \$ | (640) |  |  | \$ | 376,341 |
| Provision for loan losses |  | 33,676 |  | 33,420 |  |  |  |  |  | 67,096 |
| Non-interest income |  | 101,639 |  | 46,591 |  | 57,154 | \$ | $(36,537)$ |  | 168,847 |
| Amortization of intangibles |  | 633 |  | 2,081 |  | 117 |  |  |  | 2,831 |
| Depreciation expense |  | 11,014 |  | 5,367 |  | 4,132 |  | (16) |  | 20,497 |
| Other operating expenses |  | 169,451 |  | 147,674 |  | 43,265 |  | $(36,555)$ |  | 323,835 |
| Income tax |  | 25,071 |  | 2,766 |  | 3,555 |  | 13 |  | 31,405 |
| Net income | \$ | 90,292 | \$ | 3,766 | \$ | 5,445 | \$ | 21 | \$ | 99,524 |
| Segment Assets |  | ,383,022 |  | ,335,337 |  | 17,579 |  | (117,420) |  | 7,818,518 |

For the quarter ended June 30, 2006

| (In thousands) | Total <br> Reportable Segments |  | Corporate |  | Eliminations |  | Total Popular, Inc |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income (expense) | \$ | 376,341 | \$ | $(10,792)$ | \$ | 230 | \$ | 365,779 |
| Provision for loan losses |  | 67,096 |  |  |  |  |  | 67,096 |
| Non-interest income |  | 168,847 |  | 15,842 |  | (703) |  | 183,986 |
| Amortization of intangibles |  | 2,831 |  |  |  |  |  | 2,831 |
| Depreciation expense |  | 20,497 |  | 574 |  |  |  | 21,071 |
| Other operating expenses |  | 323,835 |  | 15,523 |  | (280) |  | 339,078 |

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| Income tax | 31,405 |  | $(9,009)$ |  | $(88)$ |  | 22,308 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Net income (loss) | $\$$ | 99,524 | $\$$ | $(2,038)$ | $\$$ | $(105)$ | $\$$ |

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For the six months ended June 30, 2006

|  | Banco Popular <br> de | Popular <br> North <br> Puerto Rico | America |
| :--- | :---: | :---: | :---: | ---: | ---: | | Total |
| :---: |
| EVERTEC | | Intersegment |
| :---: |
| Eliminations | | Reportable |
| ---: |
| Segments |

For the six months ended June 30, 2006

|  | Total <br> Reportable <br> Segments | Corporate | Eliminations | Total <br> Popular, Inc. |
| :--- | ---: | :---: | :---: | ---: |
| (In thousands) | $\$ 745,396$ | $\$(20,383)$ | $\$ 50$ | $\$ 725,543$ |
| Net interest income (expense) | 116,043 |  |  | 116,043 |
| Provision for loan losses | 379,007 | 34,831 | $(1,019)$ | 412,819 |
| Non-interest income | 5,552 |  |  | 5,552 |
| Amortization of intangibles | 41,368 | 1,138 |  | 42,506 |
| Depreciation expense | 656,124 | 32,748 | $(437)$ | 688,435 |
| Other operating expenses | 4,109 | 3,495 | 2,137 | 9,741 |
| Impact of change in fiscal period | 81,757 | $(20,601)$ | $(955)$ | 60,201 |
| Income tax |  |  |  |  |
|  | $\$ 219,450$ | $\$(2,332)$ | $\$(1,234)$ | $\$ 215,884$ |

During the six months ended June 30, 2007, the holding companies realized net gains on sale and valuation adjustments of investment securities (before tax) of approximately $\$ 108.1$ million, compared with $\$ 14.2$ million for the six months ended June 30, 2006. These net gains are included in non-interest income within the Corporate group.
Additional disclosures with respect to the Banco Popular de Puerto Rico reportable segment are as follows:
For the quarter ended June 30, 2007

|  |  |  | Total Banco |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Commercial <br> Banking | Consumer and <br> Retail Banking | Other <br> Financial <br> Services | Eliminations | | Popular de |
| :---: |
| Puerto Rico |

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| Provision for loan losses |  | 22,889 |  | 40,593 |  |  |  |  |  | 63,482 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Non-interest income |  | 22,000 |  | 80,681 |  | 22,956 |  | (547) |  | 125,090 |
| Amortization of intangibles |  | 220 |  | 325 |  | 111 |  |  |  | 656 |
| Depreciation expense |  | 3,574 |  | 6,569 |  | 298 |  |  |  | 10,441 |
| Other operating expenses |  | 44,048 |  | 118,478 |  | 16,717 |  | (79) |  | 179,164 |
| Income tax |  | 12,507 |  | 12,703 |  | 2,803 |  | (126) |  | 27,887 |
| Net income | \$ | 32,516 | \$ | 42,339 | \$ | 5,960 | \$ | (201) | \$ | 80,614 |
| Segment Assets |  | 422,905 |  | ,081,721 |  | 24,346 |  | ,551) |  | ,863,421 |

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For the six months ended June 30, 2007


Total Banco
Other
(In thousands)
Net interest income
Provision for loan losses
Non-interest income
Amortization of intangibles
Depreciation expense
Other operating expenses
Income tax
Net income

Segment Assets

| $\$ 38,681$ | $\$ 45,650$ | $\$ 5,138$ | $\$$ | 823 | $\$ 00,292$ |
| :--- | :--- | ---: | :--- | ---: | :--- | ---: |
| $\$ 10,911,596$ | $\$ 18,032,662$ | $\$ 1,035,550$ | $\$(3,596,786)$ | $\$ 26,383,022$ |  |

For the six months ended June 30, 2006

|  | Commercial | Consumer and Retail | Other <br> Financial |  | Total Banco |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  | Eliminations |  | Popular de |
|  |  |  |  |  |  |
| (In thousands) | Banking | Banking |  | Services |  |  | Puerto Rico |
| Net interest income | \$ 166,223 | \$283,236 |  | 5,055 |  |  | \$ | 287 | \$454,801 |
| Provision for loan losses | 15,203 | 42,262 |  |  |  |  | 57,465 |
| Non-interest income | 46,511 | 129,182 |  | 42,641 |  | $(1,610)$ | 216,724 |

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| Amortization of intangibles | 441 | 671 | 154 |  | 1,266 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Depreciation expense | 6,992 | 14,495 | 557 |  | 22,044 |
| Other operating expenses | 88,088 | 220,717 | 30,373 | $(502)$ | 338,676 |
| Impact of change in fiscal period |  |  | $(2,072)$ |  | $(2,072)$ |
| Income tax | 28,110 | 29,532 | 6,464 | $(382)$ | 63,724 |
| Net income | $\$ 73,900$ | $\$ 104,741$ | $\$ 12,220$ | $\$(439)$ | $\$ 190,422$ |

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Additional disclosures with respect to the Popular North America reportable segment are as follows:
2007
For the quarter ended June 30, 2007

| (In thousands) |  | o Popular <br> America | Popular <br> Financial Holdings |  | Eliminations |  | Total Popular North America |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 91,954 | \$ | 46,755 | \$ | 867 | \$ | 139,576 |
| Provision for loan losses |  | 12,217 |  | 39,468 |  |  |  | 51,685 |
| Non-interest income |  | 45,667 |  | 11,751 |  | (277) |  | 57,141 |
| Amortization of intangibles |  | 1,938 |  |  |  |  |  | 1,938 |
| Depreciation expense |  | 4,059 |  | 647 |  |  |  | 4,706 |
| Other operating expenses |  | 107,070 |  | 30,018 |  | (276) |  | 136,812 |
| Income tax |  | 3,905 |  | $(3,552)$ |  | 355 |  | 708 |
| Net income (loss) | \$ | 8,432 | \$ | $(8,075)$ | \$ | 511 | \$ | 868 |
| Segment Assets |  | ,914,122 |  | 759,262 |  | (4,739) |  | ,598,645 |

For the six months ended June 30, 2007

|  | Banco <br> Popular <br> North | Popular <br> Financial |  |  |
| :--- | :---: | :---: | :---: | :---: |
| (In thousands) | Herica | Holdings | Eliminations | Total Popular <br> North |
| America |  |  |  |  |

2006
For the quarter ended June 30, 2006

| (In thousands) | Banco Popular North America |  | Financial Holdings |  | Eliminations |  | Total Popular North America |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 97,800 | \$ | 50,683 |  |  | \$ | 148,483 |
| Provision for loan losses |  | 12,953 |  | 20,467 |  |  |  | 33,420 |
| Non-interest income (loss) |  | 52,422 |  | $(5,133)$ | \$ | (698) |  | 46,591 |
| Amortization of intangibles |  | 1,991 |  | 90 |  |  |  | 2,081 |
| Depreciation expense |  | 3,918 |  | 1,449 |  |  |  | 5,367 |

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| Other operating expenses | 106,100 | 41,715 |  | $(141)$ | 147,674 |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Income tax | 9,149 | $(6,188)$ |  | $(195)$ | 2,766 |  |
| Net income (loss) | $\$$ | 16,111 | $\$(11,983)$ | $\$$ | $(362)$ | $\$$ |
|  |  |  |  |  |  |  |
| Segment Assets | $\$ 12,955,528$ | $\$ 8,741,514$ | $\$(361,705)$ | $\$ 21,335,337$ |  |  |

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For the six months ended June 30, 2006

| (In thousands) | Banco <br> Popular North America | Popular Financial <br> Holdings | Eliminations | Total Popular North America |
| :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$195,108 | \$ 96,554 |  | \$291,662 |
| Provision for loan losses | 23,445 | 35,133 |  | 58,578 |
| Non-interest income | 105,448 | 16,021 | \$ (761) | 120,708 |
| Amortization of intangibles | 3,885 | 179 |  | 4,064 |
| Depreciation expense | 8,117 | 3,008 |  | 11,125 |
| Other operating expenses | 212,006 | 90,356 | (141) | 302,221 |
| Impact of change in fiscal period |  | 6,181 |  | 6,181 |
| Income tax | 19,700 | $(7,749)$ | (217) | 11,734 |
| Net income (loss) | \$ 33,403 | \$ $(14,533)$ | \$ (403) | \$ 18,467 |

A breakdown of intersegment eliminations, particularly revenues, by segment in which the revenues are recorded follows:

| INTERSEGMENT REVENUES* <br> (In thousands) | Quarter ended |  | Six months ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  | June 30, 2007 | $\begin{gathered} \text { June } 30, \\ 2006 \end{gathered}$ | June 30, 2007 | June 30, 2006 |
| Banco Popular de Puerto Rico: |  |  |  |  |
| P.R. Commercial Banking | \$ (64) | \$ (311) | \$ (58) | \$ (615) |
| P.R. Consumer and Retail Banking | (163) | (683) | (178) | $(1,351)$ |
| P.R. Other Financial Services | (102) | (77) | (231) | (155) |
| Popular North America: |  |  |  |  |
| Banco Popular North America | 199 | 958 | 172 | 1,892 |
| Popular Financial Holdings |  |  |  |  |
| EVERTEC | $(34,671)$ | $(36,424)$ | $(68,839)$ | $(70,238)$ |
| Total | \$(34,801) | \$ $(36,537)$ | \$ $(69,134)$ | \$(70,467) |
| * For purposes of the intersegment revenues disclosure, revenues include interest income (expense) related to internal funding and other income derived from intercompany transactions, |  |  |  |  |

mainly related to
processing /
information
technology
services.

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A breakdown of revenues and selected balance sheet information by geographical area follows:

| Geographic Information | Quarter ended |  | Six months ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  | June 30, 2007 | $\begin{gathered} \text { June } 30, \\ 2006 \end{gathered}$ | June 30, 2007 | June 30, 2006 |
| Revenues** |  |  |  |  |
| Puerto Rico | \$362,811 | \$346,625 | \$ 840,796 | \$ 708,207 |
| United States | 190,244 | 185,091 | 297,483 | 391,893 |
| Other | 21,737 | 18,049 | 43,671 | 38,262 |
| Total consolidated revenues | \$574,792 | \$549,765 | \$1,181,950 | \$1,138,362 |
| ** Total revenues include net interest income, service charges on deposit accounts, other service fees, net gain (loss) on sale and valuation adjustments of investment securities, trading account profit (loss), gain on sale of loans and valuation adjustments on loans held-for-sale, and other operating income. |  |  |  |  |


|  | June 30, | December 31, <br> 2006 | June 30, <br> (In thousands) <br> Selected Balance Sheet Information: |
| :--- | ---: | ---: | ---: |
| Puerto Rico |  |  |  |
| Total assets |  |  |  |
| Loans | $\$ 24,996,466$ | $\$ 24,621,684$ | $\$ 25,696,083$ |
| Deposits | $15,129,703$ | $14,735,092$ | $14,583,979$ |
| Mainland United States | $14,237,308$ | $13,504,860$ | $13,741,481$ |
| Total assets | $\$ 20,733,903$ | $\$ 21,570,276$ | $\$ 21,529,730$ |
| Loans | $16,955,769$ | $17,363,382$ | $17,015,808$ |

Deposits
Other
Total assets
Loans
Deposits *

| $9,900,375$ | $9,735,264$ | $8,494,076$ |
| ---: | ---: | ---: |
| $\$ 1,254,994$ | $\$ 1,212,027$ | $\$ 1,173,701$ |
| 666,373 | 638,465 | 616,845 |
| $1,248,312$ | $1,198,207$ | $1,213,963$ |

* Represents deposits from BPPR
operations
located in the
U.S. and British

Virgin Islands.

## Note 22 Restructuring Costs

During the second quarter and six months ended June 30, 2007, the Corporation recorded pre-tax restructuring costs in the Popular North America segment related to the Restructuring Plan as follows:

| (In thousands) | Quarter ended June 30, 2007 | $\begin{aligned} & \begin{array}{l} \text { Six months } \\ \text { ended } \end{array} \\ & \text { June } 30,2007 \end{aligned}$ |
| :---: | :---: | :---: |
| Personnel costs | \$ (34) | \$ 8,124(a) |
| Net occupancy expenses |  | 4,413(b) |
| Equipment expenses |  | 281 |
| Professional fees | (185)(d) | 1,762(c) |
| Communications |  | 67 |
| Other operating expenses |  | 269 |
| Total | \$ (219) | \$ 14,916 |
| (a) Severance, stay bonuses, related taxes, and other employee benefits |  |  |
| (b) Lease terminations |  |  |
| (c) Outplacement and professional service contract terminations |  |  |
| (d) Reversal of certain outplacement costs |  |  |

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Of the above restructuring costs, approximately $\$ 5.5$ million were recognized as a liability as of June 30, 2007. During the fourth quarter of 2006, and as a result of the Restructuring Plan, the Corporation recognized impairment charges on long-lived assets of $\$ 7.2$ million, mainly associated with software and leasehold improvements, and impairment in goodwill of $\$ 14.2$ million.
As of June 30, 2007, it is anticipated that the Restructuring Plan will result in the estimated combined charges presented in the table below.

|  | Impairments <br> on goodwill <br> and |  |  |
| :--- | :---: | :---: | ---: |
| (In thousands) | long-lived <br> assets | Restructuring <br> costs | Total |
| Quarter ended: | $\$ 21,471$ |  |  |
| December 31, 2006 <br> March 31, 2007 <br> June 30, 2007 |  | $\$ 15,135$ | $\$ 21,471$ |
| Total | $\$ 21,471$ | $\$ 14,916$ | $(219)$ |

The Corporation does not expect to incur additional significant restructuring costs in the remaining quarters of 2007. Settlement amounts in lease terminations may differ and are subject to the outcome of negotiations.

## Note 23 Condensed Consolidating Financial Information of Guarantor and Issuers of Registered Guaranteed Securities

The following condensed consolidating financial information presents the financial position of Popular, Inc. Holding Company ( PIHC ) (parent only), Popular International Bank, Inc. ( PIBI ), Popular North America, Inc. ( PNA ), and all other subsidiaries of the Corporation as of June 30, 2007, December 31, 2006 and June 30, 2006, and the results of their operations and cash flows for the periods ended June 30, 2007 and 2006.
PIBI is an operating subsidiary of PIHC and is the holding company of its wholly-owned subsidiaries: ATH Costa Rica S.A., EVERTEC Centroamérica S.A., T.I.I. Smart Solutions Inc., Popular Insurance V.I., Inc. and PNA.
PNA is an operating subsidiary of PIBI and is the holding company of its wholly-owned subsidiaries:
PFH, including its wholly-owned subsidiaries Equity One, Inc., Popular Financial Management, LLC, Popular Housing Services, Inc., and Popular Mortgage Servicing, Inc.;

Banco Popular North America ( BPNA ), including its wholly-owned subsidiaries Popular Leasing, U.S.A. (name being changed to Popular Equipment Finance, Inc.), Popular Insurance Agency, U.S.A., Popular FS, LLC and E-LOAN, Inc.;

Banco Popular, National Association ( BP, N.A. ), including its wholly-owned subsidiary Popular Insurance, Inc.; and

EVERTEC USA, Inc.
PIHC, PIBI and PNA are authorized issuers of debt securities and preferred stock under a shelf registration filed with the Securities and Exchange Commission.
PIHC fully and unconditionally guarantees all registered debt securities and preferred stock issued by PIBI and PNA. The principal source of income for PIHC consists of dividends from BPPR. As a member subject to the regulations of the Federal Reserve System, BPPR and BPNA must obtain the approval of the Federal Reserve Board for any dividend if the total of all dividends declared by it during the calendar year would exceed the total of its net income for that year, as defined by the Federal Reserve Board, combined with its retained net income for the preceding two
years, less any required transfers to surplus or to a fund for the retirement of any preferred stock. The payment of dividends by BPPR may also be affected by other regulatory requirements and policies, such as the maintenance of

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certain minimum capital levels. At June 30, 2007, BPPR could have declared a dividend of approximately $\$ 192$ million without the approval of the Federal Reserve Board (December 31, 2006 \$208 million; June 30, 2006 $\$ 177$ million) and BPNA could have declared a dividend of $\$ 197$ million (December 31, 2006- $\$ 246$ million; June 30, 2006-\$193 million). However, the Corporation has never received any dividend payments from its U.S. subsidiaries and it believes that the likelihood of receiving them in the foreseeable future is remote. Refer to Popular, Inc. s Form $10-\mathrm{K}$ for the year ended December 31, 2006 for further information on dividend restrictions imposed by regulatory requirements and policies on the payment of dividends by BPPR, BPNA and BP, N.A.

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## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF CONDITION
JUNE 30, 2007
(UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other | Elimination | Popular, Inc. |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | Subsidiaries | Entries | Consolidated |


| ASSETS |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Cash and due from banks | \$ | 1,775 | \$ | 317 | \$ 377 | \$ 842,176 | \$ | $(82,560)$ | \$ | 762,085 |
| Money market investments |  |  |  | 19,025 | 212 | 700,317 |  | $(144,567)$ |  | 574,987 |
| Investment securities available-for-sale, at fair value |  | 6,354 |  | 36,261 |  | 8,940,725 |  | $(8,872)$ |  | 8,974,468 |
| Investment securities held-to-maturity, at amortized cost |  | 670,336 |  | 1,501 |  | 187,642 |  | $(430,000)$ |  | 429,479 |
| Other investment securities, at lower of cost or realizable value |  | 14,425 |  | 1 | 12,392 | 133,332 |  |  |  | 160,150 |
| Trading account securities, at fair value |  |  |  |  |  | 677,247 |  | (389) |  | 676,858 |
| Investment in subsidiaries |  | ,144,484 |  | 1,052,636 | 1,995,552 | 736,311 |  | $(6,928,983)$ |  |  |
| Loans held-for-sale, at lower of cost or market value |  |  |  |  |  | 605,990 |  |  |  | 605,990 |
| Loans held-in-portfolio |  | 340,197 |  |  | 2,958,637 | 36,423,591 |  | (7,252,706) |  | 32,469,719 |
| Less Unearned income |  |  |  |  |  | 323,864 |  |  |  | 323,864 |
| Allowance for loan |  |  |  |  |  |  |  |  |  |  |
| losses |  | 40 |  |  |  | 564,807 |  |  |  | 564,847 |
|  |  | 340,157 |  |  | 2,958,637 | 35,534,920 |  | (7,252,706) |  | 31,581,008 |
| Premises and equipment, net |  | 24,891 |  |  | 133 | 562,613 |  | (132) |  | 587,505 |
| Other real estate |  |  |  |  |  | 112,858 |  |  |  | 112,858 |
| Accrued income receivable |  | 446 |  | 110 | 12,473 | 262,339 |  | $(25,622)$ |  | 249,746 |
| Other assets |  | 42,239 |  | 59,686 | 53,233 | 1,405,397 |  | $(61,094)$ |  | 1,499,461 |
| Goodwill |  |  |  |  |  | 668,469 |  |  |  | 668,469 |
|  |  | 554 |  |  |  | 101,745 |  |  |  | 102,299 |

Other intangible assets

$$
\$ 4,245,661 \quad \$ 1,169,537 \quad \$ 5,033,009 \quad \$ 51,472,081 \quad \$(14,934,925) \quad \$ 46,985,363
$$

## LIABILITIES AND <br> STOCKHOLDERS EQUITY

## Liabilities:

Deposits:
Non-interest bearing
Interest bearing

Federal funds purchased and assets sold under agreements to repurchase
Other short-term

| borrowings |  |  |  | 857,763 | $4,938,587$ | $(2,412,245)$ | $3,384,105$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Notes payable | $\$ 486,479$ |  |  | $2,890,535$ | $9,502,276$ | $(4,810,652)$ | $8,068,638$ |
| Subordinated notes |  |  |  |  | 430,000 | $(430,000)$ | 793,500 |
| Other liabilities | 62,102 | $\$$ | 66 | 94,464 | 736,241 | $(99,373)$ |  |
|  |  |  |  |  |  |  |  |
|  | 548,581 |  | 66 | $3,996,714$ | $46,710,476$ | $(7,967,663)$ | $43,288,174$ |

Minority interest in consolidated
$\begin{array}{lll}\text { subsidiaries } & 109 & 109\end{array}$

Stockholders
equity:

| Preferred stock | 186,875 |  |  |  |  | 186,875 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Common stock | $1,756,337$ | 3,961 | 2 | 70,421 | $(74,384)$ | $1,756,337$ |
| Surplus |  |  |  |  |  |  |

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## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF CONDITION
DECEMBER 31, 2006
(UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other | Elimination | Popular, Inc, |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | Subsidiaries | Entries | Consolidated |



Other intangible assets

$$
\$ 4,314,821 \quad \$ 1,258,355 \quad \$ 5,090,136 \quad \$ 51,295,853 \quad \$(14,555,178) \quad \$ 47,403,987
$$

## LIABILITIES AND <br> STOCKHOLDERS EQUITY

## Liabilities:

Deposits:
Non-interest bearing
Interest bearing

Federal funds purchased and assets sold under agreements to repurchase
Other short-term borrowings Notes payable Subordinated notes Other liabilities

| $\$ 150,787$ |  |  | 894,959 | $5,297,595$ | $(2,309,216)$ | $4,034,125$ |
| ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| 484,406 |  |  | $2,835,595$ | $9,651,217$ | $(4,233,972)$ | $8,737,246$ |
|  |  |  |  | 430,000 | $(430,000)$ |  |
| 59,322 | $\$$ | 60 | 78,988 | 758,613 | $(85,559)$ | 811,424 |
|  |  |  |  |  |  |  |
| 694,515 |  | 60 | $3,969,371$ | $46,448,150$ | $(7,328,525)$ | $43,783,571$ |

Minority interest in consolidated subsidiaries

## Stockholders

equity:

| Preferred stock | 186,875 |  |  |  |  | 186,875 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Common stock | 1,753,146 | 3,961 | 2 | 70,421 | $(74,384)$ | 1,753,146 |
| Surplus | 521,855 | 851,193 | 734,964 | 3,182,285 | $(4,763,441)$ | 526,856 |
| Retained earnings | 1,599,145 | 458,922 | 406,811 | 1,804,476 | $(2,675,210)$ | 1,594,144 |
| Accumulated other comprehensive loss, net of tax | $(233,728)$ | $(55,781)$ | $(21,012)$ | $(207,443)$ | 284,236 | $(233,728)$ |
| Treasury stock, at cost | $(206,987)$ |  |  | $(2,146)$ | 2,146 | $(206,987)$ |
|  | 3,620,306 | 1,258,295 | 1,120,765 | 4,847,593 | $(7,226,653)$ | 3,620,306 |
|  | \$4,314,821 | \$ 1,258,355 | \$5,090,136 | \$51,295,853 | \$(14,555,178) | \$47,403,987 |

