

2009 ANNUAL REPORT

Yielding Positive Results



ORIENTAL
Financial Group

“During my career I’ve been able to summarize in three words what I have to do to achieve my personal and corporate goals each year. Today I share these with you so that you may reflect upon them and utilize them during the forthcoming new year.

Desire - We must have the genuine desire to achieve our goals, not motivated by glory or money, but by the pride in having achieved or surpassed ones objectives.

Dedication - Give yourself totally to achieving your goals and those of your team. Work hard. Enjoy work. Do not allow anything or anyone to take from you the focus on your goals.

Discipline - Do not take your sight off of your goals. Measure your progress regularly so that you may fine-tune your efforts. Accept the defeat and rejections that you will encounter along the way as a learning process, which in turn will allow you to come one step closer to your goals.”

José Rafael Fernández,
President, CEO & Vice Chairman
Message to all Oriental Group employees
on January 4, 2010

Content

- 1 From the Chairman of the Board to our Shareholders
- 3 From the President & CEO to our Shareholders
- 10 Board of Directors & Executive Team
- 11 Leadership Team
- 12 Form 10-K
- General Information

From the Chairman of the Board to Our Shareholders

The past year has been a very difficult one economically, in the U.S., but particularly in Puerto Rico, which went through its fourth straight year of recession. It is gratifying, therefore, that despite these difficult headwinds, Oriental Financial Group had a very good year.

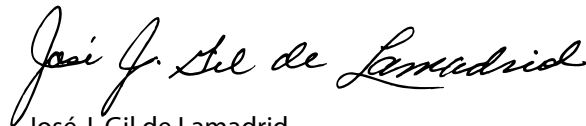
This performance is a testament to our company's ability to navigate and position itself strongly, so that we have been able to increase market share, strengthen our balance sheet and prepare for the opportunities we see developing in the local banking market in 2010 and beyond.

On behalf of myself and fellow colleagues on the Board of Directors, I wish to congratulate our management team, led by José Rafael Fernández, President and CEO, and Vice Chairman of the Board of Directors, and each of our employees, for this exceptional performance and their extraordinary effort.

I also extend my warmest appreciation as well to my fellow Directors for their commitment, dedication and professionalism in contributing to our company's ability to deal with the many issues we faced this past year and succeeded in overcoming.

As this is being written, we are seeing nascent signs of a slow recovery of the U.S. economy, and mounting hope that Puerto Rico will likewise start responding to efforts to stimulate the economy.

We appreciate the support of our shareholders as well as the loyalty of our clients. We are determined that Oriental Financial Group will continue to make a difference as we move forward

A handwritten signature in black ink, reading "José J. Gil de Lamadrid". The signature is fluid and cursive, with the first name "José" and last name "Lamadrid" being more prominent.

José J. Gil de Lamadrid
Chairman of the Board of Directors



José Rafael Fernández
President, Chief Executive Officer &
Vice Chairman of the Board

From the President & CEO to Our Shareholders

Oriental Financial Group was very successful in achieving its objectives in 2009, as world markets and the U.S. began to recover from the 2008 financial crisis and “The Great Recession” and the Puerto Rico economy showed the first signs of stabilization in the fifth year of its own recession.

We continued to build the Oriental banking-financial services franchise – increasing core deposits, loan production and assets under management, and expanding our market share organically in all three areas. In addition, we developed a new banking fee revenue source through our point of sale cash management service for commercial accounts.

Our capital position improved significantly – without the need for TARP. We sold off the majority of our non-agency securities, leaving us with a highly liquid investment portfolio of which 96% of our holdings are US government securities or securities backed by the US government.

We experienced a major reduction in our cost of funds – a combination of the Federal Reserve lowering interest rates, the structure of our wholesale funding, and our significant increase in local deposits. All this enabled us to dramatically reduce our need for higher-cost repurchase agreements and brokered certificates of deposit.

Because of our conservative lending policies, credit quality remained strong – we had a relatively small amount of net charge offs and increased our allowance for loan losses by nearly two thirds from a year ago, providing us with adequate protection even considering local economic conditions.

The Result

Pre-tax operating income increased by nearly 10%, to \$62.1 million. The nearly \$120 million in gains were realized from the sale of agency securities, derivatives and trading activities more than offset the loss on the sale of most of our non-agency securities. Net income available to common shareholders was a solid \$18.1 million, or \$0.75 per share.

At December 31, 2009, compared to a year ago, book value increased 35%, to \$10.82 per share, and stockholders’ equity increased \$68.8 million or 26%, to \$330.2 million. Our strong capital position enabled us to increase loan production and purchases by 9%, to \$323.3 million, helping families and businesses in Puerto Rico to buy homes and finance operations, thereby doing our part to contribute to the local economy.

The sale of the aforementioned non-agency securities significantly improved our asset quality and materially improved our liquidity. We enter 2010 with a strong and growing banking-financial services franchise; one of the cleanest, most secure and flexible balance sheets among Puerto Rico banks; and a favorable position for playing a major role in the possible consolidation of our industry locally.

Separate from operations, we increased transparency for shareholders, becoming the only publicly traded bank holding company in Puerto Rico to hold conference calls for investors, and moving all securities to the available for sale portfolio, where they are marked to market each month.

The following are some additional highlights from 2009.

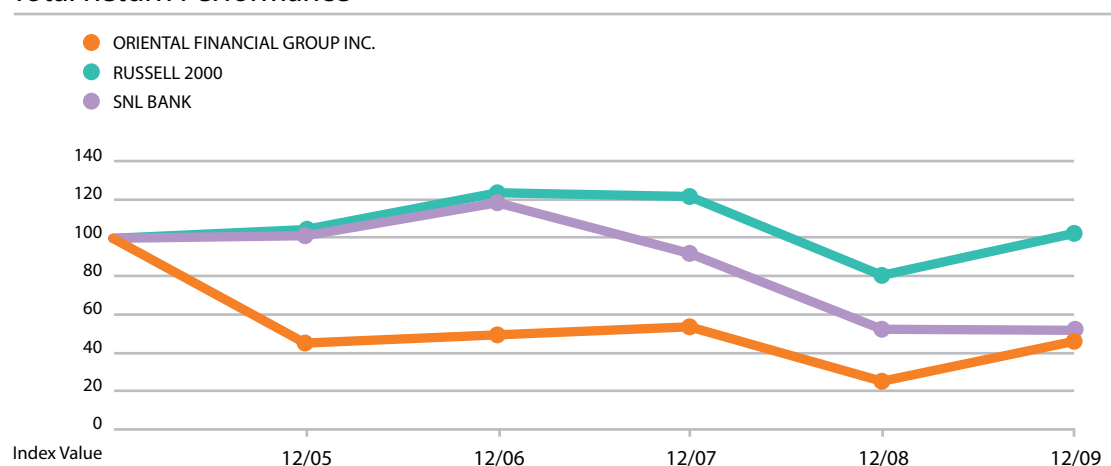
Banking Services

We achieved a nearly 30% – or a \$323 million – increase in core deposits, reflecting growth in all geographic areas, notably in San Juan, Caguas and Guaynabo. Banking service revenues increased 5%, to \$6 million, the first up year in this category since 2006.

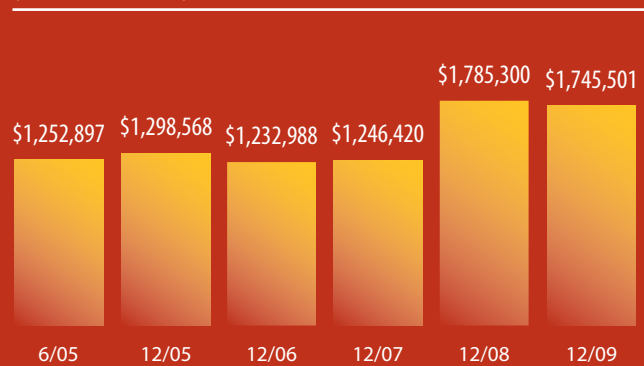
As part of our strategy, we did not rely on rate increases to attract deposits. Our growth reflects our quality image, branch upgrade and realignment, and the success of our relationship bankers. We now have 21 branches with improved locations, more of a modern look and feel, and a highly motivated team.

We experienced growth in both consumer and commercial deposits and fees. On the consumer side, our relationship bankers implemented more than 6,200 of our Most Valuable Practice customer service tool. As a result more of our clients are using value added account features, such as ATMs, debit cards, online services and telephone banking, and our Oriental Money account (checking and money market) has continued to grow in appeal. In commercial, we successfully launched a point of sale (POS) cash management business, generating \$1 million in new fees

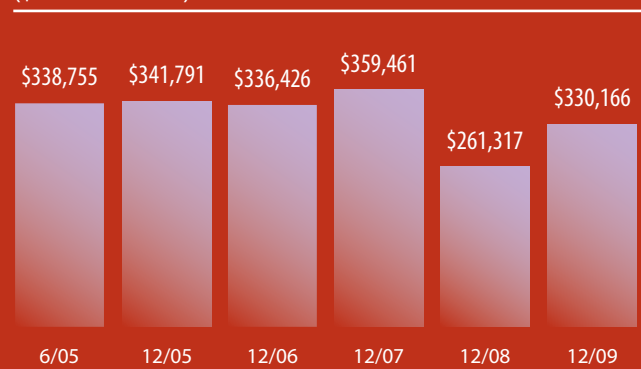
Total Return Performance



Deposits (\$ in thousands)



Stockholders' Equity (\$ in thousands)



Lending

We made significant inroads in mortgage banking, but remained conservative from a credit point of view. We moved operations back to our newly remodeled Las Cumbres offices. This enabled us to streamline processing. Efficiency increased 14% as measured by our ability to complete an average of \$3.70 million in originations per employee versus \$3.24 million in 2008.

Our focus in 2009 was generating conforming residential mortgage loans for sale in the secondary market, versus keeping them in our portfolio. Thus, while our mortgage portfolio declined 8%, to \$919 million, production and purchases increased more than 8%, to \$256 million, and revenue from mortgage banking activities expanded more than two and half times, to nearly \$10 million. This figure includes our growing servicing portfolio, which is a source of recurring revenue. We anticipate continuing to grow our mortgage business in 2010.

In commercial banking, our portfolio grew almost 6%, to nearly \$200 million, and production increased to \$58 million in new loans. Despite the economy, we believe we have good prospects in this business going forward. We are starting to see quality commercial loans at better pricing, and the opportunity to retain seasoned bankers with long-term relationships with middle market industries, professionals and small businesses.

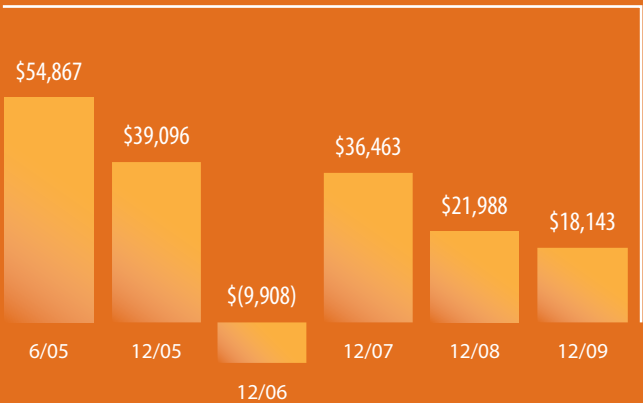
Financial Services

We are a unique type of institution in Puerto Rico, where we lead in financial planning, inheritance, asset protection and retirement planning, which are combined to form a fully integrated offering.

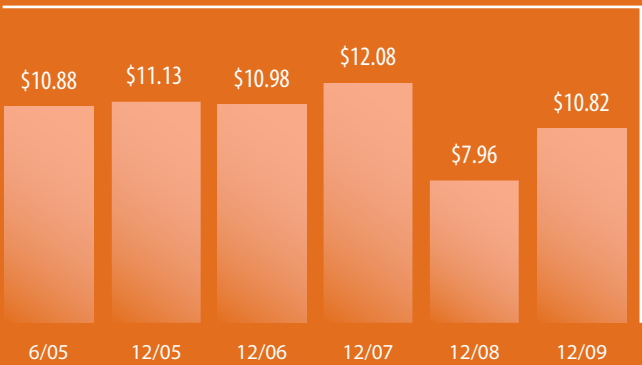
In our personal Trust, 401K and Keogh business, we reached an all time high in balances in 2009, while assets in our brokerage business rebounded in the fourth quarter. As a result, total assets managed increased \$185.7 million, or 6% year over year, to nearly \$3.1 billion. While financial service revenues fell 19% the first nine months of the year, they came back 8% in the fourth quarter. The IRA market also began to come back, with deposits up 9% year over year, to \$313 million, compared to being down nearly 10% in 2008.

In 2010, we have a good opportunity to grow financial services further. In trust, we have established strong institutional relationships with clients in Puerto Rico and with mainland investment managers. In brokerage, we plan to continue to add executives with proven ability to attract high net worth clientele. We also anticipate another successful IRA season and look forward to growing our insurance business more significantly.

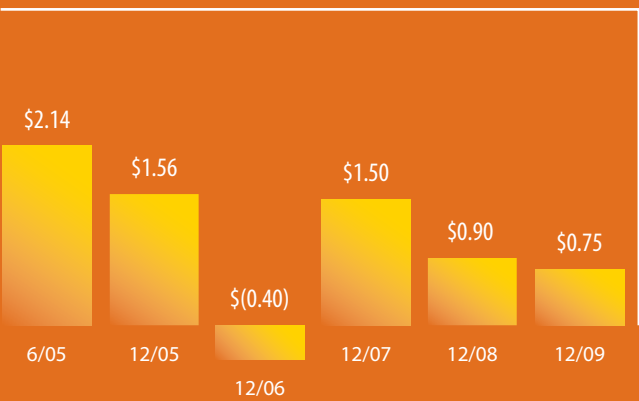
Income (loss) Available
to Common shareholders
(\$ in thousands)



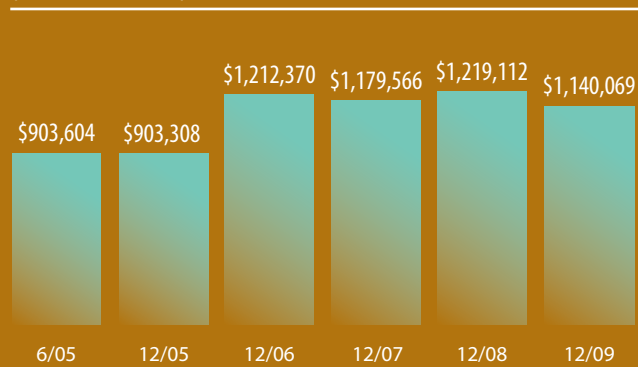
Book Value
Per Common Share



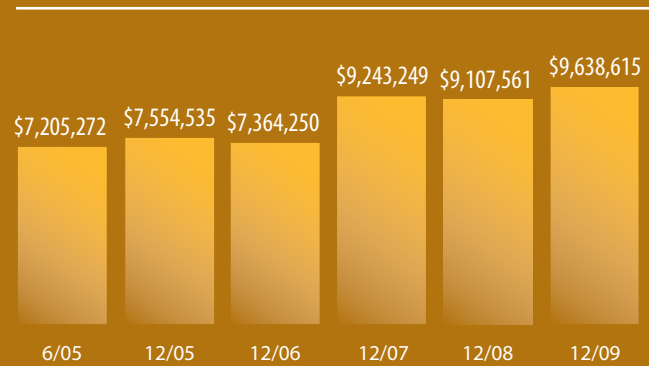
Income (loss)
Per Common Share



Total Loans, Net
(\$ in thousands)



Total Assets Owned & Managed
(\$ in thousands)



Looking Ahead

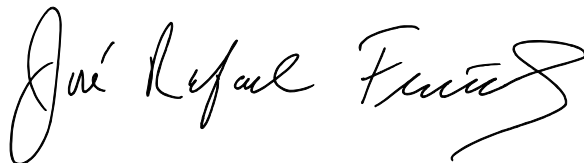
2009 was the 45th year anniversary of Oriental. Over the last five years, we have moved a long way in refining and refocusing our strategy to become a niche bank with great credibility in financial planning for mid- and high-net worth customers. In these challenging times, we are not only profitable and growing, but are viewed as part of a possible solution to the issues facing the banking industry in Puerto Rico.

Now that we have established ourselves in financial planning, our opportunity in 2010 and going forward is to grow our commercial clientele, in both loans and deposits. Our goal is to become more bank-like and less reliant on investments as a source of income. In furtherance of this strategy, we have been building the right structure and the right team.

The Puerto Rico market will continue to be difficult, so we will remain prudent and conservative. The Government of Puerto Rico is taking major steps to reduce its spending and size; we look forward to plans to reduce taxes, foster business development and create permanent new jobs.

Thank You

We extend our sincerest appreciation to our clients, our loyal and dedicated staff, shareholders, partners in the marketplace, management and executive teams, and Board of Directors. Our continued progress would not be possible without your support and commitment.

A handwritten signature in black ink, reading "José Rafael Fernández". The signature is fluid and cursive, with a large, stylized 'J' and 'F'.

José Rafael Fernández

President, Chief Executive Officer & Vice Chairman of the Board

Board of Directors & Executive Team

José J. Gil de Lamadrid, CPA - Chairman of the Board, Oriental Financial Group
José Rafael Fernández - President, CEO & Vice Chairman of the Board, Oriental Financial Group
Juan Carlos Aguayo, P.E. - President and CEO of Structural Steel Works, Inc.
Pablo Iván Altieri, M.D.
Mari Carmen Aponte, Esq.
Francisco Arriví - President and CEO of Pulte Homes International Caribbean Corp.
Nelson García, CPA - President of Impress Quality Printing
Norberto González, CPA, JD, Executive VP & Chief Financial Officer
Julian S. Inclán - President, American Paper Corp.
Ganesh Kumar, Executive VP Strategic Planning & Operations
Rafael Machargo, Esq. - Managing Partner, Machargo Chardón & Associates
Julio Micheo, CPA, Senior Executive VP and Chief Investments Officer
Pedro Morazzani, CPA - Partner, CPA Firm Zayas, Morazzani & Co.
Josen Rossi, Chairman of the Board & CEO, Aireko Enterprises
Carlos O. Souffront, Esq. - Board Secretary



From left: Pedro L. Morazzani, CPA, Rafael Machargo, Esq., Pablo I. Altieri, M.D., Ganesh Kumar, Mari Carmen Aponte, Esq., Carlos O. Souffront, Esq., Francisco Arriví, Julio R. Micheo, CPA, Nelson García, CPA, Norberto González, CPA, J.D., Juan Carlos Aguayo, P.E., Julian S. Inclán.
Seated from left: José Rafael Fernández, José J. Gil de Lamadrid, CPA

Leadership Team

Executive Team

José Rafael Fernández, President, CEO & Vice Chairman of the Board

Julio Micheo, CPA, Senior Executive VP and Chief Investments Officer

Norberto González, CPA, JD, Executive VP & Chief Financial Officer

Ganesh Kumar, Executive VP Strategic Planning & Operations

Officers

José Rafael Fernández, President, CEO & Vice Chairman of the Board

Julio Micheo, CPA, Senior Executive VP and Chief Investments Officer

Norberto González, CPA, JD, Executive VP & Chief Financial Officer

Ganesh Kumar, Executive VP, Strategic Planning & Operations

Carlos O. Souffront, Esq, Legal Counsel

Mari Evelyn Rodríguez, Senior VP, Retail Banking

José Gabriel Díaz, Esq., First Senior VP & Executive Trust Office

Luis Raúl Salvá, Senior VP, Chief Lending Officer

Sylvia Rivera, Senior VP, Mortgages

Grettel Báez, CPA, VP & General Auditor

Francisco Portero, Senior VP, Commercial Banking

Bill Hummer, President Caribbean Pension Consultants (CPC)

Juan José Santiago, CPA, Senior VP, Trust Officer

Sean Miles, Senior VP, Principal -Oriental Financial Services

Carlos Viña, CPA, Senior VP and Controller

César A. Ortiz, CPA, Esq., Senior VP, Risk Management

Patrick Dunn, Senior VP Operations – Oriental Financial Services

Rafael Cruz, Eng., Senior VP, Operations

Ana T. Ramos, Senior VP, Information Technology

Jennifer Zapata, Senior VP, Human Resources

Form 10K

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the Fiscal Year Ended December 31, 2009,

or

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

For the Transition Period from to .

Commission File No. 001-12647

ORIENTAL FINANCIAL GROUP INC.

Incorporated in the Commonwealth of Puerto Rico

IRS Employer Identification No. 66-0538893

Principal Executive Offices:

997 San Roberto Street

Oriental Center 10th Floor

Professional Office Park

San Juan, Puerto Rico 00926

Telephone Number: (787) 771-6800

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

Common Stock

(\$1.00 par value per share)

**7.125% Noncumulative Monthly Income Preferred Stock, Series A
(\$1.00 par value per share, \$25.00 liquidation preference per share)**

**7.0% Noncumulative Monthly Income Preferred Stock, Series B
(\$1.00 par value per share, \$25.00 liquidation preference per share)**

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

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

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

The aggregate market value of the common stock held by non-affiliates of Oriental Financial Group Inc. (the "Group") was \$235.0 million based upon the reported closing price of \$9.70 on the New York Stock Exchange as of June 30, 2009.

As of February 28, 2010, the Group had 24,179,686 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Group's annual report to shareholders for the year 2009 are incorporated herein by reference in response to Items 5 through 9A of Part II and Item 15(a)(1) of Part IV.

Portions of the Group's definitive proxy statement relating to the 2009 annual meeting of shareholders are incorporated herein by reference in response to Items 10 through 14 of Part III.

ORIENTAL FINANCIAL GROUP INC.

FORM 10-K

For the Year Ended December 31, 2009

TABLE OF CONTENTS

PART I

Item 1.	Business	3-16
Item 1A.	Risk Factors	16-23
Item 1B.	Unresolved Staff Comments	23
Item 2.	Properties	23
Item 3.	Legal Proceedings	23
Item 4.	Submissions of Matters to a Vote of Security Holders	23

PART II

Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	23
Item 6.	Selected Financial Data	25
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	26
Item 8.	Financial Statements and Supplementary Data	26
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	26
Item 9A.	Controls and Procedures	26
Item 9B.	Other Information	26

PART III

Item 10.	Directors, Executive Officers and Corporate Governance	27
Item 11.	Executive Compensation	27
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	27
Item 13.	Certain Relationships, Related Transactions, and Director Independence	27
Item 14.	Principal Accountant Fees and Services	27

PART IV

Item 15.	Exhibits and Financial Statement Schedules	27
----------	--	----

FORWARD-LOOKING STATEMENTS

When used in this Form 10-K or future filings by Oriental Financial Group Inc. (the “Group”) with the Securities and Exchange Commission (the “SEC”), in the Group’s press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases “would be,” “will allow,” “intends to,” “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimated,” “project,” “believe,” “should” or similar expressions are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995.

The future results of the Group could be affected by subsequent events and could differ materially from those expressed in forward-looking statements. If future events and actual performance differ from the Group’s assumptions, the actual results could vary significantly from the performance projected in the forward-looking statements.

The Group wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made and are based on management’s current expectations, and to advise readers that various factors, including regional and national economic conditions, substantial changes in levels of market interest rates, credit and other risks of lending and investment activities, competitive, and regulatory factors, legislative changes and accounting pronouncements, could affect the Group’s financial performance and could cause the Group’s actual results for future periods to differ materially from those anticipated or projected. The Group does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

PART I

ITEM 1. BUSINESS

General

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

The Group provides comprehensive financial services to its clients through a complete range of banking and financial solutions, including mortgage, commercial and consumer lending; checking and savings accounts; financial planning, insurance, wealth management, and investment brokerage; and corporate and individual trust and retirement services. The Group operates through three major business segments: Banking, Financial Services, and Treasury, and distinguishes itself based on quality service and marketing efforts focused on mid and high net worth individuals and families, including professionals and owners of small and mid-sized businesses, primarily in Puerto Rico. The Group has 21 financial centers in Puerto Rico and a subsidiary, Caribbean Pension Consultants Inc. (“CPC”), based in Boca Raton, Florida. The Group’s long-term goal is to strengthen its banking and financial services franchise by expanding its lending businesses, increasing the level of integration in the marketing and delivery of banking and financial services, continuing to maintain effective asset-liability management, growing non-interest revenues from banking and financial services, and improving operating efficiencies.

The Group’s strategy involves:

- (1) Strengthening its banking and financial services franchise by expanding its ability to attract deposits and build relationships with mid net worth individual customers and professionals and mid-market commercial businesses through aggressive marketing and expansion of its sales force;
- (2) Focusing on greater growth in mortgage, commercial and consumer lending; trust and wealth management services, insurance products; and increasing the level of integration in the marketing and delivery of banking and financial services;

(3) Matching its portfolio of investment securities with the related funding to better lock-in favorable spreads, and primarily investing in U.S. government agency obligations.

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

(5) Implementing a broad ranging effort to instill in employees and make customers aware of the Group's determination to effectively serve and advise its customer base in a responsive and professional manner.

Together with a highly experienced group of senior and mid level executives, this strategy has generally resulted in sustained growth in the Group's mortgage, commercial, consumer lending and wealth-management activities, allowing the Group to distinguish itself in a highly competitive industry. The Group is not immune from general and local financial and economic conditions. Past experience is not necessarily indicative of future performance, especially given market uncertainties, but based on a reasonable time horizon of three to five years, the strategy is expected to maintain its steady progress towards the Group's long-term goal.

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

Segment Disclosure

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

For detailed information regarding performance of the Group's operating segments, please refer to Note 17 to the Group's accompanying consolidated financial statements.