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## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF CONDITION
JUNE 30, 2006
(UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other | Elimination | Popular, Inc. |
| :--- | :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding Co. | Holding Co. | Subsidiaries | Entries | Consolidated |


| ASSETS |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Cash and due from banks | \$ 954 | \$ 1,486 | \$ 395 | \$ 905,522 | \$ $(59,465)$ | \$ 848,892 |
| Money market investments |  | 300 | 411 | 861,021 | $(241,210)$ | 620,522 |
| Investment securities available-for-sale, at fair value | 11,407 | 67,810 | 9,559 | 10,806,922 | $(6,400)$ | 10,889,298 |
| Investment securities held-to-maturity, at amortized cost | 629,692 | 2,164 |  | 218,542 | $(430,000)$ | 420,398 |
| Other investment securities, at lower of cost or realizable value | 144,994 | 5,001 | 13,392 | 148,655 |  | 312,042 |
| Trading account securities, at fair value |  |  |  | 376,757 | (487) | 376,270 |
| Investment in subsidiaries | 3,005,963 | 1,147,170 | 2,054,174 | 795,977 | (7,003,284) |  |
| Loans held-for-sale, at lower of cost or market value |  |  |  | 606,620 |  | 606,620 |
| Loans held-in-portfolio | 169,755 |  | 2,847,908 | 34,746,847 | $(5,849,504)$ | 31,915,006 |
| Less Unearned income |  |  |  | 304,994 |  | 304,994 |
| Allowance for loan |  |  |  |  |  |  |
| losses | 40 |  |  | 483,775 |  | 483,815 |
|  | 169,715 |  | 2,847,908 | 33,958,078 | $(5,849,504)$ | 31,126,197 |
| Premises and equipment, net | 26,244 |  | 136 | 566,528 | (204) | 592,704 |
| Other real estate |  |  |  | 83,658 |  | 83,658 |
| Accrued income receivable | 408 | 10 | 11,319 | 257,335 | $(23,074)$ | 245,998 |
| Other assets | 66,786 | 39,522 | 47,817 | 1,367,976 | $(6,419)$ | 1,515,682 |
| Goodwill |  |  |  | 656,189 |  | 656,189 |
|  | 554 |  |  | 104,490 |  | 105,044 |

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Other intangible assets

$$
\begin{array}{llllll}
\$ 4,056,717 & \$ 1,263,463 & \$ 4,985,111 & \$ 51,714,270 & \$(13,620,047) & \$ 48,399,514
\end{array}
$$

## LIABILITIES AND <br> STOCKHOLDERS EQUITY

## Liabilities:

Deposits:
Non-interest bearing
Interest bearing

Federal funds purchased and assets sold under agreements to

| repurchase |  |  |  | $\$ 119,400$ | $7,892,780$ | $(85,449)$ | $7,926,731$ |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Other short-term |  |  |  |  |  |  |  |  |
| borrowings |  |  | 30,378 | 132,224 | $3,683,448$ | $(1,189,114)$ | $2,656,936$ |  |
| Notes payable | $\$ 532,305$ |  |  | $3,533,056$ | $10,753,352$ | $(4,620,038)$ | $10,198,675$ |  |
| Subordinated notes |  |  |  |  | 430,000 | $(430,000)$ |  |  |
| Other liabilities | 61,419 |  | 138 | 62,929 | 622,096 | $(42,035)$ | 704,547 |  |
|  |  |  |  |  |  |  |  |  |
|  | 593,724 |  | 30,516 | $3,847,609$ | $47,035,364$ | $(6,570,804)$ | $44,936,409$ |  |

Minority interest in consolidated subsidiaries

Stockholders
equity:

| Preferred stock | 186,875 |  |  |  |  | 186,875 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Common stock | 1,750,310 | 3,961 | 2 | 70,385 | $(74,348)$ | 1,750,310 |
| Surplus | 485,630 | 815,193 | 734,964 | 3,098,740 | $(4,643,896)$ | 490,631 |
| Retained earnings | 1,581,500 | 493,693 | 446,943 | 1,826,634 | $(2,772,271)$ | 1,576,499 |
| Accumulated other comprehensive loss, net of tax | $(334,789)$ | $(79,900)$ | $(44,407)$ | $(315,151)$ | 439,458 | $(334,789)$ |
| Treasury stock, at cost | $(206,533)$ |  |  | $(1,814)$ | 1,814 | $(206,533)$ |
|  | 3,462,993 | 1,232,947 | 1,137,502 | 4,678,794 | (7,049,243) | 3,462,993 |
|  | \$4,056,717 | \$1,263,463 | \$4,985,111 | \$51,714,270 | \$(13,620,047) | \$48,399,514 |

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## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF INCOME FOR THE QUARTER ENDED JUNE 30, 2007 (UNAUDITED)

|  | Popular, |  |  |  |  | Popular, |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Inc. | PIBI | PNA | All other | Elimination | Inc. |  |
| (In thousands) | Holding Co. | Holding | Co. | Holding Co. | Subsidiaries | Entries | Consolidated |

## INTEREST

INCOME:

| Loans | \$ | 4,158 |  |  | \$ 38,419 | \$701,620 | \$ | $(87,712)$ | \$656,485 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Money market investments |  | 793 | \$ | 98 | 10 | 7,082 |  | $(2,231)$ | 5,752 |
| Investment securities |  | 9,548 |  | 821 | 224 | 109,663 |  | $(7,193)$ | 113,063 |
| Trading account securities |  |  |  |  |  | 9,611 |  |  | 9,611 |
|  |  | 14,499 |  | 919 | 38,653 | 827,976 |  | $(97,136)$ | 784,911 |

INTEREST

| Deposits |  |  |  | 184,114 | $(1,384)$ | 182,730 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Short-term borrowings | 78 |  | 14,418 | 134,435 | $(29,465)$ | 119,466 |
| Long-term debt | 8,366 |  | 37,033 | 135,323 | $(69,424)$ | 111,298 |
|  | 8,444 |  | 51,451 | 453,872 | $(100,273)$ | 413,494 |
| Net interest income (expense) | 6,055 | 919 | $(12,798)$ | 374,104 | 3,137 | 371,417 |
| Provision for loan losses |  |  |  | 115,167 |  | 115,167 |


| Net interest income (expense) after provision for loan |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| losses | 6,055 | 919 | $(12,798)$ | 258,937 | 3,137 | 256,250 |
| Service charges on deposit accounts |  |  |  | 48,392 |  | 48,392 |
| Other service fees |  |  |  | 118,143 | $(28,553)$ | 89,590 |
| Net (loss) gain on sale and valuation adjustment of |  |  |  |  |  |  |
| investment securities | $(2,132)$ | (907) |  | 4,214 |  | 1,175 |
| Trading account profit |  |  |  | 10,377 |  | 10,377 |
| Gain on sale of loans |  |  |  | 28,293 | 1 | 28,294 |

and valuation adjustments on loans
held-for-sale
Other operating income (loss)

| 529 | 1,201 | $(102)$ | 33,714 | $(9,795)$ | 25,547 |
| ---: | ---: | ---: | ---: | ---: | ---: |
| 4,452 | 1,213 | $(12,900)$ | 502,070 | $(35,210)$ | 459,625 |

OPERATING
EXPENSES:
Personnel costs:

| Salaries | 5,518 | 98 |  | 121,991 | (657) | 126,950 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Pension, profit sharing and other benefits | 1,277 | 17 |  | 36,234 | (190) | 37,338 |
|  | 6,795 | 115 |  | 158,225 | (847) | 164,288 |
| Net occupancy expenses | 612 | 8 | 1 | 25,880 |  | 26,501 |
| Equipment expenses | 385 |  |  | 31,908 | (48) | 32,245 |
| Other taxes | 335 |  |  | 11,500 |  | 11,835 |
| Professional fees | 3,295 | 8 | 57 | 70,797 | $(35,515)$ | 38,642 |
| Communications | 136 |  |  | 16,874 | (37) | 16,973 |
| Business promotion | 881 |  |  | 29,756 | (268) | 30,369 |
| Printing and supplies | 24 |  |  | 4,525 |  | 4,549 |
| Other operating expenses | $(12,112)$ | (100) | 117 | 45,317 | (384) | 32,838 |
| Amortization of intangibles |  |  |  | 2,813 |  | 2,813 |
|  | 351 | 31 | 175 | 397,595 | $(37,099)$ | 361,053 |

Income (loss) before income tax and equity in earnings of subsidiaries
Income tax
4,101 1,182
$(13,075) \quad 104,475$
1,889
98,572

Income (loss) before equity in earnings of subsidiaries

| 2,716 | 1,182 |
| :---: | :---: |
| 72,234 | $(7,926)$ |

Equity in earnings of subsidiaries 72,234
$(7,926)$
$(8,499)$
78,301
1,250
74,950

NET INCOME
(LOSS) \$ 74,950 \$(6,744) \$ $(8,642) \quad \$ 66,221 \quad \$(50,835) \quad \$ 74,950$

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POPULAR, INC.
CONDENSED CONSOLIDATING STATEMENT OF INCOME
FOR THE QUARTER ENDED JUNE 30, 2006 (UNAUDITED)

| (In thousands) | Popular, Inc. Holding Co. | PIBI Holding Co. |  | PNA Holding Co. | All other Subsidiaries | Elimination Entries | Popular, Inc. <br> Consolidated |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| INTEREST |  |  |  |  |  |  |  |
| INCOME: |  |  |  |  |  |  |  |
| Loans | \$ 2,761 |  |  | \$ 36,267 | \$643,505 | \$ $(68,741)$ | \$613,792 |
| Money market |  |  |  |  |  |  |  |
| investments | 450 | \$ | 52 | 399 | 9,740 | $(2,735)$ | 7,906 |
| Investment securities | 8,759 |  | 351 | 223 | 130,874 | $(6,933)$ | 133,274 |
| Trading account securities |  |  |  |  | 7,065 |  | 7,065 |
|  | 11,970 |  | 403 | 36,889 | 791,184 | $(78,409)$ | 762,037 |

INTEREST
EXPENSE:
Deposits

| Short-term borrowings | 49 | 395 | 3,625 | 137,142 | $(14,137)$ | 127,074 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Long-term debt | 9,067 |  | 47,370 | 142,116 | $(65,330)$ | 133,223 |
|  | 9,116 | 395 | 50,995 | 416,292 | $(80,540)$ | 396,258 |

Net interest income (expense)
Provision for loan losses

Net interest income (expense) after

| provision for loan losses | 2,854 | 8 | $(14,106)$ | 307,796 | 2,131 | 298,683 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Service charges on deposit accounts |  |  |  | 47,324 |  | 47,324 |
| Other service fees |  |  |  | 106,949 | $(26,932)$ | 80,017 |
| Net gain (loss) on sale and valuation adjustments of |  |  |  |  |  |  |
| Trading account profit | 580 |  |  | (1,830 |  | $(14,424)$ 1,830 |
| Gain on sale of loans |  |  |  | 37,178 | $(8,124)$ | 29,054 |
| Other operating income | 11,629 | 608 | 2,819 | 35,675 | $(10,546)$ | 40,185 |
|  | 15,063 | 616 | $(11,287)$ | 521,748 | $(43,471)$ | 482,669 |

OPERATING
EXPENSES:

| Personnel costs: |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Salaries | 4,766 | 95 |  | 123,113 | $(1,274)$ | 126,700 |
| Pension, profit sharing and other benefits | 1,392 | 16 |  | 38,749 | (374) | 39,783 |
|  | 6,158 | 111 |  | 161,862 | $(1,648)$ | 166,483 |
| Net occupancy expenses | 525 | 4 |  | 28,100 |  | 28,629 |
| Equipment expenses | 405 | 3 | 3 | 33,578 | (16) | 33,973 |
| Other taxes | 234 |  |  | 10,695 |  | 10,929 |
| Professional fees | 5,731 | 12 | 38 | 67,721 | $(35,014)$ | 38,488 |
| Communications | 182 |  |  | 17,128 | (17) | 17,293 |
| Business promotion | 624 |  |  | 31,507 | (140) | 31,991 |
| Printing and supplies | 10 |  |  | 4,281 |  | 4,291 |
| Other operating |  |  |  |  |  |  |
| Amortization of intangibles |  |  |  | 2,831 |  | 2,831 |
|  | $(1,410)$ | 34 | 152 | 401,422 | $(37,218)$ | 362,980 |

Income (loss) before income tax and equity in earnings of subsidiaries
Income tax

$$
16,473
$$

582
$(11,439) \quad 120,326$
$(6,253) \quad 119,689$

Income (loss) before equity in earnings of subsidiaries

| 14,534 | 582 | $(7,853)$ | 94,530 | $(4,412)$ | 97,381 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 82,847 | $(5,712)$ | 1,935 | $(18,402)$ | $(60,668)$ |  |

NET INCOME (LOSS)
\$ 97,381
$\$(5,130)$
\$ $(5,918)$
\$ 76,128
$\$(65,080)$
\$ 97,381

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## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF INCOME FOR THE SIX MONTHS ENDED JUNE 30, 2007 (UNAUDITED)

|  | Popular, <br> Inc. <br> Holding Co. |  | PIBI <br> Holding <br> Co. | PNA | Holding Co. | Subsidiaries other | Elimination |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | Popular, Inc.

INTEREST
EXPENSE:
Deposits

| Short-term borrowings | 1,965 | 28,886 | 273,140 | $(59,716)$ | 244,275 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Long-term debt | 16,732 | 73,885 | 272,687 | $(131,304)$ | 232,000 |
|  |  |  |  |  |  |
|  | 18,697 | 102,771 | 903,603 | $(192,964)$ | 832,107 |

Net interest income (expense)
Provision for loan Provision for loan losses

$$
9,145
$$

9,145
1,311
$(26,139) \quad 736,053$
6,029
726,399

7
211,506
211,513
Net interest income (expense) after provision for loan losses
Service charges on deposit accounts

9,138 1,311
$(26,139) \quad 524,547$
6,029
514,886

Other service fees
96,863
96,863
Net gain (loss) on sale and valuation adjustments of investment securitie
Trading account loss
Gain on sale of loans
Other operating income (loss)

| 116,592 | $(8,507)$ |
| ---: | ---: |
| 9,762 | 11,210 |


| $(25,139)$ |  | 82,946 |
| :---: | :---: | :---: |
| $(3,787)$ |  | $(3,787)$ |
| 44,268 | $(12,540)$ | 31,728 |
|  |  |  |
| 68,700 | $(18,681)$ | 70,362 |

$135,492 \quad 4,014 \quad 938,906 \quad(26,768) \quad 970,437$

OPERATING EXPENSES:
Personnel costs:
Salaries
Pension, profit sharing and other benefits

Net occupancy
expenses
Equipment expenses

Other taxes
Professional fees
Communications
$11,618 \quad 194$
252,716
$(1,099)$
263,429

76,201
(321)

79,234

328,917 $\quad(1,420) \quad 342,663$
$14,935 \quad 231$
328,917
1,165
673
673
710
5,777
278
Business promotion
Printing and supplies
Other operating expenses
Amortization of intangibles

358
809,766
$(73,599)$
736,381

Income (loss) before income tax and equity in earnings of subsidiaries 135,701
Income tax
29,246

Income (loss) before equity in earnings of subsidiaries
Equity in earnings of subsidiaries

106,455 3,949

87,142
$(82,917)$
$(66,609)$
$(88,916)$
151,300

NET INCOME
(LOSS) $\quad \$ 193,597 \quad \$(78,968) \quad \$(84,241) \quad \$ \quad 16,108 \quad \$ 147,101 \quad \$ \quad 193,597$

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## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF INCOME
FOR THE SIX MONTHS ENDED JUNE 30, 2006 (UNAUDITED)

|  | Popular, |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Inc. | PIBI | PNA | All other | Elimination | Popular, Inc. |  |
| (In thousands) | Holding Co. | Holding | Co. | Holding Co. | Subsidiaries | Entries | Consolidated |

## INTEREST

INCOME:

| Loans | $\$$ | 5,425 |  |  | $\$ 73,168$ | $\$ 1,263,556$ | $\$(136,522)$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Money market |  |  |  |  |  |  |  |
| investments |  |  |  |  |  |  |  |

INTEREST
EXPENSE:
Deposits

| Short-term borrowings | 103 | 841 | 10,103 | 269,480 | $(28,650)$ | 251,877 |
| :--- | ---: | :--- | :--- | :--- | ---: | ---: |
| Long-term debt | 18,049 |  | 90,337 | 288,276 | $(130,207)$ | 266,455 |
|  | 18,152 | 841 | 100,440 | 820,228 | $(160,957)$ | 778,704 |
|  |  |  |  |  |  |  |
| Net interest income <br> (expense) <br> Provision for loan <br> losses <br> 5,162 | (59) | $(26,388)$ | 742,651 | 4,177 | 725,543 |  |


| Net interest income (expense) after provision for loan losses | 5,162 | (59) | $(26,388)$ | 626,608 | 4,177 | 609,500 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Service charges on deposit accounts |  |  |  | 94,793 |  | 94,793 |
| Other service fees |  |  |  | 215,013 | $(54,650)$ | 160,363 |
| Net gain (loss) on sale and valuation adjustments of investment securities | 732 | 13,490 |  | $(16,717)$ | 411 | $(2,084)$ |
| Trading account profit |  |  |  | 1,183 | 12,122 | 13,305 |
| Gain on sale of loans |  |  |  | 84,231 | $(7,916)$ | 76,315 |
| Other operating income | 14,472 | 3,501 | 2,819 | 68,529 | $(19,194)$ | 70,127 |

OPERATING EXPENSES:
Personnel costs:
Salaries
Pension, profit sharing
and other benefits

Net occupancy expenses
Equipment expenses
Other taxes
Professional fees
Communications
Business promotion
Printing and supplies
Other operating expenses

| 10,658 | 188 |
| ---: | ---: |
| 3,020 | 36 |
| 13,678 | 224 |


| 252,932 | $(1,546)$ | 262,232 |
| ---: | ---: | ---: |
| 79,700 | $(453)$ | 82,303 |
| 332,632 | $(1,999)$ | 344,535 |

20,366 16,932 (23,569) 1,073,640 (65,050) 1,022,319

Impact of change in fiscal period at certain subsidiaries
Amortization of intangibles
(491)
,128
800
500
10,160
319
319
3,087
$(30,199)$

|  | 3,495 | 4,109 | 2,137 | 9,741 |
| ---: | ---: | ---: | ---: | ---: |
|  |  | 5,552 |  | 5,552 |
| (491) | 58 | 3,796 | 812,393 | $(69,522)$ |

Income (loss) before income tax and equity in earnings of

| subsidiaries | 20,857 | 16,874 | $(27,365)$ | 261,247 | 4,472 | 276,085 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Income tax | 2,717 |  | $(9,160)$ | 66,413 | 231 | 60,201 |

Income (loss) before equity in earnings of subsidiaries
Equity in earnings of subsidiaries

| 18,140 | 16,874 | $(18,205)$ | 194,834 | 4,241 | 215,884 |
| ---: | :---: | :---: | :---: | ---: | ---: |
| 197,744 | $(3,721)$ | 13,877 | $(10,634)$ | $(197,266)$ |  |
|  |  |  |  |  |  |
| $\$ 215,884$ | $\$ 13,153$ | $\$(4,328)$ | $\$ 184,200$ | $\$(193,025)$ | $\$$ |

NET INCOME
(LOSS) $\$ 215,884 \quad \$ 13,153 \quad \$(4,328) \quad \$ 184,200 \quad \$(193,025) \quad \$ 215,884$

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## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS FOR THE SIX MONTHS ENDED JUNE 30, 2007 (UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other | Elimination | Consolidated |
| :--- | :--- | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding | Co. | Holding <br> Co. | Subsidiaries | Entries | Popular, Inc.

## Cash flows from operating activities:

Net income (loss)

| $\$$ | 193,597 | $\$(78,968)$ | $\$(84,241)$ | $\$$ | 16,108 | $\$$ | 147,101 | $\$$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | 193,597

Adjustments to reconcile net income to net cash provided by (used in) operating activities:
Equity in undistributed earnings of subsidiaries Depreciation and amortization of premises and equipment
Provision for loan losses
Amortization of intangibles
Amortization and fair value adjustment of servicing assets
Net (gain) loss on sale and valuation adjustment of investment securities Net loss (gain) on disposition of premises and equipment Net gain on sale of loans
$(87,142)$ 82,917

66,609
88,916
$(151,300)$

1,180
238,827
(36)

39,973
7
211,506
211,513
5,796
5,796

Net amortization of premiums and accretion of discounts on investments
Net amortization of premiums and deferred loan origination fees and

## costs

(Earnings) losses from investments under the equity method Stock options expense Deferred income taxes

| $(4,515)$ | $(11,210)$ |
| :---: | :---: |
| 364 |  |
| 1,470 |  |

629
$(9,494)$
$(682)$
543
$(53,203)$

| $(812)$ | $(16,590)$ |
| ---: | ---: |
|  | 907 |
| 13,115 | $(48,112)$ |

$(3,087,103)$
$(403,712)$
held-for-sale
Proceeds from sale of loans held-for-sale
Net decrease in trading securities
Net decrease (increase) in accrued income receivable
Net decrease
(increase) in other assets

2,541
$(2,625)$
$(40,341)$
844
2,833,030

Net increase
(decrease) in interest payable

$$
130
$$

Net increase in postretirement benefit obligation
Net increase (decrease) in other liabilities

Total adjustments
Net cash provided by (used in) operating activities

$$
12,876
$$

3,701
$(14,014)$
252,254
389
255,206

## Cash flows from investing activities:

Net decrease (increase) in money market investments
Purchases of
investment securities:
Available-for-sale
Held-to-maturity
Other
Proceeds from calls, paydowns, maturities and redemptions of investment securities:
Available-for-sale
8,700
$(17,950)$
2,341
$(125,458)$
$(74,476)$
$(206,843)$
$(456,452)$
810,710
$\begin{array}{lrrr}\text { Held-to-maturity } & 978,000 & 400 & 10,979,564 \\ \text { Other } & & 5,445 & 11,957,964 \\ \text { P,445 }\end{array}$
Proceeds from sale of investment securities available -for- sale
Proceeds from sale of other investment securities
Net repayments
(disbursements) on loans 127,445
Proceeds from sale of loans
Acquisition of loan portfolios
Capital contribution to subsidiary
Assets acquired, net of cash
Mortgage servicing rights purchased
Acquisition of premises and equipment
(445)

Proceeds from sale of premises and equipment
Proceeds from sale of foreclosed assets
Dividends received from subsidiary

Net cash provided by (used in) investing activities

Cash flows from
financing activities:
Net increase in deposits
Net decrease in
federal funds purchased and assets sold under agreements to repurchase
Net decrease in other short-term borrowings
Payments of notes payable
Proceeds from issuance of notes
payable
Dividends paid to

| parent company | $(89,400)$ | 89,400 |
| :--- | :--- | :--- | :--- |
| Dividends paid | $(95,223)$ | $(95,223)$ |

Proceeds from
issuance of common
stock
8,667
8,667
Treasury stock acquired
(63)
(289)

Capital contribution
from parent
3,428
(352)

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|  | Popular, Inc. | PIBI <br> Holding <br> Co. | PNA <br> Holding <br> Co. | All other | Elimination | Consolidated |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Holding Co. | In thousands) |  |  | 11,869 | 242,814 | $(594,584)$ |
| Net cash (used in) <br> provided by financing <br> activities | $(237,208)$ |  | Entries | Popular, Inc. |  |  |
| Net increase <br> (decrease) in cash and <br> due from banks <br> Cash and due from <br> banks at beginning of <br> period | 1,773 | 160 | 55 | $(173,294)$ | $(16,767)$ | $(188,073)$ |
| Cash and due from <br> banks at end of period | $\$ 1,775$ | $\$ 317$ | $\$$ | 377 | $\$ 842,176$ | $\$(82,560)$ |

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## POPULAR, INC.

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2006 (UNAUDITED)

|  | Popular, Inc. | PIBI | PNA | All other | Elimination | Consolidated |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Holding Co. | Holding | Co. | Holding Co. | Subsidiaries | Entries | Popular, Inc.