Banking Activities

Oriental Bank and Trust (the "Bank"), the Group's main subsidiary, is a full-service Puerto Rico commercial bank with its main office located in San Juan, Puerto Rico. The Bank has 21 branches throughout Puerto Rico and was incorporated in 1964 as a federal mutual savings and loan association. It became a federal mutual savings bank in July 1983 and converted to a federal stock savings bank in April 1987. Its conversion from a federally-chartered savings bank to a commercial bank chartered under the banking law of the Commonwealth of Puerto Rico, on June 30, 1994, allowed the Bank to more effectively pursue opportunities in its market and obtain more flexibility in its businesses, placing the Bank in the mainstream of financial services in Puerto Rico. As a Puerto Rico-chartered commercial bank, it is subject to examination by the Federal Deposit Insurance Corporation (the "FDIC") and the Office of the Commissioner of Financial Institutions of Puerto Rico (the "OCFI"). The Bank offers banking services such as commercial and consumer lending, saving and time deposit products, financial planning, and corporate and individual trust services, and capitalizes on its commercial banking network to provide mortgage lending products to its clients. The Bank operates an international banking entity ("IBE") pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended (the "IBE Act"), which is a wholly-owned subsidiary of the Bank, named Oriental International Bank Inc. (the "IBE subsidiary") organized in November 2003. The IBE subsidiary offers the Bank certain Puerto Rico tax advantages and its services are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.

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

The Group's mortgage banking activities are conducted through a division of the Bank. The mortgage banking activities primarily consist of the origination and purchase of residential mortgage loans for the Group's own portfolio and from time to time, if conditions so warrant, the Group may engage in the sale of such loans to other financial institutions in the secondary market. The Group originates Federal Housing Administration ("FHA")-insured, Veterans Administration ("VA")-guaranteed mortgages, and Rural Housing Service ("RHS")-guaranteed loans that are primarily securitized for issuance of Government National Mortgage Association ("GNMA") mortgage-backed securities which can be resold to individual or institutional investors in the secondary market. Conventional loans that meet the underwriting requirements for sale or exchange under standard Federal National Mortgage Association (the "FNMA") or the Federal Home Loan Mortgage Corporation (the "FHLMC") programs are referred to as conforming mortgage loans and are also securitized for issuance of FNMA or FHLMC mortgage-backed securities. The Group is an approved seller of FNMA, as well as FHLMC, mortgage loans for issuance of FNMA and FHLMC mortgage-backed securities. The Group is also an approved issuer of GNMA mortgage-backed securities. The Group continues to outsource the servicing of the GNMA, FNMA and FHLMC pools that it issues and its mortgage loan portfolio.

Servicing assets represent the contractual right to service loans for others. Servicing assets are included as part of other assets in the consolidated statements of financial condition. Loan servicing fees, which are based on a percentage of the principal balances of the loans serviced, are credited to income as loan payments are collected. Servicing assets are initially recognized at fair value. For subsequent measurement of servicing rights, the Group has elected the amortization method with periodic testing for impairment.

Loan Underwriting

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

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

Sale of Loans and Securitization Activities

The Group may engage in the sale or securitization of a portion of the residential mortgage loans that it originates and purchases and utilizes various channels to sell its mortgage products. The Group is an approved issuer of GNMA-guaranteed mortgage-backed securities which involves the packaging of FHA loans, RHS loans or VA loans into pools of mortgage-backed securities for sale primarily to securities broker-dealers and other institutional investors. The Group can also act as issuer in the case of conforming conventional loans in order to group them into pools of FNMA or FHLMC-issued mortgage-backed securities which the Group then sells to securities broker-dealers. The issuance of mortgage-backed securities provides the Group with flexibility in selling the mortgage loans that it originates or purchases and also provides income by increasing the value and marketability of such loans. In the case of conforming conventional loans, the Group also has the option to sell such loans through the FNMA and FHLMC cash window programs.

Financial Services Activities

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

Oriental Financial Services Corp. (“OFSC”) is a Puerto Rico corporation and the Group’s subsidiary engaged in securities brokerage and investment banking activities in accordance with the Group’s strategy of providing fully integrated financial solutions to the Group’s clients. OFSC, a member of the Financial Industry Regulatory Authority (“FINRA”) and the Securities Investor Protection Corporation, is a registered securities broker-dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934. OFSC does not carry customer accounts and is, accordingly, exempt from the Customer Protection Rule (SEC Rule 15c3-3) pursuant to subsection (k)(2)(ii) of such rule. It clears securities transactions through National Financial Services, LLC, a clearing agent which carries the accounts of OFSC’s customers on a “fully disclosed” basis.

OFSC offers securities brokerage services covering various investment alternatives such as tax-advantaged fixed income securities, mutual funds, stocks, and bonds to retail and institutional clients. It also offers separately managed accounts and mutual fund asset allocation programs sponsored by unaffiliated professional asset managers. These services are designed to meet each client’s specific needs and preferences, including transaction-based pricing and asset-based fee pricing.

OFSC also manages and participates in public offerings and private placements of debt and equity securities in Puerto Rico and engages in municipal securities business with the Commonwealth of Puerto Rico and its instrumentalities, municipalities, and public corporations. Investment banking revenue from such activities include gains, losses, and fees, net of syndicate expenses, arising from securities offerings in which OFSC acts as an underwriter or agent. Investment banking revenue also includes fees earned from providing merger-and-acquisition and financial restructuring advisory services. Investment banking management fees are recorded on the offering date, sales concessions on settlement date, and underwriting fees at the time the underwriting is completed and the income is reasonably determinable.

Oriental Insurance Inc. (“Oriental Insurance”) is a Puerto Rico corporation and the Group’s subsidiary engaged in insurance agency services. It was established by the Group to take advantage of the cross-marketing opportunities provided by financial modernization legislation. Oriental Insurance currently earns commissions by acting as a licensed insurance agent in connection with the issuance of insurance policies by unaffiliated insurance companies and anticipates continued growth as it expands the products and services it provides and continues to cross market its services to the Group’s existing customer base.

Caribbean Pension Consultants, Inc., a Florida corporation, is the Group’s subsidiary engaged in the administration of retirement plans in the U.S., Puerto Rico, and the Caribbean.

Treasury Activities

Treasury activities encompass all of the Group’s treasury-related functions. The Group’s investment portfolio consists of mortgage-backed securities, obligations of U.S. Government sponsored agencies, Puerto Rico Government and agency obligations, structured credit investments, and money market instruments. Agency mortgage-

backed securities, the largest component, consist principally of pools of residential mortgage loans that are made to consumers and then resold in the form of pass-through certificates in the secondary market, the payment of interest and principal of which is guaranteed by GNMA, FNMA or FHLMC.

Market Area and Competition

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

Regulation and Supervision

General

The Group is a financial holding company subject to supervision and regulation by the Federal Reserve Board under the BHC Act, as amended by the Gramm-Leach-Bliley Act. The qualification requirements and the process for a bank holding company that elects to be treated as a financial holding company requires that all of the subsidiary banks controlled by the bank holding company at the time of election must be and remain at all times "well capitalized" and "well managed."

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

Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity provided it does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Gramm-Leach-Bliley Act specifically provides that the following activities have been determined to be "financial in nature": (a) lending, trust and other banking activities; (b) insurance activities; (c) financial, investment or economic advisory services; (d) securitization of assets; (e) securities underwriting and dealing; (f) existing bank holding company domestic activities; (g) existing bank holding company foreign activities; and (h) merchant banking activities.

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

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

The Bank is regulated by various agencies in the United States and the Commonwealth of Puerto Rico. Its main regulators are the OCFI and the FDIC. The Bank is subject to extensive regulation and examination by the OCFI and

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

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

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

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

Holding Company Structure

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

Under Federal Reserve Board policy, a bank holding company, such as the Group, is expected to act as a source of financial and managerial strength to its banking subsidiaries and to also commit resources to support them. This support may be required at times when, absent such policy, the bank holding company might not otherwise provide such support. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. The Bank is currently the only depository institution subsidiary of the Group.

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

Dividend Restrictions

The principal source of funds for the Group's holding company is the dividends from the Bank. The ability of the Bank to pay dividends on its common stock is restricted by the Puerto Rico Banking Act of 1933, as amended (the Banking Act), the FDIA and FDIC regulations. In general terms, the Banking Act provides that when the

expenditures of a bank are greater than receipts, the excess of expenditures over receipts shall be charged against the undistributed profits of the bank and the balance, if any, shall be charged against the required reserve fund of the bank. If there is no sufficient reserve fund to cover such balance in whole or in part, the outstanding amount shall be charged against the bank's capital account. The Banking Act provides that until said capital has been restored to its original amount and the reserve fund to 20% of the original capital, the bank may not declare any dividends from the reserve account. In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding a bank. For more information see Note 13 to the accompanying consolidated financial statements.

The payment of dividends by the Bank may also be affected by other regulatory requirements and policies, such as maintenance of adequate capital. If, in the opinion of the regulatory authority, a depository institution under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice (that, depending on the financial condition of the depository institution, could include the payment of dividends), such authority may require, after notice and hearing, that such depository institution cease and desist from such practice. The Federal Reserve Board has issued a policy statement that provides that insured banks and bank holding companies should generally pay dividends only out of operating earnings for the current and preceding two years. In addition, all insured depository institutions are subject to the capital-based limitations required by the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA").

Federal Home Loan Bank System

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

As a system member, the Bank is entitled to borrow from the FHLB of New York (the "FHLB-NY") and is required to invest in FHLB-NY stock in an amount equal to the greater of \$500; 1% of the Bank's aggregate unpaid principal of its home mortgage loans, home purchase contracts, and similar obligations; or 5% of the Bank's aggregate amount of outstanding advances by the FHLB-NY. The Bank is in compliance with the stock ownership rules described above with respect to such advances, commitments, home mortgage loans and similar obligations. All loans, advances and other extensions of credit made by the FHLB-NY to the Bank are secured by a portion of the Bank's mortgage loan portfolio, certain other investments, and the capital stock of the FHLB-NY held by the Bank. At no time may the aggregate amount of outstanding advances made by the FHLB-NY to the Bank exceed 20 times the amount paid in by the Bank for capital stock in the FHLB-NY.

Federal Deposit Insurance Corporation Improvement Act

Under FDICIA the federal banking regulators must take prompt corrective action in respect to depository institutions that do not meet minimum capital requirements. FDICIA, and the regulations issued thereunder, established five capital tiers: (i) "well capitalized," if it has a total risk-based capital ratio of 10.0% or more, has a Tier I risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more, and is not subject to any written capital order or directive; (ii) "adequately capitalized," if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of "well capitalized," (iii) "undercapitalized," if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances), (iv) "significantly undercapitalized," if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital ratio that is less than 3.0%, and (v) "critically undercapitalized," if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. A depository institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives a less than satisfactory examination rating in any of the following categories: asset, management, earnings, and liquidity. The Bank is a "well-capitalized" institution.

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

FDIC Insurance Assessments

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

On May 10, 2009, President Barack Obama signed the Helping Families Save Their Home Act which extends the temporary increase in the standard maximum deposit insurance amount ("SMDIA") to \$250,000 per depositor through December 31, 2013. The legislation provides that the SMDIA limit will return to \$100,000 on January 1, 2014. The legislation did not increase coverage for retirement accounts, which continues to be \$250,000.

The Temporary Liquidity Guarantee Program (TLGP) of the FDIC is intended to strengthen confidence and encourage liquidity in the banking system. The TLGP is comprised of the Debt Guarantee Program ("DGP") and the Transaction Account Guarantee Program ("TAGP"). The DGP guarantees all newly issued senior unsecured debt (e.g., promissory notes, unsubordinated unsecured notes and commercial paper) up to prescribed limits issued by participating entities, including bank holding companies, beginning on October 14, 2008 and continuing through October 31, 2009. For eligible debt issued by that date, the FDIC provides the guarantee coverage until the earlier of the maturity date of the debt or June 30, 2012. The TAGP offers a full guarantee for non interest-bearing transaction deposit accounts held at FDIC-insured depository institutions. The unlimited deposit coverage is voluntary for eligible institutions and is in addition to the \$250,000 FDIC deposit insurance per depositor that was included as part of the EESA. The TAGP coverage became effective on October 14, 2008 and will continue for participating institutions until June 30, 2010. The Group opted to become a participating entity on both of these programs and will pay applicable fees for participation. Participants in the DGP program have a fee structure based on a sliding scale, depending on length of maturity. Shorter-term debt has a lower fee structure and longer-term debt has a higher fee. The range is 50 basis points on debt of 180 days or less, and a maximum of 100 basis points for debt with maturities of one year or longer, on an annualized basis. Any eligible entity that has not chosen to opt out of the TAGP is assessed, on a quarterly basis, an annualized 10 cents per \$100 fee on balances in non-interest bearing transaction accounts that exceed the existing deposit insurance limit of \$250,000. The Group's banking subsidiary issued in March 2009 \$105 million in notes guaranteed under the TLGP. These notes are due on March 16, 2012, bear interest at a 2.75% fixed rate, and are backed by the full faith and credit of the United States. Interest on the notes is payable on the 16th of each March and September. An annual fee of 100 basis points is paid to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes.

On February 27, 2009, the FDIC adopted a final rule to alter the way in which the FDIC's risk-based assessment system differentiates for risk, change deposit insurance assessment rates, and make technical and other changes to the rules governing the risk-based assessment system. Under this final rule, risk-based rates will range between 12 and 45 cents per \$100 of domestic deposits (annualized) and between 7 and 77.5 cents per \$100 of domestic deposits

after adjustments, effective April 1, 2009. Most institutions will be charged between 7 and 24 cents per \$100 of deposits. Also on February 27, 2009, the FDIC adopted an interim final rule to impose an emergency special assessment of 20 cents per \$100 of deposits on June 30, 2009, and to allow the FDIC to impose emergency special assessments after June 30, 2009 of 10 cents per \$100 of deposits if the reserve ratio of the DIF is estimated to fall to a level that the FDIC believes would adversely affect public confidence or to a level that is close to zero or negative at the end of a calendar quarter. The Group's special assessment was \$2.9 million.

On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 30, 2009, along with each institution's risk-based deposit insurance assessment for the third quarter of 2009. The Bank's prepayment of the assessment for 2010, 2011 and 2012 amounted to \$22.6 million.

Brokered Deposits

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well capitalized institutions are not subject to limitations on brokered deposits, while adequately-capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the interest paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits. As of December 31, 2009, the Bank was a well capitalized institution and was therefore not subject to these limitations on brokered deposits.

Regulatory Capital Requirements

The Federal Reserve Board has adopted risk-based capital guidelines for bank holding companies. Under the guidelines, the minimum ratio of qualifying total capital to risk-weighted assets is 8%. At least half of the total capital is to be comprised of qualifying common stockholders' equity, qualifying noncumulative perpetual preferred stock (including related surplus), minority interests related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary, and restricted core capital elements (collectively "Tier 1 Capital"). Banking organizations are expected to maintain at least 50 percent of their Tier 1 Capital as common equity. Not more than 25% of qualifying Tier 1 Capital may consist of noncumulative perpetual preferred stock, trust preferred securities or other "so-called" restricted core capital elements. "Tier 2 Capital" may consist, subject to certain limitations, of allowance for loan and lease losses; perpetual preferred stock and related surplus hybrid capital instruments, perpetual debt, and mandatory convertible debt securities; term subordinated debt and intermediate-term preferred stock, including related surplus; and unrealized holding gains on equity securities. "Tier 3 Capital" consists of qualifying unsecured subordinated debt. The sum of Tier 2 and Tier 3 Capital may not exceed the amount of Tier 1 Capital.

The Federal Reserve Board has adopted regulations with respect to risk-based and leverage capital ratios that require most intangibles, including core deposit intangibles, to be deducted from Tier 1 Capital. The regulations, however, permit the inclusion of a limited amount of intangibles related to originated and purchased mortgage servicing rights and purchased credit card relationships and include a "grandfathered" provision permitting inclusion of certain existing intangibles.

In addition, the Federal Reserve Board has established minimum leverage ratio (Tier 1 Capital to total assets) guidelines for bank holding companies and member banks. These guidelines provide for a minimum leverage ratio of 3% for bank holding companies and member banks that meet certain specified criteria including that they have the highest regulatory rating. All other bank holding companies and member banks are required to maintain a minimum ratio of Tier 1 Capital to total assets of 4%. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the guidelines state that the Federal Reserve Board will continue to consider a "tangible Tier 1 leverage ratio" and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet the capital guidelines could subject an institution to a variety of enforcement actions including the termination of deposit insurance by the FDIC and to certain restrictions on its business. At December 31, 2009, the

Group was in compliance with all capital requirements. For more information, please refer to Note 13 to the accompanying consolidated financial statements.

Safety and Soundness Standards

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

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

Activities and Investments of Insured State-Chartered Banks

Section 24 of the FDIA, as amended by FDICIA, generally limits the activities and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national banks. Under FDIC regulations of equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank, such as the Bank, is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary engaged in permissible activities, (ii) investing as a limited partner in a partnership, or as a non-controlling interest holder of a limited liability company, the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting stock of an insured depository institution if certain requirements are met.

Under the FDIC regulations governing the activities and investments of insured state banks which further implemented Section 24 of the FDIA, as amended by FDICIA, an insured state-chartered bank may not, directly, or indirectly through a subsidiary, engage as "principal" in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the insurance fund of which it is a member and the bank is in compliance with applicable regulatory capital requirements. Any insured state-chartered bank directly or indirectly engaged in any activity that is not permitted for a national bank must cease the impermissible activity.

Transactions with Affiliates and Related Parties

Transactions between the Bank and any of its affiliates are governed by sections 23A and 23B of the Federal Reserve Act. These sections are important statutory provisions designed to protect a depository institution from transferring to its affiliates the subsidy arising from the institution's access to the Federal safety net. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. Generally, sections 23A and 23B (1) limit the extent to which a bank or its subsidiaries may engage in "covered transactions"

with any one affiliate to an amount equal to 10% of the bank's capital stock and surplus, and limit such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus, and (2) require that all such transactions be on terms that are consistent with safe and sound banking practices. The term "covered transactions" includes the making of loans, purchase of or investment in securities issued by the affiliate, purchase of assets, issuance of guarantees and other similar types of transactions. Most loans by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100 to 130 percent of the loan amount, depending on the nature of the collateral. In addition, any covered transaction by a bank with an affiliate and any sale of assets or provision of services to an affiliate must be on terms that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with nonaffiliated companies.

Regulation W of the Federal Reserve Board comprehensively implements sections 23A and 23B. The regulation unified and updated staff interpretations issued over the years prior to its adoption, incorporated several interpretative proposals (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate), and addressed issues arising as a result of the expanded scope of non-banking activities engaged in by banks and bank holding companies and authorized for financial holding companies under the Gramm-Leach-Bliley Act.

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

Community Reinvestment Act

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

USA Patriot Act

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

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

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

Privacy Policies

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

Sarbanes-Oxley Act

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

The Group includes in its annual report on Form 10-K the management assessment regarding the effectiveness of the Group's internal control over financial reporting. The internal control report includes a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the Group; management's assessment as to the effectiveness of the Group's internal control over financial reporting based on management's evaluation, as of year-end; and the framework used by management as criteria for evaluating the effectiveness of the Group's internal control over financial reporting. As of December 31, 2009, the Group's management concluded that its internal control over financial reporting was effective.

Puerto Rico Banking Act

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

The Banking Act requires that a minimum of 10% of the Bank's net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid in capital on common and preferred stock. At December 31, 2009, legal surplus amounted to \$45.3 million (December 31, 2008 - \$43.0 million). The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders. In addition, the Federal Reserve Board has issued a policy statement that bank holding companies should generally pay dividends only from operating earnings of the current and preceding two years.

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

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

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

The Banking Act permits Puerto Rico commercial banks to make loans to any one person, firm, partnership or corporation, up to an aggregate amount of 15% of the sum of: (i) the bank's paid-in capital; (ii) the bank's reserve fund; (iii) 50% of the bank's retained earnings; subject to certain limitations; and (iv) any other components that the OCFI may determine from time to time. If such loans are secured by collateral worth at least 25% more than the amount of the loan, the aggregate maximum amount shall include 33.33% of 50% of the bank's retained earnings. There are no restrictions under the Banking Act on the amount of loans that are wholly secured by bonds, securities and other evidence of indebtedness of the Government of the United States or of the Commonwealth of Puerto Rico, or by bonds, not in default, of municipalities or instrumentalities of the Commonwealth of Puerto Rico.

The Puerto Rico Finance Board is composed of the Commissioner of Financial Institutions of Puerto Rico; the Presidents of the Government Development Bank for Puerto Rico, the Economic Development Bank for Puerto Rico and the Planning Board; the Puerto Rico Secretaries of Commerce and Economic Development, Treasury and Consumer Affairs; the Commissioner of Insurance; and the President of the Public Corporation for Insurance and Supervision of Puerto Rico Cooperatives. It has the authority to regulate the maximum interest rates and finance charges that may be charged on loans to individuals and unincorporated businesses in the Commonwealth, and promulgates regulations that specify maximum rates on various types of loans to individuals.

The current regulations of the Puerto Rico Finance Board provide that the applicable interest rate on loans to individuals and unincorporated businesses (including real estate development loans, but excluding certain other personal and commercial loans secured by mortgages on real estate property) is to be determined by free competition. The Puerto Rico Finance Board also has the authority to regulate maximum finance charges on retail installment sales contracts and for credit card purchases. There is presently no maximum rate for retail installment sales contracts and for credit card purchases.

International Banking Center Regulatory Act of Puerto Rico

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

Pursuant to the IBE Act and the IBE Regulations, the Bank's IBE subsidiary has to maintain books and records of all its transactions in the ordinary course of business. It is also required to submit quarterly and annual reports of their financial condition and results of operations to the OCFI, including annual audited financial statements.

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

Employees

At December 31, 2009, the Group had 526 employees. None of its employees is represented by a collective bargaining group. The Group considers its employee relations to be good.

Internet Access to Reports

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

The Group's corporate governance guidelines, code of business conduct and ethics, and the charters of its audit committee, compensation committee, and corporate governance and nominating committee are available free of charge on the Group's website at www.orientalfg.com in the investor relations section under the corporate governance link. The Group's code of business conduct and ethics applies to its directors, officers, employees and agents, including its principal executive, financial and accounting officers.

ITEM 1A. RISK FACTORS

In addition to the other information contained elsewhere in this report and our other filings with the SEC, the following risk factors should be carefully considered in evaluating us. The risks and uncertainties described below are not the only ones that we face. Additional risks and uncertainties, not presently known to us or otherwise, may also impair our business operations. If any of the risks described below or such other risks actually occur, our business, financial condition or results of operations could be materially and adversely affected.

We may incur a significant impairment charge in connection with a decline in the market value of our investment securities portfolio, including our non-agency collateralized mortgage obligations and structured credit investments

The majority of our earnings come from our Treasury business segment, which encompasses our investment securities portfolio. The determination of fair value for investment securities involves significant judgment due to the complexity of factors contributing to the valuation, many of which are not readily observable in the market. In addition, we utilize and review information obtained from third-party sources to measure fair values. Third-party sources also use assumptions, judgments and estimates in determining securities values, and different third parties may provide different prices for securities. Moreover, depending upon, among other things, the measurement date of the security, the subsequent sale price of the security may be different from its recorded fair value. These differences may be significant, especially if the security is sold during a period of illiquidity or market disruption.

When the fair value of a security declines, management must assess whether the decline is "other-than-temporary." When the decline in fair value is deemed "other-than-temporary," the amortized cost basis of the investment security is reduced to its then current fair value. On April 1, 2009, we adopted FASB Accounting Standard Codification ("ASC") 320-10-65-1, which changed the accounting requirements for other than temporary impairments for debt securities and, in certain circumstances, separates the amount of total impairment into credit and noncredit-related amounts. The review takes into consideration current market conditions, issuer rating changes and trends, the credit worthiness of the obligator of the security, current analysts' evaluations, failure of the issuer to make scheduled interest or principal payments, our intent to not sell the security or whether it is more-likely-than-not that we will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term "other than temporary impairments" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, computed using original yield as the discount rate, to the amortized cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is

considered to be the “credit loss.” Such impairment charges reflect non-cash losses at the time of recognition. Subsequent disposition or sale of such assets could further affect our future results of operations, as they are based on the difference between the sale prices received and adjusted amortized cost of such assets at the time of sale. The review of whether a decline in fair value is other-than-temporary considers numerous factors and many of these factors involve significant judgment.

For more information about our investment securities portfolio and our other-than-temporary impairment losses on securities in 2009, see Note 2 to the accompanying consolidated financial statements.

Changes in interest rates may hurt our business

Changes in interest rates is one of the principal market risks affecting us. Our income and cash flows depend to a great extent on the difference between the interest rates earned on interest-earning assets such as loans and investment securities, and the interest rates paid on interest-bearing liabilities such as deposits and borrowings. These rates are highly sensitive to many factors that are beyond our control, including general economic conditions and the policies of various governmental and regulatory agencies (in particular, the Federal Reserve Board). Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the prepayment speed of loans, the value of loans and investment securities, the purchase of investments, the generation of deposits and the rates received on loans and investment securities and paid on deposits or other sources of funding.

We are at risk because most of our business is conducted in Puerto Rico, which is experiencing a downturn in the economy and in the real estate market

Because most of our business activities are conducted in Puerto Rico and a substantial portion of our credit exposure is in Puerto Rico, we are at risk from adverse economic, political or business developments and natural hazards that affect Puerto Rico.

Since 2006, the Puerto Rico economy has been experiencing recessionary conditions. Based on information published by the Puerto Rico Planning Board, the Puerto Rico real gross national product decreased 3.7% during the fiscal year ended June 30, 2009.

The Commonwealth of Puerto Rico government is currently addressing a fiscal deficit. It is implementing a multi-year budget plan for reducing the deficit, as its access to the municipal bond market and its credit ratings depend, in part, on achieving a balanced budget. Some of the measures implemented by the government included reducing expenses, including public-sector employment through employee layoffs. Since the government is an important source of employment on the Island, these measures could have the effect of intensifying the current recessionary cycle. The Puerto Rico Labor Department reported an unemployment rate of 14.3% for December 2009, compared with an unemployment rate of 13.1% for December 2008.

Pursuant to the Declaration of Fiscal Emergency and Omnibus Plan for Economic Stabilization and Restoration of the Puerto Rican Credit Act of March 2, 2009, for tax years beginning after December 31, 2008, and ending before January 1, 2012, every corporation engaged in trade or business in Puerto Rico, including banks, insurance companies, and international banking entities, will be subject to an additional five percent (5%) surcharge on corporate income tax. This temporary tax was enacted as a measure to generate additional revenues to address the fiscal crisis that the government of Puerto Rico is currently facing.