Cash flows from operating activities:
Net income (loss) \$ 215,884 \$ 13,153 \$ (4,328) \$ 184,200 \$(193,025) \$ 215,884 Less: Impact of change in fiscal period of certain subsidiaries, net of tax

Net income before impact of change in fiscal period

215,88
$(2,057)$
186,838
$(191,805)$
222,013
Adjustments to reconcile net income to net cash provided by (used in) operating activities:
Equity in undistributed earnings of subsidiaries
$(197,744) \quad 3,721$
Depreciation and amortization of premises and equipment Provision for loan losses
$(2,638)$
$(1,220)$
$(6,129)$

Amortization of intangibles (197,74) 3,721
(13,877)
10,634 197,266

Amortization of
servicing assets
41,404
(36)

42,506

Net (gain) loss on sale and valuation adjustment of investment securities
$(732) \quad(13,490)$
116,043
116,043

Net gain on disposition of premises and equipment Net gain on sale of loans

$$
(84,231)
$$

7,916 5,552

Net amortization of premiums and accretion of discounts on investments Net amortization of premiums and deferred loan origination fees and costs
Earnings from investments under the equity method
Stock options expense Deferred income taxes Net disbursements on loans held-for-sale Acquisitions of loans held-for-sale
$(1,419)$
387
$(454)$
$(3,490)$
$(508)$
1,198
$(9,160)$
$(18,998)$
$(3,559,262)$
$(846,117)$
Proceeds from sale of loans held-for-sale
Net decrease in trading securities
Net decrease (increase) in accrued income receivable
Net (increase) decrease in other assets
Net increase in interest payable
Net increase in postretirement benefit obligation
Net increase
(decrease) in other liabilities

Total adjustments 11,318
(15)

16,503
$(91,725)$
266

Net cash provided by (used in) operating activities

## Cash flows from

 investing activities:Net decrease (increase) in money market investments 230,000

199,108
$(299,800)$
129,048
Purchases of investment securities:
Available-for-sale
$(17,284)$
$(315,246) \quad 121,391$
(16,647,740)
$(211,139)$
(16,847,432)

Other
Proceeds from calls, paydowns, maturities and redemptions of investment securities: Available-for-sale
Held-to-maturity
Other
Proceeds from sale of investment securities available for sale Net disbursements on loans
Proceeds from sale of loans
Acquisition of loan portfolios
Capital contribution to subsidiary
Assets acquired, net of cash
Mortgage servicing rights purchased Acquisition of premises and equipment
Proceeds from sale of premises and equipment Proceeds from sale of foreclosed assets Dividends received from subsidiary

Net cash provided by (used in) investing activities

Cash flows from financing activities:
(250)
$(31,952)$
$(32,202)$

| 876,918 | $(115,060)$ | 761,858 |
| ---: | ---: | ---: |
| $16,580,599$ |  | $16,580,599$ |
| 38,722 |  | 39,263 |

$(144,056)$
$(16,432)$
$(501,092) \quad 189,306$
$(472,274)$

| 7,235 | 27,924 |
| ---: | :--- |
| $(144,056)$ |  |

212,791
$(175,856)$
$(9,599)$
$(63,469)$

26,762
66,685
60,763 (209,363)
$38,272 \quad 10,640 \quad 300,756 \quad(279,069) \quad 49,091$

Net increase in deposits
Net decrease in federal funds purchased and assets sold under agreements to repurchase
$(22,300) \quad(1,175,629) \quad 309,048$
$(888,881)$
Net (decrease) increase in other short-term borrowings
$(15,734)$
$(226,879)$
28,135
64,295
811,499

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| Payments of notes <br> payable | $(450)$ | $(205,462)$ | $(1,615,920)$ | 611,097 | $(1,210,735)$ |
| :--- | :---: | :---: | :---: | :---: | :---: |
| Proceeds from <br> issuance of notes <br> payable | 196 | 481,476 | $1,079,305$ | $(878,571)$ | 682,406 |
| Dividends paid to <br> parent company |  |  | $(209,362)$ | 209,362 | 58 |

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| (In thousands) | Popular, Inc. <br> Holding Co. | PIBI ${ }_{\text {Pr }}^{\text {Holding Co. }}$ | PNA Holding Co. | All other Subsidiaries | Elimination Entries | Consolidated Popular, Inc. |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Dividends paid | $(93,249)$ |  |  |  |  | $(93,249)$ |
| Proceeds from issuance of common stock | 47,126 |  |  |  | 167 | 47,293 |
| Capital contribution from parent |  |  |  | 34,524 | $(34,524)$ |  |
| Net cash (used in) provided by financing activities | $(46,377)$ | $(15,734)$ | 26,835 | $(1,041,715)$ | 275,141 | $(801,850)$ |
| Cash effect of change in fiscal period of certain subsidiaries |  |  | 78 | 19,570 | $(7,734)$ | 11,914 |
| Net increase (decrease) in cash and due from banks | 258 | (617) | (53) | $(56,873)$ | (220) | $(57,505)$ |
| Cash and due from banks at beginning of period | 696 | 2,103 | 448 | 962,395 | $(59,245)$ | 906,397 |
| Cash and due from banks at end of period | \$ 954 | \$ 1,486 | \$ 395 | \$ 905,522 | $(\$ 59,465)$ | \$ 848,892 |

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

This report includes management s discussion and analysis ( MD\&A ) of the consolidated financial position and financial performance of Popular, Inc. and its subsidiaries (the Corporation or Popular ). All accompanying tables, financial statements and notes included elsewhere in this report should be considered an integral part of this analysis.

## OVERVIEW

Popular, Inc. is a diversified, publicly-owned financial holding company subject to the supervision and regulation of the Board of Governors of the Federal Reserve System. The Corporation is a full service financial services provider with operations in Puerto Rico, the United States, the Caribbean and Latin America. As the leading financial institution based in Puerto Rico, the Corporation offers retail and commercial banking services through its principal banking subsidiary, Banco Popular de Puerto Rico ( BPPR ), as well as auto and equipment leasing and financing, mortgage loans, consumer lending, investment banking, broker-dealer and insurance services through specialized subsidiaries. In the United States, the Corporation has established a community banking franchise providing a broad range of financial services and products to the communities it serves. Banco Popular North America ( BPNA ) operates branches in California, Texas, Illinois, New York, New Jersey and Florida, while E-LOAN provides online consumer direct lending to obtain mortgage, auto and home equity loans, and provides an online platform to raise deposits for BPNA. Popular Financial Holdings ( PFH ) offers mortgage and personal loans and provides mortgage loan servicing. The Corporation also owns a financial transaction processing operation, EVERTEC, which strives to use its expertise in technology and electronic banking as a competitive advantage in its expansion throughout the United States, the Caribbean and Latin America, as well as internally servicing many of its subsidiaries system infrastructures and transactional processing businesses.
The financial results for the quarter ended June 30, 2007 were principally impacted by a higher provision for loan losses which continues to reflect a difficult housing environment, particularly in the U.S. mainland, and weak economic conditions in Puerto Rico impacting both the consumer and commercial sectors. Table A provides selected financial data and performance metrics for the quarters and six months ended June 30, 2007 and 2006.
Financial highlights for the quarter ended June 30, 2007, compared with the same quarter in 2006, are described below.

Net interest income improved as a result of a change in the mix of the Corporation s earning assets and interest bearing liabilities. The investment portfolio declined due to the maturity of low yielding securities that were not replaced with securities, while the mortgage loan portfolio decreased due to sales of low yielding mortgage loans from the Puerto Rico operations in 2006 and lower origination volume experienced in the U.S. mortgage sector. These decreases were partially offset by an increase in the commercial and consumer loan portfolios, which due to their nature and characteristics have higher yields. Furthermore, earning assets were funded with a greater proportion of interest bearing deposits, which generally carry a lower average cost than other borrowings. The cost of short-term borrowings increased in part due to two interest rate tightenings by the Federal Reserve in the mid to latter part of the second quarter of 2006. Refer to the Net Interest Income section of this MD\&A for further details on the variance in net interest income on a taxable equivalent basis.

The financial results for the quarter ended June 30, 2007 were impacted by a $\$ 48.1$ million increase in the provision for loan losses, which was mostly influenced by higher charge-offs in most portfolio categories due to weak economic conditions in Puerto Rico and a slowdown in the housing sector, particularly in the U.S. mainland. Further details on credit quality metrics are included later in the MD\&A.

Non-interest income totaled $\$ 203.4$ million for the quarter ended June 30, 2007, compared with $\$ 184.0$ million for the same quarter in 2006. This increase resulted from the net impact of the following principal factors / variances:

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o Lower unfavorable valuation adjustments in the fair value of PFH s residual interests derived from off-balance sheet mortgage loan securitizations (also known as interest-only securities or IOs ) during the second quarter of 2007. Unfavorable valuation adjustments in PFH s residual interests, including those classified as available-for-sale and as trading securities, amounted to $\$ 2.2$ million in the second quarter of 2007, compared with $\$ 15.5$ million in the second quarter of 2006. As of June 30, 2007, the aggregate balance of PFH s residual interests was $\$ 36$ million. As indicated in the Corporation s Form 10-Q filed on May 10, 2007 and in the Corporation s 2006 Annual Report incorporated by reference in Popular, Inc. s Form $10-\mathrm{K}$, the Corporation exited the wholesale nonprime mortgage loan origination business during the first quarter of 2007. It shut down its wholesale broker, retail and call center business divisions. Nonprime mortgage loan securitizations that resulted in the accounting for residual interests involved loans originated through those channels.
o Trading account profits, isolating the change related to the mark-to-market of PFH s residual interests classified as trading securities which amounted to $\$ 0.4$ million, increased by $\$ 8.9$ million primarily due to gains on the sale of mortgage-backed securities issued by the Corporation s mortgage banking subsidiary in Puerto Rico and favorable mark-to-market adjustments in the valuation of mortgage-backed securities held for trading purposes.
o Other operating income in the second quarter of 2006 included $\$ 11.0$ million in dividends received from Telecomunicaciones de Puerto Rico, Inc. ( TELPRI ) in that period. The shares of common stock in TELPRI were sold by the Corporation during the first quarter of 2007.
o Other service fees improved by $\$ 9.6$ million driven mostly by increases in credit and debit card fees, and in net mortgage servicing fees.
Refer to the Non-Interest Income section of this MD\&A for other factors influencing the variance in non-interest income. Also, refer to the Critical Accounting Policies / Estimates section of this MD\&A for more detailed information on the valuation of residual interests and changes in assumptions.

Operating expenses for the quarter ended June 30, 2007 decreased by $\$ 1.9$ million, or less than $1 \%$, when compared with the same quarter in 2006, mainly as a result of lower personnel costs which were reduced by approximately $\$ 2.2$ million. Personnel costs were influenced by a decline in Popular North America s reportable segment primarily due to the Restructuring Plan (the Restructuring Plan ) in the U.S. operations. In particular, PFH, which was greatly impacted by the Restructuring Plan, experienced a decline in personnel costs of $\$ 10.6$ million, when comparing its results for the second quarter of 2007 versus the same quarter in the previous year. This reduction in the Corporation s personnel costs was offset in part by other increases across the Corporation s subsidiaries, including the impact of merit increases and new units to support initiatives for new products and services. Other operating expense categories in the aggregate remained stable for the quarter ended June 30, 2007, as compared to the same quarter in the previous year. The Corporation did not incur significant charges during the second quarter of 2007 related to the Restructuring Plan of the U.S. operations. Refer to the Restructuring Plan section of this MD\&A and Note 22 to the consolidated financial statements for information on the Restructuring Plan. Also, investors may refer to the Corporation s Form 10-Q filed on May 10, 2007 and the 2006 Annual Report incorporated by reference in the Corporation s Form 10-K filed on March 1, 2007 for additional information on this plan.

Higher income tax expense despite lower taxable income as a result of the impact of the reversal of certain tax positions upon the completion during the second quarter of 2006 of various federal and Puerto Rico tax audits, as well as lower exempt income.

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Total earning assets at June 30, 2007 decreased slightly by less than $1 \%$ compared with December 31, 2006. When compared to June 30, 2006, earning assets decreased by $3 \%$. This decline was due in part to strategies to reduce the Corporation sfinancial leverage and low yielding assets. Refer to the Financial Condition section of this MD\&A for descriptive information on the composition of assets, deposits, borrowings and capital of the Corporation.

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TABLE A
Financial Highlights

Financial Condition Highlights
(In thousands) 2007

Money market investments Investment and trading securities Loans*

Total earning assets
Total assets
Deposits
Borrowings
Stockholders equity

At June 30, 2006 Variance

Average for the six months
20072006 Variance

| $\$ 574,987$ | $\$ 620,522$ | $\$(45,535)$ | $\$ 404,686$ | $\$ 625,784$ | $\$(221,098)$ |
| ---: | ---: | ---: | :---: | ---: | ---: | ---: | ---: |
| $10,240,955$ | $11,998,008$ | $(1,757,053)$ | $10,785,609$ | $12,839,939$ | $(2,054,330)$ |
| $32,751,845$ | $32,216,632$ | 535,213 | $32,712,076$ | $31,932,840$ | 779,236 |
| $43,567,787$ | $44,835,162$ | $(1,267,375)$ | $43,902,371$ | $45,398,563$ | $(1,496,192)$ |
| $46,985,363$ | $48,399,514$ | $(1,414,151)$ | $47,224,603$ | $48,759,631$ | $(1,535,028)$ |
| $25,385,995$ | $23,449,520$ | $1,936,475$ | $24,630,221$ | $22,810,528$ | $1,819,693$ |
| $17,108,679$ | $20,782,342$ | $(3,673,663)$ | $17,940,022$ | $21,536,404$ | $(3,596,382)$ |
| $3,697,080$ | $3,462,993$ | 234,087 | $3,854,240$ | $3,689,641$ | 164,599 |

Operating Highlights
(In thousands, except per share informatio
Net interest income
Provision for loan losses
Non-interest income
Operating expenses
Income tax
Net income
Net income applicable to common stock
Basic and diluted EPS

| Second Quarter |  |  | Six months ended June 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 2007 | 2006 | Variance | 2007 | 2006 | Variance |
| \$371,417 | \$365,779 | \$ 5,638 | \$726,399 | \$725,543 | \$ 856 |
| 115,167 | 67,096 | 48,071 | 211,513 | 116,043 | 95,470 |
| 203,375 | 183,986 | 19,389 | 455,551 | 412,819 | 42,732 |
| 361,053 | 362,980 | $(1,927)$ | 736,381 | 746,234 | $(9,853)$ |
| 23,622 | 22,308 | 1,314 | 40,459 | 60,201 | $(19,742)$ |
| \$ 74,950 | \$ 97,381 | \$ $(22,431)$ | \$ 193,597 | \$215,884 | \$ $(22,287)$ |
| \$ 71,972 | \$ 94,403 | \$ $(22,431)$ | \$ 187,641 | \$209,928 | \$ $(22,287)$ |
| \$ 0.26 | \$ 0.34 | \$ (0.08) | \$ 0.67 | \$ 0.75(a) | \$ (0.08) |

Six months ended June
30,
2007
\$18.94 \$21.98
15.82 18.53 19.20 11.77 12.57 0.32 40.98\% 11.64x

| $0.64 \%$ | $0.80 \%$ | $0.83 \%$ | $0.91 \%$ |
| :---: | :---: | :---: | :---: |
| 7.80 | 10.72 | 10.32 | 12.27 |
| 3.06 | 3.05 | 2.99 | 3.02 |
| 3.60 | 3.49 | 3.52 | 3.45 |
| 23.96 | 18.64 | 17.29 | 21.81 |
| 42.45 | 48.94 | 38.66 | 45.95 |
| 62.94 | 64.34 | 67.19 | 65.44 |


| Capitalization Ratios | Equity to assets | $8.24 \%$ | $7.66 \%$ | $8.16 \%$ |
| :--- | ---: | ---: | ---: | ---: |
| Tangible equity to assets | 6.72 | 6.19 | 6.63 | $6.57 \%$ |
| Equity to loans | 11.86 | 11.65 | 11.78 | 11.55 |
| Internal capital generation | 2.81 | 5.36 | 5.10 | 6.72 |
| Tier I capital to risk | adjusted assets | 10.66 | 11.26 | 10.66 |
| Total capital to risk | adjusted assets | 11.92 | 12.51 | 11.92 |
| Leverage ratio | 8.17 | 7.81 | 8.17 | 12.51 |
|  |  |  |  | 7.81 |

* Includes loans
held-for-sale.
** Non-interest expense less non-interest income divided by net interest income.
*** Non-interest expense divided by net interest income plus recurring non-interest income (refer to the Operating expenses section of this MD\&A for a description of items not considered recurring ).
(a) Quarterly amounts do not add to the year-to-date total due to rounding.

The Corporation, like other financial institutions, is subject to a number of risks, many of which are outside of management $s$ control, though efforts are made to manage those risks while optimizing returns. Among the risks assumed are: (1) market risk, which is the risk that changes in market rates and prices will adversely affect the Corporation s financial condition or results of operations, (2) liquidity risk, which is the risk that the Corporation

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will have insufficient cash or access to cash to meet operating needs and financial obligations, (3) credit risk, which is the risk that loan customers or other counterparties will be unable to perform their contractual obligations, and (4) operational risk, which is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. In addition, the Corporation is subject to legal, compliance and reputational risks, among others. As a financial services company, the Corporation s earnings are significantly affected by general business and economic conditions. Lending and deposit activities and fee income generation are influenced by the level of business spending and investment, consumer income, spending and savings, capital market activities, competition, customer preferences, interest rate conditions and prevailing market rates on competing products. The Corporation continuously monitors general business and economic conditions, industry-related indicators and trends, competition, interest rate volatility, credit quality indicators, loan and deposit demand, operational and systems efficiencies, revenue enhancements and changes in the regulation of financial services companies. The Corporation operates in a highly regulated environment and may be adversely affected by changes in federal and local laws and regulations. Also, competition with other financial institutions could adversely affect its profitability.
The description of the Corporation s business contained in Item 1 of the Corporation s Form 10-K for the year ended December 31, 2006, while not all inclusive, discusses additional information about the business of the Corporation and risk factors, many beyond the Corporation s control, that in addition to the other information in this Form 10-Q, readers should consider.
Further discussion of operating results, financial condition and credit, market and liquidity risks is presented in the narrative and tables included herein.
The shares of the Corporation s common and preferred stock are traded on the National Association of Securities Dealers Automated Quotation ( NASDAQ ) system under the symbols BPOP and BPOPO, respectively.

## CRITICAL ACCOUNTING POLICIES / ESTIMATES

The accounting and reporting policies followed by the Corporation and its subsidiaries conform to generally accepted accounting principles in the United States of America and general practices within the financial services industry. Various elements of the Corporation s accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. These estimates are made under facts and circumstances at a point in time and changes in those facts and circumstances could produce actual results that differ from those estimates.
Management has discussed the development and selection of the critical accounting policies and estimates with the Corporation s Audit Committee. The Corporation has identified as critical accounting policies those related to securities classification and related values, loans and allowance for loan losses, retained interests on transfers of financial assets subprime mortgage loans securitizations (valuations of interest-only strips and mortgage servicing rights), income taxes, goodwill and other intangible assets, and pension and postretirement benefit obligations. For a summary of the Corporation s critical accounting policies, refer to that particular section in the MD\&A included in Popular, Inc. s 2006 Financial Review and Supplementary Information to Stockholders, incorporated by reference in Popular, Inc. s Annual Report on Form 10-K for the year ended December 31, 2006 (the 2006 Annual Report ). Also, refer to Note 1 to the consolidated financial statements included in the 2006 Annual Report for a summary of the Corporation s significant accounting policies.
As indicated in the 2006 Annual Report, one of the accounting policies / estimates considered critical by the Corporation s management is that associated with the valuation of PFH s residual interests. During the six-month period ended June 30, 2007, the Corporation recognized unfavorable valuation adjustments of $\$ 55.0$ million in the fair value of PFH s residual interests. Of this amount, $\$ 30.7$ million corresponded to residual interests classified as available-for-sale and $\$ 24.3$ million corresponded to residual interests classified as trading securities. As of June 30, 2007, the aggregate balance of PFH s residual interests recognized in the Corporation s statement of financial condition was $\$ 36$ million. The unpaid principal balance of mortgage loans sold in off-balance sheet securitizations to which these residual interests are associated amounted to approximately $\$ 2.5$ billion at June 30, 2007. This

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portfolio is almost equally split between fixed-rate and adjustable-rate mortgage loans.
During the first quarter of 2007, management reviewed the critical assumptions used in the valuation of residual interests derived from off-balance sheet securitizations performed by PFH. As indicated in the Form 10-Q filed on May 10, 2007, during the first quarter of 2007, adjustments were made to two critical assumptions utilized for the valuation of PFH s residual interests, namely the discount rate and cumulative credit losses. There were no significant changes in valuation assumptions in the second quarter of 2007. There were no significant changes in the methodology or models used to value the residual interests that are described in the 2006 Annual Report.
The subprime mortgage market has experienced (1) deteriorating credit performance trends, particularly in loans originated in 2005 and 2006, (2) continued turmoil with subprime lenders due to increases in losses, bankruptcies and liquidity problems, (3) lower levels of housing activity and home price appreciation, and (4) a general tightening of credit standards that may adversely affect subprime borrowers when trying to refinance their mortgages. These factors have led to an increase in cash flow uncertainty for investors in subprime mortgage securities thereby causing risk premiums to increase. Given the increase in risk premiums along with lower liquidity for subprime securities observed in the market, in the first quarter of 2007, the Corporation changed the discount rate utilized to discount projected residual cash flows at the end of the first quarter of 2007 to $25 \%$ from $17 \%$ at the end of the fourth quarter in 2006. With respect to credit losses, lower levels of home price appreciation, declining demand for housing units leading to rising inventories, housing affordability challenges and a general tightening of underwriting standards are expected to lead to higher future cumulative credit losses. Based on an analysis by management of PFH s historical collateral performance, risk model estimates and rating agency loss coverage levels, the cumulative credit loss assumptions were also changed during the first quarter of 2007. The changes reflect an increase in the cumulative credit loss estimate range for the nine securitization transactions completed and accounted for as sale transactions during 2005 and 2006 of between 112 and 364 basis points.
The analysis performed by the Corporation reflects that all transactions, from a cumulative loss standpoint, are performing better than the median loss projection calculated by Loan Performance Corporation s Risk Model ( Risk Model ). Notwithstanding, leading credit indicators of future loss performance (60-day delinquency, 90 -day delinquency, foreclosure and REO levels) for the most recent four transactions executed in 2005 and 2006 show underperformance compared to the model projections. Although this tendency (i.e. higher delinquency but lower loss levels) is not inconsistent with the historical performance of PFH s collateral when compared to the risk model, conditions in the housing and credit markets have changed materially. Furthermore, the overall industry credit performance of mortgage collateral originated in 2005 and 2006 is showing considerable underperformance relative to other vintages (i.e. higher delinquency levels at the same stage of seasoning), which implies higher cumulative losses than originally estimated.
Refer to Note 8 to the consolidated financial statements for information on key economic assumptions used in measuring the fair value of the residual interests as of June 30, 2007. Also, the note provides a sensitivity analysis based on immediate changes to the most critical assumptions used in the valuations at June 30, 2007.
Another of the Corporation s critical accounting policies relates to the valuation of mortgage servicing rights. As further described in Note 2 to the consolidated financial statements and in the Recent Accounting Pronouncements and Interpretations section included in this MD\&A, in January 2007, the Corporation adopted SFAS No. 156
Accounting for Servicing of Financial Assets an amendment of FASB No. 140. The provisions of SFAS No. 156 did not have an impact on the estimation techniques, valuation assumptions and other subjective assessments associated with the mortgage servicing rights computations. Refer to Note 8 to the consolidated financial statements for information on key economic assumptions used in measuring the fair value of mortgage servicing rights as of June 30, 2007 and to Note 7 for SFAS No. 156 required disclosures.
There were no significant changes in the valuation methodology or assumptions related to MSRs. The valuations for the second quarter of 2007 included a slowdown in the prepayment speed in the Puerto Rico serviced portfolio and an evaluation of delinquency assumptions for PFH s purchased MSRs. Delinquency assumptions were adjusted on several acquired MSRs to better reflect market expectations given higher than projected delinquency levels in the collateral underlying those transactions.

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Also, during the quarter ended March 31, 2007, the Corporation adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109 (FIN 48), which also relates to one of the Corporation s critical accounting policies, namely income taxes. As indicated in the section below, the impact of the FIN 48 adoption in the first quarter of 2007 was not material to the Corporation. Refer to Note 14 to the consolidated financial statements for information on the financial impact and required disclosures.

## RECENT ACCOUNTING PRONOUNCEMENTS AND INTERPRETATIONS

SFAS No. 155 Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140
In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. SFAS No. 155 permits companies to elect, on a transaction-by-transaction basis, to apply a fair value measurement to hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation under SFAS No. 133. This statement also clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The adoption of SFAS No. 155 in 2007 did not have a material impact on the Corporation s consolidated financial statements during the six months ended June 30, 2007.
SFAS No. 156 Accounting for Servicing of Financial Assets an amendment of FASB No. 140
SFAS No. 156 requires that all separately recognized servicing assets and liabilities be initially measured at fair value, if practicable. For subsequent measurements, SFAS No. 156 permits companies to choose between using an amortization method or a fair value measurement method for reporting purposes by class of servicing asset or liability. The Corporation adopted SFAS No. 156 in January 2007. The Corporation elected the fair value measurement for mortgage servicing rights ( MSRs ). Servicing rights associated with Small Business Administration ( SBA ) commercial loans will continue to be accounted at the lower of cost or market method. The initial impact of adoption of the fair value measurement for MSRs was included as a cumulative effect of a change in accounting principle directly in stockholders equity and resulted in a net increase in stockholders equity of approximately $\$ 9.6$ million, net of deferred taxes. Refer to Note 7 to the consolidated financial statements for additional information on the adoption of SFAS No. 156 disclosures.

## FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109 (FIN 48)

In 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition related to income taxes. The accounting provisions of FIN 48 were effective for the Corporation beginning in the first quarter of 2007. Based on management s assessment, there was no impact on retained earnings as of January 1, 2007 due to the initial application of the provisions of FIN 48. Also, as a result of the implementation, the Corporation did not recognize any change in the liability for unrecognized tax benefits. Refer to Note 14 to the consolidated financial statements for further information on the impact of FIN 48.
EITF Issue No. 06-03 How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation) (EITF 06-03)
EITF $06-03$ provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The

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Corporation saccounting policy is to account on a net basis for the taxes collected from customers and remitted to governmental authorities. The corresponding amounts recognized in the consolidated financial statements are not significant.
EITF Issue No. 06-5 Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance (EITF 06-5) EITF 06-5 focuses on how an entity should determine the amount that could be realized under the insurance contract at the balance sheet date in applying FTB 85-4, and whether the determination should be on an individual or group policy basis. At the September 2006 meeting, the Task Force affirmed as a final consensus that the cash surrender value and any additional amounts provided by the contractual terms of the insurance policy that are realizable at the balance sheet date should be considered in determining the amount that could be realized under FTB $85-4$, and any amounts that are not immediately payable in cash to the policyholder should be discounted to their present value. Additionally, the Task Force affirmed as a final consensus the tentative conclusion that in determining the amount that could be realized, companies should assume that policies will be surrendered on an individual-by-individual basis, rather than surrendering the entire group policy. Also, the Task Force reached a consensus that contractual limitations on the ability to surrender a policy do not affect the amount to be reflected under FTB 85-4, but, if significant, the nature of those restrictions should be disclosed. The Corporation adopted the EITF $06-5$ guidance in the first quarter of 2007 and as a result recorded a $\$ 0.9$ million cumulative effect adjustment to beginning retained earnings (reduction of capital) for the existing bank-owned life insurance arrangement.
SFAS No. 157 Fair Value Measurements
SFAS No. 157, issued in September 2006, defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets carried at fair value will be classified and disclosed in one of the three categories in accordance with the hierarchy. The three levels of the fair value hierarchy are: (1) quoted market prices for identical assets or liabilities in active markets; (2) observable market-based inputs or unobservable inputs that are corroborated by market data; and (3) unobservable inputs that are not corroborated by market data. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Corporation will adopt the provisions of SFAS No. 157 commencing with the first quarter of 2008. The Corporation is evaluating the impact that this accounting pronouncement may have in its consolidated financial statements and disclosures.
SFAS No. 159 Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities
In February 2007, the FASB issued SFAS No. 159, which provides companies with an option to report selected financial assets and liabilities at fair value. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, Fair Value Measurements, and No. 107, Disclosures about Fair Value of Financial Instruments. SFAS No. 159 is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. The Corporation will adopt the provisions of SFAS No. 159 commencing in January 2008. Management is evaluating the impact that this accounting standard may have on its consolidated financial statements.
FSP FIN No. 39-1 Amendment of FASB Interpretation No. 39
In April 2007, the FASB issued Staff Position FSP FIN 39-1 which defines right of setoff and specifies what conditions must be met for a derivative contract to qualify for this right of setoff. It also addresses the applicability of a right of setoff to derivative instruments and clarifies the circumstances in which it is appropriate to offset amounts
recognized for those instruments in the statement of financial position. In addition, this FSP permits the offsetting of fair value amounts recognized for multiple derivative instruments executed with the same counterparty

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under a master netting arrangement and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments. This interpretation is effective for fiscal years beginning after November 15, 2007, with early application permitted. The adoption of FSP FIN 39-1 is not expected to have a material impact on the Corporation s consolidated financial statements.
FSP FIN No. $46(R) 7$ Application of FASB Interpretation No. $46(R)$ to Investment Companies
In May 2007, the FASB issued Staff Position FSP FIN No. $46(\mathrm{R})$ which amends the scope of the exception to FIN 46 $(\mathrm{R})$ to indicate that investments accounted for at fair value in accordance with the specialized accounting guidance in the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide for Investment Companies, are not subject to consolidation under FIN No. 46 (R). This interpretation is effective for fiscal years beginning on or after December 15, 2007. Management is evaluating the impact, if any, that the adoption of this interpretation may have on its consolidated financial statements.

## SOP 07-01 Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies

The Statement of Position SOP 07-01 issued in June 2007 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide for Investment Companies ( AICPA Guide ). Additionally, it provides guidance as to whether a parent company or an equity method investor can apply the specialized industry accounting principles of the AICPA Guide. SOP 07-01 is effective for fiscal years beginning on or after December 15, 2007, with early application encouraged. Management is evaluating the impact, if any, that the adoption of SOP 07-1 may have on its consolidated financial statements.

## NET INTEREST INCOME

Tables B and C present the different components of the Corporation s net interest income, on a taxable equivalent basis, for the quarter and six months ended June 30, 2007, compared with the same periods in 2006, segregated by major categories of interest earning assets and interest bearing liabilities.
The interest earning assets include investment securities and loans that are exempt from income tax, principally in Puerto Rico ( P.R. ). The main sources of tax-exempt interest income are investments in obligations of some U.S. Government agencies and sponsored entities of the P.R. Commonwealth and its agencies, and assets held by the Corporation s international banking entities, which are tax-exempt under P.R. laws. To facilitate the comparison of all interest data related to these assets, the interest income has been converted to a taxable equivalent basis, using the applicable statutory income tax rates at each respective quarter and six-month periods. The marginal tax rate for P.R. subsidiaries in 2007 was $39 \%$, compared to $43.5 \%$ for BPPR and $41.5 \%$ for the other P.R. subsidiaries in the quarter and six-month periods ended June 30, 2006. The marginal tax rates for the quarter and six months ended June 30, 2006 reflected the impact of transitory increases which expired at the end of 2006. The taxable equivalent computation considers the interest expense disallowance required by the P.R. tax law, also affected by the mentioned increases in tax rates. The expiration of the temporary additional tax for the P.R. operations was the main reason for the decrease in the taxable equivalent benefit.
Average outstanding securities balances are based upon amortized cost excluding any unrealized gains or losses on securities available-for-sale. Non-accrual loans have been included in the respective average loan categories. Loan fees collected and costs incurred in the origination of loans are deferred and amortized over the term of the loan as an adjustment to interest yield. Interest income for the quarter and six months ended June 30, 2007 included unfavorable impacts of $\$ 2.5$ million and $\$ 5.2$ million, respectively, consisting principally of amortization of net loan origination costs (net of origination fees) and the amortization of net premiums on loans purchased, partially offset by prepayment penalties and late payment charges. The unfavorable impact for the quarter and six months ended June 30, 2006 amounted to $\$ 4.6$ million and $\$ 11.9$ million, respectively. The reduction for the second quarter of 2007, compared to the same quarter in the previous year, was mainly the result of a lower balance of premium amortized related to mortgage loans purchased in the U.S. operations, primarily in years prior to 2006, due to reduced loan prepayments and to the direct impact of the maturity run-off of the purchased mortgage loan portfolio. During late 2005, as part of a strategic business decision, the Corporation reduced the volume of purchases of

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mortgage loans, which in the past were used as part of the loans used to complete securitization transactions. As shown in Table B, net interest income on a taxable equivalent basis for the second quarter of 2007 remained consistent, when compared to the same quarter of the previous year. Throughout 2006 the Corporation experienced a change in the mix of its earning assets due to the maturities of low yielding securities, the sale of low yielding mortgage loans, and the reduction experienced in the U.S. mortgage sector. Increased production in commercial and consumer loans, which carry a higher yield, partially offset the decrease in investments and mortgage loans and contributed to the increase in the yield of earning assets. Refer to the Financial Condition section of this MD\&A for further information on the change in the different categories of earning assets.
TABLE B
Analysis of Levels \& Yields on a Taxable Equivalent Basis
Quarter ended June 30,

$\$ 45,196 \quad(\$ 1,368) \quad 3.78 \% \quad 3.52 \% \quad 0.26 \%$

$3.60 \% \quad 3.49 \% \quad 0.11 \%$ Net interest margin

Net interest income on a taxable $\begin{array}{lllll}\text { equivalent basis } & 394,451 & 395,175 & (724) & (\$ 18,284)\end{array}$
$3.06 \% \quad 3.05 \% \quad 0.01 \%$ Net interest spread
Taxable equivalent adjustment $\quad 23,034 \quad 29,396 \quad(6,362)$
$\begin{array}{lllll}\text { Net interest income } & \$ 371,417 & \$ 365,779 & \$ 5,638\end{array}$

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.

* Includes interest
bearing demand deposits
corresponding
to certain
government
entities in
Puerto Rico.


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The Corporation $s$ funding sources also experienced a change in its mix which contributed to the positive variance related to the change in levels as shown in Table B . The reduction of low yielding assets allowed the Corporation to reduce its levels of borrowed money while focusing on increasing its deposit base, which generally carry a lower cost. The E-LOAN internet deposit gathering initiative, launched in the latter part of 2006, contributed to these efforts. Also, there were increases in non-internet certificates of deposits and money market accounts gathered through the branch network of BPPR and BPNA.
The increase in the net interest margin, on a taxable equivalent basis, was mainly the result of the following factors: Higher yields in commercial loans and construction loans, mainly in the floating rate portfolios which were favorably impacted by the rising interest rates as a result of the two tightenings performed by the Federal Reserve in the mid to latter part of the second quarter of 2006. As of June 30,2007 , approximately $62 \%$ of the commercial and construction loan portfolio had floating or adjustable interest rates.

Higher yields in the mortgage loan portfolio in part as a result of higher rates for new loans, a reduction in the premium amortized for securitized mortgage loans due to a reduction in prepayment speeds, and the sale of low yielding mortgage loans from the P.R. operations during 2006.

Increase in the yield of consumer loans driven in part by home equity lines of credit with floating rates and an increase in the rate for the P.R. consumer loan portfolio.
Unfavorable items impacting net interest margin are detailed as follows:
Higher cost of short-term borrowings as a result of the previously mentioned tightenings performed by the Federal Reserve during the second quarter of 2006.

Increased cost of interest bearing deposits as a result of savings and time deposits raised through the E-LOAN platform in the second half of 2006, which carry higher rates due to the competitive interest rates offered. Also, the Corporation raised a greater volume of certificates of deposit through non-internet channels, a higher cost deposit category. Furthermore, there was an increase in the costs of certain NOW and money market accounts influenced by competitive campaigns to attract and retain customers, mainly in the U.S. operations, as well as certain accounts with floating rates which were impacted by increases in interest rates.
As shown in Table C, for the six-month period ended June 30, 2007, the net interest income on a taxable equivalent basis decreased mainly as a result of a lower benefit derived from the taxable equivalent adjustment due to the expiration of the temporary additional tax for the P.R. operations. In addition the variance is also influenced by the factors previously described in the quarterly results.

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TABLE C
Analysis of Levels \& Yields on a Taxable Equivalent Basis
Six month period ended June 30,

| Average Volume |  |  | Average Yields / Costs |  |  |  | 2007 | $\begin{gathered} \text { Interest } \\ 2006 \end{gathered}$ | Variance | Variance Attributable to |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 7 | 2006 | Variance | 2007 | 2006 | Variance |  |  |  |  | Rate | Volume |
| (\$ in millions) |  |  |  |  |  |  | (In thousands) |  |  |  |  |
| 105 | \$ 626 | \$ (221) | 5.46\% | 5.40\% | 0.06\% | Money market investments | \$ 10,949 | \$ 16,748 | \$ $(5,799)$ | 142 | \$ (5,941) |
| 158 | 12,324 | $(2,166)$ | 5.15 | 5.08 | 0.07 | Investment securities | 261,259 | 312,819 | $(51,560)$ | 3,549 | $(55,109)$ |
| 627 | 516 | 111 | 6.36 | 6.57 | (0.21) | Trading securities | 19,777 | 16,795 | 2,982 | (543) | 3,525 |
| 19 | 13,466 | $(2,276)$ | 5.22 | 5.15 | 0.07 |  | 291,985 | 346,362 | $(54,377)$ | 3,148 | $(57,525)$ |
| 770 | 13,185 | 1,585 | 7.81 | 7.44 | 0.37 | Loans: <br> Commercial | 572,340 | 486,285 | 86,055 | 24,353 | 61,702 |
| 196 | 1,312 | (116) | 7.85 | 7.47 | 0.38 | Leasing | 46,948 | 48,986 | $(2,038)$ | 2,438 | $(4,476)$ |
| 412 | 12,480 | $(1,068)$ | 7.13 | 6.80 | 0.33 | Mortgage | 406,670 | 424,260 | $(17,590)$ | 19,831 | $(37,421)$ |
| 334 | 4,956 | 378 | 10.78 | 10.40 | 0.38 | Consumer | 285,759 | 256,380 | 29,379 | 5,731 | 23,648 |
| 12 | 31,933 | 779 | 8.06 | 7.65 | 0.41 |  | 1,311,717 | 1,215,911 | 95,806 | 52,353 | 43,453 |
| 02 | \$45,399 | \$ $(1,497)$ | 7.34\% | 6.91\% | 0.43\% | Total earning assets | \$1,603,702 | \$1,562,273 | \$ 41,429 | \$ 55,501 | \$(14,072) |
|  |  |  |  |  |  | Interest bearing deposits: |  |  |  |  |  |
| 282 | \$ 3,841 | \$ 441 | 2.57\% | 1.84\% | 0.73\% | NOW and money market* | \$ 54,655 | \$ 35,076 | \$ 19,579 | \$ 13,075 | \$ 6,504 |
| 770 | 5,447 | 323 | 1.98 | 1.31 | 0.67 | Savings | 56,576 | 35,476 | 21,100 | 2,635 | 18,465 |
| 550 | 9,578 | 972 | 4.68 | 4.00 | 0.68 | Time deposits | 244,601 | 189,820 | 54,781 | 32,275 | 22,506 |
| 502 | 18,866 | 1,736 | 3.48 | 2.78 | 0.70 |  | 355,832 | 260,372 | 95,460 | 47,985 | 47,475 |
| 522 | 11,226 | $(1,704)$ | 5.17 | 4.52 | 0.65 | Short-term borrowings | 244,275 | 251,877 | $(7,602)$ | 42,746 | $(50,348)$ |
| 418 | 10,311 | $(1,893)$ | 5.55 | 5.21 | 0.34 | Medium and long-term debt | 232,000 | 266,455 | $(34,455)$ | ,069 | (4,524) |



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## NON-INTEREST INCOME

Refer to Table D for a breakdown of non-interest income by major categories for the quarters and six months ended June 30, 2007 and 2006.
TABLE D
Non-Interest Income

| (In thousands) | Quarter ended June 30, |  |  |  |  |  | Six months ended June 30, |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2007 |  |  | 2006 | \$ Variance |  | 2007 |  | 2006 |  | \$ Variance |  |
| Service charges on deposit accounts | \$ | 48,392 | \$ | 47,324 | \$ | 1,068 | \$ | 96,863 | \$ | 94,793 | \$ | 2,070 |
| Other service fees: |  |  |  |  |  |  |  |  |  |  |  |  |
| Credit card fees and discounts | \$ | 24,999 | \$ | 22,371 | \$ | 2,628 | \$ | 48,523 | \$ | 44,944 | \$ | 3,579 |
| Debit card fees |  | 16,855 |  | 15,085 |  | 1,770 |  | 32,956 |  | 30,004 |  | 2,952 |
| Insurance fees |  | 14,720 |  | 14,411 |  | 309 |  | 27,669 |  | 26,552 |  | 1,117 |
| Processing fees |  | 11,677 |  | 10,939 |  | 738 |  | 23,789 |  | 21,218 |  | 2,571 |
| Sale and administration of investment products |  | 7,311 |  | 6,649 |  | 662 |  | 14,571 |  | 14,106 |  | 465 |
| Mortgage servicing fees, net of amortization and fair |  |  |  |  |  |  |  |  |  |  |  |  |
| value adjustments |  | 4,641 |  | (919) |  | 5,560 |  | 10,869 |  | (667) |  | 11,536 |
| Trust fees |  | 2,530 |  | 2,313 |  | 217 |  | 4,926 |  | 4,644 |  | 282 |
| Other fees |  | 6,857 |  | 9,168 |  | $(2,311)$ |  | 14,136 |  | 19,562 |  | $(5,426)$ |
| Total other service fees | \$ | 89,590 | \$ | 80,017 | \$ | 9,573 |  | 177,439 |  | 160,363 |  | 17,076 |
| Net gain (loss) on sale and valuation adjustment of |  |  |  |  |  |  |  |  |  |  |  |  |
| Trading account profit (loss) |  | 10,377 |  | 1,830 |  | 8,547 |  | $(3,787)$ |  | 13,305 |  | $(17,092)$ |
| Gain on sale of loans and valuation adjustments on loans |  |  |  |  |  |  |  |  |  |  |  |  |
| held-for-sale |  | 28,294 |  | 29,054 |  | (760) |  | 31,728 |  | 76,315 |  | $(44,587)$ |
| Other operating income |  | 25,547 |  | 40,185 |  | $(14,638)$ |  | 70,362 |  | 70,127 |  | 235 |
| Total non-interest income |  | 203,375 |  | 183,986 |  | 19,389 |  | 455,551 |  | 412,819 |  | 42,732 |

The increase in non-interest income for the quarter and six months ended June 30, 2007, compared with the same periods in the previous year, was mostly impacted by:

Higher other service fees which are detailed by category in Table D above.
o The favorable variance in mortgage servicing fee income was related to higher servicing fees due to growth in the portfolio of loans serviced for others which rose by approximately $\$ 4.4$ billion from June 30, 2006 to the same date in 2007, and higher late payment fees derived from the serviced portfolio. Also, the positive variance was impacted in part by the adoption of SFAS No. 156 in 2007, which eliminated the monthly amortization of the mortgage servicing rights. As indicated in the Recent Accounting Pronouncements and Interpretations section of this MD\&A, the Corporation elected the fair value measurement to account for residential mortgage servicing rights. The residential mortgage servicing rights are no longer amortized in proportion to and over the period of estimated net servicing income. Refer to Note 7 to the consolidated financial statements for detailed information on the adoption of SFAS No. 156. Any fair value adjustment of MSRs is being recorded in other service fees in the consolidated statement of operations together with the loan servicing fees charged to third-parties on the serviced portfolio. These favorable variances were partially offset by lower prepayment penalty fees on loans serviced due to a slowdown in prepayments.
o The increases in credit and debit card fees were the result of higher volume of credit card accounts, increased transactional volume, and reward program membership fees, among others.

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o There were lower other fees primarily due to lower brokered loan fees related to support services provided to mortgage brokers on the origination of loans for their portfolios. These service fees were reduced as PFH discontinued the broker-origination channel as part of the Restructuring Plan.
Higher net gain on sale and valuation adjustments of investment securities, which is broken down as follows:

| (In thousands) | Quarter ended June 30, |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | \$ |  |  |  |  |  |  | \$ |
|  | 2007 | 2006 |  | Variance | 2007 | 2006 |  | Variance |
| Net gain on sale of investment securities | \$ 2,493 | \$ 579 | \$ | 1,914 | \$ 121,219 | \$ 14,853 | \$ | 106,366 |
| Valuation adjustments of investment securities | $(1,318)$ | $(15,003)$ |  | 13,685 | $(38,273)$ | $(16,937)$ | \$ | $(21,336)$ |
| Total | \$ 1,175 | \$ $(14,424)$ | \$ | 15,599 | \$ 82,946 | \$ $(2,084)$ | \$ | 85,030 |

The variances in the unfavorable valuation adjustments indicated in the table above were principally related to PFH s residual interests classified as available-for-sale as described in the Overview and Critical Accounting Policies / Estimates sections of this MD\&A.

The increase in the net gain on sale of investment securities for the six months ended June 30, 2007, compared to the same period in 2006, was principally due to a gain of approximately $\$ 118.7$ million on the sale of the Corporation s interest in TELPRI in the first quarter of 2007. The gains on sale of securities in 2006 were primarily associated with marketable equity securities.

The trading account profit (loss) category is broken down as follows:

| (In thousands) | Quarter ended June 30, |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | \$ |  |  |  |  | 2006 | Variance |  |
|  | 2007 | 2006 |  | ariance | 2007 |  |  |  |
| Mark-to-market of PFH s residual interests | \$ (835) | \$ (467) | \$ | (368) | \$ $(24,313)$ | \$ (72) | \$ | $(24,241)$ |
| Other trading account profit | 11,212 | 2,297 |  | 8,915 | 20,526 | 13,377 |  | 7,149 |
| Total | \$ 10,377 | \$ 1,830 | \$ | 8,547 | \$ $(3,787)$ | \$ 13,305 | \$ | $(17,092)$ |

Similar to PFH s residual interests classified as available-for-sale, the residual interests classified as trading securities were also unfavorably impacted by the unfavorable conditions in the subprime market, which heightened in the first quarter of 2007.

Higher other trading account profit in the second quarter and six months ended June 30, 2007 were mainly due to higher gains on mortgage-backed securities sold as a result of higher price margins in the Puerto Rico secondary mortgage market fostered by the changes that took place in the local mortgage banking industry and a steady demand from loan buyers. Furthermore, the variance in trading profits for the second quarter of 2007 compared with the same quarter in 2006 was associated with favorable mark-to-market adjustments in the valuation of mortgage-backed securities. The other trading account profits for the six months ended June 30, 2006 included $\$ 8.5$ million in trading profits associated with the pooling of approximately $\$ 464$ million in mortgage loans at Banco Popular de Puerto Rico into Fannie Mae mortgage-backed securities that were sold to investors during that first quarter of 2006.

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The category of gain on sales of loans and unfavorable valuation adjustments of loans held-for-sale is broken down as follows:

| (In thousands) | Quarter ended June 30, |  |  |  | Six months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2007 \$ |  |  |  | 2007 | 2006 | \$ |  |
|  | 2007 | 2006 |  | ariance |  |  |  | Variance |
| Gain on sales of loans | \$ 31,905 | \$ 29,054 | \$ | 2,851 | \$ 52,218 | \$ 76,315 | \$ | $(24,097)$ |
| Lower of cost or market valuation adjustment on |  |  |  |  |  |  |  |  |
| loans held-for-sale | $(3,611)$ |  |  | $(3,611)$ | $(20,490)$ |  |  | $(20,490)$ |
| Total | \$ 28,294 | \$ 29,054 | \$ | (760) | 31,728 | \$76,315 |  | $(44,587)$ |

The decrease in gain on sales of loans for the six-month period ended June 30, 2007 compared to the same period in 2006 was primarily related to PFH , which experienced a lower volume of loans originated and sold due to its exiting the wholesale subprime mortgage business. Furthermore, there were lower gains on the sale of

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Small Business Administration ( SBA ) loans by the Corporation s U.S. banking subsidiary during the six months ended June 30, 2007.
During the six months ended June 30, 2007, PFH completed one off-balance sheet mortgage loan securitization involving approximately $\$ 461$ million in loans with realized gains of approximately $\$ 13.5$ million. The mortgage loan portfolio that was securitized consisted principally of subprime mortgage loans originated by PFH in the latter part of 2006 and in 2007 by the business divisions that were shut down as part of the Restructuring Plan. The Corporation recorded $\$ 8$ million in mortgage servicing rights and $\$ 4.7$ million in interest-only residuals associated with this securitization transaction. During the six months ended June 30, 2006, PFH completed two off-balance sheet mortgage loan securitizations involving approximately $\$ 652$ million in loans, in which the Corporation realized approximately $\$ 11.5$ million in gains in connection with these transactions.
The unfavorable valuation adjustment of mortgage loans held-for-sale indicated in the table above resulted principally from deterioration in the U.S. subprime market experienced in the first quarter of 2007. These loans were securitized by PFH mostly in the second quarter of 2007.

Lower other operating income in the second quarter of 2007, when compared to the same quarter of 2006, was the result of a decline in dividend income from TELPRI. As indicated previously, the Corporation sold its interest in TELPRI in the first quarter of 2007. The dividend income recorded in 2006 was primarily associated with a special dividend resulting from the sale by TELPRI of certain of its operations in 2006.