A period of reduced economic growth or a recession has historically resulted in a reduction in lending activity and an increase in the rate of defaults in commercial loans, consumer loans and residential mortgages. A recession may have a significant adverse impact on our net interest income and fee income. We may also experience significant losses on the loan portfolio due to a higher level of defaults on commercial loans, consumer loans and residential mortgages.

The decline in Puerto Rico’s economy has had an adverse effect in the credit quality of our loan portfolios as delinquency rates have increased in the short-term and may continue to increase until the economy stabilizes. Among other things, we have experienced an increase in the level of our non-performing assets and loan loss

provision, which adversely affects our profitability. If the decline in economic activity continues, additional increases in the allowance for loan losses could be necessary and there could be further adverse effects on our profitability. The reduction in consumer spending may also continue to impact growth in our other interest and non-interest revenue sources.

The level of real estate prices in Puerto Rico had been more stable than in other U.S. markets, but the current economic environment has accelerated the devaluation of properties and has increased portfolio delinquency when compared with previous periods. Additional economic weakness in Puerto Rico and the U.S. mainland could further pressure residential property values, loan delinquencies, foreclosures and the cost of repossessing and disposing of real estate collateral. The housing market has suffered a substantial slowdown in sales activity in recent quarters.

Financial results are constantly exposed to market risk

Market risk refers to the probability of variations in the net interest income or the fair value of assets and liabilities due to changes in interest rates, currency exchange rates or equity prices. Despite the varied nature of market risks, the primary source of this risk to us is the impact of changes in interest rates on net interest income.

Net interest income is the difference between the revenue generated on earning assets and the interest cost of funding those assets. Depending on the duration and repricing characteristics of the assets, liabilities and off-balance sheet items, changes in interest rates could either increase or decrease the level of net interest income. For any given period, the pricing structure of the assets and liabilities is matched when an equal amount of such assets and liabilities mature or reprice in that period.

We use an asset-liability management software to project future movements in our balance sheet and income statement. The starting point of the projections generally corresponds to the actual values of the balance sheet on the date of the simulations. These simulations are highly complex, and use many simplifying assumptions.

We are subject to interest rate risk because of the following factors:

- Assets and liabilities may mature or reprice at different times. For example, if assets reprice slower than liabilities and interest rates are generally rising, earnings may initially decline.
- Assets and liabilities may reprice at the same time but by different amounts. For example, when the general level of interest rates is rising, we may increase rates charged on loans by an amount that is less than the general increase in market interest rates because of intense pricing competition. Also, basis risk occurs when assets and liabilities have similar repricing frequencies but are tied to different market interest rate indices that may not move in tandem.
- Short-term and long-term market interest rates may change by different amounts, i.e., the shape of the yield curve may affect new loan yields and funding costs differently.
- The remaining maturity of various assets and liabilities may shorten or lengthen as interest rates change. For example, if long-term mortgage interest rates decline sharply, mortgage-backed securities held in the securities available-for-sale portfolio may prepay significantly earlier than anticipated, which could reduce portfolio income. If prepayment rates increase, we would be required to amortize net premiums into income over a shorter period of time, thereby reducing the corresponding asset yield and net interest income. Prepayment risk also has a significant impact on mortgage-backed securities and collateralized mortgage obligations, since prepayments could shorten the weighted average life of these portfolios.
- Interest rates may have an indirect impact on loan demand, credit losses, loan origination volume, the value of financial assets and financial liabilities, gains and losses on sales of securities and loans, the value of mortgage servicing rights and other sources of earnings.

In limiting interest rate risk to an acceptable level, management may alter the mix of floating and fixed rate assets and liabilities, change pricing schedules, adjust maturities through sales and purchases of investment securities, and enter into derivative contracts, among other alternatives. We may suffer losses or experience lower spreads than anticipated in initial projections as management implement strategies to reduce future interest rate exposure.

The hedging transactions we enter into may not be effective in managing the exposure to market risk, including interest rate risk

We offer certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index and we use derivatives, such as option agreements with major broker-dealer companies, to manage our exposure to changes in the value of the index. We may also use derivatives, such as interest rate swaps, to manage part of our exposure to market risk caused by changes in interest rates. The derivative instruments that we may utilize also have their own risks, which include: (1) basis risk, which is the risk of loss associated with variations in the spread between the asset yield and the funding and/or hedge cost; (2) credit or default risk, which is the risk of insolvency or other inability of the counterparty to a particular transaction to perform its obligations thereunder; and (3) legal risk, which is the risk that we are unable to enforce certain terms of such instruments. All or any of such risks could expose us to losses.

If a counterparty to a derivative contract fails to perform, our credit risk is equal to the net fair value of the contract. Although we deal with counterparties that have high quality credit ratings at the time we enter into the counterparty relationships, there can be no assurances that our counterparties will have the ability to perform under their contracts. If a counterparty fails to perform, including as a result of the bankruptcy or insolvency of a counterparty, we would incur losses as a result.

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

A comprehensive risk management function is essential to the financial and operational success of our business. The types of risk we monitor and seek to manage include, but are not limited to, operational risk, market risk, fiduciary risk, legal and compliance risk, liquidity risk and credit risk. We have adopted various policies, procedures and systems to monitor and manage risk. There can be no assurance that those policies, procedures and systems are adequate to identify and mitigate all risks inherent in our various businesses. In addition, our businesses and the markets in which we operate are continuously evolving. If we fail to fully understand the implications of changes in our business or the financial markets and to adequately or timely enhance our risk framework to address those changes, we could incur losses.

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

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

Any sustained period of increased delinquencies, foreclosures or losses could harm our ability to sell loans, the price we receive on the sale of such loans, and the value of our mortgage loan portfolio, all of which could have a negative impact on our results of operations and financial condition. In addition, any material decline in real estate values would weaken our collateral loan-to-value ratios and increase the possibility of loss if a borrower defaults.

A continuing decline in the real estate market in the U.S. mainland and ongoing disruptions in the capital markets may harm our investment securities and wholesale funding portfolios

The housing market in the U.S. is undergoing a correction of historic proportions. After a period of several years of booming housing markets, fueled by liberal credit conditions and rapidly rising property values, the sector has been in the midst of a substantial correction since early 2007. The general level of property values in the U.S., as

measured by several indices widely followed by the market, has declined. These declines are the result of ongoing market adjustments that are aligning property values with income levels and home inventories. The supply of homes in the market has increased substantially, and additional property value decreases may be required to clear the overhang of excess inventory in the U.S. market.

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

Our business requires continuous access to various funding sources. While we are able to fund our operations through deposits as well as through advances from the Federal Home Loan Bank of New York and other alternative sources, our business is significantly dependent upon other wholesale funding sources, such as repurchase agreements and brokered deposits. While most of our repurchase agreements have been structured with initial terms to maturity of between three and ten years, the counterparties have the right to exercise put options before the contractual maturities.

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

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

Our decisions regarding credit risk and the allowance for loan losses may materially and adversely affect our business and results of operations

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

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

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

Although we believe that our allowance for loan losses is currently sufficient given the constant monitoring of the risk inherent in our loan portfolio, there is no precise method of predicting loan losses and therefore we always face

the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. In addition, the FDIC as well as the Office of the Commissioner of Financial Institutions of Puerto Rico may require us to establish additional reserves. Additions to the allowance for loan losses would result in a decrease of our net earnings and capital and could hinder our ability to pay dividends.

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

From the time that we fund the mortgage loans we originate to the time we sell them, we are generally at risk for any mortgage loan defaults. Once we sell the mortgage loans, the risk of loss from mortgage loan defaults and foreclosures passes to the purchaser or insurer of the mortgage loans. However, in the ordinary course of business, we make representations and warranties to the purchasers and insurers of mortgage loans relating to the validity of such loans. If there is a breach of any of these representations or warranties, we may be required to repurchase the mortgage loan and bear any subsequent loss on the mortgage loan. In addition, we incur higher liquidity risk with respect to the non-conforming mortgage loans originated by us, because of the lack of a favorable secondary market in which to sell them.

Competition with other financial institutions could adversely affect our profitability

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

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

We are subject to extensive regulation, supervision and examination by federal and Puerto Rico banking authorities. As a result of the recent turmoil in U.S. financial markets, there may be significant changes and increased regulation of banks and bank holding companies in the future. Any change in applicable federal or Puerto Rico laws or regulations could significantly affect our powers, authority and operations, and could have a material adverse effect on our financial condition and results of operations. Regulatory changes could also impose additional costs which could negatively impact our profitability. Further, regulators, in the performance of their supervisory and enforcement duties, have significant discretion and power to prevent or remedy unsafe and unsound practices or violations of laws by banks and bank holding companies. The exercise of this regulatory discretion and power may have a negative impact on us.

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

We operate an international banking entity pursuant to the International Banking Center Regulatory Act of Puerto Rico that provides us with significant tax advantages. Our international banking entity has the benefits of exemptions from Puerto Rico income taxes on interest earned on, or gain realized from the sale of, non-Puerto Rico assets, including U.S. government obligations and certain mortgage backed securities. This exemption has allowed us to have effective tax rates significantly below the maximum statutory tax rates. In the past, the legislature of Puerto Rico has considered proposals to curb the tax benefits afforded to international banking entities. In the event legislation passed in Puerto Rico to eliminate or modify the tax exemption enjoyed by international banking entities, the consequences could have a materially adverse impact on us, including increasing our tax burden or otherwise adversely affecting our financial condition, results of operations or cash flows.

Competition in attracting talented people could adversely affect our operations

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

We may engage in FDIC-assisted transactions, which could present risk to our business

We may have opportunities to acquire the assets and liabilities of failed banks in FDIC-assisted transactions. Although these transactions typically provide for FDIC assistance to an acquirer to mitigate certain risks, such as sharing exposure to loan losses and providing indemnification against certain liabilities of the failed institution, we would still be subject to many of the same risks we would face in acquiring another bank in a negotiated transaction, including risks associated with maintaining customer relationships and failure to realize the anticipated acquisition benefits in the amounts and within the timeframes we expect. In addition, because these transactions are structured in a manner that would not allow us the time and access to information normally associated with preparing for and evaluating a negotiated transaction, we may face additional risk in FDIC-assisted transactions, including additional strain on management resources, management of problem loans, problems related to integration of personnel and operating systems and impact to our capital resources requiring us to raise additional capital. We may not be successful in overcoming these risks or any other problems encountered in connection with FDIC-assisted transactions. Our inability to overcome these risks could have a material effect on our business, financial condition and results of operations.

Stock price volatility

The trading price of our common stock could be subject to significant fluctuations due to a change in sentiment in the market regarding the operations, business prospects or industry outlook. Risk factors may include the following:

- operating results that may be worse than the expectations of management, securities analysts and investors;
- developments in the business or in the financial sector in general;
- regulatory changes affecting the industry in general or the business and operations;
- the operating and securities price performance of peer financial institutions;
- announcements of strategic developments, acquisitions and other material events by us or our competitors;
- changes in the credit, mortgage and real estate markets, including the markets for mortgage-related securities; and
- changes in global financial markets and global economies and general market conditions.

Stock markets, in general, and our common stock in particular, have recently experienced significant price and volume volatility and the market price of our common stock may continue to be subject to similar market fluctuations that may be unrelated to the operating performance or prospects.

Dividends on our common stock

Holders of our common stock are only entitled to receive such dividends as our board of directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on the common stock, we are not required to do so. The Group expects to continue to pay dividends but its ability to pay future dividends at current levels will necessarily depend upon its earnings, financial condition, and market conditions.

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

Our financial statements are subject to the application of our accounting principles generally accepted in the United States (“GAAP”), which are periodically revised and/or expanded. Accordingly, from time to time we are required

to adopt new or revised accounting standards issued by FASB. Market conditions have prompted accounting standard setters to promulgate new guidance which further interprets or seeks to revise accounting pronouncements related to financial instruments, structures or transactions as well as to issue new standards expanding disclosures. The impact of accounting developments that have been issued but not yet implemented is disclosed in our annual reports on Form 10-K and our quarterly reports on Form 10-Q. An assessment of proposed standards is not provided as such proposals are subject to change through the exposure process and, therefore, the effects on our financial statements cannot be meaningfully assessed. It is possible that future accounting standards that we are required to adopt could change the current accounting treatment that we apply to our consolidated financial statements and that such changes could have a material effect on our financial condition and results of operations.

ITEM 1B. *UNRESOLVED STAFF COMMENTS*

None.

ITEM 2. *PROPERTIES*

The Group leases its main offices located at 997 San Roberto Street, Oriental Center, Professional Offices Park, San Juan, Puerto Rico. The executive office, treasury, trust division, brokerage, investment banking, commercial banking, insurance services, and back-office support departments are maintained at such location.

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

At December 31, 2009, the aggregate future rental commitments under the terms of the leases, exclusive of taxes, insurance and maintenance expenses payable by the Group was \$25.4 million.

The Group's investment in premises and equipment, exclusive of leasehold improvements at December 31, 2009, was \$24.2 million.

ITEM 3. *LEGAL PROCEEDINGS*

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

ITEM 4. *SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS*

Not applicable.

PART II

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

The Group's common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "OFG". Information concerning the range of high and low sales prices for the Group's common stock for each quarter in the years ended December 31, 2009 and 2008, as well as cash dividends declared for such periods are contained in Table 7 ("Capital, Dividends and Stock Data") and under the "Stockholders' Equity" caption in the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A").

Information concerning legal or regulatory restrictions on the payment of dividends by the Group and the Bank is contained under the caption "Dividend Restrictions" in Item 1 of this report.

As of December 31, 2009, the Group had approximately 4,123 holders of record of its common stock, including all directors and officers of the Group, and beneficial owners whose shares are held in "street" name by securities broker-dealers or other nominees.

The Puerto Rico Internal Revenue Code of 1994, as amended, generally imposes a withholding tax on the amount of any dividends paid by Puerto Rico corporations to individuals, whether residents of Puerto Rico or not, trusts,

estates, and special partnerships at a special 10% withholding tax rate. Prior to the first dividend distribution for the taxable year, such shareholders may elect to be taxed on the dividends at the regular rates, in which case the special 10% tax will not be withheld from such year's distributions. Dividends distributed by Puerto Rico corporations to foreign corporations or partnerships not engaged in trade or business in Puerto Rico are also generally subject to withholding tax at a 10% rate.

United States citizens who are non-residents of Puerto Rico will not be subject to Puerto Rico tax on dividends if the individual's gross income from sources within Puerto Rico during the taxable year does not exceed \$1,300 if single, or \$3,000 if married, and form AS 2732 of the Puerto Rico Treasury Department "Withholding Tax Exemption Certificate for the Purpose of Section 1147" is filed with the withholding agent. U.S. income tax law permits a credit against the U.S. income tax liability, subject to certain limitations, for certain foreign income taxes paid or deemed paid with respect to foreign source income, including that arising from dividends from foreign corporations, such as the Group.

The Group's Amended and Restated 2007 Omnibus Performance Incentive Plan (the "Omnibus Plan"), which provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units and dividend equivalents, as well as equity-based performance awards. The Omnibus Plan replaced and superseded the Oriental Financial Group Inc. 1996, 1998 and 2000 Incentive Stock Option Plans (the "Stock Option Plans"). All outstanding stock options under the Stock Option Plans continue in full force and effect, subject to their original terms and conditions.

The following table shows certain information pertaining to the Omnibus plan as of December 31, 2009:

<u>Plan Category</u>	<u>(a)</u> Number of Securities to Be Issued Upon Exercise of Outstanding Options, warrants and rights	<u>(b)</u> Weighted-Average Exercise Price of Outstanding Options, warrants and rights	<u>(c)</u> Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding those reflected in column (a))
Equity compensation plans approved by shareholders:			
Omnibus Plan	219,301(1)	10.47	330,699

(1) Includes 71,676 stock options and 147,625 restricted stock units.

The Group recorded approximately \$742,000, \$559,000 and \$86,000 related to compensation expense for options issued during the years ended December 31, 2009, 2008, and 2007, respectively.

Purchases of equity securities by the issuer and affiliated purchasers

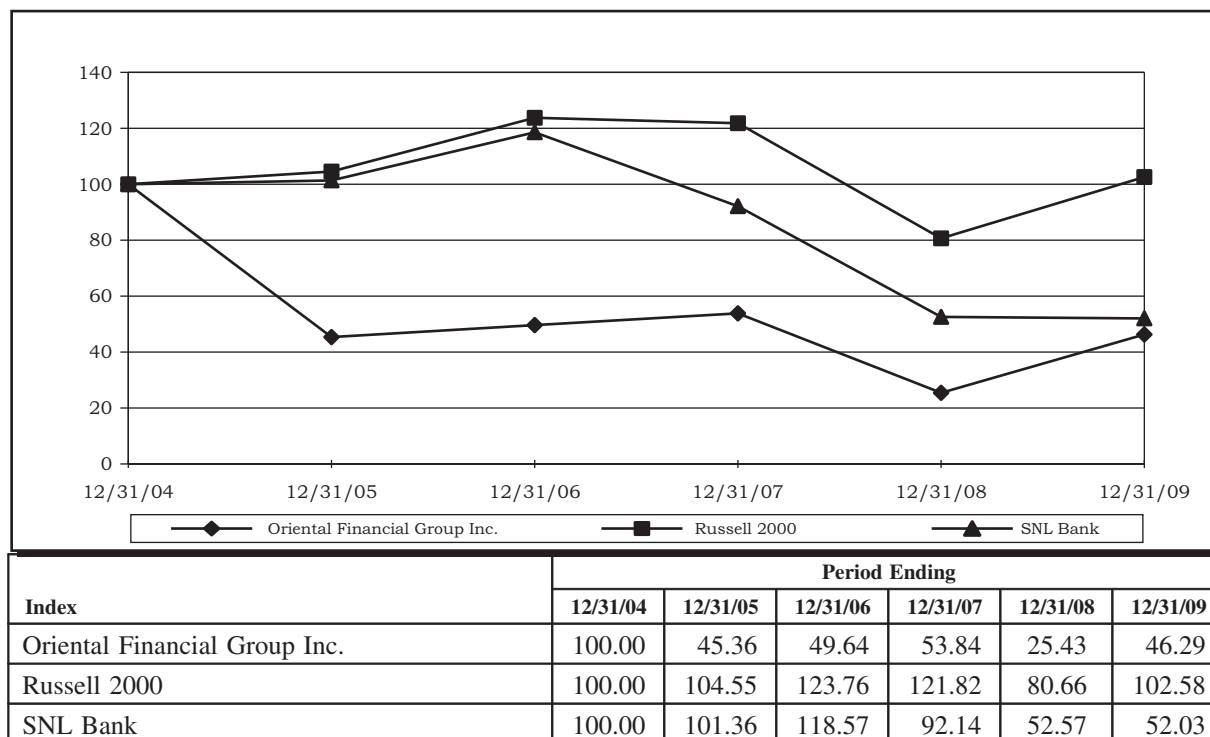
Under the Group's current stock repurchase program it is authorized to purchase in the open market up to \$15.0 million of its outstanding shares of common stock. The shares of common stock repurchased are to be held by the Group as treasury shares. There were no repurchases made under the program during 2009. The approximate dollar value of shares that may yet be repurchased under the plan amounted to \$11.3 million at December 31, 2009.

Stock Performance Graph

The following performance graph shall not be deemed incorporated by reference by any general statement incorporating by reference this annual report on Form 10-K into any filing under the Securities Act of 1933, as amended (the "Securities Act") or the Exchange Act, except to the extent that the Group specifically incorporates this information by reference, and shall not otherwise be deemed filed under these Acts.

The following performance graph compares the yearly percentage change in the Group's cumulative total shareholder return on its shares of common stock to that of the Russell 2000 Index and the SNL Bank Index. The peer group and broad equity market indexes used herein are respectively the Russell 2000 Index and SNL Bank Index. The performance graph assumes that \$100 was invested on December 31, 2004 in each of the Group's common stock, the Russell 2000 Index and the SNL Bank Index. The comparisons in this table are set forth in response to SEC disclosure requirements, and are therefore not intended to forecast or be indicative of future performance of the Group's common stock.

*Comparison of 5 Year Cumulative Total Return
Assumes Initial Investment of \$100
December 2009*



ITEM 6. SELECTED FINANCIAL DATA

The information required by this item is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0. The following ratios of the Group should be read in conjunction with the portions of such report filed as Exhibit 13.0. Selected financial data are presented for the last five fiscal years.

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

Consolidated Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends:	Year Ended December 31,				Six-Month Period Ended December 31,	Fiscal Year Ended June 30,
	2009	2008	2007	2006	2005	2005
Excluding Interest on Deposits	1.18x	1.07x	1.22x	(A)	1.21x	1.66x
Including Interest on Deposits	1.13x	1.05x	1.17x	(A)	1.16x	1.48x

(A) During 2006, earnings were not sufficient to cover preferred dividends, and the ratio was less than 1:1. The Group would have had to generate additional earnings of \$10.0 million to achieve a ratio of 1:1 in 2006.

For purposes of computing these consolidated ratios, earnings represent income before income taxes plus fixed charges and amortization of capitalized interest, less interest capitalized. Fixed charges consist of interest expensed and capitalized, amortization of debt issuance costs, and the Group's estimate of the interest component of rental expense. The term "preferred stock dividends" is the amount of pre-tax earnings that is required to pay dividends on the Group's outstanding preferred stock. As of the dates presented above, the Group had noncumulative preferred stock issued and outstanding amounting to \$68.0 million as follows: (1) Series A amounting to \$33.5 million or 1,340,000 shares at a \$25 liquidation value; and (2) Series B amounting to \$34.5 million or 1,380,000 shares at a \$25 liquidation value.

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

The information required by this item is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations."

ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

The information regarding the market risk of the Group is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0, under the caption "Risk Management".

ITEM 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

The information required by this item is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0. The consolidated financial statements of this report set forth the list of all reports required by this item, and they are incorporated herein by reference.

ITEM 9. *CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE*

Not applicable.

ITEM 9A. *CONTROLS AND PROCEDURES*

a. *Disclosure Controls and Procedures*

The Group's management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of December 31, 2009, an evaluation was carried out under the supervision and with the participation of the Group's management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of the Group's disclosure controls and procedures. Based upon such evaluation, the CEO and CFO have concluded that, as of the end of the period covered by this annual report on Form 10-K, the Group's disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Group in the reports that it files or submits under the Securities Exchange Act of 1934.

b. *Management's Report on Internal Control over Financial Reporting*

The Management's Report on Internal Control over Financial Reporting is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0.

c. *Attestation Report of the Public Accounting Firm*

The registered public accounting firm's attestation report on the Group's internal control over financial reporting is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0.

d. *Changes in Internal Control over Financial Reporting*

There have not been any changes in the Group's internal control over financial reporting (as such term is defined in rules 13a — 15(f) and 15d — 15 (f) under the Exchange Act) during the last quarter of the year ended December 31, 2009, that has materially affected, or is reasonably likely to materially affect, the Group's internal control over financial reporting.

ITEM 9B. *OTHER INFORMATION*

Not applicable.

PART III

Items 10 through 14 will be provided by incorporating the information required under such items by reference from the Group's definitive proxy statement to be filed with the SEC no later than 120 days after the end of the fiscal year covered by this report.

PART IV

ITEM 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

(a)(1) — Financial Statements

The list of financial statements required by this item is set forth in the financial data index incorporated by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0.

(a)(2) — Financial Statement Schedules

No schedules are presented because the information is not applicable or is included in the consolidated financial statements or in the notes thereto described in (a)(1) above.

(a)(3) — Exhibits

<u>Exhibit No.:</u>	<u>Description Of Document:</u>
3(i)	Certificate of Incorporation, as amended.(1)
3(ii)	By-Laws.(2)
4.1	Certificate of Designation of the 7.125% Noncumulative Monthly Income Preferred Stock, Series A.(3)
4.2	Certificate of Designation of the 7.0% Noncumulative Monthly Income Preferred Stock, Series B.(4)
10.5	Lease Agreement between Oriental Financial Group Inc. and Professional Office Park V, Inc.(5)
10.6	First Amendment to Lease Agreement Dated May 18, 2004, between Oriental Financial Group Inc. and Professional Office Park V, Inc.(5)
10.8	Employment Agreement between Oriental Financial Group Inc. and José Rafael Fernández(6)
10.12	Change in Control Compensation Agreement between Oriental Financial Group Inc. and José R. Fernández(5)
10.13	Change in Control Compensation Agreement between Oriental Financial Group Inc. and Norberto González(5)
10.14	Change in Control Compensation Agreement between Oriental Financial Group Inc. and Ganesh Kumar(5)
10.17	Change in Control Compensation Agreement between Oriental Financial Group Inc. and Mari Evelyn Rodríguez(6)
10.18	Change in Control Compensation Agreement between Oriental Financial Group Inc. and Julio R. Micheo(9)
10.19	Technology Outsourcing Agreement between Oriental Financial Group Inc. and Metavante Corporation(10)
10.20	Amended and Restated 2007 Omnibus Performance Incentive Plan(11)
10.21	Form of qualified stock option award and agreement(12)
10.22	Form of restricted stock award and agreement(13)
10.23	Form of restricted unit award and agreement(14)
10.24	Agreement between Oriental Financial Group Inc. and José J. Gil de Lamadrid(15)
12.0	Computation of Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends (included in Item 6 hereof).
13.0	Portions of the 2009 annual report to shareholders

<u>Exhibit No.:</u>	<u>Description Of Document:</u>
21.0	List of subsidiaries
23.1	Consent of KPMG LLP
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

-
- (1) Incorporated herein by reference from Exhibit No. 3 of the Group's registration statement on Form S-3 filed with the SEC on April 2, 1999.
- (2) Incorporated herein by reference from Exhibit No. 3(ii) of the Group's current report on Form 8-K filed with the SEC on June 23, 2008.
- (3) Incorporated herein by reference from Exhibit No. 4.1 of the Group's registration statement on Form 8-A filed with the SEC on April 30, 1999.
- (4) Incorporated herein by reference from Exhibit No. 4.1 of the Group's registration statement on Form 8-A filed with the SEC on September 26, 2003.
- (5) Incorporated herein by reference from Exhibit 10 of the Group's annual report on Form 10-K filed with the SEC on September 13, 2005.
- (6) Incorporated herein by reference from Exhibit 10.1 of the Group's quarterly report on Form 10-Q filed with the SEC on October 17, 2006.
- (7) Incorporated herein by reference from Exhibit 10.2 of the Group's current report on Form 8-K filed with the SEC on December 4, 2006.
- (8) Incorporated herein by reference from Exhibit 10.1 of the Group's current report on Form 8-K filed with the SEC on December 4, 2006.
- (9) Incorporated herein by reference from Exhibit 10 of the Group's current report on Form 10-K filed with the SEC on December 15, 2006.
- (10) Incorporated herein by reference from Exhibit 10.23 of the Group's annual report on Form 10-K filed with the SEC on March 28, 2007.
- (11) Incorporated herein by reference from the Group's definitive proxy statement for the 2009 annual meeting of stockholders filed with the SEC on April 28, 2008.
- (12) Incorporated herein by reference from Exhibit No. 10.1 of the Group's registration statement on Form S-8 filed with the SEC on November 30, 2007.
- (13) Incorporated herein by reference from Exhibit No. 10.2 of the Group's registration statement on Form S-8 filed with the SEC on November 30, 2007.
- (14) Incorporated herein by reference from Exhibit 10.27 of the Group's annual report on Form 10-K filed with the SEC on March 16, 2009.
- (15) Incorporated herein by reference from Exhibit 10.28 of the Group's quarterly report on Form 10-Q filed with the SEC on November 6, 2009.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

ORIENTAL FINANCIAL GROUP INC.