## OPERATING EXPENSES

Refer to Table E for a breakdown of operating expenses by major categories. Also, this table identifies the categories of the statement of income impacted by the restructuring costs related to Popular North America reportable segment. These costs are segregated to ease the financial comparison analysis.
TABLE E
Operating Expenses

| (In thousands) | Six months ended June |  |  |  |  |  |  | Six months ended June 30, 2007 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | \$ |  | 30, Restructuring |  | Costs |  |  |  | \$ |
|  | 2007 | 2006 | Variance |  | 2007 |  | ( RC | ) RC | 2006 |  | Variance |
| Personnel costs | \$ 164,288 | \$ 166,483 | \$ $(2,195)$ | \$ | 342,663 | \$ | 8,124 | \$ 334,539 | 344,535 | \$ | $(9,996)$ |
| Net occupancy expenses | 26,501 | 28,629 | $(2,128)$ |  | 58,515 |  | 4,413 | 54,102 | 57,267 |  | $(3,165)$ |
| Equipment expenses | 32,245 | 33,973 | $(1,728)$ |  | 64,641 |  | 281 | 64,360 | 67,170 |  | $(2,810)$ |
| Other taxes | 11,835 | 10,929 | 906 |  | 23,682 |  |  | 23,682 | 21,170 |  | 2,512 |
| Professional fees | 38,642 | 38,488 | 154 |  | 74,629 |  | 1,762 | 72,867 | 75,566 |  | $(2,699)$ |
| Communications | 16,973 | 17,293 | (320) |  | 34,035 |  | 67 | 33,968 | 34,593 |  | (625) |
| Business promotion | 30,369 | 31,991 | $(1,622)$ |  | 58,741 |  |  | 58,741 | 64,814 |  | $(6,073)$ |
| Printing and supplies | 4,549 | 4,291 | 258 |  | 8,825 |  |  | 8,825 | 8,923 |  | (98) |
| Other operating expenses | 32,838 | 28,072 | 4,766 |  | 64,854 |  | 269 | 64,585 | 56,903 |  | 7,682 |
| Impact of change in fiscal period of certain |  |  |  |  |  |  |  |  | 9,741 |  | $(9,741)$ |

subsidiaries
Amortization of intangibles

Total $\$ 361,053 \quad \$ 362,980 \quad \$(1,927) \quad \$ 736,381 \quad \$ 14,916 \quad \$ 721,465 \quad \$ 746,234 \quad \$(24,769)$

There were no significant restructuring costs incurred in the second quarter of 2007; as such, the breakdown is not included in Table E.
Isolating the severance costs associated with the Restructuring Plan (refer to the Restructuring Plan section later in this MD\&A for details), the reduction in personnel costs for the quarter ended June 30, 2007, compared with the same quarter in the previous year, was impacted by a decline in Popular North America s reportable segment of $\$ 8.5$ million, primarily due to lower headcount in PFH s operations. This reduction was offset in part by the impact of

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merit increases across the Corporation s subsidiaries which, for the most part, took place during the second quarter for exempt employees, and by new hires required to support initiatives for new products and services. Full-time equivalent employees (FTEs) were 12,158 at June 30, 2007, a decrease of 670 from the same date in 2006, primarily as a result of PFH exiting the wholesale subprime mortgage business. Popular North America s reportable segment experienced a decline of $\$ 10.0$ million in personnel costs for the six months ended June 30, 2007 when compared to the same period in 2006.
The reduction in net occupancy expenses for the quarter ended June 30, 2007, when compared to the same quarter in the previous year, was the result of lower lease rentals due to certain lease contract terminations, including closing certain PFH s offices and lower building demolition costs, among various factors. The decrease in equipment expenses was due to lower equipment depreciation, maintenance and repair expenses, as well as lower equipment requirement due to the streamlining of PFH s operations. The reduction in business promotion resulted primarily from cost control measures on marketing expenditures on the U.S. mainland operations and lower sponsorship expenses, partially offset by higher reward program expenses. Similar factors influenced the variance in those operating expense categories for the six months ended June 30, 2007, isolating the restructuring costs, compared to the same period in 2006. Also, the decrease in professional fees for the six-month period of 2007, excluding the restructuring costs, included lower legal fees, temporary services, and title, appraisal and recording fees associated with the loan business, among others, partially offset by higher business strategy consulting and computer service fees.
Table A presents the Corporation s efficiency ratio for the quarters and six months ended June 30, 2007 and 2006. The efficiency ratio measures how much of a company $s$ revenue is used to pay operating expenses. As stated in the Glossary of Selected Financial Terms included in the 2006 Annual Report, in determining the efficiency ratio the Corporation includes recurring non-interest income items, thus isolating income items that may be considered volatile in nature. Management believes that the exclusion of those items would permit greater comparability for analytical purposes. Amounts within non-interest income not considered recurring in nature by the Corporation amounted to $\$ 1.2$ million in the quarter ended June 30, 2007, compared with (\$14.4) million in the same quarter of the previous year. These amounts corresponded principally to net gains on sale and valuation adjustments of investment securities available-for-sale.

## INCOME TAX

Income tax expense for the quarter ended June 30, 2007 amounted to $\$ 23.6$ million, compared with $\$ 22.3$ million in the same quarter of 2006. The increase was primarily due to lower exempt interest income net of disallowance of expenses attributed to such exempt income and to the reversal of several tax positions during 2006 upon the completion of various federal and Puerto Rico tax audits. These variances were partially offset by lower pre-tax earnings and higher capital gain income subject to a preferential tax rate. Also, the income tax expense for the quarter ended June 30, 2007 was impacted by a lower statutory tax rate in the Puerto Rico operations as indicated in the Net Interest Income section of this MD\&A. The effective tax rate for second quarter of 2007 was $23.96 \%$, compared with $18.64 \%$ for the second quarter of 2006.
Income tax expense for the six-month period ended June 30,2007 amounted to $\$ 40.5$ million, compared with $\$ 60.2$ million reported for the same period in 2006. The decrease was primarily due to lower pre-tax earnings and to higher capital gains subject to a preferential tax rate. On the other hand, these decreases were partially offset by lower exempt interest income net of disallowance of expenses attributed to such exempt income. The effective tax rate for the six-month period ended June 30, 2007 was $17.29 \%$, compared with $21.81 \%$ for the same period in 2006.

## REPORTABLE SEGMENT RESULTS

The Corporation s reportable segments for managerial reporting purposes consist of Banco Popular de Puerto Rico, Popular North America and EVERTEC. Also, a Corporate group has been defined to support the reportable segments. For managerial reporting purposes, the costs incurred by this latter group are not allocated to the three reportable segments.
As described below in the Restructuring Plan section of this MD\&A, during the first quarter of 2007, the

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Corporation reorganized the legal structure of its U.S. operations taking into account the changes and expectations of PFH s restructuring and integration plan. These changes also impacted the Corporation s determination of reportable segments for managerial reporting purposes. Commencing in the first quarter of 2007, the U.S. operations were combined into a single reportable segment defined as Popular North America. This segment includes the operations of BPNA, including its wholly-owned subsidiary E-LOAN (legally transferred from PFH to BPNA in January 2007), and Popular Financial Holdings. For a description of the Corporation s reportable segments, including additional financial information and the underlying management accounting process, refer to Note 21 to the consolidated financial statements. Financial information for periods prior to 2007 was restated to conform to the 2007 presentation. The Corporate group had a net loss of $\$ 13.0$ million in the second quarter of 2007, compared with a net loss of $\$ 2.0$ million in the same quarter of 2006. During the second quarter of 2006, the Corporate group recorded $\$ 11.0$ million in dividend income from its investment in TELPRI, as indicated previously in this report. The Corporate group had net income of $\$ 75.5$ million for the six months ended June 30, 2007, compared to net losses of $\$ 2.3$ million in the same period of the previous year. During the six months ended June 30, 2007, the Corporate group realized net gains on the sale and valuation adjustment of investment securities approximating $\$ 108.1$ million, mainly due to a gain on the sale of TELPRI shares in the first quarter of 2007, compared with $\$ 14.2$ million in the same period of 2006. This favorable variance on the year-to-date results of the Corporate group was offset in part by a higher income tax expense in 2007, compared to tax benefits due to a taxable loss in 2006. Also, the TELPRI dividend income recorded in 2006 was mostly exempt income.
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 reported net income of $\$ 80.6$ million for the quarter ended June 30,2007 , a decrease of $\$ 9.7$ million, or $11 \%$, when compared with the same quarter in the previous year. The main factors that contributed to the variance in results for the quarter ended June 30, 2007, when compared to the second quarter of 2006 , included:
higher net interest income by $\$ 8.7$ million, or $4 \%$, primarily related to the commercial banking business;
higher provision for loan losses by $\$ 29.8$ million, or $89 \%$, primarily associated with higher net charge-offs mainly in the consumer and commercial loan portfolios. The ratio of allowance for loan losses to loans held-in-portfolio for the Banco Popular de Puerto Rico reportable segment was $2.17 \%$ at June 30, 2007, compared with $2.01 \%$ at June 30, 2006 and $2.09 \%$ at December 31, 2006. The provision for loan losses represented $130 \%$ of net charge-offs for the second quarter of 2007, compared with $139 \%$ of net charge-offs in the same period of 2006. The provision for the second quarter of 2007 considers deterioration in the loan portfolio in Puerto Rico due to the slowdown in the local economy;
higher non-interest income by $\$ 23.5$ million, or $23 \%$, mainly due to higher trading account profits, higher gain on sale of securities and higher other service fees, principally net mortgage servicing fees, credit card fees and fees on the sale and administration of investment products;
higher operating expenses by $\$ 9.2$ million, or $5 \%$, primarily associated with higher personnel costs due in part to higher commissions, salaries due to annual merit increases, and deferred compensation, among others; also, there were higher professional fees, other operating taxes, business promotion and other operating expenses, partially offset by lower net occupancy expenses; and
higher income taxes by $\$ 2.8$ million, or $11 \%$, primarily due to lower exempt interest income net of disallowance of expenses attributed to such exempt income, and by the reversal of several tax positions during 2006 upon the completion of various Puerto Rico tax audits, partially offset by lower pre-tax earnings and a lower statutory tax rate.
Net income for the six months ended June 30, 2007 totaled $\$ 166.9$ million, a decrease of $\$ 23.5$ million, or $12 \%$, compared with the same period in the previous year. These results reflected:
higher net interest income by $\$ 14.6$ million, or 3\%;
higher provision for loan losses by $\$ 53.0$ million, or $92 \%$;
higher non-interest income by $\$ 25.1$ million, or $12 \%$;
higher operating expenses by $\$ 15.6$ million, or $4 \%$; and
lower income tax expense by $\$ 5.3$ million.

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## EVERTEC

EVERTEC s net income for the quarter ended June 30, 2007 totaled $\$ 6.6$ million, an increase of $\$ 1.2$ million, or $21 \%$, compared with the results of the same quarter in the previous year.
The principal factors that contributed to the variance in results for the quarter ended June 30, 2007, when compared with the second quarter of 2006, included:
higher net interest income by $\$ 0.4$ million, or $63 \%$;
higher non-interest income of $\$ 2.7$ million, or $5 \%$, as a result of higher electronic transactions processing fees related to the automated teller machine network. Also, the positive variance was due to business expansion, particularly in payment processing, cash processing, workforce management, and IT consulting services;
higher operating expenses by $\$ 1.7$ million, or $4 \%$, primarily personnel costs in part due to additional headcount resulting from various small-scale acquisitions during 2006 and 2007 and impact of merit increases, among other factors. Also, there were higher other operating expenses, mainly due to sundry losses related to certain receivables, offset in part by lower net occupancy expenses; and
higher income tax expense by $\$ 0.3$ million primarily due to higher taxable income, offset in part by the reduction in the tax rate from $41.5 \%$ in 2006 to $39 \%$ in 2007.
Net income for the six months ended June 30, 2007 totaled $\$ 13.8$ million, compared with net income of $\$ 10.5$ million for the same period in the previous year. These results reflected:
higher non-interest income by $\$ 7.4$ million, or $7 \%$; and
higher operating expenses by $\$ 3.2$ million, or $3 \%$.

## Popular North America

For the quarter ended June 30, 2007, net income for the reportable segment of Popular North America totaled $\$ 0.9$ million, compared to net income of $\$ 3.8$ million for the second quarter of 2006. The main factors that contributed to this quarterly variance included:
lower net interest income by $\$ 8.9$ million, or $6 \%$, mainly due to higher costs of funds, principally savings and time deposits and short-term debt, partially offset by higher loan yields;
higher provision for loan losses by $\$ 18.3$ million, of $55 \%$, primarily due to higher net charge-offs in the mortgage and consumer loan portfolios, especially in the subprime market;
higher non-interest income by $\$ 10.6$ million, or $23 \%$, which includes the impact of lower unfavorable valuation adjustments of residual interests held by PFH in 2007 compared to 2006 by $\$ 13.3$ million, and higher service charges on deposit accounts; partially offset by lower gains on the sale of loans and other operating income;
lower operating expenses by $\$ 11.7$ million, or $8 \%$, mainly due to lower personnel costs due to the reduction in headcount at PFH and lower business promotion expenses, partially offset by higher professional fees, mainly consulting fees, and lower net occupancy and equipment expenses; and
lower income tax expense by $\$ 2.1$ million mainly due to lower taxable income.
Net losses for the six months ended June 30, 2007 totaled $\$ 63.0$ million, compared with net income of $\$ 18.5$ million in the same period of the previous year. These results reflected:
lower net interest income by $\$ 20.0$ million, or $7 \%$;
higher provision for loan losses by $\$ 42.4$ million, or $72 \%$;
lower non-interest income by $\$ 81.9$ million, or $68 \%$, which includes the impact of the unfavorable valuation adjustments of residual interests held by PFH , the unfavorable valuation adjustment in the value of mortgage
loans held-for-sale, and lower gains on the sale of loans. These are generally described in the Non-Interest section of this MD\&A. The unfavorable valuation adjustments of residual interests amounted to $\$ 55.0$ million in the six-month period ended June 30, 2007, compared with $\$ 17.0$ million in the same period of 2006;
lower operating expenses by $\$ 16.8$ million, or $5 \%$; mainly due to last year s recognition of PFH s subsidiaries impact of change in fiscal period which amounted to $\$ 6.2$ million (increased operating expenses for 2006), lower business promotion expenses and lower personnel costs due to reduction in headcount. The

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latter was partially offset by the impact of the severance costs associated with the restructuring of PFH and the impact of additional personnel for units that support new products and services. Furthermore, there were higher net occupancy expenses, outplacement costs and consulting services also related with the Restructuring Plan;
and
income tax benefit of $\$ 34.3$ million for the six-month period ended June 30, 2007, compared with income tax expense of $\$ 11.7$ million in the same period in 2006.

## RESTRUCTURING PLAN

As indicated in the 2006 Annual Report, in January 2007, the Corporation announced the Restructuring Plan of PFH s businesses. Since PFH s performance was poor in 2006, origination volumes had dropped, net interest margin narrowed and the expense base was unsustainable, management initiated the restructuring actions. The Restructuring Plan, which is being implemented throughout 2007, has the following four basic components:
exiting the wholesale subprime mortgage origination business during the first quarter of 2007, which entailed shutting down the wholesale broker, retail and call center business divisions;
consolidating support activities at PFH (Finance, Credit Risk, Compliance, Human Resources, Facilities) within BPNA to reduce expenses;
integrating PFH s existing commercial lending businesses (mortgage warehouse and mixed use) into BPNA s business lending groups; and
focusing on the core Equity One network of 132 consumer finance branches in 15 states. As part of the Restructuring Plan, the Corporation also executed an internal corporate reorganization of its U.S. subsidiaries. In January 2007, E-LOAN, as well as all of its direct and indirect subsidiaries, with the exception of E-LOAN Insurance Services, Inc. and E-LOAN International, Inc., became operating subsidiaries of BPNA. Prior to the consummation of this U.S. reorganization, E-LOAN was a direct wholly-owned subsidiary of PFH. E-LOAN continues to offer its broad range of products and conducts its direct activities through its online platform. Management will be leveraging the E-LOAN brand, technology and internet financial services platform over the next several years to complement BPNA s community banking growth strategy.
This reorganization and the Restructuring Plan led management to redefine its business reportable segments.
Commencing in 2007, the U.S. operations are combined into a single reportable segment defined as Popular North America . This segment includes the operations of BPNA and PFH, including all of its wholly-owned subsidiaries. For the six-month period ended June 30, 2007, the Corporation recorded pre-tax restructuring charges in the Popular North America segment related to the Restructuring Plan as follows:

|  | Six months <br> ended |
| :--- | ---: | ---: |
| (In thousands) | June 30,2007 |
| Severance, stay bonuses and other benefits | $\$ 8,124$ |
| Outplacement costs | 1,019 |
| Lease terminations | 4,413 |
| Others | 1,360 |
| Total restructuring costs | $\$ 14,916$ |

There were no significant charges related to the Restructuring Plan recorded in the second quarter of 2007. The above restructuring costs were recorded substantially in the first quarter of 2007. Refer to the Operating Expenses section of this MD\&A for the classification of these charges in the consolidated statement of income. Of the above restructuring costs, approximately $\$ 5.5$ million were recognized as a liability as of June 30 , 2007, and are expected to be paid out
with operating cash flows. These costs correspond primarily to lease terminations and severance payments. During the fourth quarter of 2006, and as a result of the Restructuring Plan, the Corporation recognized impairment charges on long-lived assets of $\$ 7.2$ million, mainly associated with software and leasehold improvements, and impairment in goodwill of $\$ 14.2$ million.

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As of June 30, 2007, it is anticipated that the Restructuring Plan will result in the estimated combined charges presented in the table below.

| (In thousands) | Impairments on goodwill and longlived assets | Restructuring costs | Total |
| :---: | :---: | :---: | :---: |
| Quarter ended: |  |  |  |
| December 31, 2006 | \$ 21,471 |  | \$21,471 |
| March 31, 2007 |  | \$15,135 | 15,135 |
| June 30, 2007 |  | (219) | (219) |
| Total | \$ 21,471 | \$ 14,916 | \$36,387 |

The Corporation does not expect to incur additional significant restructuring costs in the remaining quarters of 2007. Settlement amounts in lease terminations may differ and are subject to the outcome of negotiations.
It is anticipated that the cost reduction initiatives resulting from the Restructuring Plan will result in an expense reduction of approximately $\$ 39$ million on an annualized basis, related to approximately $\$ 34$ million in salary and benefits, $\$ 3$ million in net occupancy expenses and $\$ 2$ million in equipment expenses.
The Corporation exited PFH s wholesale broker, retail mortgage and call center origination channels during the first quarter of 2007. In addition, the Corporation had previously exited PFH s asset acquisition channel in early 2006.
Certain mortgage loan assets originated through these channels are expected to run-off over a time period which may average between 18 to 30 months.
PFH has conducted mortgage loan securitizations since 1997. Securitizations conducted prior to 2001 and certain securitizations conducted during 2005, 2006 and 2007 qualified for sale accounting under the provisions of SFAS No. 140. Accordingly, the loans sold in these off-balance sheet securitizations are not consolidated in the Corporation s financial statements. The unpaid principal balances ( UPB ) of the sold loans amounted to $\$ 2.5$ billion at June 30, 2007. The outstanding balance of residual interests ("IOs") and MSRs related to these off-balance sheet securitizations was $\$ 36$ million and $\$ 33$ million, respectively, at June 30, 2007. As previously mentioned, during the six months ended June 30, 2007, the Corporation recognized other-than-temporary impairments amounting to $\$ 55.0$ million related to these residual interests.
The business channels exited also originated mortgage loans, which were used by PFH in conducting asset securitizations that did not meet the sale criteria under SFAS No. 140; accordingly, the transactions were treated as on-balance sheet securitizations for accounting purposes. The outstanding balance of owned-in-trust loans, which are part of PFH s portfolio, is presented in the table below and in Table F under the column Owned-in-Trust . The table below also presents the excess of trust assets over securitized debt in the form of bond certificates due to investors, as well as the related unamortized net premiums/FAS 91 on loans and the allowance for loan losses attributable to the owned-in-trust portfolio.

|  | June 30, <br> (In millions) | March 31, <br> 2007 | December 31, <br> 2006 |
| :--- | ---: | ---: | ---: | ---: |
| Loans | $\$ 3,947$ | $\$ 4,240$ | $\$ 4,543$ |
| Other real estate | 83 | 63 | 59 |
| Securitization advances | 37 | 43 | 56 |
| Delinquency advances | 11 | 11 | 9 |
| Escrow advances | 17 | 18 | 17 |

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| Total trust assets | 4,095 | 4,375 | 4,684 |
| :--- | :---: | :---: | :---: |
| Less: Balance of bond certificates | $(3,842)$ | $(4,106)$ | $(4,391)$ |
| Excess of trust assets ( overcollateralization ) | 253 | 269 | 293 |
| Unamortized net premiums and net deferred origination <br> fees/costs <br> Allowance for loan losses | 99 | 108 | 117 |
| Total exposure | $(67)$ | $(66)$ | $(55)$ |
|  | $\$ 285$ | $\$ 311$ | $\$$ |

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As of June 30, 2007, the exited lines of business also had outstanding $\$ 0.8$ billion in mortgage loans that were not sold / securitized, and are included in Table F under the column Owned . The remaining $\$ 1.3$ billion presented under this column in Table F is the outstanding balance of loans originated through the branch network and customer loan center. The allowance for loan losses related to these loans Owned amounted to approximately $\$ 24$ million as of June 30, 2007, $\$ 22$ million as of March 31, 2007 and $\$ 21$ million as of December 31, 2006.
Financial results for PFH s exited operations for the second quarter 2007 were an estimated loss of $\$ 13.6$ million, net of taxes. For the six-month period ended June 30, 2006 the net loss approximated $\$ 86.7$ million, net of taxes. The net loss considers the impairments in the valuation of the IOs taken during 2007, the restructuring charges previously mentioned and increased provisioning for loan losses as a result of the credit deterioration in the subprime market.
Table F
PFH Mortgage Loan Portfolio (excludes loans held-for-sale) Performance Trends

|  | Owned-in-Trust (a) |  |  | Owned (b) |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { June } 30, \\ 2007 \end{gathered}$ | $\begin{gathered} \text { March 31, } \\ 2007 \end{gathered}$ | December <br> 31, 2006 | $\begin{gathered} \text { June } 30, \\ 2007 \end{gathered}$ | $\begin{gathered} \text { March 31, } \\ 2007 \end{gathered}$ | $\begin{gathered} \text { December 31, } \\ 2006 \end{gathered}$ |
| Current Balance |  |  |  |  |  |  |
| Weighted-average coupon (WAC) | 7.56\% | 7.55\% | 7.55\% | 8.97\% | 9.04\% | 8.94\% |
| Avg. |  |  |  |  |  |  |
| Loan-to-Value (LTV) (d) | 83.93\% | 83.43\% | 83.39\% | 82.64\% | 74.75\% | 78.38\% |
| Avg. Loan |  |  |  |  |  |  |
| Balance (\$) \$ | \$ 138,658 | \$ 139,508 | \$ 139,942 | \$ 67,067 | \$ 64,913 | \$ 68,514 |
| Avg. FICO ${ }^{\circledR}$ (e) | 617 | 633 | 632 | 606 | 622 | 622 |
| Bankruptcy (\% of |  |  |  |  |  |  |
| Charge-offs |  |  |  |  |  |  |
| \%-quarter | 1.27\% | 1.01\% | 1.00\% | 1.40\% | 1.30\% | 1.08\% |
| Total Delinquency | 11.94\% | 10.57\% | 10.93\% | 10.21\% | 9.68\% | 8.67\% |
| 30 Days (\% of \$ ) | 3.09\% | 2.63\% | 3.48\% | 2.35\% | 2.63\% | 2.54\% |
| 60 Days (\% of \$ ) | 1.31\% | 1.13\% | 1.30\% | 1.14\% | 1.04\% | 0.89\% |
| 90+ Days (\% of \$ ) | 2.09\% | 1.94\% | 1.84\% | 2.91\% | 3.05\% | 2.48\% |
| Foreclosure (\% of |  |  |  |  |  |  |
| \$) | 5.45\% | 4.86\% | 4.31\% | 3.81\% | 2.96\% | 2.75\% |
| Business Channel |  |  |  |  |  |  |
| Broker | 16\% | 16\% | 17\% | 17\% | 18\% | 22\% |
| Asset Acquisition | 72\% | 72\% | 72\% | 15\% | 18\% | 17\% |
| Retail Mortgage |  |  |  |  |  |  |
| Customer Loan |  |  |  |  |  |  |
| Center ( CLC ) (f) | ) $5 \%$ | 4\% | 4\% | 7\% | 5\% | 6\% |
| Decentralized |  |  |  |  |  |  |
| (branches) |  |  |  | 53\% | 52\% | 47\% |
| Other | 1\% | $2 \%$ | 1\% | 4\% | 3\% | 3\% |
| Product Type |  |  |  |  |  |  |
| Fixed-rate | 63\% | 62\% | 60\% | 74\% | 73\% | 69\% |
|  | 26\% | 27\% | 29\% | 15\% | 15\% | 20\% |


| ARM (Adjustable <br> rate mortgage) <br> Balloon | $4 \%$ | $4 \%$ | $4 \%$ | $10 \%$ | $11 \%$ | $10 \%$ |
| :---: | :---: | :---: | :---: | :---: | :---: | ---: |
| Interest only | Fixed | $1 \%$ | $1 \%$ | $1 \%$ |  |  |
| Interest only | ARM | $6 \%$ | $6 \%$ | $6 \%$ | $1 \%$ | $1 \%$ |

(a) Owned-in-trust represents mortgage loans securitized in on-balance sheet securitizations, as such, are part of PFH s portfolio under SFAS No. 140.
(b) Owned portfolio represents mortgage loans originated / acquired, but not sold / securitized.
(c) Excluding
deferred fees, origination costs, net premiums and other items.
(d) LTV a lending risk ratio calculated by dividing the total amount of the mortgage or loan by the fair value of the property.
(e) $\mathrm{FICO}^{\circledR}$ the Corporation uses external credit scores as a useful measure for assessing the credit quality of a borrower.