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

Dated: March 11, 2010

By: /s/ Norberto González
Norberto González
Executive Vice President and Chief Financial Officer

Dated: March 11, 2010

By: /s/ César A. Ortiz
César A. Ortiz
Senior Vice President and Controller

Dated: March 11, 2010

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the date indicated.

By: /s/ José J. Gil de Lamadrid
José J. Gil de Lamadrid
Chairman of the Board

Dated: March 11, 2010

By: /s/ José Rafael Fernández
José Rafael Fernández
Vice Chairman of the Board

Dated: March 11, 2010

By: /s/ Juan Carlos Aguayo
Juan Carlos Aguayo
Director

Dated: March 11, 2010

By: /s/ Pablo I. Altieri
Dr. Pablo I. Altieri
Director

Dated: March 11, 2010

By: /s/ Maricarmen Aponte
Maricarmen Aponte
Director

Dated: March 11, 2010

By: /s/ Francisco Arriví
Francisco Arriví
Director

Dated: March 11, 2010

By: /s/ Nelson García
Nelson García
Director

Dated: March 11, 2010

By: /s/ Julian Inclán
Julian Inclán
Director

Dated: March 11, 2010

By: /s/ Rafael Machargo

Rafael Machargo
Director

Dated: March 11, 2010

By: /s/ Pedro Morazzani

Pedro Morazzani
Director

Dated: March 11, 2010

By: /s/ Josen Rossi

Josen Rossi
Director

Dated: March 11, 2010

ORIENTAL FINANCIAL GROUP INC.

FORM-10K

FINANCIAL DATA INDEX

FINANCIAL STATEMENTS

Reports of Independent Registered Public Accounting Firm	F-1
Management's Report on Internal Control Over Financial Reporting	F-2
Attestation Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting	F-3
Consolidated Statements of Financial Condition as of December 31, 2009 and 2008	F-4
Consolidated Statements of Operations for the years ended December 31, 2009, 2008, and 2007	F-5
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2009, 2008, and 2007	F-6
Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2009, 2008, and 2007	F-7
Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008, and 2007	F-8
Notes to the Consolidated Financial Statements	F-10 to F-61

FINANCIAL REVIEW AND SUPPLEMENTARY INFORMATION

Selected Financial Data	F-62
Management's Discussion and Analysis of Financial Condition and Results of Operations . . .	F-64 to F-96
Risk Management	F-96 to F-100
Quarterly Financial Data	F-100
Critical Accounting Policies	F-102 to F-106
Exhibit 21.0 — List Of Subsidiaries	
Exhibit 23.1 — Consent Of Independent Registered Public Accounting Firm	
Exhibit 31.1 and Exhibit 31.2 — Management Certifications Pursuant To Section 302 Of The Sarbanes-Oxley Act Of 2002	
Exhibit 32.1 and Exhibit 32.2 — Certifications Pursuant To Section 906 Of The Sarbanes- Oxley Act Of 2002 (18 U.S.C. §1350)	

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
Oriental Financial Group Inc.:

We have audited the accompanying consolidated statements of financial condition of Oriental Financial Group Inc. and subsidiaries (the “Group”) as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in stockholders’ equity, comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Group’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oriental Financial Group, Inc. and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in note 1 to the consolidated financial statements, the Group changed its method of evaluating other-than-temporary impairments of debt securities and for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly due to the adoption of new accounting requirements issued by the FASB, as of April 1, 2009.

Also, as discussed in note 1 to the consolidated financial statements, effective January 1, 2009, the Group adopted for subsequent measurement of servicing rights, the fair value measurement method. Under the fair value measurement method, the Group measures servicing rights at fair value at each reporting date and reports changes in fair value of servicing asset in earnings in the period in which the changes occur.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Oriental Financial Group Inc. and subsidiaries’ internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 11, 2010 expressed an unqualified opinion on the effectiveness of the Group’s internal control over financial reporting.

/s/ KPMG LLP

San Juan, Puerto Rico
March 11, 2010

Stamp No. 2446616 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

ORIENTAL FINANCIAL GROUP INC.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and stockholders of Oriental Financial Group Inc.:

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

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

- (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Group;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Group are being made only in accordance with authorization of management and directors of the Group; and
- (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Group's assets that could have a material effect on the financial statements.

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

As called for by Section 404 of the Sarbanes-Oxley Act of 2002, management has assessed the effectiveness of the Group's internal control over financial reporting as of December 31, 2009. Management made its assessment using the criteria set forth in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Criteria").

Based on its assessment, management has concluded that the Group maintained effective internal control over financial reporting as of December 31, 2009 based on the COSO Criteria.

The effectiveness of the Group's internal control over financial reporting as of December 31, 2009, has been audited by KPMG LLP, the Group's independent registered public accounting firm, as stated in their report dated March 11, 2010.

By: /s/ José Rafael Fernández
José Rafael Fernández
President and Chief Executive Officer
Date: March 11, 2010

By: /s/ Norberto González
Norberto González
Executive Vice President and Chief Financial Officer
Date: March 11, 2010

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Oriental Financial Group Inc.:

We have audited Oriental Financial Group Inc.'s (the "Group") internal control over financial reporting as of December 31, 2009, based on *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Group's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Group's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Oriental Financial Group Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of Oriental Financial Group Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity, comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2009, and our report dated March 11, 2010, expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

San Juan, Puerto Rico
March 11, 2010

Stamp No. 2446618 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

ORIENTAL FINANCIAL GROUP INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2009 AND 2008

	December 31,	
	2009	2008
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	\$ 247,691	\$ 14,370
Money market investments	29,432	52,002
Total cash and cash equivalents	277,123	66,372
Investments:		
Trading securities, at fair value with amortized cost of \$522 (December 31, 2008 — \$255) . . .	523	256
Investment securities available-for-sale, at fair value with amortized cost of \$5,044,017 (December 31, 2008 — \$4,052,574)	4,953,659	3,924,207
Other investments	150	150
Federal Home Loan Bank (FHLB) stock, at cost	19,937	21,013
Total investments	4,974,269	3,945,626
Securities sold but not yet delivered	—	834,976
Loans:		
Mortgage loans held-for-sale, at lower of cost or fair value	27,261	26,562
Loans receivable, net of allowance for loan losses of \$23,272 (December 31, 2008 — \$14,293)	1,112,808	1,192,550
Total loans, net	1,140,069	1,219,112
Accrued interest receivable	33,656	43,914
Deferred tax asset, net	31,685	28,463
Premises and equipment, net	19,775	21,184
Foreclosed real estate	9,347	9,162
Other assets	64,909	36,727
Total assets	\$6,550,833	\$6,205,536
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Demand deposits	\$ 693,506	\$ 453,798
Savings accounts	86,792	50,152
Certificates of deposit	965,203	1,281,350
Total deposits	1,745,501	1,785,300
Borrowings:		
Federal funds purchased and other short-term borrowings	49,179	29,193
Securities sold under agreements to repurchase	3,557,308	3,761,121
Advances from FHLB	281,753	308,442
FDIC-guaranteed term notes	105,834	—
Subordinated capital notes	36,083	36,083
Total borrowings	4,030,157	4,134,839
Securities purchased but not yet received	413,359	398
Accrued expenses and other liabilities	31,650	23,682
Total liabilities	6,220,667	5,944,219
Stockholders' equity:		
Preferred stock, \$1 par value; 5,000,000 shares authorized; \$25 liquidation value; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding	68,000	68,000
Common stock, \$1 par value; 40,000,000 shares authorized; 25,739,397 shares issued; 24,235,088 shares outstanding (December 31, 2008 — 25,739,397; 24,297,132)	25,739	25,739
Additional paid-in capital	213,445	212,625
Legal surplus	45,279	43,016
Retained earnings	77,584	51,233
Treasury stock, at cost 1,504,309 shares (December 31, 2008 — 1,442,265 shares)	(17,142)	(17,109)
Accumulated other comprehensive loss, net of tax of \$7,445 (December 31, 2008 — \$6,004) . .	(82,739)	(122,187)
Total stockholders' equity	330,166	261,317
Commitments and Contingencies		
Total liabilities and stockholders' equity	\$6,550,833	\$6,205,536

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

ORIENTAL FINANCIAL GROUP INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007

	Year Ended December 31,		
	2009	2008	2007
	(In thousands, except per share data)		
Interest income:			
Loans	\$ 73,076	\$ 79,165	\$ 85,802
Mortgage-backed securities	198,015	184,019	111,006
Investment securities and other	48,310	75,855	92,556
Total interest income	319,401	339,039	289,364
Interest expense:			
Deposits	54,693	49,781	52,794
Securities sold under agreements to repurchase	116,755	161,363	147,690
Advances from FHLB and other borrowings	12,380	14,280	12,042
FDIC-guaranteed term notes	3,175	—	—
Subordinated capital notes	1,465	2,304	3,108
Total interest expense	188,468	227,728	215,634
Net interest income	130,933	111,311	73,730
Provision for loan losses	15,650	8,860	6,550
Net interest income after provision for loan losses	115,283	102,451	67,180
Non-interest income (loss):			
Financial service revenues	14,473	16,481	17,295
Banking service revenues	6,020	5,726	7,862
Investment banking revenues (losses)	(4)	950	126
Mortgage banking activities	9,728	3,685	2,401
Total banking and financial service revenues	30,217	26,842	27,684
Excess of amortized cost over fair value on other-than-temporarily impaired securities	(101,472)	(58,804)	—
Non-credit related unrealized loss on securities recognized in other comprehensive income	41,398	—	—
Other-than-temporary impairments on securities	(60,074)	(58,804)	—
Net gain (loss) on:			
Sale of securities	4,385	35,070	2,953
Derivatives	28,927	(12,943)	10,997
Mortgage tax credits	—	(2,480)	—
Early extinguishment of repurchase agreements	(17,551)	—	—
Trading securities	12,564	(13)	23
Foreclosed real estate	(570)	(670)	(349)
Other investments	43	148	1,174
Other	71	608	20
Total non-interest income (loss), net	(1,988)	(12,242)	42,502
Non-interest expenses:			
Compensation and employees' benefits	31,971	30,572	28,376
Occupancy and equipment	14,763	13,843	12,624
Professional and service fees	10,428	9,203	7,161
Insurance	7,233	2,421	848
Advertising and business promotion	4,208	3,970	4,472
Taxes, other than payroll and income taxes	3,004	2,514	2,151
Electronic banking charges	2,194	1,726	1,826
Loan servicing expenses	1,586	1,383	1,740
Communication	1,567	1,292	1,302
Director and investors relations	1,374	1,159	2,103
Clearing and wrap fees expenses	1,177	1,250	1,070
Other	3,873	3,409	3,186
Total non-interest expenses	83,378	72,742	66,859
Income before income taxes	29,917	17,467	42,823
Income tax expense (benefit)	6,972	(9,323)	1,558
Net income	22,945	26,790	41,265
Less: Dividends on preferred stock	(4,802)	(4,802)	(4,802)
Income available to common shareholders	\$ 18,143	\$ 21,988	\$ 36,463
Income per common share:			
Basic	\$ 0.75	\$ 0.91	\$ 1.50
Diluted	\$ 0.75	\$ 0.90	\$ 1.50
Average common shares outstanding	24,289	24,260	24,326
Average potential common shares-options	17	67	41
Average diluted common shares outstanding	24,306	24,327	24,367
Cash dividends per share of common stock	\$ 0.16	\$ 0.56	\$ 0.56

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

ORIENTAL FINANCIAL GROUP INC.

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007**

<u>CHANGES IN STOCKHOLDERS' EQUITY:</u>	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Preferred stock:			
Balance at beginning and end of year	<u>\$ 68,000</u>	<u>\$ 68,000</u>	<u>\$ 68,000</u>
Common stock:			
Balance at beginning of year	25,739	25,557	25,431
Stock options exercised	<u>—</u>	<u>182</u>	<u>126</u>
Balance at end of year	<u>25,739</u>	<u>25,739</u>	<u>25,557</u>
Additional paid-in capital:			
Balance at beginning of year	212,625	210,073	209,033
Stock-based compensation expense	742	559	86
Capital contribution	78	—	—
Stock options exercised	<u>—</u>	<u>1,993</u>	<u>954</u>
Balance at end of year	<u>213,445</u>	<u>212,625</u>	<u>210,073</u>
Legal surplus:			
Balance at beginning of year	43,016	40,573	36,245
Transfer from retained earnings	<u>2,263</u>	<u>2,443</u>	<u>4,328</u>
Balance at end of year	<u>45,279</u>	<u>43,016</u>	<u>40,573</u>
Retained earnings:			
Balance at beginning of year	51,233	45,296	26,772
Cumulative effect on initial adoption of accounting principle	14,359	—	—
Net income	22,945	26,790	41,265
Cash dividends declared on common stock	(3,888)	(13,608)	(13,611)
Cash dividends declared on preferred stock	(4,802)	(4,802)	(4,802)
Transfer to legal surplus	<u>(2,263)</u>	<u>(2,443)</u>	<u>(4,328)</u>
Balance at end of year	<u>77,584</u>	<u>51,233</u>	<u>45,296</u>
Treasury stock:			
Balance at beginning of year	(17,109)	(17,023)	(12,956)
Stock purchased	(182)	(235)	(4,297)
Stock used to match defined contribution plan 1165(e)	<u>149</u>	<u>149</u>	<u>230</u>
Balance at end of year	<u>(17,142)</u>	<u>(17,109)</u>	<u>(17,023)</u>
Accumulated other comprehensive loss, net of tax:			
Balance at beginning of year	(122,187)	(13,015)	(16,099)
Cumulative effect on initial adoption of accounting principle	(14,359)	—	—
Other comprehensive income (loss), net of tax	<u>53,807</u>	<u>(109,172)</u>	<u>3,084</u>
Balance at end of year	<u>(82,739)</u>	<u>(122,187)</u>	<u>(13,015)</u>
Total stockholders' equity	<u>\$ 330,166</u>	<u>\$ 261,317</u>	<u>\$359,461</u>

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

ORIENTAL FINANCIAL GROUP INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007

<u>COMPREHENSIVE INCOME (LOSS)</u>	<u>Year Ended December 31,</u>		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
		(In thousands)	
Net income	\$ 22,945	\$ 26,790	\$41,265
Other comprehensive income (loss):			
Unrealized gain (loss) on securities available-for-sale arising during the year	(3,323)	(121,204)	17,492
Realized (gain) loss on investment securities included in net income . . .	(4,385)	(35,070)	(2,953)
Excess of amortized cost over fair value on other-than-temporarily impaired securities	101,472	38,932	—
Non-credit related unrealized loss on securities	(41,398)	—	—
Realized gain on derivatives designated as cash flow hedges included in net income	—	—	(773)
Gain from termination of cash flow hedging	—	—	(8,225)
Income tax effect related to unrealized loss (gain) on securities available-for-sale	1,441	8,170	(2,457)
Other comprehensive income (loss) for the year	53,807	(109,172)	3,084
Comprehensive income (loss)	\$ 76,752	\$ (82,382)	\$44,349

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

ORIENTAL FINANCIAL GROUP INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007.

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Cash flows from operating activities:			
Net income	\$ 22,945	\$ 26,790	\$ 41,265
Adjustments to reconcile net income to net cash used in operating activities:			
Amortization of deferred loan origination fees, net of costs	218	(428)	(721)
Amortization of premiums, net of accretion of discounts	13,075	(786)	792
Other-than-temporary impairments on securities	60,074	58,804	—
Depreciation and amortization of premises and equipment	5,987	5,443	5,419
Deferred income tax expense (benefit)	(1,782)	(9,931)	1,332
Equity in losses (earnings), of investment in limited liability partnership	—	—	279
Provision for loan losses	15,650	8,860	6,550
Stock-based compensation	742	559	86
Fair value adjustment of servicing asset	(4,301)	(293)	—
(Gain) loss on:			
Sale of securities	(4,385)	(35,070)	(2,953)
Sale of mortgage loans held-for-sale	(3,827)	(2,408)	(2,401)
Derivatives	(28,927)	12,943	(10,997)
Mortgage tax credits	—	2,480	—
Early extinguishment of repurchase agreements	17,551	—	—
Sale of foreclosed real estate	570	670	349
Sale of premises and equipment	(71)	1	(20)
Originations and purchases of loans held-for-sale	(230,240)	(140,080)	(114,722)
Proceeds from sale of loans held-for-sale	106,071	58,355	54,510
Net (increase) decrease in:			
Trading securities	(267)	866	(879)
Accrued interest receivable	10,258	8,401	(24,375)
Other assets	(26,008)	(10,082)	(2,680)
Net increase (decrease) in:			
Accrued interest on deposits and borrowings	(5,622)	2,717	4,787
Accrued expenses and other liabilities	8,295	(2,163)	6,588
Net cash used in operating activities	(43,994)	(14,352)	(37,791)
Cash flows from investing activities:			
Purchases of:			
Investment securities available-for-sale	(12,577,326)	(4,159,014)	(3,434,208)
Investment securities held-to-maturity	—	(14,000)	(158,842)
FHLB stock	(26,981)	(22,164)	(43,390)
Equity options	(4,067)	(5,596)	(10,474)
Maturities and redemptions of:			
Investment securities available-for-sale	3,825,193	970,543	744,976
Investment securities held-to-maturity	—	304,133	633,052
FHLB stock	28,057	21,809	36,339
Other investments	—	1,511	29,274
Investment in limited liability partnership	—	—	11,634

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Proceeds from sales of:			
Investment securities available-for-sale	9,101,639	1,687,779	786,409
Investment securities held-to-maturity	—	834,975	—
Foreclosed real estate	9,312	3,264	4,017
Premises and equipment	128	14	—
Origination and purchase of loans, excluding loans held-for-sale	(93,093)	(157,063)	(189,773)
Principal repayment of loans	131,079	111,869	219,108
Additions to premises and equipment	(4,636)	(4,863)	(7,025)
Net cash provided by (used in) investing activities	389,305	(426,803)	(1,378,903)
Cash flows from financing activities:			
Net increase (decrease) in:			
Deposits	(26,764)	564,516	19,016
Securities sold under agreements to repurchase	(217,551)	(100,023)	1,320,609
Federal funds purchased and other short term borrowings	19,986	1,733	13,892
Proceeds from:			
Issuance of FDIC-guaranteed term notes	105,000	—	—
Advances from FHLB	1,397,880	2,098,070	5,279,620
Exercise of stock options	—	2,175	1,080
Capital contribution	78	—	—
Repayments of advances from FHLB	(1,424,580)	(2,121,370)	(5,131,520)
Repayment of term notes	—	—	(15,000)
Purchase of treasury stock	(182)	(235)	(4,297)
Termination of derivative instruments	20,263	(7,912)	1,620
Dividends paid on common and preferred stock	(8,690)	(18,410)	(18,413)
Net cash provided by (used in) financing activities	(134,560)	418,544	1,466,607
Net change in cash and cash equivalents	210,751	(22,611)	49,913
Cash and cash equivalents at beginning of year	66,372	88,983	39,070
Cash and cash equivalents at end of year	<u>\$ 277,123</u>	<u>\$ 66,372</u>	<u>\$ 88,983</u>
Supplemental Cash Flow Disclosure and Schedule of Noncash Activities:			
Interest paid	<u>\$ 191,992</u>	<u>\$ 225,011</u>	<u>\$ 213,764</u>
Income taxes paid	<u>\$ 54</u>	<u>\$ 54</u>	<u>\$ —</u>
Mortgage loans securitized into mortgage-backed securities	<u>\$ 147,419</u>	<u>\$ 72,753</u>	<u>\$ 56,544</u>
Investment securities held-to-maturity transferred to available-for-sale	<u>\$ —</u>	<u>\$ 375,780</u>	<u>\$ —</u>
Securities sold but not yet delivered	<u>\$ —</u>	<u>\$ 834,976</u>	<u>\$ —</u>
Securities purchased but not yet received	<u>\$ 413,359</u>	<u>\$ 398</u>	<u>\$ 111,431</u>
Transfer from loans to foreclosed real estate	<u>\$ 10,067</u>	<u>\$ 8,889</u>	<u>\$ 3,709</u>
Transfer from loans receivable to mortgage loans held for sale	<u>\$ 19,832</u>	<u>\$ —</u>	<u>\$ —</u>

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

ORIENTAL FINANCIAL GROUP INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2009, 2008, AND 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Oriental Financial Group Inc. (the “Group” or “Oriental”) conform to U.S. generally accepted accounting principles (“GAAP”) and to financial services industry practices. The following is a description of the Group’s most significant accounting policies:

Nature of Operations

The Group is a publicly-owned financial holding company incorporated under the laws of the Commonwealth of Puerto Rico. It has four direct subsidiaries, Oriental Bank and Trust (the “Bank”), Oriental Financial Services Corp. (“Oriental Financial Services”), Oriental Insurance, Inc. (“Oriental Insurance”) and Caribbean Pension Consultants, Inc., which is located in Boca Raton, Florida. The Group also has a special purpose entity, Oriental Financial (PR) Statutory Trust II (the “Statutory Trust II”). Through these subsidiaries and its divisions, the Group provides a wide range of financial services such as mortgage, commercial and consumer lending, financial planning, insurance sales, money management and investment banking and brokerage services, as well as corporate and individual trust services.

The main offices of the Group and its subsidiaries are located in San Juan, Puerto Rico. The Group is subject to examination, regulation and periodic reporting under the U.S. Bank Holding Company Act of 1956, as amended, which is administered by the Board of Governors of the Federal Reserve System.

The Bank operates through 21 financial centers located throughout Puerto Rico and is subject to the supervision, examination and regulation of the Office of the Commissioner of Financial Institutions of Puerto Rico (“OCIF”) and the Federal Deposit Insurance Corporation (“FDIC”). The Bank offers banking services such as commercial and consumer lending, saving and time deposit products, financial planning, and corporate and individual trust services, and capitalizes on its commercial banking network to provide mortgage lending products to its clients. Oriental International Bank Inc. (“OIB”), a wholly-owned subsidiary of the Bank, operates as an international banking entity (“IBE”) pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended. OIB offers the Bank certain Puerto Rico tax advantages. OIB activities are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.

Oriental Financial Services is subject to the supervision, examination and regulation of the Financial Industry Regulatory Authority (“FINRA”), the SEC, and the OCIF. Oriental Insurance is subject to the supervision, examination and regulation of the Office of the Commissioner of Insurance of Puerto Rico.

The Group’s mortgage banking activities are conducted through a division of the Bank. The mortgage banking activities consist of the origination and purchase of residential mortgage loans for the Group’s own portfolio and, if the conditions so warrant, the Group engages in the sale of such loans to other financial institutions in the secondary market. The Group originates Federal Housing Administration (“FHA”)-insured and Veterans Administration (“VA”)-guaranteed mortgages that are primarily securitized for issuance of Government National Mortgage Association (“GNMA”) mortgage-backed securities which can be resold to individual or institutional investors in the secondary market. Conventional loans that meet the underwriting requirements for sale or exchange under standard Federal National Mortgage Association (the “FNMA”) or the Federal Home Loan Mortgage Corporation (the “FHLMC”) programs are referred to as conforming mortgage loans and are also securitized for issuance of FNMA or FHLMC mortgage-backed securities. The Group is an approved seller of FNMA, as well as FHLMC, mortgage loans for issuance of FNMA and FHLMC mortgage-backed securities. The Group is also an approved issuer of GNMA mortgage-backed securities. The Group outsources the servicing of the GNMA, FNMA and FHLMC pools that it issues and of its mortgage loan portfolio.

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate mainly to the determination of the allowance for loan losses, the valuation of securities and derivative instruments, and the determination of income taxes and other-than-temporary impairment of securities.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Group and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. The special purpose entity is exempt from the consolidation requirements of GAAP.

Cash Equivalents

The Group considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months or less at the date of acquisition.

Earnings per Common Share

Basic earnings per share is calculated by dividing income available to common shareholders (net income reduced by dividends on preferred stock) by the weighted average of outstanding common shares. Diluted earnings per share is similar to the computation of basic earnings per share except that the weighted average of common shares is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares (options) had been issued, assuming that proceeds from exercise are used to repurchase shares in the market (treasury stock method). Any stock splits and dividends are retroactively recognized in all periods presented in the consolidated financial statements.

Securities Purchased/Sold Under Agreements to Resell/Repurchase

The Group purchases securities under agreements to resell the same or similar securities. Amounts advanced under these agreements represent short-term loans and are reflected as assets in the consolidated statements of financial condition. It is the Group's policy to take possession of securities purchased under resale agreements while the counterparty retains effective control over the securities. The Group monitors the fair value of the underlying securities as compared to the related receivable, including accrued interest, and requests additional collateral when deemed appropriate. The Group also sells securities under agreements to repurchase the same or similar securities. The Group retains effective control over the securities sold under these agreements; accordingly, such agreements are treated as financing arrangements, and the obligations to repurchase the securities sold are reflected as liabilities. The securities underlying the financing agreements remain included in the asset accounts. The counterparty to repurchase agreements generally has the right to repledge the securities received as collateral.

Investment Securities

Securities are classified as held-to-maturity, available-for-sale or trading. Securities for which the Group has the intent and ability to hold to maturity are classified as held-to-maturity and are carried at amortized cost. Securities that might be sold prior to maturity because of interest rate changes, to meet liquidity needs, or to better match the repricing characteristics of funding sources are classified as available-for-sale. These securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported net of tax in other comprehensive income.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Group classifies as trading those securities that are acquired and held principally for the purpose of selling them in the near future. These securities are carried at fair value with realized and unrealized changes in fair value included in earnings in the period in which the changes occur.

The Group's investment in the Federal Home Loan Bank (FHLB) of New York stock, a restricted security, has no readily determinable fair value and can only be sold back to the FHLB at cost. Therefore, the carrying value represents its fair value.

Premiums and discounts are amortized to interest income over the life of the related securities using the interest method. Net realized gains or losses on sales of investment securities, and unrealized loss valuation adjustments considered other than temporary, if any, on securities classified as either available-for-sale or held-to-maturity are reported separately in the statements of operations. The cost of securities sold is determined on the specific identification method.

Financial Instruments

Certain financial instruments, including derivatives, trading securities and investment securities available-for-sale, are recorded at fair value and unrealized gains and losses are recorded in other comprehensive income or as part of non-interest income, as appropriate. Fair values are based on listed market prices, if available. If listed market prices are not available, fair value is determined based on other relevant factors, including price quotations for similar instruments. The fair values of certain derivative contracts are derived from pricing models that consider current market and contractual prices for the underlying financial instruments as well as time value and yield curve or volatility factors underlying the positions.

Effective January 1, 2008, the Group determines the fair value of its financial instruments based on the Fair Value Measurement framework, which establishes a fair value hierarchy that prioritizes the inputs of valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1-Level 1 asset and liabilities include equity securities that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. government agency securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2-Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on valuations obtained from third-party pricing services for identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments and (iii) derivative contracts and financial liabilities (e.g. callable brokered CDs and medium-term notes elected for fair value option under the fair value measurement framework, whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3-Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, for which the determination of fair value requires significant management judgment or estimation.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On April 1, 2009, the Group changed its method of valuating other-than-temporary impairments of debt securities and for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly due to the adoption of FASB Accounting Standard Codification (“ASC”) 820-1-35-51.

Impairment of Investment Securities

The Group conducts periodic reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairments. On April 1, 2009, the Group adopted FASB Accounting Standard Codification (“ASC”) 320-10-65-1, which changed the accounting requirements for other than temporary impairments for debt securities, and in certain circumstances, separates the amount of total impairment into credit and noncredit-related amounts. The review takes into consideration current market conditions, issuer rating changes and trends, the credit worthiness of the obligator of the security, current analysts’ evaluations, failure of the issuer to make scheduled interest or principal payments, the Group’s intent to not sell the security or whether it is more-likely-than-not that the Group will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term “other than temporary impairment” is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, discounted at the rate equal to the yield used to accrete current and prospective beneficial interest for the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the “credit loss.”

The Group’s review for impairment generally entails:

- intent to sell the debt security;
- if it is more likely than not that the entity will be required to sell the debt securities before the anticipated recovery;
- identification and evaluation of investments that have indications of possible other-than-temporary impairment;
- periodic evaluation of investment in FHLB stock;
- analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position and the expected recovery period;
- discussion of evidential matter, including an evaluation of factors or triggers that could cause individual investments to qualify as having other-than-temporary impairment and those that would not support other-than-temporary impairment; and
- documentation of the results of these analyses.

Derivative Financial Instruments

As part of the Group’s asset and liability management, the Group may use option agreements and interest rate contracts, which include interest rate swaps to hedge various exposures or to modify interest rate characteristics of various assets or liabilities.

The Group recognizes all derivative instruments as assets and liabilities at fair value. If certain conditions are met, the derivative may qualify for hedge accounting treatment and be designated as one of the following types of hedges: (a) hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

firm commitment (“fair value hedge”); (b) a hedge of the exposure to variability of cash flows of a recognized asset, liability or forecasted transaction (“cash flow hedge”) or (c) a hedge of foreign currency exposure (“foreign currency hedge”).

In the case of a qualifying fair value hedge, changes in the value of the derivative instruments that have been highly effective are recognized in current period earnings along with the change in value of the designated hedged item. In the case of a qualifying cash flow hedge, changes in the value of the derivative instruments that have been highly effective are recognized in other comprehensive income, until such time as earnings are affected by the variability of the cash flows of the underlying hedged item. In either a fair value hedge or a cash flow hedge, net earnings may be impacted to the extent the changes in the fair value of the derivative instruments do not perfectly offset changes in the fair value or cash flows of the hedged items. If the derivative is not designated as a hedging instrument, the changes in fair value of the derivative are recorded in earnings. There were no derivatives designated as a hedge as of December 31, 2009.

Certain contracts contain embedded derivatives. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated and carried at fair value.

The Group uses several pricing models that consider current fair value and contractual prices for the underlying financial instruments as well as time value and yield curve or volatility factors underlying the positions to derive the fair value of certain derivatives contracts.

Off-Balance Sheet Instruments

In the ordinary course of business, the Group enters into off-balance sheet instruments consisting of commitments to extend credit, further discussed in Note 14 to the consolidated financial statements. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The Group periodically evaluates the credit risks inherent in these commitments, and establishes accruals for such risks if and when these are deemed necessary.

Mortgage Banking Activities and Loans Held-For-Sale

The residential mortgage loans reported as held-for-sale are stated at the lower-of-cost-or-fair value, cost being determined on the outstanding loan balance less unearned income, and fair value determined in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. Realized gains or losses on these loans are determined using the specific identification method. Loans held-for-sale include all conforming mortgage loans originated and purchased, which from time to time the Group sells to other financial institutions or securitizes conforming mortgage loans into Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) pass-through certificates.

Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities

The Group recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

The Group is not engaged in sales of mortgage loans and mortgage-backed securities subject to recourse provisions except for those provisions that allow for the repurchase of loans as a result of a breach of certain representations and warranties other than those related to the credit quality of the loans included in the sale transactions.

A transfer of financial assets (all or a portion of the financial asset) in which the Group surrenders control over these financial assets shall be accounted for as a sale to the extent that consideration, other than beneficial interests in the

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

transferred assets, is received in exchange. The Group has surrendered control over transferred assets if all of the following conditions are met:

- a. The transferred assets have been isolated from the Group — put presumptively beyond the reach of the Group and its creditors even in bankruptcy or other receivership.
- b. Each transferee has the right to pledge or exchange the assets it received and no condition both constrains the transferee from taking advantage of its rights to pledge or exchange and provided more than a trivial benefit to the Group.
- c. The Group does not maintain effective control over the transferred assets through either (1) an agreement that both entitles and obligates the Group to repurchase or redeem them before their maturity or (2) the ability to unilaterally cause the holder to return specific assets other than through a cleanup call.

If a transfer of financial assets in exchange for cash or other consideration (other than beneficial interests in the transferred assets) does not meet the criteria for a sale as described above, the Group would account for the transfer as a secured borrowing.

When the Group sells or securitizes mortgage loans, it generally makes customary representations and warranties regarding the characteristics of the loans sold. The Group's mortgage operations group conforming conventional mortgage loans into pools which are exchanged for FNMA and GNMA mortgage-backed securities, which are generally sold to private investors, or may sell the loans directly to FNMA or other private investors for cash. To the extent the loans do not meet specified characteristics, investors are generally entitled to require the Group to repurchase such loans or indemnify the investor against losses if the assets do not meet certain guidelines. GNMA programs allow financial institutions to buy back individual delinquent mortgage loans that meet certain criteria from the securitized loan pool for which the Group provides servicing. At the Group's option and without GNMA prior authorization, the Group may repurchase such delinquent loans for an amount equal to 100% of the loan's remaining principal balance. This buy-back option is considered a conditional option until the delinquency criteria is met, at which time the option becomes unconditional. When the loans backing a GNMA security are initially securitized, the Group treats the transaction as a sale for accounting purposes because the conditional nature of the buy-back option means that the Group does not maintain effective control over the loans and therefore these are derecognized from the balance sheet. When individual loans later meet GNMA's specified delinquency criteria and are eligible for repurchase, the Group is deemed to have regained effective control over these loans and they must be brought back onto the Group's books as assets at fair value, regardless of whether the Group intends to exercise the buy-back option. Quality review procedures are performed by the Group as required under the government agency programs to ensure that assets guideline qualifications are met. The Group has not recorded any specific contingent liability in the consolidated financial statements for these customary representation and warranties related to loans sold by the Group, and management believes that, based on historical data, the probability of payments and expected losses under these representation and warranty arrangements is not significant.

Servicing assets

The Group periodically sells or securitizes loans while retaining the obligation to perform the servicing of such loans. In addition, the Group may purchase or assume the right to service loans originated by others. Whenever the Group undertakes an obligation to service a loan, management assesses whether a servicing asset and/or liability should be recognized. A servicing asset is recognized whenever the compensation for servicing is expected to more than adequately compensate the servicer for performing the servicing. Likewise, a servicing liability would be recognized in the event that servicing fees to be received are not expected to adequately compensate the Group for its expected cost. Servicing assets are presented as other assets in the consolidated statements of financial condition.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Effective January 1, 2007, all separately recognized servicing assets are initially recognized at fair value with the income statement effect recorded in mortgage banking activities. For subsequent measurement of servicing rights, during 2009 the Group elected the fair value measurement method. Under the fair value measurement method, the Group measures servicing rights at fair value at each reporting date and reports changes in fair value of servicing asset in earnings in the period in which the changes occur, and are included with mortgage banking activities in the consolidated statement of operations. The fair value of servicing rights is subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses. The implementation of the fair value method did not have a material cumulative effect adjustment.

The fair value of servicing rights is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration actual and expected loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions.

The following table presents the changes in servicing rights measured using the fair value method for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
	<u>(In thousands)</u>	
Fair value at beginning of year	\$2,819	\$2,526
Purchases	—	—
Servicing from securitizations or assets transferred	3,058	1,446
Changes due to payment on loans(1)	(309)	(174)
Changes in fair value due to changes in valuation model inputs or assumptions . .	<u>1,552</u>	<u>(979)</u>
Fair value at end of year	<u><u>\$7,120</u></u>	<u><u>\$2,819</u></u>

(1) Represents changes due to collection/ realization of expected cash flows over time.

Key economic assumptions ranges used in measuring the servicing assets retained at the date of the residential mortgage loan securitizations where:

	<u>2009</u>	<u>2008</u>
Constant prepayment rate	7.52%-32.22%	5.09%-31.79%
Discount rate	10.00%-13.50%	10.00%-13.00%

The sensitivity of the current fair value of servicing assets to immediate 10 percent and 20 percent adverse changes in the above key assumptions were as follows:

	<u>December 31, 2009</u>
	<u>(in thousands)</u>
Carrying value of servicing assets	\$7,120
Constant prepayment rate	
Decrease in fair value due to 10% adverse change	\$ (312)
Decrease in fair value due to 20% adverse change	\$ (603)
Discount rate	
Decrease in fair value due to 10% adverse change	\$ (330)
Decrease in fair value due to 20% adverse change	\$ (632)

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 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 this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which may magnify or offset the sensitivities.

Mortgage banking activities, a component of total banking and financial service revenues in the consolidated statements of operations, include the changes from period to period in the fair value of the servicing rights, which may result from changes in the valuation model inputs or assumptions (principally reflecting changes in discount rates and prepayment speed assumptions) and other changes, including changes due to collection/realization of expected cash flows.

Servicing fees income which is reported in the consolidated statement of operations as mortgage banking activities is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; and are recorded as income when earned. Servicing fees totaled \$1.6 million, \$903 thousand and \$118 thousand for the years ended December 31, 2009, 2008, and 2007, respectively. There were no late fees and ancillary fees recorded for any year.

Loans and Allowance for Loan Losses

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, unamortized discount related to mortgage servicing right (MSR) sold and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees and costs and premiums and discounts on loans purchased are deferred and amortized over the estimated life of the loans as an adjustment of their yield through interest income using a method that approximates the interest method. When a loan is paid off or sold, any unamortized deferred fee (cost) is credited (charged) to income.

Interest recognition is discontinued when loans are 90 days or more in arrears on principal and/or interest based on contractual terms, except for collateralized residential mortgage loans for which recognition is discontinued when they become 365 days or more past due based on contractual terms and are then written down, if necessary, based on the specific evaluation of the collateral underlying the loan. Loans for which the recognition of interest income has been discontinued are designated as non-accruing. Collections are accounted for on the cash method thereafter, until qualifying to return to accrual status. Such loans are not reinstated to accrual status until interest is received on a current basis and other factors indicative of doubtful collection cease to exist.

The Group follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan losses to provide for inherent losses in the loan portfolio. This methodology includes the consideration of factors such as economic conditions, portfolio risk characteristics, prior loss experience, and results of periodic credit reviews of individual loans. The provision for loan losses charged to current operations is based on such methodology. Loan losses are charged and recoveries are credited to the allowance for loan losses.

Larger commercial loans that exhibit potential or observed credit weaknesses are subject to individual review and grading. Where appropriate, allowances are allocated to individual loans based on management's estimate of the borrower's ability to repay the loan given the availability of collateral, other sources of cash flow and legal options available to the Group.

Included in the review of individual loans are those that are impaired. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or as a practical expedient, at the observable market price of the loan or the fair value of the collateral, if the loan is collateral dependent. Loans are individually evaluated for impairment, except large groups of small balance homogeneous loans that are collectively evaluated for impairment and loans that are recorded at fair value or at the lower of cost or fair value. The Group measures for impairment all commercial loans over \$250 thousand and over

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

90-days past due. The portfolios of mortgages and consumer loans are considered homogeneous, and are evaluated collectively for impairment.

The Group, using a rating system, applies an overall allowance percentage to each loan portfolio category based on historical credit losses adjusted for current conditions and trends. This calculation is the starting point for management's systematic determination of the required level of the allowance for loan losses. Other data considered in this determination includes: the credit grading assigned to commercial loans, delinquency levels, loss trends and other information including underwriting standards and economic trends.

Loan loss ratios and credit risk categories are updated quarterly and are applied in the context of GAAP and the importance of depository institutions having prudent, conservative, but not excessive loan allowances that fall within an acceptable range of estimated losses. While management uses current available information in estimating probable loan losses, factors beyond the Group's control, such as regulatory requirements and factors affecting general economic conditions may require future changes to the allowance.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful life of each type of asset. Amortization of leasehold improvements is computed using the straight-line method over the terms of the leases or estimated useful lives of the improvements, whichever is shorter.

Long-lived assets and identifiable intangibles, except for financial instruments, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing the review for recoverability, an estimate is made of the future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized if the fair value is less than the carrying amount of the related asset. Otherwise, an impairment loss is not recognized. There were no such impairment losses in the years presented in the accompanying consolidated financial statements.

Foreclosed Real Estate

Foreclosed real estate is initially recorded at the lower of the related loan balance or the fair value less cost to sell of the real estate at the date of foreclosure. At the time properties are acquired in full or partial satisfaction of loans, any excess of the loan balance over the estimated fair value of the property is charged against the allowance for loan losses. After foreclosure, these properties are carried at the lower of cost or fair value less estimated costs to sell based on recent appraised values or options to purchase the foreclosed property. Any excess of the carrying value over the estimated fair value, less estimated costs to sell, is charged to operations. The costs and expenses associated to holding these properties in portfolio are expensed as incurred.

Income Taxes

In preparing the consolidated financial statements, the Group is required to estimate income taxes. This involves an estimate of current income tax expense together with an assessment of temporary differences resulting from differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The determination of current income tax expense involves estimates and assumptions that require the Group to assume certain positions based on its interpretation of current tax laws and regulations. Changes in assumptions affecting estimates may be required in the future and estimated tax assets or liabilities may need to be increased or decreased accordingly. The accrual for tax contingencies is adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation. When particular matters arise, a number of years may elapse before such matters are audited and finally resolved. Favorable resolution of such matters could be recognized as a reduction to the Group's effective tax rate in the year of

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

resolution. Unfavorable settlement of any particular issue could increase the effective tax rate and may require the use of cash in the year of resolution.

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of the Group's net deferred tax assets assumes that the Group will be able to generate sufficient future taxable income based on estimates and assumptions. If these estimates and related assumptions change in the future, the Group may be required to record valuation allowances against its deferred tax assets resulting in additional income tax expense in the consolidated statements of operations.

Management evaluates the realizability of the deferred tax assets on a regular basis and assesses the need for a valuation allowance. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in valuation allowance from period to period are included in the Group's tax provision in the period of change.

In addition to valuation allowances, the Group establishes accruals for uncertain tax positions when, despite the belief that the Group's tax return positions are fully supported, the Group believes that certain positions are likely to be challenged. The uncertain tax positions accruals are adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law, and emerging legislation. The Group's uncertain tax positions accruals are reflected as income tax payable as a component of accrued expenses and other liabilities. These accruals are reduced upon expiration of statute of limitations.

The Group follows a two-step approach for recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation process, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.

The Group's policy is to include interest and penalties related to unrecognized income tax benefits within the provision for income taxes on the consolidated statements of operations.

Equity-Based Compensation Plan

The Oriental Financial Group Inc. Amended and Restated 2007 Omnibus Performance Incentive Plan (the "Omnibus Plan") provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units and dividend equivalents, as well as equity-based performance awards. The Omnibus Plan was adopted in 2007 and amended and restated in 2008.

The purpose of the Omnibus Plan is to provide flexibility to the Group to attract, retain and motivate directors, officers, and key employees through the grant of awards based on performance and to adjust its compensation practices to the best compensation practice and corporate governance trends as they develop from time to time. The Omnibus Plan is further intended to motivate high levels of individual performance coupled with increased shareholder returns. Therefore, awards under the Omnibus Plan (each, an "Award") are intended to be based upon the recipient's individual performance, level of responsibility and potential to make significant contributions to the Group. Generally, the Omnibus Plan will terminate as of (a) the date when no more of the Group's shares of common stock are available for issuance under the Omnibus Plan, or, if earlier, (b) the date the Omnibus Plan is terminated by the Group's Board of Directors (the "Board").

The Board's Compensation Committee (the "Committee"), or such other committee as the Board may designate, has full authority to interpret and administer the Omnibus Plan in order to carry out its provisions and purposes. The Committee has the authority to determine those persons eligible to receive an Award and to establish the terms and conditions of any Award. The Committee may delegate, subject to such terms or conditions or guidelines as it shall determine, to any employee or group of employees any portion of its authority and powers under the Omnibus Plan

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

with respect to participants who are not directors or executive officers subject to the reporting requirements under Section 16(a) of the Securities Exchange Act of 1934. Only the Committee may exercise authority in respect of Awards granted to such participants.

The Omnibus Plan replaced and superseded the Oriental Financial Group Inc. 1996, 1998 and 2000 Incentive Stock Option Plans (the “Stock Option Plans”). All outstanding stock options under the Stock Option Plans continue in full force and effect, subject to their original terms and conditions.

The Group follows the fair value method of recording stock-based compensation. Effective July 1, 2005, the Group uses the modified prospective transition method, which requires measurement of the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award with the cost to be recognized over the service period. It applies to all awards unvested and granted after this effective date and awards modified, repurchased, or cancelled after that date.

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances, except for those resulting from investments by owners and distributions to owners. GAAP requires that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and on derivative activities that qualify and are designated for cash flows hedge accounting, are reported as a separate component of the stockholders’ equity section of the consolidated statements of financial condition, such items, along with net income, are components of comprehensive income.

Commitments and Contingencies

Liabilities for loss contingencies, arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

Subsequent Events

The Group has evaluated events subsequent to the balance sheet date and prior to filing of this annual report on Form 10-K for the year ended December 31, 2009 and has adjusted and disclosed those events that have occurred that would require adjustment or disclosure in the consolidated financial statements.

Reclassifications

Certain amounts in prior years have been reclassified to conform to the presentation adopted in the current year.

Recent Accounting Developments:

In June 2009, the FASB issued FAS No. 168, “*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles — a replacement of FASB Statement No. 162*,” (“FAS 168”). FAS 168 establishes the FASB Accounting Standards Codification (“Codification”) as the source of authoritative GAAP for nongovernmental entities. The Codification does not change GAAP. Instead, it takes all individual pronouncements that currently comprise GAAP and reorganizes them into approximately 90 accounting Topics, and displays all Topics using a consistent structure. Contents in each Topic are further organized first by Subtopic, then Section and finally Paragraph. The Paragraph level is the only level that contains substantive content. Citing particular content in the Codification involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure. FASB suggests that all citations begin with “FASB ASC,” where ASC stands for Accounting Standards Codification. Changes to the ASC subsequent to June 30, 2009 are referred to as Accounting Standards Updates (“ASU”).

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In conjunction with the issuance of FAS 168, the FASB also issued its first Accounting Standards Update No. 2009-1, “*Topic 105 — Generally Accepted Accounting Principles*” (“ASU 2009-1”) which includes FAS 168 in its entirety as a transition to the ASC. ASU 2009-1 is effective for interim and annual periods ending after September 15, 2009 and will not have an impact on the Group’s financial position or results of operations but will change the referencing system for accounting standards. Certain of the following pronouncements were issued prior to the issuance of the ASC and adoption of the ASUs. For such pronouncements, citations to the applicable Codification by Topic, Subtopic and Section are provided where applicable in addition to the original standard type and number.

FAS 166 “*Accounting for Transfers of Financial Assets*” and FAS 167, “*Amendments to FASB Interpretation No. 46(R)*” (not yet reflected in FASB ASC) were issued in June 2009, and change the way entities account for securitizations and special-purpose entities, and will have a material effect on how banking organizations account for off-balance sheet vehicles. The new standards amend FAS 140, “*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*”, and FASB Interpretation No. 46(R), “*Consolidation of Variable Interest Entities*”. Both Statements 166 and 167 will be effective January 1, 2010 for companies reporting earnings on a calendar-year basis. The Group does not expect that the adoption of FAS 166 and 167 would have a material impact on the Group’s consolidated financial statements.

The FASB issued ASU 2009 — 05, “*Fair Value Measurements and Disclosures (Topic 820) — Measuring Liabilities at Fair Value*” in August 2009 to provide guidance when estimating the fair value of a liability. When a quoted price in an active market for the identical liability is not available, fair value should be measured using (a) the quoted price of an identical liability when traded as an asset; (b) quoted prices for similar liabilities or similar liabilities when traded as assets; or (c) another valuation technique consistent with the principles of Topic 820 such as an income approach or a market approach. If a restriction exists that prevents the transfer of the liability, a separate adjustment related to the restriction is not required when estimating fair value. The ASU was effective October 1, 2009 for the Group and did not have an impact on financial position or operations.

ASU 2009-12, “*Fair Value Measurements and Disclosures (Topic 820) — Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*” issued in September 2009, allows a company to measure the fair value of an investment that has no readily determinable fair market value on the basis of the investee’s net asset value per share as provided by the investee. This allowance assumes that the investee has calculated net asset value in accordance with the GAAP measurement principles of Topic 946 as of the reporting entity’s measurement date. Examples of such investments include investments in hedge funds, private equity funds, real estate funds and venture capital funds. The update also provides guidance on how the investment should be classified within the fair value hierarchy based on the value for which the investment can be redeemed. The amendment is effective for interim and annual periods ending after December 15, 2009 with early adoption permitted. The Group does not have investments in such entities and, therefore, there will be no impact to its financial statements.

Issued October, 2009, ASU 2009-15, “*Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing*” amends ASC Topic 470 and provides guidance for accounting and reporting for own-share lending arrangements issued in contemplation of a convertible debt issuance. At the date of issuance, a share-lending arrangement entered into on an entity’s own shares should be measured at fair value in accordance with Topic 820 and recognized as an issuance cost, with an offset to additional paid-in capital. Loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs. The amendments also require several disclosures including a description and the terms of the arrangement and the reason for entering into the arrangement. The effective dates of the amendments are dependent upon the date the share-lending arrangement was entered into and include retrospective application for arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009. The Group does not expect the update to have an impact on its consolidated financial statements.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not expected to have a material impact on the Group’s financial position, results of operations or cash flows.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

2. INVESTMENTS

Investment Securities

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the securities owned by the Group at December 31, 2009 and 2008, were as follows:

	December 31, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
	(In thousands)				
Available-for-sale					
Obligations of US Government sponsored agencies	\$1,037,722	\$ 359	\$ 30,990	\$1,007,091	3.18%
Puerto Rico Government and agency obligations	71,537	9	6,181	65,365	5.37%
Structured credit investments	61,722	—	23,340	38,382	3.69%
Total investment securities	1,170,981	368	60,511	1,110,838	
FNMA and FHLMC certificates	2,766,317	22,154	24,298	2,764,173	4.62%
GNMA certificates	339,830	7,317	1,044	346,103	4.81%
CMOs issued by US Government sponsored agencies . . .	279,454	7,057	3	286,508	5.20%
Non-agency collateralized mortgage obligations	487,435	—	41,398	446,037	5.78%
Total mortgage-backed-securities and CMOs	3,873,036	36,528	66,743	3,842,821	
Total securities available-for-sale	\$5,044,017	\$36,896	\$127,254	\$4,953,659	4.48%

	December 31, 2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
	(In thousands)				
Available-for-sale					
Obligations of US Government sponsored agencies	\$ 941,144	\$ 7,172	\$ 6,400	\$ 941,916	5.37%
Puerto Rico Government and agency obligations	91,599	597	9,307	82,889	5.40%
Structured credit investments	176,127	3,469	43,415	136,181	4.25%
Total investment securities	1,208,870	11,238	59,122	1,160,986	
FNMA and FHLMC certificates	1,521,428	25,527	205	1,546,750	5.51%
GNMA certificates	332,071	4,206	496	335,781	5.76%
CMOs issued by US Government sponsored agencies . . .	352,579	202	1,755	351,026	5.34%
Non-agency collateralized mortgage obligations	637,626	—	107,962	529,664	8.49%
Total mortgage-backed-securities and CMOs	2,843,704	29,935	110,418	2,763,221	
Total securities available-for-sale	\$4,052,574	\$41,173	\$169,540	\$3,924,207	5.90%

For 2009, 2008, and 2007 the Group's investment securities portfolio generated tax-exempt interest income of \$171.0 million, \$189.1 million, and \$184.7 million, respectively. Exempt interest relates mostly to interest earned on obligations of the United States and Puerto Rico governments and certain mortgage-backed securities, including securities held by the Bank's international banking entity. For 2009, 2008, and 2007, the Group's investment securities portfolio generated taxable interest income of \$75.3 million, \$70.8 million, and \$18.9 million, respectively.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The amortized cost and fair value of the Group's investment securities at December 31, 2009, by contractual maturity, are shown in the next table. Securities not due on a single contractual maturity date, such as collateralized mortgage obligations, are classified in the period of final contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2009	
	Available-for-sale	
	Amortized Cost	Fair Value
	(In thousands)	
Investment securities		
Due within one year	\$ 334,796	\$ 334,801
Due after 5 to 10 years	337,959	330,811
Due after 10 years	498,226	445,226
	<u>1,170,981</u>	<u>1,110,838</u>
Mortgage-backed-securities and CMOs		
Due after 5 to 10 years	17,549	18,143
Due after 10 years	3,855,487	3,824,678
	<u>3,873,036</u>	<u>3,842,821</u>
	<u>\$5,044,017</u>	<u>\$4,953,659</u>

Keeping with the Group's investment strategy, during 2009 and 2008, there were certain sales of available-for-sale securities because the Group felt at the time of such sales that gains could be realized while at the same time having good opportunities to invest the proceeds in other investment securities with attractive yields and terms that would allow the Group to continue to protect its net interest margin.