These scores are
numbers
supplied by
credit
information
providers, based
on statistical
models that
summarize an
individual s
credit record.
$\mathrm{FICO}^{\circledR}$ scores, developed by
Fair Isaac
Corporation, are the most
commonly used credit scores.
(f) CLC unit that anticipates
possible
refinancing
needs of the customer and makes efforts to retain the customer by offering the company s products.

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## FINANCIAL CONDITION

Refer to the consolidated financial statements included in this Form 10-Q for the Corporation s consolidated statements of condition as of June 30, 2007, December 31, 2006 and June 30, 2006. Also, refer to Table A for financial highlights on major line items of the consolidated statement of condition.
When compared to December 31, 2006, total assets as of June 30, 2007 remained stable, reflecting a slight decrease of less than $1 \%$. When compared to June 30, 2006, total assets as of June 30, 2007 declined $3 \%$.
A breakdown at period-end of the Corporation s loan portfolio, its principal category of earning assets, is presented in Table G below.
TABLE G
Loans Ending Balances (including Loans Held-for-Sale)

|  |  |  | $\begin{gathered} \text { Variance } \\ \text { June 30, } 2007 \end{gathered}$ |  | $\begin{gathered} \text { Variance } \\ \text { June 30, } 2007 \end{gathered}$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | June 30, 2007 | December 31, 2006 | $\begin{gathered} \text { vs. } \\ \text { December 31, } \\ 2006 \end{gathered}$ | June 30, 2006 | vs. |
| Commercial * | \$15,145,422 | \$14,536,837 | \$ 608,585 | \$13,696,562 | \$ 1,448,860 |
| Lease financing | 1,184,560 | 1,226,490 | $(41,930)$ | 1,294,966 | $(110,406)$ |
| Mortgage ** | 11,008,524 | 11,695,156 | $(686,632)$ | 12,209,940 | $(1,201,416)$ |
| Consumer | 5,413,339 | 5,278,456 | 134,883 | 5,015,164 | 398,175 |
| Total | \$32,751,845 | \$32,736,939 | \$ 14,906 | \$32,216,632 | \$ 535,213 |

* Includes
commercial
construction
** Includes
residential
construction
The increase in commercial loans from December 31, 2006 to June 30, 2007 was principally in commercial mortgage, construction and SBA loans. The increase in commercial loans from June 30, 2006 to June 30, 2007 also reflected growth in those areas. Commercial construction loans, which are included within the commercial category in Table G, amounted to $\$ 1.6$ billion at June 30, 2007, compared with $\$ 1.4$ billion at December 31, 2006 and $\$ 1.2$ billion at June 30, 2006.
The decline in mortgage loans from December 31, 2006 to June 30, 2007 was mostly due to the off-balance sheet securitization completed by PFH in the second quarter of 2007 as described in the Non-Interest Income section of this MD\&A, which involved approximately $\$ 461$ million in unpaid principal balance of subprime mortgage loans. Also, the reduction was in part due to lower origination volume resulting from exiting certain business channels of the PFH operations, as described in the Restructuring Plan and Overview of Mortgage Loan Exposure at PFH sections of this MD\&A, offset in part by successful loan origination business strategies by the banking subsidiary in the U.S. mainland, which targets principally the Hispanic market at attractive loan yields. The decline in mortgage loans from June 30, 2006 to the same date in 2007 was in part due to certain large transactions disclosed in the 2006 Annual Report that took place during that year, which involved bulk sales of mortgage loans, off-balance sheet securitizations of subprime mortgage loans, and pooling of loans and sales of the newly-issued FNMA securities. These sales and securitizations were part of the Corporation strategy to deleverage its balance sheet and reduce low-yielding assets.


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A breakdown of the consumer loan portfolio is presented in Table H .
TABLE H
Breakdown of Consumer Loans
$\left.\begin{array}{lccccc} & & \text { Variance } & & \begin{array}{c}\text { Variance } \\ \text { June 30, }\end{array} \\ \text { 2007 }\end{array}\right]$

The increase in personal loans from December 31, 2006 to June 30, 2007 was principally attributed to higher volume of home equity lines of credit in the Popular North America operations. The increase from June 30, 2006 to the same date in 2007 was also attributed to higher volume of home equity lines after a strategic decision was made in mid-2006 to substantially retain those loans in portfolio, and to a growth in personal loans at BPPR which was associated with favorable customer response to mailing campaigns and cross-selling initiatives. The reduction in auto loans from December 31, 2006 and June 30, 2006 to June 30, 2007 was twofold. First, there was a decline in the auto loan portfolio of the Popular North America reportable segment as BPNA s auto loan portfolio continues to runoff because of management $s$ decision to cease auto loan originations through dealer channels and instead focusing on originating auto loans through the E-LOAN channel. Second, the economic slowdown in the Puerto Rico market has reduced automobile sales.
Investment and trading securities totaled $\$ 10.2$ billion at June 30, 2007, compared with $\$ 10.6$ billion at December 31, 2006 and $\$ 12.0$ billion at June 30, 2006. The decline in the Corporation s investment securities portfolio from June 30, 2006 was mainly due to maturities of agency securities with low rates which were not replaced because the interest spread was not favorable and as part of the Corporation s deleveraging strategy. Notes 5 and 6 to the consolidated financial statements provide additional information of the Corporation s available-for-sale and held-to-maturity investment portfolios.
Refer to Note 10 of the consolidated financial statements for details on the composition of intangible assets.
Table I provides a breakdown of the Other Assets caption presented in the consolidated statements of condition.
TABLE I
Breakdown of Other Assets


Bank-owned life insurance program

| Servicing rights | 201,861 | 164,999 | 36,862 | 159,486 | 42,375 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Prepaid expenses | 200,307 | 168,717 | 31,590 | 176,003 | 24,304 |
| Securitization advances and | 106,123 | 181,387 | $(75,264)$ | 251,482 | $(145,359)$ |
| related assets |  |  |  |  |  |
| Investments under the equity | 82,620 | 66,794 | 15,826 | 63,550 | 19,070 |
| method | 77,484 | 55,413 | 22,071 | 79,925 | $(2,441)$ |
| Derivative assets | 201,122 | 408,816 | $(207,694)$ | 206,875 | $(5,753)$ |
| Others |  |  |  | $(\$ 16,221)$ |  |

Explanations for the principal variances from December 31, 2006 to June 30, 2007 were:
Increase in net deferred tax assets was mainly associated with higher unrealized losses on securities available-for-sale, the increase in the allowance for loan losses,

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the residual interests recognized on the off-balance sheet securitization, and the increase in net operating loss carryforward.
Increase in servicing rights was mainly due to purchased mortgage servicing rights in the Popular North America reportable segment resulting from new servicing contracts, mortgage servicing rights derived from the off-balance sheet securitization executed by PFH in 2007, and from sales and securitizations of originated loans by the Puerto Rico operations. Also, the increase was due in part to the adoption of SFAS No. 156 during 2007, in which the Corporation elected to account for residential mortgage servicing rights at fair value. Notes 2 and 7 provide further information on the implementation impact of this accounting pronouncement.

Increase in prepaid expenses was mostly due to the payment during the second quarter of 2007 of the municipal license and corporate property taxes.

Refer to Note 9 to the consolidated financial statements for a detail of the Corporation s derivatives as of June 30, 2007 and December 31, 2006.

The decrease in securitization advances and related assets was primarily associated to PFH s on-balance sheet securitization performed in December 2006, which required a pre-funded amount of $\$ 66$ million to be held in trust. As disclosed in the 2006 Annual Report, this pre-funded amount was classified as an other asset in the consolidated statement of condition. In early 2007, PFH delivered additional loans to the securitization trust and received back the pre-funded amount.

Decrease in the others caption was mainly due to lower trade receivables. At June 30, 2007 and December 31, 2006, there were securities trade receivables of $\$ 12$ million and $\$ 232$ million, respectively, for mortgage-backed securities sold prior to quarter and year-end, with a settlement date in July 2007 and January 2007, respectively.
Principal variances in other assets from June 30, 2006 to the same date in 2007 were mostly due to similar factors as described above. In addition, the decrease in securitization advances and related assets from June 30, 2006 was also associated with PFH s collection during the third quarter of 2006 of excess cash held by the securitization trusts of approximately $\$ 69$ million.
A breakdown of the Corporation s deposits at period-end is included in Table J:

## TABLE J

Deposits Ending Balances

| (In thousands) | June 30, | December 31, | Variance <br> June 30, 2007 |  | Variance <br> June 30, 2007 |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | vs. | June 30, | vs. |
|  | 2007 | 2006 | 2006 | 2006 | June 30, 2006 |
| Demand deposits* | \$ 4,977,827 | \$ 4,910,848 | \$ 66,979 | \$ 4,940,362 | \$ 37,465 |
| Savings, NOW and money |  |  |  |  |  |
| market deposits | 9,477,737 | 9,200,732 | 277,005 | 8,644,295 | 833,442 |
| Time deposits | 10,930,431 | 10,326,751 | 603,680 | 9,864,863 | 1,065,568 |
| Total | \$25,385,995 | \$24,438,331 | \$ 947,664 | \$23,449,520 | \$ 1,936,475 |

[^0]deposits.
Deposit growth since December 31, 2006 was influenced in part by competitive rate campaigns in Puerto Rico focused on retail certificates of deposit to individuals. Furthermore, there was additional volume of public funds gathered from successful biding processes with competitive rates and strong sales efforts. Also, the increase in deposits was the result of money market campaigns in the U.S. operations during 2007. The increase in deposits from June 30, 2006 was also influenced by deposits captured through the online webpage of E-LOAN. The latter approximated $\$ 1.5$ billion at June 30, 2007. Brokered certificates of deposit, included in the category of time deposits, totaled $\$ 638$ million at June 30, 2007, compared with $\$ 866$ million at December 31, 2006 and $\$ 1.1$ billion at June 30, 2006.The aggregate amount of overdrafts in demand deposit accounts that were reclassified to loans was $\$ 115$ million as of June 30, 2007, \$136 million as of December 31, 2006 and $\$ 96$ million as of June 30, 2006.
At June 30, 2007, borrowed funds totaled $\$ 17.1$ billion, compared with $\$ 18.5$ billion at December 31, 2006 and $\$ 20.8$ billion at June 30, 2006. Refer to Note 11 to the consolidated financial statements for additional information on the Corporation s borrowings as of such dates.

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Refer to the consolidated statements of condition and of stockholders equity included in this Form 10-Q for information on the composition of stockholders equity at June 30, 2007, December 31, 2006 and June 30, 2006. Also, the disclosures of accumulated other comprehensive income (loss), an integral component of stockholders equity, are included in the consolidated statements of comprehensive income (loss).
The Corporation offers a dividend reinvestment and stock purchase plan for stockholders that allows them to reinvest dividends in shares of common stock at a $5 \%$ discount from the average market price at the time of the issuance, as well as purchase shares of common stock directly from the Corporation by making optional cash payments. The Corporation continues to exceed the well-capitalized guidelines under the federal banking regulations. Ratios and amounts of total risk-based capital, Tier 1 risk-based capital and Tier 1 leverage at June 30, 2007, December 31, 2006, and June 30, 2006 are presented on Table K. As of such dates, BPPR, BPNA and Banco Popular, National Association were all well-capitalized.
The average tangible equity amounted to $\$ 3.1$ billion at June 30, 2007, $\$ 3.0$ billion at December 31, 2006, and $\$ 2.9$ billion at June 30, 2006. Total tangible equity was $\$ 2.9$ billion at June 30, 2007, $\$ 2.8$ billion at December 31, 2006, and $\$ 2.7$ billion at June 30, 2006.

## TABLE K

## Capital Adequacy Data


classification.
At June 30, 2007, the capital adequacy minimum requirement for Popular, Inc. was (in thousands): Total Capital of $\$ 2,829,731$, Tier I Capital
of $\$ 1,414,866$, and Tier I Leverage of $\$ 1,384,517$ based on a $3 \%$ ratio or $\$ 1,846,023$ based on a $4 \%$ ratio according to the Bank s classification.

## OFF-BALANCE SHEET SECURITIZATION ACTIVITIES

In connection with PFH s securitization transactions, the Corporation is a party to pooling and servicing agreements pursuant to each of which the Corporation transfers (on a servicing retained basis) certain of the Corporation s loans to a special purpose entity, which in turn transfers the loans to a securitization trust fund that has elected to be treated as one or more Real Estate Mortgage Investment Conduits ( REMICs ). The two-step transfer of loans by the Corporation to a securitization trust fund, in which the Company surrenders control over the loans, is accounted for as a sale to the extent that consideration other than beneficial interests is received in exchange. SFAS No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities sets forth the criteria that must be met for control over transferred assets to be considered to have been surrendered. When the Corporation transfers financial assets and the transfer fails any one of the SFAS No. 140 criteria, the Corporation is

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then prevented from derecognizing the transferred financial assets and the transaction is accounted for as a secured borrowing.
The trusts created as part of off-balance sheet mortgage loans securitizations, conducted prior to 2001, in 2005, 2006 and 2007, are not consolidated in the Corporation s financial statements since the transactions qualified for sale accounting based on the provisions of SFAS No. 140. The investors and the securitization trusts have no recourse to the Corporation s assets or revenues. The Corporation s creditors have no recourse to any assets or revenues of the special purpose entity or the securitization trust funds. At June 30, 2007 and 2006, these trusts held approximately $\$ 2.5$ billion and $\$ 2.4$ billion, respectively, in assets in the form of mortgage loans. Their liabilities in the form of debt principal due to investors approximated $\$ 2.3$ billion at June 30, 2007 and 2006. The Corporation retained servicing responsibilities and certain subordinated interests in these securitizations in the form of interest-only securities. Their value is subject to credit, prepayment and interest rate risks on the transferred financial assets. The servicing rights and interest-only securities retained by the Corporation are recorded in the statements of condition at fair value.

## CREDIT RISK MANAGEMENT AND LOAN QUALITY

Table L summarizes the movement in the allowance for loan losses and presents several loan loss statistics for the quarters and six months ended June 30, 2007 and 2006.
TABLE L
Allowance for Loan Losses and Selected Loan Losses Statistics

|  | Second Quarter |  |  | Six months ended June 30, |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| (Dollars in thousands) | 2007 | 2006 | Variance | 2007 | 2006 | Variance |
|  |  |  |  |  |  |  |
| Balance at beginning of period | $\$ 541,748$ | $\$ 468,321$ | $\$ 73,427$ | $\$ 522,232$ | $\$ 461,707$ | $\$ 0,525$ |
| Provision for loan losses | 115,167 | 67,096 | 48,071 | 211,513 | 116,043 | 95,470 |
| Impact of change in reporting period * |  |  |  |  | 2,510 | $(2,510)$ |
|  |  |  |  |  |  |  |
|  | 656,915 | 535,417 | 121,498 | 733,745 | 580,260 | 153,485 |
|  |  |  |  |  |  |  |
| Losses charged to the allowance: |  |  |  |  |  |  |
| Commercial | 21,532 | 12,972 | 8,560 | 38,860 | 25,425 | 13,435 |
| Lease financing | 6,200 | 7,007 | $(807)$ | 12,608 | 12,023 | 585 |
| Mortgage | 23,492 | 14,066 | 9,426 | 44,100 | 25,383 | 18,717 |
| Consumer | 55,481 | 33,047 | 22,434 | 102,688 | 64,279 | 38,409 |
|  |  |  |  |  |  |  |
| Subtotal | 106,705 | 67,092 | 39,613 | 198,256 | 127,110 | 71,146 |
|  |  |  |  |  |  |  |
| Recoveries: | 3,487 | 4,369 | $(882)$ | 6,969 | 8,728 | $(1,759)$ |
| Commercial | 2,510 | 2,287 | 223 | 4,508 | 6,073 | $(1,565)$ |
| Lease financing | 706 | 295 | 411 | 851 | 426 | 425 |
| Mortgage | 7,934 | 8,539 | $(605)$ | 17,030 | 15,438 | 1,592 |
| Consumer |  |  |  |  |  |  |
|  | 14,637 | 15,490 | $(853)$ | 29,358 | 30,665 | $(1,307)$ |
| Subtotal |  |  |  |  |  |  |
| Net loans charged-off: | 18,045 | 8,603 | 9,442 | 31,891 | 16,697 | 15,194 |
| Commercial | 3,690 | 4,720 | $(1,030)$ | 8,100 | 5,950 | 2,150 |
| Lease financing | 22,786 | 13,771 | 9,015 | 43,249 | 24,957 | 18,292 |
| Mortgage | 47,547 | 24,508 | 23,039 | 85,658 | 48,841 | 36,817 |
| Consumer |  |  |  |  |  |  |

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| Subtotal | 92,068 | 51,602 | 40,466 | 168,898 | 96,445 | 72,453 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Balance at end of period | $\$ 564,847$ | $\$ 483,815$ | $\$ 81,032$ | $\$ 564,847$ | $\$ 483,815$ | $\$ 81,032$ |

Ratios:
Net charge-offs to average loans held-in-portfolio
Provision to net charge-offs

| $1.16 \%$ | $0.66 \%$ | $1.06 \%$ | $0.62 \%$ |
| :--- | :--- | :--- | :--- |
| 1.25 x | 1.30 x | 1.25 x | 1.20 x |

* Represents the net effect of provision for loan losses, less net charge-offs corresponding to the impact of the change in fiscal period at certain
subsidiaries (as described in the Overview
section and in the 2006 Annual Report).


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Also, Table M presents annualized net charge-offs to average loans by loan category for the quarters and six-month period ended June 30, 2007 and 2006.
TABLE M
Annualized Net Charge-offs to Average Loans Held-in-Portfolio

|  | Quarter ended June 30, |  | Six months ended June 30, |  |
| :--- | :--- | :--- | :--- | :--- |
|  | 2007 | 2006 | 2007 | 2006 |
|  |  |  |  |  |
| Commercial | $0.49 \%$ | $0.26 \%$ | $0.43 \%$ | $0.25 \%$ |
| Lease financing | 1.24 | 1.45 | 1.35 | 0.91 |
| Mortgage | 0.87 | 0.48 | 0.80 | 0.42 |
| Consumer | 3.61 | 2.00 | 3.28 | 2.01 |
|  |  |  |  |  |
|  | $1.16 \%$ | $0.66 \%$ | $1.06 \%$ | $0.62 \%$ |

The increase in the ratio of commercial loans net charge-offs to average loans held-in-portfolio for the quarter and six-month period was mostly associated with deterioration in the economic conditions in Puerto Rico, triggered in part by the local government s budgetary imbalance, the new sales tax implemented at the end of 2006 and higher cost of living which has impacted consumer spending, and therefore has negatively impacted certain industries and commercial businesses.
The decrease in the charge-offs to average loans held-in-portfolio in the lease financing portfolio during the quarter resulted from a large amount of charge-offs in the U.S. leasing subsidiary during the second quarter of 2006 related to a particular customer lending relationship. The increase in net charge-offs to average loans held-in-portfolio in the lease financing portfolio during the six-month period was the result of higher delinquencies in Puerto Rico. Mortgage loans net charge-offs as a percentage of average mortgage loans held-in-portfolio increased primarily due to the slowdown in the housing sector and higher delinquency levels experienced in the U.S. mainland, primarily in the Corporation s subprime mortgage loan portfolio. This increase also reflects the impact of the reduction in the mortgage loan portfolio at PFH. Refer to the Overview of Mortgage Loan Exposure at PFH section in this MD\&A for information on PFH s mortgage loan portfolio, including credit statistics. Although deteriorating economic conditions have impacted the mortgage delinquency rates in Puerto Rico increasing the levels of non-accruing mortgage loans, no significant increase in losses has occurred. The mortgage loans net charge-off to average mortgage loans held-in-portfolio ratio in the Puerto Rico operations was $0.09 \%$ for the second quarter of 2007. Historically the Corporation has experienced a low level of losses in its P.R. mortgage loan portfolio.
Consumer loans net charge-offs as a percentage of average consumer loans held-in-portfolio rose primarily due to higher delinquencies in the Puerto Rico operations. This primarily reflects the impact of a slowdown in the Puerto Rico economy, triggered by the government fiscal crisis, higher oil prices and the new sales tax enacted in 2006.

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## NON-PERFORMING ASSETS

A summary of non-performing assets, which includes past-due loans that are no longer accruing interest, renegotiated loans and real estate property acquired through foreclosure, is presented in Table N , along with certain credit quality metrics. For a summary of the Corporation s policy for placing loans on non-accrual status, refer to the sections of Loans and Allowance for Loan Losses included in Note 1 to the audited consolidated financial statements included in Popular, Inc. s 2006 Annual Report.
TABLE N
Non-Performing Assets

|  |  |  |  | As a | $\begin{gathered} \text { \$ Variance } \\ \text { June } 30 \text {, } \\ 2007 \end{gathered}$ |  |  | Variance |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | As a percentage of loans | December | percentage of loans | VS. <br> December |  | of loans | $\begin{gathered} \text { June } 30, \\ 2007 \end{gathered}$ |
| (Dollars in thousands) | June 30, 2007 | HIP* <br> by category | $\begin{gathered} 31, \\ 2006 \end{gathered}$ | HIP* <br> by category | $\begin{gathered} 31, \\ 2006 \end{gathered}$ | June 30, 2006 | HIP* <br> by category | June 30 , 2006 |
| Commercial | \$240,817 | 1.6\% | \$158,214 | 1.1\% | \$ 82,603 | \$147,753 | 1.1\% | \$ 93,064 |
| Lease financing | 12,682 | 1.1 | 11,898 | 1.0 | 784 | 3,038 | 0.2 | 9,644 |
| Mortgage | 562,523 | 5.4 | 499,402 | 4.5 | 63,121 | 409,689 | 3.5 | 152,834 |
| Consumer | 42,230 | 0.8 | 48,074 | 0.9 | $(5,844)$ | 37,823 | 0.8 | 4,407 |
| Total non-performing loans | 858,252 | 2.7 | 717,588 | 2.2 | 140,664 | 598,303 | 1.9 | 259,949 |
| Other real estate | 112,858 |  | 84,816 |  | 28,042 | 83,658 |  | 29,200 |
| Total non-performing assets | \$971,110 | 3.02\% | \$802,404 | 2.51\% | \$168,706 | \$681,961 | 2.16\% | \$289,149 |
| Accruing loans past due 90 days or more | \$ 104,497 |  | \$ 99,996 |  | \$ 4,501 | \$ 94,183 |  | \$ 10,314 |

Non-performing assets to total assets
Allowance for loan losses to loans held-in-portfolio
Allowance for loan
losses to non-performing assets
Allowance for loan losses to $\begin{array}{llll}\text { non-performing loans } & 65.81 & 72.78 & 80.86\end{array}$

[^1]The increase in non-performing mortgage loans was mainly due to the continued deterioration in the subprime market in the U.S. mainland as well as higher delinquencies triggered by deteriorating economic conditions in Puerto Rico. Refer to the Overview of Mortgage Loan Exposure at PFH section in this MD\&A for information on PFH s mortgage loan portfolio. The rise in non-performing commercial loans reflected principally the current economic conditions, primarily in Puerto Rico. Refer to Part II Other Information, Item 1A. Risk Factors, included in this Form 10-Q for further information on Puerto Rico s current economic condition. Also, there was an increase in non-performing commercial loans in the Corporation s U.S. operations. Non-performing loans as of June 30, 2007 included 84\% secured by real estate.
Other real estate owned, representing real estate property acquired through foreclosure, increased principally in the Popular North America reportable segment. With the slowdown in the U.S. housing market, there is a continued economic deterioration in certain geographic areas, which also has a negative effect on the market for resale of the repossessed real estate properties.
Accruing loans past due 90 days or more are composed primarily of credit cards, FHA / VA and other insured mortgage loans, and delinquent mortgage loans included in the Corporation sfinancial statements pursuant to GNMA s buy-back option program. Under SFAS No. 140, servicers of loans underlying Ginnie Mae mortgage-backed securities must report as their own assets the defaulted loans that they have the option to purchase, even when they elect not to exercise that option. Also, accruing loans past due 90 days or more include residential conventional loans purchased from other financial institutions that although delinquent, the Corporation has received timely payment from the sellers / servicers, and in some instances, have partial guarantees under recourse agreements.