During the third quarter of 2009, the Group engaged in a series of transactions involving the sale of certain FNMA and FHLMC mortgage-backed securities with similar characteristics, in which the aggregate gains amounted to \$36.6 million, while the aggregate losses amounted to \$1.2 million. The sale of these securities was the result of the Group's decision to restructure this homogeneous component of the investment securities portfolio and to take advantage of market opportunities in light of anticipated economic conditions that could have a negative impact on the value of these securities going forward. Also, the Group, as part of its asset and liability management, purchases agency discount notes close to their maturities as a short term vehicle to reinvest the proceeds of sales of transactions until similar investment securities with attractive yields can be purchased. The discount notes are pledged as collateral for repurchase agreements. During the year ended December 31, 2009, the Group sold \$855.5 million of discount notes with minimal aggregate gross gains of approximately \$8 thousand and sold \$1.627 billion of discounted notes with minimal aggregate gross losses of approximately \$20 thousand.

In December 2009, the Group made the strategic decision to sell \$116.0 million of collateralized debt obligations at a loss of \$73.9 million. For the same strategic reasons, in early January 2010, the Group sold \$374.3 million, amortized cost, of non-agency collateralized mortgage obligations which contemplated a loss of \$45.8 million accounted for as other-than temporary impairment in the fourth quarter of 2009. This loss was accounted for as other-than-temporary impairment in the fourth quarter of 2009 and no additional gain or loss was realized on the sale in January 2010, since these assets were sold at the same value reflected at December 31, 2009.

Gains on sales of securities for 2008 included \$14.4 million from the sale on December 31, 2008 of \$820.6 million of agency-issued held-to-maturity securities. On that date, the remaining securities in the held-to-maturity portfolio were transferred to the available-for-sale portfolio at a fair value of \$354.5 million with net unrealized loss of \$23.2 million.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The tables below present an analysis of the gross realized gains and losses by category for the years ended December 31, 2009 and 2008:

<u>Description</u>	<u>Year Ended December 31, 2009</u>					<u>Gross</u>
	<u>Original Face</u>	<u>Original Cost</u>	<u>Sale Price</u>	<u>Sale Book Value</u>	<u>Gross Gains</u>	<u>Losses</u>
	<u>(In thousands)</u>					
Sale of Securities Available-for-Sale						
Investment securities						
Obligations of U.S. Government sponsored agencies	\$3,189,385	\$3,190,113	\$3,189,827	\$3,188,991	\$ 856	\$ 20
Structured credit investments	134,000	114,128	42,210	116,094	—	73,884
Puerto Rico Government and agency obligations	90,000	90,612	90,000	90,000	—	—
Total investment securities	<u>3,413,385</u>	<u>3,394,853</u>	<u>3,322,037</u>	<u>3,395,085</u>	<u>856</u>	<u>73,904</u>
Mortgage-backed securities and CMOs						
FNMA and FHLMC certificates	5,520,419	5,490,838	5,088,807	5,018,408	71,549	1,150
GNMA certificates	347,667	355,949	353,801	353,176	625	—
CMO issued by U.S. Government sponsored agencies	330,000	330,938	336,994	330,585	6,409	—
Total mortgage-backed securities and CMOs	<u>6,198,086</u>	<u>6,177,725</u>	<u>5,779,602</u>	<u>5,702,169</u>	<u>78,583</u>	<u>1,150</u>
Total	<u>\$9,611,471</u>	<u>\$9,572,578</u>	<u>\$9,101,639</u>	<u>\$9,097,254</u>	<u>\$79,439</u>	<u>\$75,054</u>

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Description	Year Ended December 31, 2008					
	Original Face	Original Cost	Sale Price	Sale Book Value	Gross Gains	Gross Losses
	(In thousands)					
Sale of Securities Available-for-Sale						
Investment securities						
Obligations of U.S. Government sponsored agencies	\$ 793,300	\$ 792,957	\$ 791,278	\$ 782,063	\$ 9,215	\$—
Puerto Rico Government and agency obligations	1,830	1,843	1,862	1,804	58	—
Total investment securities	795,130	794,800	793,140	783,867	9,273	—
Mortgage-backed securities and CMOs						
FNMA and FHLMC certificates	821,488	817,883	703,921	693,370	10,551	—
GNMA certificates	196,578	199,030	190,718	189,872	907	61
Total mortgage-backed securities and CMOs	1,018,066	1,016,913	894,639	883,242	11,458	61
	1,813,196	1,811,713	1,687,779	1,667,109	20,731	61
Sale of Securities Held-to-Maturity						
Investment securities						
Obligations of U.S. Government sponsored agencies	125,000	124,981	127,870	125,000	2,870	—
Total investment securities	125,000	124,981	127,870	125,000	2,870	—
Mortgage-backed securities and CMOs						
FNMA and FHLMC certificates	1,028,748	906,544	488,628	481,518	7,110	—
GNMA certificates	319,223	272,090	115,358	113,441	1,917	—
CMOs issued by U.S. Government sponsored agencies	140,473	140,979	103,119	100,616	2,503	—
Total mortgage-backed securities and CMOs	1,488,444	1,319,613	707,105	695,575	11,530	—
	1,613,444	1,444,594	834,975	820,575	14,400	—
Total	\$3,426,640	\$3,256,307	\$2,522,754	\$2,487,684	\$35,131	\$61

The following table shows the Group's gross unrealized losses and fair value of investment securities available-for-sale and held-to-maturity, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2009 and 2008:

December 31, 2009
Available-for-sale

	Less than 12 months		
	Amortized Cost	Unrealized Loss	Fair Value
	(In thousands)		
FNMA and FHLMC certificates	1,772,575	24,287	1,748,288
Obligations of U.S. Government sponsored agencies	602,926	30,990	571,936
GNMA certificates	154,916	1,030	153,886
CMOs issued by U.S. Government sponsored agencies	2,701	3	2,698
	2,533,118	56,310	2,476,808

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	12 months or more		
	Amortized Cost	Unrealized Loss	Fair Value
FNMA and FHLMC certificates	\$ 605	\$ 11	\$ 594
GNMA certificates	350	14	336
Non-agency collateralized mortgage obligations	113,122	41,398	71,724
Puerto Rico Government and agency obligations	71,155	6,181	64,974
Structured credit investments	<u>61,722</u>	<u>23,340</u>	<u>38,382</u>
	<u>246,954</u>	<u>70,944</u>	<u>176,010</u>

	Total		
	Amortized Cost	Unrealized Loss	Fair Value
FNMA and FHLMC certificates	1,773,180	24,298	1,748,882
Obligations of U.S. Government sponsored agencies	602,926	30,990	571,936
GNMA certificates	155,266	1,044	154,222
Non-agency collateralized mortgage obligations	113,122	41,398	71,724
Puerto Rico Government and agency obligations	71,155	6,181	64,974
Structured credit investments	61,722	23,340	38,382
CMOs issued by U.S. Government sponsored agencies	<u>2,701</u>	<u>3</u>	<u>2,698</u>
	<u>\$2,780,072</u>	<u>\$127,254</u>	<u>\$2,652,818</u>

**December 31, 2008
Available-for-sale**

	Less than 12 months		
	Amortized Cost	Unrealized Loss	Fair Value
	(In thousands)		
Non-agency collateralized mortgage obligations	\$ 234,198	\$48,564	\$185,634
CMOs issued by U.S. Government sponsored agencies	334,690	1,756	332,934
Obligations of U.S. Government sponsored agencies	325,500	6,400	319,100
Structured credit investments	50,262	11,815	38,447
Puerto Rico Government and agency obligations	252	1	251
FNMA and FHLMC certificates	52,519	148	52,371
GNMA certificates	<u>19,582</u>	<u>229</u>	<u>19,353</u>
	<u>1,017,003</u>	<u>68,913</u>	<u>948,090</u>

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	12 months or more		
	<u>Amortized Cost</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>
Non-agency collateralized mortgage obligations	403,428	59,398	344,030
Structured credit investments	100,548	31,599	68,949
Puerto Rico Government and agency obligations	71,218	9,306	61,912
FNMA and FHLMC certificates	1,025	57	968
GNMA certificates	9,084	267	8,817
	<u>585,303</u>	<u>100,627</u>	<u>484,676</u>

	Total		
	<u>Amortized Cost</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>
Non-agency collateralized mortgage obligations	637,626	107,962	529,664
CMOs issued by U.S. Government sponsored agencies	334,690	1,756	332,934
Obligations of U.S. Government sponsored agencies	325,500	6,400	319,100
Structured credit investments	150,810	43,414	107,396
Puerto Rico Government and agency obligations	71,470	9,307	62,163
FNMA and FHLMC certificates	53,544	205	53,339
GNMA certificates	28,666	496	28,170
	<u>\$1,602,306</u>	<u>\$169,540</u>	<u>\$1,432,766</u>

The Group constantly monitors the non-agency mortgage-backed securities portfolio to measure the collateral performance and gauge trends for such positions, and the effect of collateral behavior on credit enhancements, cash flows, and fair values of the bonds. The Group also periodically monitors any rating migration, and takes into account the time lag between underlying performance and rating agency actions. This assessment is made using a cash flow model that estimates the cash flows on the underlying mortgages, based on the security-specific collateral and deal structure, and also includes inputs such as constant default rates, prepayment rates, and loss severity. The cash flows estimated by the model are distributed through the different tranches of each security, considering subordination for the different tranches. The anticipated cash flows expected to be collected from these debt securities were discounted at the rate equal to the yield used to accrete the current and prospective beneficial interest for the securities. Significant inputs included estimated cash flows, defaults and recoveries. The present value of the expected cash flows was compared to the current outstanding balance of the tranche to determine the ratio of the estimated present value of expected cash flows to the total current balance for the tranche. This ratio was then multiplied by the principal balance of the security to determine the credit-related impairment loss.

On January 11, 2010, the Group sold \$420.1 million of non-agency collateralized mortgage obligations at a loss of \$45.8 million. This loss was accounted for as other-than-temporary impairment in the fourth quarter of 2009. In addition, during 2009 the Group recorded \$10.0 million of credit related other than temporary impairment losses on several of the non-agency collateralized mortgage obligations that were sold in January 2010. As a result, during 2009 the Group recorded a total of \$55.8 million of credit related other than temporary impairment losses on the non-agency collateralized mortgage obligations that were sold in January 2010.

During 2009, the Group recorded other-than-temporary impairment losses for a total of \$60.1 million on its portfolio of non-agency collateralized mortgage obligations (\$55.8 million on those that were sold, and \$4.3 million on the remaining security). At December 31, 2009, non-agency collateralized mortgage obligations include \$41.4 million of non-credit unrealized losses recognized in other comprehensive income (loss). At December 31,

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

2009, the excess of amortized cost over fair value on other-than-temporarily impaired securities amounted to \$101.5 million.

The following table summarizes other-than-temporary impairment losses (in thousands) on securities for the year ended December 31, 2009:

Excess of amortized cost over fair value on other-than-temporarily impaired securities . .	\$(101,472)
Non-credit related unrealized loss on securities recognized in other comprehensive income	41,398
Net impairment losses recognized in earnings	<u><u>(\$ 60,074)</u></u>

The Group adopted the provisions of FASB ASC 320-10-65-1, as of April 1, 2009. For those debt securities for which the fair value of the security is less than its amortized cost, the Group does not intend to sell such security, and it is more likely than not that it will not be required to sell such security prior to the recovery of its amortized cost basis less any current period credit losses, these provisions require that the credit-related portion of other-than-temporary impairment losses be recognized in earnings while the noncredit-related portion is recognized in other comprehensive income, net of related taxes.

As a result of the adoption of Transition Guidance FASB ASC 320-10-65-1, during 2009 \$4.3 million of net credit-related impairment losses were recognized in earnings and \$41.4 million of noncredit-related impairment losses were recognized in other comprehensive income for a non-agency collateralized mortgage obligation pool not expected to be sold. Major inputs to measure the amount related to the credit losses were 12.82% of default rate, 46.14% of severity, and 12.83% for prepayment rate. Also, as of April 1, 2009 the Group reclassified the noncredit-related portion of other-than-temporary impairment losses previously recognized on this security in earnings in the third quarter of 2008. This reclassification was reflected as a cumulative effect adjustment of \$14.4 million that increased retained earnings and increased accumulated other comprehensive loss. The amortized cost basis of this non-agency collateralized mortgage obligation pool for which other-than-temporary impairment losses were recognized in the third quarter of 2008 was adjusted by the amount of the cumulative effect adjustment. At December 31, 2009 the total credit related other-than-temporary impairment loss recorded on this non-agency collateralized mortgage obligation amounted to \$25.4 million (\$21.1 million in 2008, before the adoption of FASB ASC 320-10-65-1, and \$4.3 million in 2009). The Group does not intend to sell this security, and it is more likely than not, that it will not be required to sell this security prior to the recovery of its amortized cost basis less any current period credit losses.

The following table presents a summary of credit-related impairment losses recognized in earnings (in thousands) on securities for which portions of other-than-temporary impairment were recognized in other comprehensive income:

Credit-related impairment loss recognized in earnings in 2008 on a non-agency security not expected to be sold after considering effect of adoption of FASB ASC 320-10-65-1	\$21,080
Credit-related impairment loss recognized in 2009 on non-agency security not expected to be sold	4,309
Credit-related impairment losses recognized in 2009 on non-agency securities sold in January 2010	55,765
Total credit related impairment losses recognized in earnings up to December 31, 2009 . .	<u><u>\$81,154</u></u>

In December 2009, the Group made the strategic decision to sell \$116.0 million of collateralized debt obligations at a loss of \$73.9 million. These securities had been downgraded during 2009 to a credit rating below investment grade, thus having a negative effect on the Group's asset quality. As a result of this transaction, and to the January 2010 sale of most of the non-agency collateralized mortgage obligations, the Group significantly reduced its exposure to non-agency securities and was able to improve its risk-based capital position.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

At December 31, 2009, the Group's remaining portfolio of structured credit investments amounted to \$61.7 million (amortized cost) in the available-for-sale portfolio, with net unrealized losses of approximately \$23.3 million. The Group's structured credit investments portfolio consist of two types of instruments: synthetic collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs). The Group estimates that it will recover all interest and principal for the Group's specific tranches of these securities. This assessment is based on an analysis in which the credit quality of the Group's positions was evaluated through a determination of the expected losses on the underlying collateral. The losses on the underlying corporate pools were inferred by observations on the credit ratings and credit spreads of the reference entities or market quotes used to derive the credit spreads. The spreads of the portfolios were converted to loss probabilities, and these were applied to a model that provided estimated projected losses for each security. The model results show that the estimated future collateral losses, if any, are lower than the Group's subordination levels for each one of these securities. Therefore, these securities are deemed to have sufficient credit support to absorb the estimated collateral losses.

Other-than-temporary impairment analysis is based on estimates that depend on market conditions and are subject to further change over time. In addition, while the Group believes that the methodology used to value these exposures is reasonable, the methodology is subject to continuing refinement, including those made as a result of market developments. Consequently, it is reasonably possible that changes in estimates or conditions could result in the need to recognize additional other-than-temporary impairment charges in the future.

Other securities in an unrealized loss position at December 31, 2009 are mainly composed of securities issued or backed by U.S. government agencies and U.S. government sponsored agencies. These investments are primarily highly liquid securities that have a large and efficient secondary market. Valuations are performed on a monthly basis. The Group's management believes that the unrealized losses of such other securities at December 31, 2009, are also temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuer or guarantor. At December 31, 2009, the Group does not have the intent to sell these investments in unrealized loss position.

3. PLEDGED ASSETS

At December 31, 2009, residential mortgage loans amounting to \$546.7 million were pledged to secure advances and borrowings from the FHLB. Investment securities with fair values totaling \$3.9 billion, \$72.6 million and \$85.3 million at December 31, 2009, were pledged to secure investment securities sold under agreements to repurchase, public fund deposits and other funds, respectively. Also, at December 31, 2009, investment securities with fair values totaling \$8.4 million were pledged against interest rate swaps contracts, while others with fair values of \$128 thousand and \$119 thousand, were pledged to the Puerto Rico Treasury Department and to the OCFI, respectively.

As of December 31, 2009, investment securities available-for-sale not pledged amounted to \$887.1 million. As of December 31, 2009, mortgage loans not pledged amounted to \$396.2 million.

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

4. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans Receivable

The Group's credit activities are mainly with customers located in Puerto Rico. The Group's loan transactions are encompassed within three main categories: mortgage, commercial and consumer. The composition of the Group's loan portfolio at December 31, 2009 and 2008 was as follows:

	December 31,	
	2009	2008
	(In thousands)	
Loans secured by real estate:		
Residential — 1 to 4 family	\$ 898,790	\$ 976,569
Home equity loans, secured personal loans and others	20,145	23,507
Commercial	157,631	145,377
Deferred loan fees, net	(3,318)	(3,197)
	<u>1,073,248</u>	<u>1,142,256</u>
Other loans:		
Commercial	40,146	41,700
Personal consumer loans and credit lines	22,864	23,054
Deferred loan fees, net	(178)	(167)
	<u>62,832</u>	<u>64,587</u>
Loans receivable	1,136,080	1,206,843
Allowance for loan losses	(23,272)	(14,293)
Loans receivable, net	1,112,808	1,192,550
Mortgage loans held-for-sale	27,261	26,562
Total loans, net	<u>\$1,140,069</u>	<u>\$1,219,112</u>

At December 31, 2009 and 2008, loans on which the accrual of interest has been discontinued amounted to \$57.1 million and \$38.8 million, respectively. The gross interest income that would have been recorded in the years ended December 31, 2009, 2008, and 2007 if non-accrual loans had performed in accordance with their original terms amounted to \$3.6 million, \$2.5 million, and \$2.0 million, respectively. The Group's investment in loans past due 90 days or more and still accruing amounted to \$47.3 million and \$38.7 million at December 31, 2009 and 2008, respectively.

Allowance for Loan Losses

The Group maintains an allowance for loan losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. The Group's allowance for loan losses policy provides for a detailed quarterly analysis of probable losses. The analysis includes a review of historical loan loss experience, value of underlying collateral, current economic conditions, financial condition of borrowers and other pertinent factors. While management uses available information in estimating probable loan losses, future additions to the allowance may be required based on factors beyond the Group's control.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The changes in the allowance for loan losses for the years ended December 31, 2009, 2008, and 2007 were as follows:

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Balance at beginning of year	\$14,293	\$10,161	\$ 8,016
Provision for loan losses	15,650	8,860	6,550
Loans charged-off	(7,028)	(5,104)	(4,906)
Recoveries	357	376	501
Balance at end of year	<u>\$23,272</u>	<u>\$14,293</u>	<u>\$10,161</u>

The Group evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. At December 31, 2009, the total investment in impaired commercial loans was \$15.6 million (December 31, 2008 — \$4.6 million). The impaired commercial loans were measured based on the fair value of collateral. The average investment in impaired commercial loans for the years ended December 31, 2009, 2008 and 2007, amounted to \$9.0 million, \$1.9 million, and \$1.5 million, respectively. The valuation allowance for impaired commercial loans amounted to approximately \$709 thousand and \$1.1 million at December 31, 2009 and 2008, respectively. Net credit losses on impaired commercial loans for the year ended December 31, 2009 were approximately \$776 thousand. There were no credit losses on impaired commercial loans for the years ended December 31, 2008 and 2007. At December 31, 2009, the total investment in impaired mortgage loans was \$10.7 million (December 31, 2008 — \$3.0 million). Impairment on mortgage loans assessed as troubled debt restructuring was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately \$683 thousand and \$45 thousand at December 31, 2009 and 2008, respectively.

5. PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2009 and 2008 are stated at cost less accumulated depreciation and amortization as follows:

	Useful Life (Years)	December 31,	
		2009	2008
		(In thousands)	
Land	—	\$ 978	\$ 1,014
Buildings and improvements	40	2,982	3,033
Leasehold improvements	5 — 10	19,198	17,741
Furniture and fixtures	3 — 7	8,527	7,490
Information technology and other	3 — 7	11,744	12,527
		43,429	41,805
Less: accumulated depreciation and amortization		(23,654)	(20,621)
		<u>\$ 19,775</u>	<u>\$ 21,184</u>

Depreciation and amortization of premises and equipment for the years ended December 31, 2009, 2008, and 2007, totaled \$6.0 million, \$5.4 million, and \$5.4 million, respectively. These are included in the consolidated statements of operations as part of occupancy and equipment expenses.

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

6. ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

Accrued interest receivable at December 31, 2009 and 2008 consists of the following:

	December 31,	
	2009	2008
	(In thousands)	
Loans	\$10,888	\$10,910
Investments	<u>22,768</u>	<u>33,004</u>
	<u>\$33,656</u>	<u>\$43,914</u>

Other assets at December 31, 2009 and 2008 consist of the following:

	December 31,	
	2009	2008
	(In thousands)	
Prepaid FDIC Insurance	\$22,568	\$ —
Forward settlement swaps	8,511	—
Servicing asset	7,120	2,819
Investment in equity indexed options	6,464	12,801
Other prepaid expenses	4,269	3,433
Mortgage tax credits	3,819	5,047
Debt issuance costs	3,531	875
Goodwill	2,006	2,006
Investment in Statutory Trusts	1,086	1,086
Accounts receivable and other assets	<u>5,535</u>	<u>8,660</u>
	<u>\$64,909</u>	<u>\$36,727</u>

On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 30, 2009, along with each institution's risk-based deposit insurance assessment for the third quarter of 2009. The prepayment of the assessment for 2010, 2011 and 2012 amounted to \$22.6 million.

At December 31, 2009 there are open forward settlement swaps with an aggregate notional amount of \$900 million. The forward settlement date of these swaps is December 28, 2011 with final maturities rasing from December 28, 2013 through December 28, 2014. A derivative asset of \$8.5 million is recognized in the consolidated statement of financial position, related to the valuation of these swaps.

The Group periodically sells or securitizes loans while retaining the obligation to perform the servicing of such loans. In addition, the Group may purchase or assume the right to service loans originated by others. Whenever the Group undertakes an obligation to service a loan, management assesses whether a servicing asset and/or liability should be recognized. A servicing asset is recognized whenever the compensation for servicing is expected to more than adequately compensate the servicer for performing the servicing.

The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index. The Group uses option agreements with major broker-dealer companies to manage its exposure to changes in this index. Under the terms of the option agreements, the Group receives the average increase in the month-end value of the index in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings. At December 31, 2009 and 2008, the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of \$6.5 million (notional amount of \$150.7 million) and \$12.8 million

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(notional amount of \$155.4 million), respectively; the options sold to customers embedded in the certificates of deposit and recorded as deposits in the consolidated statement of financial condition, represented a liability of \$9.5 million (notional amount of \$145.4 million) and \$16.6 million (notional amount of \$149.8 million), respectively and are included in other liabilities on the consolidated statements of financial condition.

In December 2007, the Commonwealth of Puerto Rico established mortgage loan tax credits to financial institutions that provided financing for the acquisition of new homeowners for the period from December 2007 to December 2008 up to a maximum amount of \$220 million in tax credits overall. At December 31, 2009 and 2008 mortgage loan tax credits amounted to \$3.8 million and \$5.0 million, respectively. A loss of \$2.5 million was included in the Consolidated Statements of Operations for the year ended December 31, 2008, representing a provision for loss on mortgage loan tax credits for new homeowners which surpassed the \$220 million limit established by the government and is now doubtful whether these tax credits will be granted. No provision for loss on mortgage tax credits was recorded for the year ended December 31, 2009.

In March 2009, the Group's banking subsidiary issued \$105 million in notes guaranteed under the FDIC Temporary Liquidity Guarantee Program. Shortly after issuance of the notes, the Group paid \$3.2 million (equivalent to an annual fee of 100 basis points) to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes. These costs have been deferred and are being amortized over the term of the notes. At December 31, 2009 this deferred issue cost was \$2.3 million.

7. DEPOSITS AND RELATED INTEREST

Total deposits as of December 31, 2009, and December 31, 2008 consist of the following:

	December 31, 2009	December 31, 2008
	(In thousands)	
Non-interest bearing demand deposits	\$ 73,548	\$ 53,056
Interest-bearing savings and demand deposits	706,750	450,786
Individual retirement accounts	312,843	286,691
Retail certificates of deposit	312,410	292,046
Total Retail Deposits	1,405,551	1,082,579
Institutional deposits	136,683	184,283
Brokered deposits.	203,267	518,438
	<u>\$1,745,501</u>	<u>\$1,785,300</u>

At December 31, 2009 and 2008, the weighted average interest rate of the Group's deposits was 3.13%, and 3.54%, respectively, inclusive of non-interest bearing deposits of \$73.5 million, and \$53.1 million, respectively. Interest expense for the years ended December 31, 2009 and 2008, and 2007 is set forth below:

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Demand and savings deposits	\$18,115	\$14,396	\$14,776
Certificates of deposit	36,578	35,385	38,018
	<u>\$54,693</u>	<u>\$49,781</u>	<u>\$52,794</u>

At December 31, 2009 and 2008, time deposits in denominations of \$100 thousand or higher amounted to \$359.1 million, and \$548.4 million, including public fund deposits from various local government agencies of \$63.4 million and \$72.3 million at a weighted average rate of 0.62% and 2.04%, which were collateralized with investment securities with fair value of \$72.6 million and \$82.1 million, respectively.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Excluding equity indexed options in the amount of \$9.5 million, which are used by the Group to manage its exposure to the Standard & Poor's 500 stock market index, and also excluding accrued interest of \$3.9 million and unamortized deposit discounts in the amount of \$15.2 million, the scheduled maturities of certificates of deposit at December 31, 2009 are as follows:

	<u>(In thousands)</u>
Within one year:	
Three(3) months or less	\$229,837
Over 3 months through 1 year	<u>324,664</u>
	554,501
Over 1 through 2 years	197,475
Over 2 through 3 years	105,852
Over 3 through 4 years	67,858
Over 4 through 5 years	<u>41,326</u>
	<u>\$967,012</u>

The aggregate amount of overdraft in demand deposit accounts that were reclassified to loans amounted to \$1.6 million as of December 31, 2009, (December 31, 2008 — \$2.2 million).

8. BORROWINGS

Federal Funds Purchased and Short Term Borrowings

At December 31, 2009, federal funds purchased and short term borrowings amounted to \$49.2 million (December 31, 2008 — \$29.2 million) which mainly consist of federal funds purchased with a weighted average rate of 0.44% (December 31, 2008 — 1.49%).

Securities Sold under Agreements to Repurchase

At December 31, 2009, securities underlying agreements to repurchase were delivered to, and are being held by, the counterparties with whom the repurchase agreements were transacted. The counterparties have agreed to resell to the Group the same or similar securities at the maturity of the agreements.

At December 31, 2009, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of \$7.3 million, were as follows:

	<u>Borrowing Balance</u>	<u>Fair Value of Underlying Collateral</u>
	<u>(In thousands)</u>	
Citigroup Global Markets Inc.	\$1,700,000	\$1,880,838
Credit Suisse Securities (USA) LLC	1,250,000	1,327,820
UBS Financial Services Inc.	500,000	569,726
JP Morgan Chase Bank NA	<u>100,000</u>	<u>121,649</u>
Total	<u>\$3,550,000</u>	<u>\$3,900,033</u>

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The terms of the Group's structured repurchase agreements range between three and ten years, and the counterparties have the right to exercise at par on a quarterly basis put options before their contractual maturity from one to three years after the agreements' settlement dates. The following table shows a summary of these agreements and their terms, excluding accrued interest in the amount of \$7.3 million, at December 31, 2009:

<u>Year of Maturity</u>	<u>Borrowing Balance</u> (In thousands)	<u>Weighted-Average Coupon</u>	<u>Settlement Date</u>	<u>Maturity Date</u>	<u>Next Put Date</u>
2010	\$ 100,000	4.39%	8/14/2007	8/16/2010	2/14/2010
	<u>100,000</u>				
2011	100,000	4.17%	12/28/2006	12/28/2011	3/28/2010
	350,000	4.23%	12/28/2006	12/28/2011	3/28/2010
	100,000	4.29%	12/28/2006	12/28/2011	3/28/2010
	<u>350,000</u>	4.35%	12/28/2006	12/28/2011	3/28/2010
	<u>900,000</u>				
2012	350,000	4.26%	5/9/2007	5/9/2012	2/9/2010
	100,000	4.50%	8/14/2007	8/14/2012	2/14/2010
	100,000	4.47%	9/13/2007	9/13/2012	3/13/2010
	<u>150,000</u>	4.31%	3/6/2007	12/6/2012	3/7/2010
	<u>700,000</u>				
2014	<u>100,000</u>	4.72%	7/27/2007	7/27/2014	1/27/2010
	<u>100,000</u>				
2017	500,000	4.51%	3/2/2007	3/2/2017	3/2/2010
	250,000	0.25%	3/2/2007	3/2/2017	3/2/2010
	100,000	0.00%	6/6/2007	3/6/2017	3/6/2010
	<u>900,000</u>	<u>0.00%</u>	3/6/2007	6/6/2017	3/6/2010
	<u>1,750,000</u>				
	<u>\$3,550,000</u>	<u>2.85%</u>			

As part of its general banking and asset and liability management strategies, in July 2009 the Group executed a \$200 million deleverage of its balance sheet at the holding company level by terminating certain repurchase agreements at a cost of approximately \$17.6 million (before income taxes).

None of the structured repurchase agreements referred to above with put dates up to the date of this filing were put by the counterparties at their corresponding put dates. Such repurchase agreements include \$1.25 billion, which reset at the put date at a formula which is based on the three-month LIBOR rate less fifteen times the difference between the ten-year SWAP rate and the two-year SWAP rate, with a minimum of 0.00% on \$1.0 billion and 0.25% on \$250 million, and a maximum of 10.6%. These repurchase agreements bear the respective minimum rates of 0.0% (from March 6, 2009) and 0.25% (from March 2, 2009) to at least their next put dates scheduled for June 2010.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table presents the borrowings under repurchase agreements, excluding accrued interest in the amount of \$7.3 million and \$11.1 million, respectively, at December 31, 2009 and 2008, their maturities and approximate fair values of their collateral as follows:

	December 31,			
	2009	Fair Value of Underlying Collateral	2008	Fair Value of Underlying Collateral
	Borrowing Balance		Borrowing Balance	
	(In thousands)			
GNMA certificates				
Within 30 days	\$ —	\$ 90,229	\$ —	\$ 215,923
Less than 1 year	5,216	5,349	—	—
1 — 3 years	157,236	110,211	24,232	25,127
3 — 5 years	—	—	80,264	84,364
over 5 years	<u>128,060</u>	<u>105,741</u>	<u>109,621</u>	<u>82,977</u>
	<u>290,512</u>	<u>311,530</u>	<u>214,117</u>	<u>408,391</u>
FNMA certificates				
Within 30 days	—	144,260	—	239,966
Less than 1 year	583	603	—	—
1 — 3 years	816,020	838,797	8,701	9,050
3 to 5 years	100,000	81,727	404,596	424,447
over 5 years	<u>616,187</u>	<u>585,626</u>	<u>853,669</u>	<u>786,220</u>
	<u>1,532,790</u>	<u>1,651,013</u>	<u>1,266,966</u>	<u>1,459,683</u>
FHLMC certificates				
Within 30 days	—	75,325	—	24,883
Less than 1 year	94,201	94,168	—	—
1 — 3 years	147,309	151,919	67,067	70,128
3 to 5 years	—	—	113,903	117,852
over 5 years	<u>313,786</u>	<u>252,599</u>	<u>371,557</u>	<u>340,142</u>
	<u>555,296</u>	<u>574,011</u>	<u>552,527</u>	<u>553,005</u>
CMOs				
Within 30 days	—	22,048	—	12,059
3 to 5 years	337,727	335,840	801,237	876,170
over 5 years	<u>—</u>	<u>—</u>	<u>77,134</u>	<u>81,600</u>
	<u>337,727</u>	<u>357,888</u>	<u>878,371</u>	<u>969,829</u>
US Agency securities				
Within 30 days	—	310,422	—	147,118
3 to 5 years	141,708	124,776	50,000	51,117
over 5 years	<u>691,967</u>	<u>570,393</u>	<u>788,019</u>	<u>809,281</u>
	<u>833,675</u>	<u>1,005,591</u>	<u>838,019</u>	<u>1,007,516</u>
Total	<u>\$3,550,000</u>	<u>\$3,900,033</u>	<u>\$3,750,000</u>	<u>\$4,398,424</u>

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

At December 31, 2009 and 2008, the weighted average interest rate of the Group's repurchase agreements was 2.85% and 4.34%, respectively and included agreements with interest ranging from 0.00% to 4.72% and 3.71% to 4.67%, respectively. The following summarizes significant data on securities sold under agreements to repurchase as of December 31, 2009 and 2008, excluding accrued interest:

	December 31,	
	2009	2008
	(In thousands)	
Average daily aggregate balance outstanding	\$3,659,442	\$3,800,673
Maximum amount outstanding at any month-end	\$3,762,353	\$3,836,635
Weighted average interest rate during the year	3.16%	4.25%
Weighted average interest rate at year end	2.85%	4.34%

Advances from the Federal Home Loan Bank

At December 31, 2009 and 2008, advances from the FHLB consisted of the following, excluding accrued interest of \$1.8 million and \$1.7 million, respectively:

<u>Maturity Date</u>	<u>Fixed Interest Rate</u>	December 31,	
		2009	2008
		(In thousands)	
January-2009	0.44%	—	26,700
May-2012	4.37%	25,000	25,000
July-2012	4.57%	25,000	25,000
July-2012	4.26%	25,000	25,000
August-2012	4.33%	50,000	50,000
August-2012	4.09%	100,000	100,000
May-2014	4.20%	25,000	25,000
May-2014	4.22%	30,000	30,000
		<u>\$280,000</u>	<u>\$306,700</u>
Weighted average interest rate		<u>4.24%</u>	<u>3.91%</u>

Advances are received from the FHLB under an agreement whereby the Group is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances. At December 31, 2009, these advances were secured by mortgage loans amounting to \$546.7 million. Also, at December 31, 2009, the Group has an additional borrowing capacity with the FHLB of \$158.6 million. At December 31, 2009, the weighted average maturity of FHLB's advances was 35.6 months (December 31, 2008 — 43.6 months).

During 2007, the Group restructured most of its FHLB advances portfolio into longer-term, structured advances. The terms of these advances range between five and seven years, and the FHLB has the right to exercise at par on a quarterly basis put options before the contractual maturity of the advances from six months to one year after the

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

advances' settlement dates. The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of \$1.8 million, at December 31, 2009:

<u>Year of Maturity</u>	<u>Borrowing Balance</u> (In thousands)	<u>Weighted-Average Coupon</u>	<u>Settlement Date</u>	<u>Maturity Date</u>	<u>Next Put Date</u>
2012					
	\$ 25,000	4.37%	5/4/2007	5/4/2012	2/4/2010
	25,000	4.57%	7/24/2007	7/24/2012	1/24/2010
	25,000	4.26%	7/30/2007	7/30/2012	1/30/2010
	50,000	4.33%	8/10/2007	8/10/2012	2/10/2010
	<u>100,000</u>	4.09%	8/16/2007	8/16/2012	2/16/2010
	<u>225,000</u>				
2014					
	25,000	4.20%	5/8/2007	5/8/2014	2/8/2010
	<u>30,000</u>	<u>4.22%</u>	5/11/2007	5/11/2014	2/11/2010
	<u>55,000</u>				
	<u>\$280,000</u>	<u>4.24%</u>			

None of the structured advances from the FHLB referred to above were put by the counterparty at their corresponding put dates.

Subordinated Capital Notes

Subordinated capital notes amounted to \$36.1 million at December 31, 2009 and 2008.

In August 2003, the Statutory Trust II, special purpose entity of the Group, was formed for the purpose of issuing trust redeemable preferred securities. In September 2003, \$35.0 million of trust redeemable preferred securities were issued by the Statutory Trust II as part of pooled underwriting transactions. Pooled underwriting involves participating with other bank holding companies in issuing the securities through a special purpose pooling vehicle created by the underwriters.

The proceeds from this issuance were used by the Statutory Trust II to purchase a like amount of floating rate junior subordinated deferrable interest debentures ("subordinated capital notes") issued by the Group. The subordinated capital note has a par value of \$36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (3.20% at December 31, 2009; 4.82% at December 31, 2008), payable quarterly, and matures on September 17, 2033. The subordinated capital note purchased by the Statutory Trust II may be called at par after five years and quarterly thereafter (next call date March 2010). The trust redeemable preferred securities have the same maturity and call provisions as the subordinated capital notes. The subordinated deferrable interest debentures issued by the Group are accounted for as a liability denominated as subordinated capital notes on the consolidated statements of financial condition.

The subordinated capital notes are treated as Tier 1 capital for regulatory purposes. Under Federal Reserve Board rules, restricted core capital elements, which are qualifying trust preferred securities, qualifying cumulative perpetual preferred stock (and related surplus) and certain minority interests in consolidated subsidiaries, are limited in the aggregate to no more than 25% of a bank holding company's core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability.

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

FDIC- Guaranteed Term Notes — Temporary Liquidity Guarantee Program

The Group's banking subsidiary issued in March 2009 \$105 million in notes guaranteed under the FDIC Temporary Liquidity Guarantee Program. These notes are due on March 16, 2012, bear interest at a 2.75% fixed rate, and are backed by the full faith and credit of the United States. Interest on the notes is payable on the 16th of each March and September, beginning September 16, 2009. Shortly after issuance of the notes, the Group paid \$3.2 million (equivalent to an annual fee of 100 basis points) to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes. This cost has been deferred and is being amortized over the term of the notes.

9. DERIVATIVE ACTIVITIES

The Group may use various derivative instruments as part of its asset and liability management. These transactions involve both credit and market risks. The notional amounts are amounts on which calculations, payments, and the value of the derivatives are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. The actual risk of loss is the cost of replacing, at market, these contracts in the event of default by the counterparties. The Group controls the credit risk of its derivative financial instrument agreements through credit approvals, limits, monitoring procedures and collateral, when considered necessary.

Derivative instruments are generally negotiated over-the-counter ("OTC") contracts. Negotiated OTC derivatives are generally entered into between two counterparties that negotiate specific contractual terms, including the underlying instrument, amount, exercise price, and maturity.

The Group generally uses interest rate swaps and options in managing its interest rate risk exposure. Under the swaps, the Group usually pays a fixed monthly or quarterly cost and receives a floating thirty or ninety-day payment based on LIBOR. Floating rate payments received from the swap counterparties partially offset the interest payments to be made. If market conditions warrant, the Group might terminate the swaps prior to their maturity.

During the year ended December 31, 2009 gains of \$28.9 million were recognized and reflected as "Derivative Activities" in the consolidated statements of operations. These gains were due to:

- (a) several interest-rate swap contracts that the Group entered to manage its interest rate risk exposure, which were terminated before December 31, 2009 (\$20.4 million);and
- (b) fair value as of December 31, 2009 of open forward settlement swaps with an aggregate notional amount of \$900 million (\$8.5 million). The forward settlement date of these swaps is December 28, 2011 with final maturities ranging from December 28, 2013 through December 28, 2014. A derivative asset of \$8.5 million is recognized in the consolidated statement of financial position, related to the valuation of these swaps.

During the year ended December 31, 2008 losses of \$12.9 million were recognized and reflected as "Derivative Activities" in the consolidated statements of operations. These losses were mainly due to a \$4.9 loss in connection to equity index option agreements in which performance by the counterparty (Lehman Brothers Finance S.A.), which filed for bankruptcy on October 3, 2008, is uncertain, resulting in a credit risk exposure for such amount, and an interest-rate swap contract that the Group entered into in January 2008 to manage the Group's interest rate risk exposure with a nominal amount of \$500 million. Such contract was subsequently terminated, resulting in a loss to the Group of approximately \$7.9 million.

The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index. The Group uses option agreements with major broker-dealer companies to manage its exposure to changes in this index. Under the terms of the option agreements, the Group receives the average increase in the month-end value of the index in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

There were no derivatives designated as a hedge as of December 31, 2009 and 2008. At December 31, 2009 and 2008, the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of \$6.5 million (notional amount of \$150.7 million) and \$12.8 million (notional amount of \$155.4 million), respectively; the options sold to customers embedded in the certificates of deposit and recorded as deposits in the consolidated statement of financial condition, represented a liability of \$9.5 million (notional amount of \$145.4 million) and \$16.6 million (notional amount of \$149.8 million), respectively.

At December 31, 2009, the yearly contractual maturities of derivative instruments were as follows:

<u>Year Ending December 31,</u>	<u>Equity Indexed Options Purchased</u>	<u>Equity Indexed Options Written</u>
	<u>(In thousands)</u>	
2010	9,045	8,481
2011	21,415	20,159
2012	64,285	63,733
2013	38,590	36,051
2014	<u>17,340</u>	<u>17,023</u>
	<u>150,675</u>	<u>145,447</u>

10. EMPLOYEE BENEFIT PLAN

The Group has a cash or deferred arrangement profit sharing plan qualified under Section 1165(e) of the Puerto Rico Internal Revenue Code of 1994, as amended (the “Puerto Rico Code”) and the Section 401(a) and (e) of the United States Revenue Code of 1986, as amended (the “U.S. Code”), covering all full-time employees of the Group who are age twenty-one or older. Under this plan, participants may contribute each year from 2% to 10% of their compensation, as defined in the Puerto Rico Code and U.S. Code, up to a specified amount. The Group currently contributes 80 cents for each dollar contributed by an employee, up to \$832 per employee. The Group’s matching contribution is invested in shares of its common stock. The plan is entitled to acquire and hold qualified employer securities as part of its investment of the trust assets pursuant to ERISA Section 407. For the years ended December 31, 2009, 2008 and 2007, the Group contributed 37,956, 9,697, and 17,216, respectively, shares of its common stock with a fair value of approximately \$148,700, \$148,600, and \$204,200, respectively at the time of contribution. The Group’s contribution becomes 100% vested once the employee completes three years of service.

Also, the Group offers to its senior management a non-qualified deferred compensation plan, where executives can defer taxable income. Both the employer and the employee have flexibility because non-qualified plans are not subject to ERISA contribution limits nor are they subject to discrimination tests in terms of who must be included in the plan. Under this plan, the employee’s current taxable income is reduced by the amount being deferred. Funds deposited in a deferred compensation plan can accumulate without current income tax to the individual. Income taxes are due when the funds are withdrawn.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

11. RELATED PARTY TRANSACTIONS

The Bank grants loans to its directors, executive officers and to certain related individuals or organizations in the ordinary course of business. These loans are offered at the same terms as loans to non-related parties. The activity and balance of these loans were as follows:

	December 31,	
	2009	2008
	(In thousands)	
Balance at the beginning of year	\$2,564	\$1,960
New loans	1,809	605
Repayments	(71)	(226)
Other	—	225
Balance at the end of year	<u>\$4,302</u>	<u>\$2,564</u>

12. INCOME TAX

Under the Puerto Rico Code, all companies are treated as separate taxable entities and are not entitled to file consolidated returns. The Group and its subsidiaries are subject to Puerto Rico regular income tax or alternative minimum tax (“AMT”) on income earned from all sources. The AMT is payable if it exceeds regular income tax. The excess of AMT over regular income tax paid in any one year may be used to offset regular income tax in future years, subject to certain limitations.

The components of income tax expense (benefit) for the years ended December 31, 2009, 2008, and 2007 are as follows:

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Current income tax expense	\$ 8,754	\$ 608	\$ 226
Deferred income tax expense (benefit)	(1,782)	(9,931)	1,332
Income tax expense (benefit)	<u>\$ 6,972</u>	<u>\$(9,323)</u>	<u>\$1,558</u>

The Group maintained an effective tax rate lower than the maximum marginal statutory rate of 40.95%, 39%, and 39% as of December 31, 2009, 2008 and 2007, respectively, mainly due to the interest income arising from investments exempt from Puerto Rico income taxes, net of expenses attributable to the exempt income. For the years ended December 31, 2009 and 2008 and 2007, the Group generated tax-exempt interest income of \$175.4 million, \$193.4 million and \$184.7 million, respectively. Exempt interest relates mostly to interest earned on obligations of the United States and Puerto Rico governments and certain mortgage-backed securities, including securities held by the Bank’s international banking entity. Pursuant to the Declaration of Fiscal Emergency and Plan for Economic Stabilization and Restoration of the Puerto Rico Credit Act of March 9, 2009, for tax years beginning after December 31, 2008, and ending before January 1, 2012, every taxable corporation engaged in trade or business in Puerto Rico, including banks and insurance companies, are subject to an additional 5% surcharge on corporate income tax, increasing the maximum tax rate from 39% to 40.95%. Also, income earned by international banking entities, which was previously fully exempt, is subject to a 5% income tax during the same period. These temporary taxes were enacted as a measure to generate additional revenues to address the fiscal crisis that the government of Puerto Rico is currently facing. Income tax expense for the year ended December 31, 2009 includes approximately \$5.6 million related to these tax impositions. The tax effect of the income earned by the international banking entity is included in the table below as “Tax effect of exempt income, net”.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Group's income tax expense differs from amounts computed by applying the applicable statutory rate to income before income taxes as follows:

	Year Ended December 31,					
	2009		2008		2007	
	Amount	Rate	Amount	Rate	Amount	Rate
(Dollars in thousands)						
Tax at statutory rates	\$ 12,251	40.95%	\$ 6,813	39.0%	\$ 16,701	39.0%
Tax effect of exempt income, net	(22,081)	−73.8%	(11,285)	−64.6%	(16,052)	−37.5%
Effect of tax rate on capital loss carryforwards	16,481	55.1%	—	—	—	—
Change in valuation allowance	81	0.3%	(3,340)	−19.1%	573	1.3%
Income tax contingencies provision/(credit) . .	671	2.2%	(1,956)	−11.2%	529	1.2%
Other items, net	(431)	−1.4%	445	2.6%	(193)	−0.4%
Income tax expense (benefit)	\$ 6,972	23.3%	\$ (9,323)	−53.3%	\$ 1,558	3.6%

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of the Group's net deferred tax assets assumes that the Group will be able to generate sufficient future taxable income based on estimates and assumptions. If these estimates and related assumptions change in the future, the Group may be required to record valuation allowances against its deferred tax assets resulting in additional income tax expense in the consolidated statements of operations. The components of the Group's deferred tax asset, net at December 31, 2009 and 2008, are as follows:

	December 31,	
	2009	2008
(In thousands)		
Deferred tax assets:		
Allowance for loan losses and other reserves	\$ 9,166	\$ 5,611
Unamortized discount related to mortgage servicing rights sold.	700	1,028
Deferred gain on sale of assets.	192	180
Deferred loan origination fees	377	2,110
Other-than-temporary impairment	—	7,681
Unrealized net loss included in accumulated other comprehensive income	7,445	6,004
S&P option contracts	5,848	6,644
Net capital and operating loss carryforwards.	14,387	1,698
Other deferred tax assets	1,462	664
Total gross deferred tax asset	39,577	31,620
Deferred tax liabilities:		
Derivative unrealized net gain	(3,319)	—
Deferred loan origination costs	(1,706)	(1,719)
Other deferred tax liabilities	(1,533)	(185)
Total deferred tax liabilities	(6,558)	(1,904)
Less: Valuation allowance	(1,334)	(1,253)
Net deferred tax asset	\$31,685	\$28,463

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In assessing the realizability of the deferred tax asset, management considers whether it is more likely than not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of the deferred tax asset is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax asset are deductible, management believes it is more likely than not that the Group will realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2009. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry-forward period are reduced.

At December 31, 2009, the holding company and its subsidiaries have operating and capital loss carry-forwards for income tax purposes of approximately \$125.5 million, which are available to offset future taxable income through December 2014.

The Group benefits from favorable tax treatment under regulations relating to the activities of the Bank's IBE subsidiary. Any change in such tax regulations, whether by applicable regulators or as a result of legislation subsequently enacted by the Legislature of Puerto Rico, could adversely affect the Group's profits and financial condition. Pursuant to the Declaration of Fiscal Emergency and Plan for Economic Stabilization and Restoration of the Puerto Rico Credit Act of March 9, 2009, for tax years beginning after December 31, 2008, and ending before January 1, 2012, every taxable corporation engaged in trade or business in Puerto Rico, including banks and insurance companies, are subject to an additional 5% surcharge on corporate income tax, increasing the maximum tax rate from 39% to 40.95%. Also, income earned by international banking entities, which was previously exempt, is subject to a 5% income tax during the same period. These temporary taxes were enacted as a measure to generate additional revenues to address the fiscal crisis that the government of Puerto Rico is currently facing.

The Group follows a two-step approach for recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation process, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.

The Group classifies unrecognized tax benefits in income taxes payable. These gross unrecognized tax benefits would affect the effective tax rate if realized. For the year ended December 31, 2009 \$842 thousand, in unrecognized tax losses expired due to statute of limitation (year ended December 31, 2008 — \$2.5 million in unrecognized tax benefits). The balance of unrecognized tax benefits at December 31, 2009 and 2008 was \$6.3 million and \$5.6 million, respectively, including \$2.1 million at December 31, 2009 (December 31, 2008 — \$1.6 million) for the payment of interest and penalties relating to unrecognized tax benefits. The tax periods from 2005 to 2009 remain subject to examination by the Puerto Rico Department of Treasury.

13. STOCKHOLDERS' EQUITY

Treasury Stock

Under the Group's current stock repurchase program it is authorized to purchase in the open market up to \$15.0 million of its outstanding shares of common stock. The shares of common stock repurchased are to be held by the Group as treasury shares. There were no repurchases during 2009 and 2008. The approximate dollar value of shares that may yet be repurchased under the plan amounted to \$11.3 million at December 31, 2009.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The activity in connection with common shares held in treasury by the Group for 2009, 2008, and 2007 is set forth below:

	Year Ended December 31,					
	2009		2008		2007	
	Shares	Dollar Amount	Shares	Dollar Amount	Shares	Dollar Amount
	(In thousands)					
Beginning of year	1,442	\$17,109	1,436	\$17,023	989	\$12,956
Common shares repurchased under the repurchase program	—	—	—	—	459	4,236
Common shares repurchased /used to match defined contribution plan, net	62	33	6	86	(12)	(169)
End of year	<u>1,504</u>	<u>\$17,142</u>	<u>1,442</u>	<u>\$17,109</u>	<u>1,436</u>	<u>\$17,023</u>

Equity-Based Compensation Plan

The Omnibus Plan was amended and restated in 2008. It provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, and dividend equivalents, as well as equity-based performance awards. The Omnibus Plan replaced and superseded the Stock Option Plans. All outstanding stock options under the Stock Option Plans continue in full force and effect, subject to their original terms. Under the Omnibus Plan, the group granted 15,676 options and 53,609 restricted units in 2009.