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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 these estimated loan losses based on evaluations of inherent risks in the loan portfolios. The Corporation s management evaluates the adequacy of the allowance for loan losses on a monthly basis. In this evaluation management considers current economic conditions and the resulting impact on Popular s loan portfolio, the composition of the portfolio by loan type and risk characteristics, historical loss experience, loss volatility, results of periodic credit reviews of individual loans, regulatory requirements and loan impairment measurement, among other factors. The increase in the Corporation s allowance level as of June 30, 2007 reflects the prevailing negative economic outlook, particularly in the non-prime mortgage business, and the deterioration in Puerto Rico s economy.
The Corporation s methodology to determine its allowance for loan losses is based on SFAS No. 114, Accounting by Creditors for Impairment of a Loan (as amended by SFAS No. 118) and SFAS No. 5, Accounting for Contingencies. Under SFAS No. 114, commercial loans over a predetermined amount are identified for evaluation on an individual basis, and specific reserves are calculated based on impairment analyses. SFAS No. 5 provides for the recognition of a loss contingency for a group of homogeneous loans, which are not individually evaluated under SFAS No. 114, when it is probable that a loss has been incurred and the amount can be reasonably estimated. To determine the allowance for loan losses under SFAS No. 5, the Corporation uses historical net charge-offs and volatility experience segregated by loan type and legal entity. Refer to the 2006 Annual Report for additional information on the Corporation s methodology for assessing the adequacy of the allowance for loan losses. Under SFAS No. 114, the Corporation considers a commercial loan to be impaired when the loan amounts to $\$ 250,000$ or more and interest and / or principal is past due 90 days or more, or, when the loan amounts to $\$ 500,000$ or more and based on current information and events, it is probable that the debtor will be unable to pay all amounts due according to the contractual terms of the loan agreement. The Corporation s recorded investment in impaired commercial loans and the related valuation allowance calculated under SFAS No. 114 at June 30, 2007, December 31, 2006 and June 30, 2006 were:

|  | June 30, 2007 |  | December 31, 2006 |  | June 30, 2006 |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Recorded <br> Investment | Valuation <br> Allowance | Recorded <br> Investment | Valuation <br> Allowance | Recorded <br> Investment | Valuation <br> Allowance |  |
| (In millions) |  |  |  |  |  |  |  |
| Impaired loans: | $\$ 156.6$ | $\$ 40.7$ | $\$ 125.7$ | $\$ 37.0$ | $\$ 68.6$ | $\$ 21.3$ |  |
| Valuation allowance <br> required | 119.5 |  | 82.5 |  | 58.9 |  |  |
| No valuation allowance <br> required | $\$ 276.1$ | $\$ 40.7$ | $\$ 208.2$ | $\$ 37.0$ | $\$ 127.5$ | $\$ 21.3$ |  |
| Total impaired loans |  |  |  |  |  |  |  |

Average impaired loans during the second quarter of 2007 and 2006 were $\$ 259$ million and $\$ 122$ million, respectively. The Corporation recognized interest income on impaired loans of $\$ 2.1$ million and $\$ 0.7$ million for the quarters ended June 30, 2007 and June 30, 2006, respectively, and $\$ 4.2$ million and $\$ 1.7$ million for the six months ended on those same dates, respectively.
In addition to the non-performing loans included in Table N, there were $\$ 99$ million of loans at June 30, 2007, which in management s opinion are currently subject to potential future classification as non-performing, and are considered impaired under SFAS No. 114. At December 31, 2006 and June 30, 2006, these potential problem loans approximated $\$ 103$ million and $\$ 32$ million, respectively. The increase in potential problem loans since June 30, 2006 was principally associated with particular commercial lending relationships in the Corporation s Puerto Rico banking operations.
Under standard industry practice, closed-end consumer loans are not customarily placed on non-accrual status prior to being charged-off. Excluding the closed-end consumer loans from non-accruing at June 30, 2007, adjusted
non-performing assets would have been $\$ 929$ million, or $2.89 \%$, of loans held-in-portfolio and the allowance to non-performing loans ratio would have been $69.22 \%$. At December 31, 2006, adjusted non-performing assets would have been $\$ 754$ million, or $2.36 \%$, of loans held-in-portfolio and the allowance to non-performing loans ratio would have been $78.00 \%$. At June 30, 2006, adjusted non-performing assets would have been $\$ 644$ million, or $2.04 \%$, of loans held-in-portfolio and the allowance to non-performing loans would have been $86.32 \%$.

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As explained in the 2006 Annual Report, the Corporation is exposed to geographical and government risk. Popular, Inc. has partly diversified its geographical risk as a result of its growth strategy in the United States and the Caribbean. The Corporation sassets and revenue composition by geographical area and by business segment reporting are presented in Note 21 to the consolidated financial statements.
Refer to Part II Other Information, Item 1A. Risk Factors, included in this Form 10-Q for further information on Puerto Rico s current economic condition.
At June 30, 2007, the Corporation had $\$ 815$ million of credit facilities granted to or guaranteed by the P.R. Government and its political subdivisions, of which $\$ 50$ million are uncommitted lines of credit. Of these total credit facilities granted, $\$ 670$ million in loans were outstanding at June 30, 2007. A substantial portion of the Corporation s credit exposure to the Government of Puerto Rico is either collateralized loans or obligations that have a specific source of income or revenues identified for their repayment. Some of these obligations consist of senior and subordinated loans to public corporations that obtain revenues from rates charged for services or products, such as water and electric power utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from the central Government. The Corporation also has loans to various municipalities for which the good faith, credit and unlimited taxing power of the applicable municipality has been pledged to their repayment. These municipalities are required by law to levy special property taxes in such amounts as shall be required for the payment of all of its general obligation bonds and loans. Another portion of these loans consists of special obligations of various municipalities that are payable from the basic real and personal property taxes collected within such municipalities. The full faith and credit obligations of the municipalities have a first lien on the basic property taxes.
Furthermore, as of June 30, 2007, the Corporation had outstanding $\$ 186$ million in Obligations of Puerto Rico, States and Political Subdivisions as part of its investment portfolio. Refer to Notes 5 and 6 to the consolidated financial statements for additional information. Of that total, $\$ 163$ million is exposed to the creditworthiness of the P.R. Government and its municipalities. Of that portfolio, $\$ 59$ million are in the form of Puerto Rico Commonwealth Appropriation Bonds, which are currently rated Ba1, one notch below investment grade, by Moody s and BBB-, the lowest investment grade rating, by Standard \& Poor s Rating Services ( S\&P ), another nationally recognized credit rating agency.

## Overview of Mortgage Loan Exposure at PFH

PFH historically originated mortgage loan production through various channels including asset acquisition, mortgage loan brokers and its retail branch network. As part of the Restructuring Plan, PFH has ceased originating loans through all channels except for loans originated directly through its consumer finance branches and the customer loan center ( CLC ). This has resulted in a significant reduction in total origination of mortgage loans at PFH.
Subprime mortgage loans refer to mortgage loans made to individuals with a $\mathrm{FICO}^{\circledR}$ score of 660 or below. $\mathrm{FICO}^{\circledR}$ scores are used as an indicator of the probability of default for loans. A portion of the loans originated and retained by PFH is subprime under this definition.
As of June 30, 2007, mortgage loans held-in-portfolio outstanding at PFH amounted to $\$ 6.0$ billion, as compared to $\$ 6.9$ billion as of December 31, 2006 and $\$ 7.1$ billion as of June 30, 2006. Refer to Table F for a breakdown of the portfolio between owned and owned-in-trust. Of the balance as of June 30, 2007, $\$ 4.1$ billion or approximately $68 \%$ had $\mathrm{FICO}^{\circledR}$ scores of 660 or below. As distinguished by coupon type, $74 \%$ of the loan portfolio had fixed-rate coupons, while $26 \%$ had adjustable rates (ARMs).
As of June 30, 2007, $\$ 533$ million in ARMs were scheduled to readjust their rate for the first time between July 1, 2007 and December 31, 2007, and $\$ 525$ million were scheduled to readjust their rate in 2008.
The average $\mathrm{FICO}^{\circledR}$ score for PFH s mortgage loans was 611 as of June 30,2007 while the average loan-to-value ratio of the portfolio as of that date was $83.4 \%$. The unpaid principal balance at June 30, 2007 of loans originated in 2006 amounted to $\$ 1.1$ billion, or approximately $15 \%$ of PFH s total loans held-in-portfolio and $3 \%$ of the Corporation s loans held-in-portfolio at June 30, 2007.

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One of the characteristics of subprime loans is that their delinquency and charge-off rates tend to be higher than for agency conforming loans or Alt-A loans. Alt-A loans are loans usually made to borrowers who have unsteady sources of income or simply have too little documented income to qualify for a conforming loan. For the quarter ended June 30, 2007, the ratio of non-performing mortgage loans to mortgage loans held-in-portfolio for PFH amounted to $7.1 \%$, while annualized mortgage charge-offs to average loans for the quarter amounted to $1.3 \%$.
A portion of the mortgage loans held by PFH as of June 30, 2007 is pledged as collateral for asset-backed securities issued by the Corporation as a financing vehicle. These owned-in-trust loans pose similar risks to the Corporation as those loans owned outright, with the difference that part of the potential losses related to owned-in-trust loans may be borne by the bondholders under certain circumstances, primarily if cumulative loan losses exceed the level of overcollateralization. As of June 30, 2007, $\$ 3.9$ billion in mortgage loans were owned-in-trust and its related overcollateralization amounted to $\$ 253$ million.
Overcollateralization is defined as a type of credit enhancement by which an issuer of bond certificates pledges collateral in excess of what is needed to adequately cover the repayment of the bond certificates. For more detailed information on PFH s mortgage loan portfolio, please refer to Table O. As a mean for investors to analyze the trend in PFH s mortgage loan exposure, Table P includes information as of March 31, 2007.

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Table 0
Mortgage Loan Exposure at Popular Financial Holdings (excludes mortgage loans held-for-sale) As of June 30, 2007

|  | Total | Vintage | Vintage | Vintage | Vintage | Vintage |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Vintages | 2007 | 2006 | 2005 | 2004 | 2003 \& Prior |

## Subprime mortgage loans

| Owned portfolio | $\$ 1,508,440$ | $\$ 278,276$ | $\$$ | 467,642 | $\$$ | 366,351 | $\$$ | 133,836 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| FICO-Average | 572 | 595 | 575 | 563 | 52,335 |  |  |  |
| Loan-to-value |  |  |  |  | 564 | 565 |  |  |
| Average | $83.2 \%$ | $80.1 \%$ | $81.0 \%$ | $90.3 \%$ | $89.3 \%$ | $77.2 \%$ |  |  |
| \% Fixed-rate | $83 \%$ | $92 \%$ | $81 \%$ | $71 \%$ | $88 \%$ | $91 \%$ |  |  |
| \% ARM | $17 \%$ | $8 \%$ | $19 \%$ | $29 \%$ | $12 \%$ | $9 \%$ |  |  |
| Delinquencies \% | $13.2 \%$ | $1.6 \%$ | $11.1 \%$ | $18.9 \%$ | $17.0 \%$ | $19.3 \%$ |  |  |
| Non-performing \% | $8.6 \%$ | $0.4 \%$ | $6.8 \%$ | $12.4 \%$ | $12.0 \%$ | $13.7 \%$ |  |  |

Charge-offs \%
Second Quarter 2007

| (a) | $1.7 \%$ | $0.0 \%$ | $0.8 \%$ | $3.1 \%$ | $2.0 \%$ | $2.2 \%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Subprime mortgage loans

| Owned-in-Trust | \$2,591,066 | \$ | 0 | \$ | 382,924 | \$ 1,016,694 | \$ | 490,106 | \$ | 701,342 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| $\mathrm{FICO}^{\circledR}$-Average | 572 |  |  |  | 579 | 570 |  | 575 |  | 569 |
| Loan-to-value |  |  |  |  |  |  |  |  |  |  |
| Average | 84.2\% |  |  |  | 84.4\% | 83.3\% |  | 84.3\% |  | 84.8\% |
| \% Fixed-rate | 61\% |  |  |  | 29\% | 47\% |  | 84\% |  | 84\% |
| \% ARM | 39\% |  |  |  | 71\% | 53\% |  | 16\% |  | 16\% |
| Delinquencies \% | 17.6\% |  |  |  | 12.5\% | 18.6\% |  | 14.5\% |  | 21.0.\% |
| Non-performing \% | 11.1\% |  |  |  | 7.7\% | 11.5\% |  | 9.3\% |  | 13.5\% |

Charge-offs \%
Second Quarter 2007

| (a) |  | 1.8\% |  |  |  | 1.0\% |  | 2.0\% |  | 1.0\% |  | 2.4\% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Prime mortgage |  |  |  |  |  |  |  |  |  |  |  |  |
| loans Owned |  |  |  |  |  |  |  |  |  |  |  |  |
| portfolio | \$ | 517,817 | \$ | 75,511 | \$ | 158,225 | \$ | 126,421 | \$ | 60,384 | \$ | 97,276 |
| $\mathrm{FICO}^{\circledR}$-Average |  | 707 |  | 694 |  | 702 |  | 705 |  | 712 |  | 719 |
| Loan-to-value |  |  |  |  |  |  |  |  |  |  |  |  |
| Average |  | 81.2\% |  | 79.4\% |  | 79.9\% |  | 86.9\% |  | 84.7\% |  | 72.8\% |
| \% Fixed-rate |  | 88\% |  | 93\% |  | 81\% |  | 82\% |  | 96\% |  | 98\% |
| \% ARM |  | 12\% |  | 7\% |  | 19\% |  | 18\% |  | 4\% |  | 2\% |
| Delinquencies \% |  | 1.9\% |  | 0.4\% |  | 4.0\% |  | 0.8\% |  | 1.1\% |  | 1.8\% |
| Non-performing \% |  | 1.3\% |  |  |  | 3.6\% |  | 0.1\% |  | 0.4\% |  | 0.9\% |
| Charge-offs \% |  |  |  |  |  |  |  |  |  |  |  |  |
| Second Quarter 2007 |  |  |  |  |  |  |  |  |  |  |  |  |
| (a) |  | 1.3\% |  | 0.0\% |  | 0.1\% |  | 3.3\% |  | 1.0\% |  | 1.1\% |

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## Prime mortgage

 loans| Owned-in-Trust | $\$ 1,355,963$ | $\$ 84,774$ | $\$ 427,546$ | $\$ 440,129$ | $\$ 403,514$ |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| FICO $^{\circledR}$-Average | 712 |  | 693 | 705 | 716 | 716 |
| Loan-to-value |  |  |  |  |  |  |
| Average | $83.36 \%$ | $83.5 \%$ | $84.9 \%$ | $80.6 \%$ | $84.4 \%$ |  |
| \% Fixed-rate | $81 \%$ | $42 \%$ | $59 \%$ | $95 \%$ | $98 \%$ |  |
| \% ARM | $19 \%$ | $58 \%$ | $41 \%$ | $5 \%$ | $2 \%$ |  |
| Delinquencies \% | $1.2 \%$ | $2.3 \%$ | $1.6 \%$ | $0.7 \%$ | $1.1 \%$ |  |
| Non-performing \% | $0.7 \%$ | $1.4 \%$ | $0.8 \%$ | $0.3 \%$ | $0.8 \%$ |  |

Non-performing \%
0.7\%

Charge-offs \%
Second Quarter 2007
(a)

Loans without

| FICO scores | $\$ 26,124$ | $\$ 20,679$ | $\$$ | 3,701 | $\$$ | 239 | $\$$ | 51 | $\$$ | 1,454 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

PFH Mortgage

| Loans (b) | $\$ 5,999,410$ | $\$ 374,466$ | $\$ 1,097,266$ | $\$ 1,937,251$ | $\$ 1,124,506$ | $\$ 1,465,921$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| FICO®-Average | 611 | 616 | 603 | 604 | 626 | 614 |
| Loan-to-value |  |  |  |  |  |  |
| Average | $83.4 \%$ | $79.9 \%$ | $81.7 \%$ | $86.1 \%$ | $83.4 \%$ | $83.0 \%$ |
| \% Fixed-rate | $74 \%$ | $92 \%$ | $60 \%$ | $57 \%$ | $89 \%$ | $90 \%$ |
| \% ARM | $26 \%$ | $8 \%$ | $40 \%$ | $43 \%$ | $11 \%$ | $10 \%$ |
| Delinquencies \% | $11.4 \%$ | $1.3 \%$ | $9.9 \%$ | $13.7 \%$ | $8.7 \%$ | $13.9 \%$ |
| Non-performing \% | $7.1 \%$ | $0.3 \%$ | $6.2 \%$ | $8.6 \%$ | $5.6 \%$ | $9.2 \%$ |
| Charge-offs \% |  |  |  |  |  |  |
| Second Quarter 2007 |  |  |  |  |  |  |
| (a) | $1.3 \%$ | $0.0 \%$ | $0.7 \%$ | $1.9 \%$ | $0.8 \%$ | $1.7 \%$ |

Deferred fees, origination costs, net premiums and other items
\$ 48,457
PFH Total Mortgage Loans HIP
\$6,047,867
(a) The average balances used to calculate these net charge-offs to average loans ratios were calculated using the ending balances as of March 31, 2007 and June 30, 2007 for these business areas.
(b) Includes loans without $\mathrm{FICO}^{\circledR}$ scores.

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Table $\mathbf{P}$
Mortgage Loan Exposure at Popular Financial Holdings (excludes mortgage loans held-for-sale) As of March 31, 2007

| (In thousands) | Total Vintages | Vintage 2007 |  | Vintage 2006 |  | $\begin{aligned} & \text { Vintage } \\ & 2005 \end{aligned}$ |  | Vintage 2004 |  | Vintage 03 \& Prior |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Subprime mortgage loans Owned |  |  |  |  |  |  |  |  |  |  |
| $\mathrm{FICO}^{\circledR}$-Average | 599 | 603 |  | 601 |  | 607 |  | 598 |  | 585 |
| Loan-to-value Average | 83.0\% | 79.5\% |  | 80.7\% |  | 89.6\% |  | 88.1\% |  | 77.0\% |
| \% Fixed-rate | 82.1\% | 92.4\% |  | 82.4\% |  | 69.0\% |  | 90.9\% |  | 91.3\% |
| \% ARM | 17.9\% | 7.6\% |  | 17.6\% |  | 31.0\% |  | 9.1\% |  | 8.7\% |
| Delinquencies \% | 11.5\% |  |  | 8.0\% |  | 13.6\% |  | 14.2\% |  | 18.1\% |
| Non-performing \% | 7.2\% |  |  | 3.2\% |  | 9.4\% |  | 10.0\% |  | 12.3\% |
| Charge-offs \% First Quarter 2007 (a) | 1.7\% | 0.0\% |  | 0.1\% |  | 2.6\% |  | 1.9\% |  | 4.0\% |
| Subprime mortgage loans |  |  |  |  |  |  |  |  |  |  |
| Owned-in-Trust | \$2,960,095 |  | \$ | 430,621 |  | ,129,023 | \$ | 581,337 | \$ | 819,114 |
| $\mathrm{FICO}^{\text {®-Average }}$ | 606 |  |  | 591 |  | 607 |  | 617 |  | 608 |
| Loan-to-value Average | 83.5\% |  |  | 84.0\% |  | 83.1\% |  | 82.6\% |  | 84.3\% |
| \% Fixed-rate | 62.8\% |  |  | 29.1\% |  | 48.1\% |  | 85.0\% |  | 85.0\% |
| \% ARM | 37.2\% |  |  | 70.9\% |  | 51.9\% |  | 15.0\% |  | 15.0\% |
| Delinquencies \% | 12.6\% |  |  | 7.7\% |  | 13.3\% |  | 9.7\% |  | 16.3\% |
| Non-performing \% | 8.0\% |  |  | 4.6\% |  | 8.3\% |  | 6.1\% |  | 10.9\% |
| Charge-offs \% First Quarter 2007 (a) | 1.4\% |  |  | 0.2\% |  | 1.0\% |  | 1.1\% |  | 3.0\% |
| Prime mortgage loans Owned |  |  |  |  |  |  |  |  |  |  |
| $\mathrm{FICO}^{\circledR}$-Average | 699 | 692 |  | 694 |  | 700 |  | 701 |  | 707 |
| Loan-to-value Average | 80.7\% | 78.2\% |  | 79.6\% |  | 88.4\% |  | 85.7\% |  | 71.4\% |
| \% Fixed-rate | 85.5\% | 87.6\% |  | 78.5\% |  | 82.1\% |  | 88.1\% |  | 97.1\% |
| \% ARM | 14.5\% | 12.4\% |  | 21.5\% |  | 17.9\% |  | 11.9\% |  | 2.9\% |
| Delinquencies \% | 5.2\% |  |  | 4.2\% |  | 6.4\% |  | 5.1\% |  | 6.5\% |
| Non-performing \% | 3.2\% |  |  | 1.5\% |  | 4.1\% |  | 4.1\% |  | 4.4\% |
| Charge-offs \% First Quarter 2007 (a) | 0.4\% | 0.0\% |  | 0.2\% |  | 0.6\% |  | 0.9\% |  | 0.4\% |
| Prime mortgage loans |  |  |  |  |  |  |  |  |  |  |
| Owned-in-Trust | \$ 1,277,861 |  | \$ | 68,362 | \$ | 438,174 | \$ | 411,172 | \$ | 360,153 |
| $\mathrm{FICO}^{\circledR}$-Average | 698 |  |  | 695 |  | 697 |  | 702 |  | 699 |
| Loan-to-value Average | 84.1\% |  |  | 84.1\% |  | 85.3\% |  | 81.4\% |  | 85.7\% |
| \% Fixed-rate | 76.1\% |  |  | 45.2\% |  | 51.8\% |  | 91.6\% |  | 93.9\% |
| \% ARM | 23.9\% |  |  | 54.8\% |  | 48.2\% |  | 8.4\% |  | 6.1\% |
| Delinquencies \% | 5.8\% |  |  | 5.5\% |  | 6.6\% |  | 4.1\% |  | 6.7\% |
| Non-performing \% | 3.9\% |  |  | 3.9\% |  | 4.4\% |  | 3.0\% |  | 4.5\% |
| Charge-offs \% First Quarter 2007 (a) | 0.1\% |  |  | 0.0\% |  | 0.1\% |  | 0.1\% |  | 0.2\% |
| Loans without FICO scores | \$ 97,476 | \$ 14,177 | \$ | 55,501 | \$ | 8,715 | \$ | 4,033 | \$ | 15,050 |

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| PFH Mortgage Loans (b) | $\$ 6,235,226$ | $\$ 159,483$ | $\$ 1,169,832$ | $\$ 2,114,992$ | $\$ 1,207,531$ | $\$ 1,583,388$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| FICO®-Average | 627 | 621 | 616 | 631 | 640 | 627 |
| Loan-to-value Average | $80.5 \%$ | $74.4 \%$ | $77.4 \%$ | $85.4 \%$ | $82.7 \%$ | $82.5 \%$ |
| \% Fixed-rate | $72.2 \%$ | $92.2 \%$ | $61.0 \%$ | $55.3 \%$ | $88.1 \%$ | $89.1 \%$ |
| \% ARM | $27.8 \%$ | $7.8 \%$ | $39.0 \%$ | $44.7 \%$ | $11.9 \%$ | $10.9 \%$ |
| Delinquencies \% | $10.3 \%$ |  | $7.0 \%$ | $11.5 \%$ | $8.1 \%$ | $13.7 \%$ |
| Non-performing \% | $6.3 \%$ |  | $3.4 \%$ | $7.4 \%$ | $5.4 \%$ | $9.2 \%$ |
| Charge-offs \% First Quarter 2007 (a) | $1.1 \%$ | $0.0 \%$ | $0.1 \%$ | $1.1 \%$ | $0.8 \%$ | $2.3 \%$ |

Deferred fees, origination costs, net
premiums and other items
\$ 135,835
PFH Total Mortgage Loans HIP $\$ 6,371,061$
(a) The average balances used to calculate these net charge-offs to average loans ratios were calculated using the ending balances as of December 31, 2006 and March 31, 2007 for these business areas.
(b) Includes loans without $\mathrm{FICO}^{\circledR}$ scores.

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## Item 3. Quantitative and Qualitative Disclosures About Market Risk MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments or other assets due to changes in interest rates, currency exchange rates or equity prices. Interest rate risk, a component of market risk, is the exposure to adverse changes in net interest income due to changes in interest rates, which can be affected by the shape and the slope of the yield curves to which the financial products of the Corporation are related. Management considers interest rate risk a prominent market risk in terms of its potential impact on earnings. Interest rate risk may occur for one or more reasons, such as the maturity or repricing of assets and liabilities at different times, changes in credit spreads, changes in short and long-term market interest rates, or the maturity of assets or liabilities may be shortened or lengthened as interest rates change. Depending on the duration and repricing characteristics of the Corporation s assets, liabilities and off-balance sheet items, changes in interest rates could either increase or decrease the level of net interest income.
The techniques for measuring the potential impact of the Corporation s exposure to market risk from changing interest rates, which were described in the 2006 Annual Report, have remained substantially constant from the end of 2006. Due to the importance of critical assumptions in measuring market risk, the risk models currently incorporate third-party developed data for critical assumptions such as prepayment speeds on mortgage-related products, estimates on the duration of the Corporation s deposits, and interest rate scenarios.
The Corporation maintains a formal asset and liability management process to quantify, monitor and control interest rate risk and to assist management in maintaining stability in the net interest margin under varying interest rate environments. Management employs a variety of measurement techniques including the use of an earnings simulation model to analyze the net interest income sensitivity to changing interest rates. Sensitivity analysis is calculated on a monthly basis 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 possible 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. Simulations are processed using various interest rate scenarios to determine potential changes to the future earnings of the Corporation. The asset and liability management group also performs validation procedures on various assumptions used as part of the sensitivity analysis as well as validations of results on a monthly basis. In addition, third-party validation reports are received for the mortgage related prepayment assumptions.
Computations of the prospective effects of hypothetical interest rate changes are based on many assumptions, including relative levels of market interest rates, interest rate spreads, loan prepayments and deposit decay. Thus, they should not be relied upon as indicative of actual results. Furthermore, the computations 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 actually may occur in the future.
Based on the results of the sensitivity analyses as of June 30, 2007, the Corporation s net interest income for the next twelve months is estimated to increase by $\$ 15.1$ million in a hypothetical 200 basis points rising rate scenario, and the change for the same period, utilizing a similar hypothetical decline in the rate scenario, is an estimated increase of $\$ 1.8$ million. Both hypothetical rate scenarios consider the gradual change to be achieved during a twelve-month period from the prevailing rates at June 30, 2007.
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 that are caused by interest rate volatility. The market value of these derivatives is subject to interest rate fluctuations, and as a result, it could have a positive or negative effect in the Corporation s net interest income. Refer to Note 9 to the consolidated financial statements for further information on the Corporation s derivative instruments. The Corporation conducts business in certain Latin American markets through several of its processing and information technology services and products subsidiaries. Also, it holds interests in Consorcio de Tarjetas

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Dominicanas, S.A. ( CONTADO ) and Centro Financiero BHD, S.A. ( BHD ) in the Dominican Republic. Although not significant, some of these businesses are conducted in the country s foreign currency. The resulting foreign currency translation adjustment, from operations for which the functional currency is other than the U.S. dollar, is reported in accumulated other comprehensive loss in the consolidated statements of condition, except for highly inflationary environments in which the effects are included in other operating income in the consolidated statements of income. At June 30, 2007, the Corporation had approximately $\$ 34$ million in an unfavorable foreign currency translation adjustment as part of accumulated other comprehensive loss, compared with $\$ 37$ million, also unfavorable, at December 31, 2006 and June 30, 2006.

## LIQUIDITY

Liquidity risk may arise whenever the Corporation s ability to raise cash and the runoff of its assets are substantially less than the runoff of its liabilities and its commitments to fund loans, meet customer deposit withdrawals and other cash commitments. The Corporation has established policies and procedures to assist it in remaining sufficiently liquid to meet all of its financial obligations, finance expected future growth and maintain a reasonable safety margin for cash commitments under both normal operating conditions and under unpredictable circumstances of industry or market stress.
The Corporation has adopted contingency plans for raising financing under stress scenarios, where important sources of funds that are usually fully available are temporarily not willing to lend to the Corporation. These plans call for using alternate funding mechanisms such as the pledging or securitization of certain asset classes, committed credit lines, and loan facilities put in place with the FHLB and the FED. The Corporation has a substantial amount of assets available for raising funds through non-traditional channels and is confident that it has adequate alternatives to rely on under a scenario where some primary funding sources are temporarily unavailable.
The Corporation s liquidity position is closely monitored on an ongoing basis. Management believes that available sources of liquidity are adequate to meet the funding needs in the normal course of business.
The composition of the Corporation s financing to total assets at June 30, 2007 and December 31, 2006 follows:
\(\left.$$
\begin{array}{lccccc} & & \begin{array}{c}\text { \% increase } \\
\text { (decrease) }\end{array}
$$ \& <br>

from\end{array}\right]\)| \% of total assets |
| :---: |
| December |

The Corporation s core deposits, which consist of demand, savings, money markets, and time deposits under $\$ 100$ thousand, constituted $77 \%$ of total deposits at June 30, 2007. Certificates of deposit with denominations of \$100 thousand and over at June 30, 2007 represented $23 \%$ of total deposits. Their distribution by maturity was as follows:
(In millions)
3 months or less

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3 to 6 months ..... 1,263
6 to 12 months ..... 993
Over 12 months ..... 1,294

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The consolidated statements of cash flows in the accompanying consolidated financial statements provide information on the Corporation s cash inflows and outflows.
There have been no significant changes in the Corporation s aggregate contractual obligations since the end of 2006. Refer to Note 11 to the consolidated financial statements for the composition of the Corporation sborrowings at June 30, 2007. Also, refer to Note 12 to the consolidated financial statements for the Corporation s involvement in certain commitments at June 30, 2007.

## Risks to Liquidity

Maintaining adequate credit ratings on Popular s debt obligations is an important factor for liquidity because the credit ratings influence the Corporation s ability to borrow, the cost at which it can raise financing and its access to funding sources. The credit ratings are based on the financial strength, credit quality and concentrations in the loan portfolio, the level and volatility of earnings, capital adequacy, the quality of management, the liquidity of the balance sheet, the availability of a significant base of core retail and commercial deposits, and the Corporation s ability to access a broad array of wholesale funding sources, among other factors. Changes in the credit rating of the Corporation or any of its subsidiaries to a level below investment grade may affect the Corporation $s$ ability to raise funds in the capital markets. The Corporation s counterparties are sensitive to the risk of a rating downgrade. In the event of a downgrade, it may be expected that the cost of borrowing funds in the institutional market would increase. In addition, the ability of the Corporation to raise new funds or renew maturing debt may be more difficult.
In early August 2005, FitchRatings, a nationally-recognized credit rating agency, changed the Corporation s rating outlook from stable to negative . Following the announcement by the Corporation of the acquisition of E-LOAN in 2005, Fitch expressed concerns indicating that, while the Corporation s capital profile is acceptable for current ratings, the level of tangible common equity would fall following the E-LOAN acquisition as a result of the intangibles recorded, primarily goodwill and trademark. Also, the outlook change considered the risk of greater exposure to the subprime lending business.
Management evaluated such concerns and took actions to address them. In the fourth quarter of 2005 and the first quarter of 2006, the Corporation issued additional shares of common stock to strengthen the level of tangible equity capital. Furthermore, strategic changes have been implemented at PFH that should have the effect of decreasing the growth of the subprime loan portfolio at the Corporation. Refer to the Restructuring Plan section in this MD\&A for information on these particular efforts. In May 2007, Fitch changed the Corporation s senior debt rating to A- from A , while the outlook was revised to stable from negative. The primary drivers behind the changes were recent trends in the Corporation s credit quality and changes in core profitability as compared to a peer group of A- rated institutions. The rating for short-term obligations was maintained at F-1 .
The Corporation is also rated by two other nationally-recognized credit rating agencies. In recent exchanges with these two agencies, the Corporation was advised that they are following closely recent trends in the Corporation s business. One area of concern is the decline in the profitability of the U.S. business during 2006 and possible impact of the remaining subprime exposure on future financial results. The second concern is the deterioration of general credit quality in the Puerto Rico economy and its possible impact on the level of future credit losses. Nonetheless, in March 2007, Moody s Investors Service upgraded the senior debt ratings for the Corporation. These were revised to
A2 at the holding company level, from the previous level of A3 , an increase of one notch. The rating for short-term obligations was also increased to P-1, which is Moody s highest classification. The outlook by Moody s remains stable. As of June 30, 2007, the Corporation s ratings with Standard and Poor s had a stable outlook.

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The Corporation and BPPR s debt ratings at June 30, 2007 were as follows:

|  | Popular, Inc. |  | BPPR |  |
| :--- | :---: | :---: | :---: | :---: |
|  | Short-term <br> debt | Long-term <br> debt | Short-term <br> debt | Long-term <br> debt |
| FitchRatings | F-1 | A- | F-1 | A- |
| Moody s | P-1 | A2 | P-1 | A1 |
| S\&P | A-2 | BBB+ | A-2 | A- |

The ratings above are subject to revisions or withdrawal at any time by the assigning rating agency. Each rating should be evaluated independently of any other rating.
Some of the Corporation s borrowings and deposits are subject to rating triggers , contractual provisions that accelerate the maturity of the underlying obligations in the case of a change in rating. Therefore, the need for the Corporation to raise funding in the marketplace could increase more than usual in the case of a rating downgrade. The amount of obligations subject to rating triggers that could accelerate the maturity of the underlying obligations was $\$ 14$ million at June 30, 2007.
In the course of borrowing from institutional lenders, the Corporation has entered into contractual agreements to maintain certain levels of debt, capital and asset quality, among other financial covenants. If the Corporation were to fail to comply with those agreements, it may result in an event of default. Such failure may accelerate the repayment of the related obligations. An event of default could also affect the ability of the Corporation to raise new funds or renew maturing borrowings. At June 30, 2007, the Corporation had $\$ 0.9$ billion in outstanding obligations subject to covenants, including those which are subject to rating triggers and those outstanding under the commercial paper program. The Corporation was in compliance with debt covenants in all credit facilities with outstanding balances as of June 30, 2007.
Management believes that there have been no significant changes in liquidity risk compared with the disclosures in Popular, Inc. s 2006 Annual Report for the year ended December 31, 2006, except for matters covered in this MD\&A.

## 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 on June 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Corporation sinternal control over financial reporting.

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## Part II Other Information

## Item 1. Legal Proceedings

The Corporation and its subsidiaries are defendants in various lawsuits arising in the ordinary course of business. Management believes, based on the opinion of legal counsel, that the aggregate liabilities, if any, arising from such actions will not have a material adverse effect on the financial position and results of operations of the Corporation.

## Item 1A. Risk Factors

Except as noted below, there have been no material changes to the risk factors as previously disclosed under Item 1A. in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2006.
The Corporation is exposed to greater risk because a significant portion of the business is concentrated in Puerto Rico, which has experienced an economic slowdown.
A significant portion of the Corporation s financial activities and credit exposure is concentrated in Puerto Rico ( the Island ). Consequently, the financial condition and results of operations are highly dependent on the Island s economic conditions. An extended economic slowdown, adverse political or economic developments in Puerto Rico, or natural disasters such as hurricanes affecting the Island, could result in a downturn in loan originations, an increase in the level of non-performing assets, an increase in the rate of foreclosure loss on mortgage loans and a reduction in the value of the Corporation s loans and loan servicing portfolio, all of which would adversely affect the Corporation s profitability.
The Commonwealth Government is projecting a slight recovery of Puerto Rico s economy for fiscal year 2008 (ending June 30), after a contraction of $1.4 \%$ in the previous year. The Puerto Rico Planning Board, the public agency in charge of economic analysis for the Commonwealth, projects real growth of $0.8 \%$ for fiscal year 2008.
In its monthly Index of Economic Activity, the Puerto Rico Planning Board registered a $0.1 \%$ increase on a monthly basis in February 2007. The Index of Economic Activity, which is composed of eight indicators, registered growth of $0.2 \%$ on a monthly basis in January 2007 after seven consecutive monthly decreases.
Retail sales for the first quarter of calendar year 2007, for which the most recent government data is available, increased $1.0 \%$ on a nominal basis, when compared with the same quarter a year ago. Retail sales of new and used automobiles fell $13.3 \%$ in the first quarter of calendar year 2007, when compared with the same period a year ago. Though consumers finances continue to be under stress, the Commonwealth Government avoided a repeat this year of the partial government shutdown in May 2006 that upset consumption trends and overall confidence. The Governor of Puerto Rico signed on June 30, 2007, the measures that were approved by the Legislative Assembly for the General Budget for the Commonwealth for fiscal 2008 totaling $\$ 9.2$ billion.
However, the Commonwealth s fiscal situation still poses a challenge for growth. Government receipts amounted to $\$ 3.7$ billion for the first five months of calendar year 2007, down $\$ 6.1$ million, or $0.2 \%$, when compared with the same five-month period a year ago.
In general terms, general fund revenue and sales tax receipts have been running below government projections, which increase the risk that revenues will not be sufficient to meet government spending in the current fiscal year, requiring measures to balance the deficit. The political process needed to address this scenario may be a source of instability, as it may impact business and consumer confidence.
In July 2007, the Commonwealth issued $\$ 2.7$ billion in debt obligations in the U.S. municipal securities market, to refinance outstanding debt previously secured by appropriations from the government s general fund. In addition, $\$ 1.0$ billion in bonds were sold by the Commonwealth in the Puerto Rico market, to local investors. The bond offering will reduce the cost of financing outstanding government debt, and is expected to increase the liquidity in the financial system on the Island.

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Though the pace of construction, as measured by the value of permits, increased in May 2007, for which the most recent government data is available, the sector continues to reflect weakness in both public and private sectors. The total value of construction permits, including both the private and public sectors, increased $52.8 \%$ in May 2007, when compared with the same month of the previous year. However, the value of permits for the first five months of calendar year 2007 was still down $15.4 \%$, when compared with the same five-month period of the previous year. The value of permits for private projects rose $56.7 \%$ in May 2007, when compared with the same month of the previous year. However, the value of permits for private projects was still down $13.6 \%$ up until May for calendar year 2007, when compared with the same five-month period of the previous year. The value of permits for public projects rose $34.0 \%$ in May 2007, when compared with the same month of the previous year. However, the value of permits for public projects was still down $24.0 \%$ up until May for calendar year 2007, when compared with the same five-month period of the previous year.
Unemployment has been trending upward, reaching 11.8\% in June 2007. According to the Puerto Rico Labor Department, total employment on the Island had declined by 25,000 jobs from June 2006 to June 2007, a decrease of 2.0\%.

Data on tourist activity, which are only available through February 2007, shows fewer visitors during the first eight months of fiscal year 2007 (July 2006 to February 2007). Total hotel registrations amounted to 1.3 million during the eight-month period, down $6.0 \%$ when compared with the same period of the previous fiscal year.
Sustained highs in crude oil prices have also negatively impacted the economy of Puerto Rico, where energy production runs close to $70.0 \%$ on imported oil.
The current weak state of the economy and uncertainty in the private and public sectors may also have an adverse effect on the credit quality of the Corporation s loan portfolios, as delinquency rates may increase in the short-term, until the economy stabilizes. Also, a potential reduction in consumer spending may also impact growth in other interest and non-interest revenue sources of the Corporation.
A prolonged economic slowdown, a decline in the real estate market in the U.S mainland, and disruption in the capital markets could harm the results of operations of one of the Corporation s business segments.
The residential mortgage loan origination business has historically been cyclical, enjoying periods of strong growth and profitability followed by periods of shrinking volumes and industry-wide losses. Any decline in residential mortgage loan originations in the market could also reduce the level of mortgage loans the Corporation may produce in the future and adversely impact its business. During periods of rising interest rates, refinancing originations for many mortgage products tend to decrease as the economic incentives for borrowers to refinance their existing mortgage loans are reduced. In addition, the residential mortgage loan origination business is impacted by home values. Over the past several years, residential real estate values in some areas of the U.S. mainland have increased greatly, which has contributed to the recent rapid growth in the residential mortgage industry, particularly with respect to re-financings. If residential real estate values decline, this could lead to lower volumes and higher losses across the industry, adversely impacting the Corporation s business.
Because the Corporation makes loans to borrowers that have FICO scores below 660 through its subsidiary PFH, the actual rates of delinquencies, foreclosures and losses on these loans could be higher during economic slowdowns. Rising unemployment, higher interest rates, declines in housing prices and an overall tightening by lenders of credit standards on new loans tend to have a greater negative effect on the ability of such borrowers to repay their mortgage loans. As of June 30, 2007 approximately $68 \%$ of PFH s mortgage loan portfolio was subprime, meaning that they have a credit score of 660 or below. This represented approximately $39 \%$ of the Corporation s mortgage loans held-in-portfolio as of such date. Any sustained period of increased delinquencies, foreclosures or losses could harm the Corporation s ability to sell loans, the prices it receives for its loans, the values of its mortgage loans held-for-sale or its residual interests in securitizations, which could harm the Corporation s financial condition and results of operations. In addition, any material decline in real estate values would weaken the Corporation s collateral loan-to-value ratios and increase the possibility of loss if a borrower defaults. In such event, the Corporation will be subject to the risk of loss on such mortgage assets arising from borrower defaults to the extent not covered by third-party credit enhancement.

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Refer to the Management s Discussion and Analysis on this Form 10-Q for further information on PFH s credit exposure associated with its subprime mortgage loan portfolio and the Restructuring Plan executed in 2007, which has reduced the Corporation s exposure in this industry sector.

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

The Corporation previously filed two registration statements covering the offering of the Corporation s common stock, at market prices, as an investment option for employee and employer contributions under the Banco Popular de Puerto Rico Employees Stock Plan (Puerto Rico) (the BPPR Plan ) and the Popular, Inc. Puerto Rico Savings and Investment Plan (the Puerto Rico Surviving Plan ). Effective July 1, 2006, the BPPR Plan was merged with and into the Puerto Rico Surviving Plan. When the plans were merged, the shares previously registered with respect to the BPPR Plan were not carried over to the registration statement related to the Puerto Rico Surviving Plan. As a result, subsequent offers of shares to participants in the Puerto Rico Surviving Plan caused the number of shares offered to those participants to exceed the amount of the shares registered with respect to the Puerto Rico Surviving Plan. During the quarter ended June 30, 2007, 374,538 unregistered shares were sold to participants of the Puerto Rico Surviving Plan. Absent an exemption, the offer or sale of securities in an amount in excess of that registered under an effective registration would be an unregistered offering of securities under the Securities Act of 1933 (the Securities Act ). The Corporation, however, believes that the offer and sale of the Corporation s common stock and interests in the Puerto Rico Surviving Plan are covered by the exemption for intrastate offers and sales contained in Section 3(a)(11) of the Securities Act since participation in the Puerto Rico Surviving Plan is limited to Puerto Rico employees. On August 9, 2007, the Corporation registered $6,000,000$ shares of common stock and related interests in the Puerto Rico Surviving Plan for offer to plan participants.
The Corporation also previously filed two registration statements covering the offering of the Corporation s common stock, at market prices, as an investment option for employee and employer contributions under the following plans for its U.S.-based employees: the Popular Financial Holdings, Inc. Savings and Retirement Plan (formerly known as the Equity One, Inc. Savings and Retirement Plan (the PFH Plan )) and the Popular, Inc. USA 401(k) Savings and Investment Plan (the U.S. Surviving Plan ). Effective April 1, 2006, the PFH Plan was merged with and into the U.S. Surviving Plan. As a result of an error in recordkeeping and the merger of the PFH Plan with and into the U.S. Surviving Plan and the participation of E-LOAN employees in the Plan starting January 1, 2007, the latter two of which had the effect of significantly increasing the number of participants in the U.S. Surviving Plan, the amount of shares issued under the U.S. Surviving Plan has exceeded the amount of shares registered. For the quarter ended June 30, 2007, the number of unregistered shares sold under the U.S. Surviving Plan was 109,809 shares. The Corporation has determined that the offer and sale of the shares and interests in the U.S. Surviving Plan above the amount registered were not exempt from registration under the Securities Act, and that such sale should have been registered under the Securities Act. Under the applicable provisions of the federal securities laws, plan participants that purchased unregistered shares of common stock may seek to rescind the transaction within one year following the date of purchase. Approximately 546,278 unregistered shares were sold to plan participants under the U.S. Surviving Plan during the twelve-month period ended June 30, 2007, the most recent twelve-month period for which participant account data is available from the Corporation sthird-party plan recordkeeper. During that period, the Corporation s common stock price ranged from a low of $\$ 15.82$ per share to a high of $\$ 20.12$ per share. The closing price of the Corporation s common stock on August 8, 2007 was $\$ 13.05$ per share. On August 9, 2007, the Corporation registered $5,000,000$ shares of common stock and related interests in the U.S. Surviving Plan for offer to plan participants. All shares of common stock under all the above-referenced Plans were purchased on the open market. The Corporation is considering its alternatives to address the unregistered offering that occurred. The Corporation does not expect that the exercise of any applicable rescission rights by plan participants will have a material impact on the financial condition or liquidity of the Corporation.

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## Issuer Purchases of Equity Securities

In April 2004, the Corporation s shareholders adopted the Popular, Inc. 2004 Omnibus Incentive Plan. The maximum number of shares of common stock issuable under this Plan is $10,000,000$.
The following table sets forth the details of purchases of common stock during the quarter ended June 30, 2007 under the 2004 Omnibus Incentive Plan.

Not in thousands

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares <br> Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs (a) |
| :---: | :---: | :---: | :---: | :---: |
| April 1 April 30 |  |  |  | 8,599,185 |
| May 1 May 31 | 26,751 | \$ 17.22 | 26,751 | 8,572,434 |
| June 1 June 30 |  |  |  | 8,575,626 |
| Total June 30, 2007 | 26,751 | \$ 17.22 | 26,751 | 8,575,626 |

## (a) Includes shares forfeited.

## Item 4. Submission of Matters to a Vote of Security Holders

The Annual Shareholders Meeting of Popular, Inc. was held on May 1, 2007. A quorum was obtained with $249,007,435$ shares represented in person or by proxy, which represented approximately $89.22 \%$ of all votes eligible to be cast at the meeting. Three Directors of the Corporation, Michael Masin, Manuel Morales Jr. and José R.
Vizcarrondo, were elected for a three-year term. The following directors were not up for reelection and continued to hold office after the meeting: Juan J. Bermúdez, Richard L. Carrión, María Luisa Ferré, Francisco M. Rexach Jr., Frederic V. Salerno and William J. Teuber Jr. José B. Carrión Jr. would have attained 72 years of age during the term to be served, therefore, in accordance with Board policy, Mr. Carrión Jr. was not nominated for reelection. The ratification of PricewaterhouseCoopers LLP as the Corporation s independent registered public accounting firm for 2007 was also approved at the Annual Meeting. The result of the voting on each of the proposals is set forth below: Proposal 1: Election of three (3) Class 2 Directors for a three-year term:

| Nominees | Votes For | Withheld |
| :--- | :---: | :---: |
| Michael Masin | $244,065,864$ | $4,941,572$ |
| Manuel Morales Jr. | $244,606,210$ | $4,401,226$ |
| José R. Vizcarrondo. | $244,325,224$ | $4,682,212$ |

Proposal 2: Ratification of the appointment of PricewaterhouseCoopers LLP as the Corporation s independent registered public accounting firm for 2007:

In favor:
239,254,010
Against:
922,326
Abstain:
8,831,098
Item 6. Exhibits

Exhibit No. 12.1
31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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## 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. <br> (Registrant)

Date: August 9, 2007

By: /s/ Jorge A. Junquera<br>Jorge A. Junquera<br>Senior Executive Vice President \& Chief Financial Officer

Date: August 9, 2007

By: /s/ Ileana González Quevedo<br>Ileana González Quevedo<br>Senior Vice President \& Corporate<br>Comptroller


[^0]:    * Includes interest and non-interest bearing demand

[^1]:    * $\mathrm{HIP}=$ held-in-portfolio