The activity in outstanding options for 2009, 2008, and 2007 is set forth below:

	Year Ended December 31,					
	2009		2008		2007	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Beginning of year	500,200	\$17.14	717,700	\$16.15	833,533	\$15.61
Options granted	15,676	8.28	23,000	17.93	140,500	12.22
Options exercised	—	—	(182,200)	11.93	(134,586)	8.52
Options forfeited	(1,500)	21.86	(58,300)	21.49	(121,747)	17.09
End of year	<u>514,376</u>	<u>\$16.86</u>	<u>500,200</u>	<u>\$17.14</u>	<u>717,700</u>	<u>\$16.15</u>

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes the range of exercise prices and the weighted average remaining contractual life of the options outstanding at December 31, 2009:

<u>Range of Exercise Prices</u>	<u>Outstanding</u>			<u>Exercisable</u>	
	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Contract Life (Years)</u>	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
\$ 5.63 to \$ 8.45	22,502	\$ 8.06	6.7	6,826	\$ 7.55
8.45 to 11.27	3,000	10.29	7.6	—	—
11.27 to 14.09	247,339	12.42	6.0	111,614	12.42
14.09 to 16.90	62,035	15.60	4.6	46,035	15.78
19.72 to 22.54	29,600	20.70	5.2	19,600	20.10
22.54 to 25.35	88,850	23.98	4.3	88,850	23.98
25.35 to 28.17	61,050	27.48	4.8	61,050	27.48
	<u>514,376</u>	<u>\$16.86</u>	<u>5.4</u>	<u>333,975</u>	<u>\$19.06</u>
Aggregate Intrinsic Value	<u>\$ 63,239</u>			<u>\$ 22,206</u>	

The average fair value of each option granted during 2009, 2008, and 2007, was \$4.49, \$5.39, and \$2.67, respectively. The average fair value of each option granted was estimated at the date of the grant using the Black-Scholes option pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no restrictions and are fully transferable and negotiable in a free trading market. Black-Scholes does not consider the employment, transfer or vesting restrictions that are inherent in the Group's employee options. Use of an option valuation model, as required by GAAP, includes highly subjective assumptions based on long-term predictions, including the expected stock price volatility and average life of each option grant.

The following assumptions were used in estimating the fair value of the options granted:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Weighted Average Assumptions:			
Dividend yield	4.55%	4.78%	4.96%
Expected volatility	36%	35%	33%
Risk-free interest rate	4.40%	3.23%	4.82%
Expected life (in years)	8.5	8.5	8.5

The following table summarizes the restricted units activity under the Omnibus Plan:

	<u>Year Ended December 31,</u>					
	<u>2009</u>		<u>2008</u>		<u>2007</u>	
	<u>Restricted Stock</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Restricted Stock</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Restricted Stock</u>	<u>Weighted Average Grant Date Fair Value</u>
Beginning of year	99,916	\$18.54	38,006	\$12.49	—	\$ —
Restricted units granted	53,609	8.18	71,316	21.14	38,006	12.49
Restricted units exercised	—	—	—	—	—	—
Restricted units forfeited	(5,900)	21.86	(9,406)	13.88	—	—
End of year	<u>147,625</u>	<u>\$14.64</u>	<u>99,916</u>	<u>\$18.54</u>	<u>38,006</u>	<u>\$12.49</u>

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Earnings per Common Share

The calculation of earnings per common share for the years ended December 31, 2009, 2008, and 2007 is as follows:

	Year Ended December 31,		
	2009	2008	2007
	(In thousands, except per share data)		
Net income	\$22,945	\$26,790	\$41,265
Less: Dividends on preferred stock	(4,802)	(4,802)	(4,802)
Income available to common shareholders'	<u>\$18,143</u>	<u>\$21,988</u>	<u>\$36,463</u>
Weighted average common shares and share equivalents:			
Average common shares outstanding	24,289	24,260	24,326
Average potential common shares-options	17	67	41
Total	<u>24,306</u>	<u>24,327</u>	<u>24,367</u>
Earnings per common share — basic	<u>\$ 0.75</u>	<u>\$ 0.91</u>	<u>\$ 1.50</u>
Earnings per common share — diluted	<u>\$ 0.75</u>	<u>\$ 0.90</u>	<u>\$ 1.50</u>

For the years ended December 31, 2009, 2008, and 2007, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 355,720, 193,399, and 635,934, respectively.

Legal Surplus

The Banking Act requires that a minimum of 10% of the Bank's net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid in capital on common and preferred stock. At December 31, 2009, legal surplus amounted to \$45.3 million (December 31, 2008 - \$43.0 million). The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders. In addition, the Federal Reserve Board has issued a policy statement that bank holding companies should generally pay dividends only from operating earnings of the current and preceding two years.

Preferred Stock

On May 28, 1999, the Group issued 1,340,000 shares of 7.125% Noncumulative Monthly Income Preferred Stock, Series A, at \$25 per share. Proceeds from issuance of the Series A Preferred Stock, were \$32.4 million, net of \$1.1 million of issuance costs. The Series A Preferred Stock has the following characteristics: (1) annual dividends of \$1.78 per share, payable monthly, if declared by the Board of Directors; missed dividends are not cumulative, (2) redeemable at the Group's option beginning on May 30, 2004, (3) no mandatory redemption or stated maturity date and (4) liquidation value of \$25 per share.

On September 30, 2003, the Group issued 1,380,000 shares of 7.0% Noncumulative Monthly Income Preferred Stock, Series B, at \$25 per share. Proceeds from issuance of the Series B Preferred Stock, were \$33.1 million, net of \$1.4 million of issuance costs. The Series B Preferred Stock has the following characteristics: (1) annual dividends of \$1.75 per share, payable monthly, if declared by the Board of Directors; missed dividends are not cumulative, (2) redeemable at the Group's option beginning on October 31, 2008, (3) no mandatory redemption or stated maturity date, and (4) liquidation value of \$25 per share.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Accumulated Other Comprehensive Income

Accumulated other comprehensive income (loss), net of income tax, as of December 31, 2009 and 2008, consisted of:

	December 31,	
	2009	2008
	(In thousands)	
Unrealized loss on securities available-for-sale which are not other-than-temporarily impaired	\$(48,786)	\$(128,191)
Unrealized loss on securities available-for-sale which a portion of other-than-temporary impairment has been recorded in earnings	(41,398)	—
Tax effect of accumulated other comprehensive income	7,445	6,004
	<u>\$(82,739)</u>	<u>\$(122,187)</u>

Regulatory Capital Requirements

The Group (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Group's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Group and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Group and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations) and of Tier 1 capital to average assets (as defined in the regulations). As of December 31, 2009 and 2008, the Group and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2009 and 2008, the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. The Group's and the Bank's actual capital amounts and ratios as of December 31, 2009 and 2008 are as follows:

<u>Group Ratios</u>	<u>Actual</u>		<u>Minimum Capital Requirement</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(Dollars in thousands)			
<u>As of December 31, 2009</u>				
Total Capital to Risk-Weighted Assets	\$437,975	19.84%	\$176,591	8.00%
Tier I Capital to Risk-Weighted Assets	\$414,702	18.79%	\$ 88,295	4.00%
Tier I Capital to Total Assets	\$414,702	6.52%	\$254,323	4.00%
<u>As of December 31, 2008</u>				
Total Capital to Risk-Weighted Assets	\$403,528	17.73%	\$182,044	8.00%
Tier I Capital to Risk-Weighted Assets	\$389,235	17.11%	\$ 91,022	4.00%
Tier I Capital to Total Assets	\$389,235	6.38%	\$244,101	4.00%

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
Bank Ratios						
As of December 31, 2009						
Total Capital to Risk-Weighted Assets	\$382,611	17.59%	\$174,042	8.00%	\$217,553	10.00%
Tier I Capital to Risk-Weighted Assets.	\$359,339	16.52%	\$ 87,021	4.00%	\$130,532	6.00%
Tier I Capital to Total Assets.	\$359,339	5.78%	\$248,678	4.00%	\$310,847	5.00%
As of December 31, 2008						
Total Capital to Risk-Weighted Assets	\$325,593	14.86%	\$175,281	8.00%	\$219,101	10.00%
Tier I Capital to Risk-Weighted Assets.	\$311,300	14.21%	\$ 87,640	4.00%	\$131,461	6.00%
Tier I Capital to Total Assets.	\$311,300	5.42%	\$229,903	4.00%	\$287,378	5.00%

The Group's ability to pay dividends to its stockholders and other activities can be restricted if its capital falls below levels established by the Federal Reserve Board's guidelines. In addition, any bank holding company whose capital falls below levels specified in the guidelines can be required to implement a plan to increase capital.

14. COMMITMENTS

Loan Commitments

At December 31, 2009, there were \$38.8 million in loan commitments, which represents unused lines of credit provided to customers. Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates, bear variable interest and may require payment of a fee. Since the commitments may expire unexercised, the total commitment amounts do not necessarily represent future cash requirements. The Group evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the customer.

At December 31, 2009, commitments to sell or securitize mortgage loans, expiring on or before November 1, 2010, amounted to approximately \$255.1 million. At December 31, 2008, commitments to sell or securitize mortgage loans amounted to approximately \$316.3 million.

Lease Commitments

The Group has entered into various operating lease agreements for branch facilities and administrative offices. Rent expense for the years ended December 31, 2009, 2008 and 2007 amounted to \$5.6 million, \$5.1 million and

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

\$4.2 million, respectively. Future rental commitments under terms of leases in effect at December 31, 2009, exclusive of taxes, insurance, and maintenance expenses payable by the Group, are summarized as follows:

<u>Year Ending December 31,</u>	<u>Minimum Rent</u> <u>(In thousands)</u>
2010	\$ 3,551
2011	3,643
2012	3,604
2013	3,456
2014	3,346
Thereafter	<u>7,832</u>
	<u>\$25,432</u>

15. LITIGATION

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

16. FAIR VALUE

As discussed in Note 1, effective January 1, 2008, the Group follows the fair value measurement framework under GAAP.

Fair Value Measurement

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

Level 1-Level 1 asset and liabilities include equity securities that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. government agency securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2-Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on valuations obtained from third-party pricing services for identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments and (iii) derivative contracts and financial liabilities (e.g. callable brokered CDs and medium-term notes elected for fair value option under the fair value measurement framework, whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3-Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, for which the determination of fair value requires significant management judgment or estimation.

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following is a description of the valuation methodologies used for instruments measured at fair value:

Investment securities

The fair value of investment securities is based on quoted market prices, when available, or market prices provided by recognized broker dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument. Structured credit investments and non-agency collateralized mortgage obligations are classified as Level 3. The estimated fair value of the structured credit investments and the non-agency collateralized mortgage obligations are determined by using a third-party cash flow valuation model to calculate the present value of projected future cash flows. The assumptions, which are highly uncertain and require a high degree of judgment, include primarily market discount rates, current spreads, duration, leverage, default, home price depreciation, and loss rates. The assumptions used are drawn from a wide array of data sources, including the performance of the collateral underlying each deal. The external-based valuation, which is obtained at least on a quarterly basis, is analyzed and its assumptions are evaluated and incorporated in either an internal-based valuation model when deemed necessary or compared to counterparties prices and agreed by management.

Derivative instruments

The fair values of the derivative instruments were provided by valuation experts and counterparties. Certain derivatives with limited market activity are valued using externally developed models that consider unobservable market parameters. Based on their valuation methodology, derivative instruments are classified as Level 3. The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index (S&P Index), and uses equity indexed option agreements with major broker-dealer companies to manage its exposure to changes in this index. Their fair value is obtained through the use of an external based valuation that was thoroughly evaluated and adopted by management as its measurement tool for these options. The payoff of these options is linked to the average value of the S&P Index on a specific set of dates during the life of the option. The methodology uses an average rate option or a cash-settled option whose payoff is based on the difference between the expected average value of the S&P Index during the remaining life of the option and the strike price at inception. The assumptions, which are uncertain and require a degree of judgment, include primarily S&P Index volatility, forward interest rate projections, estimated index dividend payout, and leverage.

Servicing asset

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

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

The impairment is measured based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations, in accordance with the provisions of ASC 310-10-35. Currently, the associated loans considered impaired are classified as Level 3.

Foreclosed real estate

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

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

	December 31, 2009			
	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Investment securities available-for-sale	\$ —	\$4,843,553	\$110,106	\$4,953,659
Money market investments	29,432	—	—	29,432
Derivative assets	—	8,511	6,464	14,975
Derivative liabilities	—	—	(9,543)	(9,543)
Servicing asset	—	—	7,120	7,120
	<u>\$29,432</u>	<u>\$4,852,064</u>	<u>\$114,147</u>	<u>\$4,995,643</u>
	December 31, 2008			
	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Investment securities available-for-sale	\$ —	\$3,258,359	\$665,848	\$3,924,207
Money market instruments	52,002	—	—	52,002
Derivative assets	—	—	12,801	12,801
Derivative liabilities	—	—	(16,588)	(16,588)
Servicing asset	—	—	2,819	2,819
	<u>\$52,002</u>	<u>\$3,258,359</u>	<u>\$664,880</u>	<u>\$3,975,241</u>

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2009 and 2008:

Total Fair Value Measurements (Year Ended December 31, 2009)				
Level 3 Instruments Only	Investment Securities Available-for-Sale	Derivative Assets	Derivative Liabilities	Servicing Asset
(In thousands)				
Balance at beginning of year	\$ 665,848	\$12,801	\$(16,588)	\$ 2,819
Gains (losses) included in earnings	(133,943)	(7,174)	7,328	
Gains (losses) included in other comprehensive income	75,713	—	—	
New instruments acquired	—	3,460	(3,362)	
Principal repayments and amortization	(137,558)	(2,623)	3,079	(1,600)
Adoption of FASB ASC 320-10-65-1	14,359	—	—	
Transfer of non-agency CMOs sold in January 2010 (Level 2 at December 31, 2009)	(374,313)	—	—	
Servicing from securitization or assets transferred	—	—	—	3,058
Change in fair value	—	—	—	2,843
Balance at end of year	<u>\$ 110,106</u>	<u>\$ 6,464</u>	<u>\$ (9,543)</u>	<u>\$ 7,120</u>

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

<u>Level 3 Instruments Only</u>	<u>Total Fair Value Measurements</u> <u>(Year ended December 31, 2008)</u>			
	<u>Investment Securities Available-for-Sale</u>	<u>Derivative Assets</u>	<u>Derivative Liabilities</u>	<u>Servicing Asset</u>
	(In thousands)			
Balance at beginning of year	\$ 78,360	\$ 40,709	\$(38,793)	\$2,526
Gains (losses) included in earnings	(38,932)	(19,257)	14,226	—
Gains (losses) included in other comprehensive income	(37,935)	—	—	—
New instruments acquired	—	6,676	(6,626)	—
Principal repayments and amortization	(19,931)	(15,327)	14,605	(903)
Transfer of non-agency CMOs to level 3	609,149	—	—	
Transfers from held-to-maturity portfolio	75,137	—	—	
Servicing from securitization or assets transferred	—	—	—	1,446
Change in fair value	—	—	—	(250)
Balance at end of year	<u>\$665,848</u>	<u>\$ 12,801</u>	<u>\$(16,588)</u>	<u>\$2,819</u>

In early January 2010, the Group sold \$420.1 million of non-agency CMOs which were previously included as Level 3 instruments. Since the sales price of these securities was available during the preparation of the consolidated statements of financial condition they were transferred to Level 2 instruments for the December 31, 2009 presentation.

The table below presents a detail of investment securities available-for-sale classified as level 3 at December 31, 2009:

<u>Type</u>	<u>December 31, 2009</u>				
	<u>Amortized Cost</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Weighted Average Yield</u>	<u>Principal Protection</u>
	(In thousands)				
Non-agency collateralized mortgage obligations					
Alt-A Collateral	<u>\$113,122</u>	<u>\$41,399</u>	<u>\$ 71,723</u>	<u>5.24%</u>	6.97%
Structured credit investments					
CDO	25,548	10,400	15,148	5.90%	6.97%
CLO	15,000	5,997	9,003	2.42%	7.52%
CLO	11,974	4,434	7,540	1.81%	26.18%
CLO	<u>9,200</u>	<u>2,508</u>	<u>6,692</u>	<u>2.07%</u>	21.71%
	<u>61,722</u>	<u>23,339</u>	<u>38,383</u>	<u>3.69%</u>	
	<u>\$174,844</u>	<u>\$64,738</u>	<u>\$110,106</u>	<u>4.70%</u>	

Additionally, the Corporation may be required to measure certain assets at fair value in periods subsequent to initial recognition on a nonrecurring basis in accordance with generally accepted accounting principles. The adjustments to fair value usually result from the application of lower of cost or fair value accounting, identification of impaired loans requiring specific reserves under ASC 310-10-35 "Accounting by Creditors for Impairment of a Loan", or

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

write-downs of individual assets. The following tables present financial and non-financial assets that were subject to a fair value measurement on a nonrecurring basis during the years ended December 31, 2009 and 2008 and which were still included in the consolidated statement of financial condition as such dates. The amounts disclosed represent the aggregate of the fair value measurements of those assets as of the end of the reporting periods.

	Carrying value at December 31,	
	2009	2008
	Level 3	Level 3
	(In thousands)	
Impaired loans(1)	\$26,299	\$ 7,592
Foreclosed real estate(2)	9,347	9,162
	<u>\$35,646</u>	<u>\$16,754</u>

(1) Relates mostly to certain impaired collateral dependent loans. The impairment was measured based on the fair value of collateral, which is derived from appraisals that take into consideration prices on observed transactions involving similar assets in similar locations, in accordance with provisions of ASC 310-10-35.

(2) Represents the fair value of foreclosed real estate that was measured at fair value.

Impaired loans, which are measured using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$26.3 million and \$7.6 million at December 31, 2009 and 2008, respectively, with a valuation allowance of \$1.4 million and \$1.1 million at December 31, 2009 and 2008, respectively.

Fair Value of Financial Instruments

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

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

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The estimated fair value and carrying value of the Group's financial instruments at December 31, 2009 and 2008 is as follows:

	December 31,			
	2009		2008	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	(In thousands)			
Financial Assets:				
Cash and cash equivalents	\$ 277,123	\$ 277,123	\$ 66,372	\$ 66,372
Trading securities	523	523	256	256
Investment securities available-for-sale	4,953,659	4,953,659	3,924,207	3,924,207
FHLB stock	19,937	19,937	21,013	21,013
Securities sold but yet not delivered	—	—	834,976	834,976
Total loans (including loans held-for-sale)	1,150,340	1,140,069	1,216,398	1,219,112
Investment in equity indexed options	6,464	6,464	12,801	12,801
Accrued interest receivable	33,656	33,656	43,914	43,914
Derivative asset	8,511	8,511	—	—
Servicing asset	7,120	7,120	2,819	2,819
Financial Liabilities:				
Deposits	1,741,417	1,745,501	1,789,309	1,785,300
Securities sold under agreements to repurchase . . .	3,777,157	3,557,308	4,016,479	3,761,121
Advances from FHLB	301,004	281,753	333,906	308,442
FDIC-guaranteed term notes	111,472	105,834	—	—
Subordinated capital notes	36,083	36,083	36,083	36,083
Federal funds purchased and other short term borrowings	49,179	49,179	29,193	29,193
Securities and loans purchased but not yet received	413,359	413,359	398	398
Accrued expenses and other liabilities	31,650	31,650	23,682	23,682

The following methods and assumptions were used to estimate the fair values of significant financial instruments at December 31, 2009 and 2008:

- Cash and cash equivalents, money market investments, time deposits with other banks, securities sold but not yet delivered, accrued interest receivable and payable, securities and loans purchased but not yet received, federal funds purchased, accrued expenses and other liabilities have been valued at the carrying amounts reflected in the consolidated statements of financial condition as these are reasonable estimates of fair value given the short-term nature of the instruments.
- Investments in FHLB stock are valued at their redemption value.
- The fair value of investment securities is based on quoted market prices, when available, or market prices provided by recognized broker dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument. The estimated fair value of the structured credit investments and the non-agency collateralized mortgage obligations are determined by using a third-party cash flow valuation model to calculate the present value of projected future cash flows. The assumptions used, which are highly uncertain and require a high degree of judgment, include primarily market discount rates, current spreads, duration, leverage, default, home price depreciation, and loss rates. The assumptions used are drawn from a wide array of data sources, including the

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

performance of the collateral underlying each deal. The external-based valuation, which is obtained at least on a quarterly basis, is analyzed and its assumptions are evaluated and incorporated in either an internal-based valuation model when deemed necessary or compared to counterparties prices and agreed by management.

- The fair values of the derivative instruments are provided by valuation experts and counterparties. Certain derivatives with limited market activity are valued using externally developed models that consider unobservable market parameters. The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index (S&P Index), and uses equity indexed option agreements with major broker-dealer companies to manage its exposure to changes in this index. Their fair value is obtained through the use of an external based valuation that was thoroughly evaluated and adopted by management as its measurement tool for these options. The payoff of these options is linked to the average value of the S&P Index on a specific set of dates during the life of the option. The methodology uses an average rate option or a cash-settled option whose payoff is based on the difference between the expected average value of the S&P Index during the remaining life of the option and the strike price at inception. The assumptions, which are uncertain and require a degree of judgment, include primarily S&P Index volatility, forward interest rate projections, estimated index dividend payout, and leverage.
- The fair value of the loan portfolio (including loans held-for-sale) is estimated by segregating by type, such as mortgage, commercial and consumer. Each loan category is further segmented into fixed and adjustable interest rates and by performing and non-performing categories. The fair value of performing loans is calculated by discounting contractual cash flows, adjusted for prepayment estimates, if any, using estimated current market discount rates that reflect the credit and interest rate risk inherent in the loan, which is not currently an indication of an exit price. An exit price valuation approach could result in a different fair value estimate.
- The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is based on the discounted value of the contractual cash flows, using estimated current market discount rates for deposits of similar remaining maturities.
- For short-term borrowings, the carrying amount is considered a reasonable estimate of fair value. The subordinated capital note has a par value of \$36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (3.20% at December 31, 2009; 4.82% at December 31, 2008), payable quarterly. The fair value of long-term borrowings is based on the discounted value of the contractual cash flows, using current estimated market discount rates for borrowings with similar terms and remaining maturities and put dates.
- The fair value of commitments to extend credit and unused lines of credit is based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.
- The fair value of servicing assets is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration actual and expected loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions.

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

17. SEGMENT REPORTING

The Group segregates its businesses into the following major reportable segments of business: Banking, Financial Services, and Treasury. Management established the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Group's organization, nature of its products, distribution channels and economic characteristics of the products were also considered in the determination of the reportable segments. The Group measures the performance of these reportable segments based on pre-established goals of different financial parameters such as net income, net interest income, loan production, and fees generated. Non-interest expenses allocations among segments were reviewed during the second quarter of 2009 to reallocate expenses from the Banking to the Financial Services and Treasury segments for a suitable presentation. The Group's methodology for allocating non-interest expenses among segments is based on several factors such as revenues, employee headcount, occupied space, dedicated services or time, among others. These factors are reviewed on a periodical basis and may change if the conditions warrant.

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

Financial services are comprised of the Bank's trust division (Oriental Trust), the broker dealer subsidiary (Oriental Financial Services Corp.), the insurance agency subsidiary (Oriental Insurance, Inc.), and the pension plan administration subsidiary (Caribbean Pension Consultants, Inc.). The core operations of this segment are financial planning, money management and investment banking, brokerage services, insurance sales activity, corporate and individual trust and retirement services, as well as pension plan administration services.

The Treasury segment encompasses all of the Group's asset and liability management activities such as: purchases and sales of investment securities, interest rate risk management, derivatives, and borrowings. Intersegment sales and transfers, if any, are accounted for as if the sales or transfers were to third parties, that is, at current market prices. The accounting policies of the segments are the same as those described in the "Summary of Significant Accounting Policies" included Group's annual report on Form 10K. Following are the results of operations and the selected financial information by operating segment as of and for the years ended December 31, 2009, 2008, and 2007:

Year Ended December 31, 2009	Banking	Financial Services	Treasury	Total Major Segments	Eliminations	Total
	(In thousands)					
Interest income	\$ 73,076	\$ 47	\$ 246,278	\$ 319,401	\$ —	\$ 319,401
Interest expense	(35,099)	—	(153,369)	(188,468)	—	(188,468)
Net interest income	37,977	47	92,909	130,933	—	130,933
Provision for loan losses	(15,650)	—	—	(15,650)	—	(15,650)
Non-interest income (loss)	15,269	14,496	(31,753)	(1,988)	—	(1,988)
Non-interest expenses	(57,204)	(14,783)	(11,391)	(83,378)	—	(83,378)
Intersegment revenue	1,297	—	—	1,297	(1,297)	—
Intersegment expense	—	(1,172)	(125)	(1,297)	1,297	—
Income (loss) before income taxes	\$ (18,311)	\$ (1,412)	\$ 49,640	\$ 29,917	\$ —	\$ 29,917
Total assets as of December 31, 2009	\$1,655,515	\$ 9,879	\$5,223,969	\$6,889,363	\$(338,530)	\$6,550,833

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Year Ended December 31, 2008	Banking	Financial Services	Treasury	Total Major Segments	Eliminations	Total
	(In thousands)					
Interest income	\$ 80,725	\$ 97	\$ 258,217	\$ 339,039	\$ —	\$ 339,039
Interest expense	(33,128)	—	(194,600)	(227,728)	—	(227,728)
Net interest income	47,597	97	63,617	111,311	—	111,311
Provision for loan losses	(8,860)	—	—	(8,860)	—	(8,860)
Non-interest income (loss)	7,104	17,236	(36,582)	(12,242)	—	(12,242)
Non-interest expenses	(57,210)	(11,413)	(4,119)	(72,742)	—	(72,742)
Intersegment revenue	3,702	—	—	3,702	(3,702)	—
Intersegment expense	—	(2,954)	(748)	(3,702)	3,702	—
Income (loss) before income taxes	\$ (7,667)	\$ 2,966	\$ 22,168	\$ 17,467	\$ —	\$ 17,467
Total assets as of December 31, 2008	\$1,524,979	\$ 10,763	\$4,912,694	\$6,448,436	\$(242,900)	\$6,205,536
Year Ended December 31, 2007	Banking	Financial Services	Treasury	Total Major Segments	Eliminations	Total
	(In thousands)					
Interest income	\$ 85,797	\$ 226	\$ 203,341	\$ 289,364	\$ —	\$ 289,364
Interest expense	(34,364)	(926)	(180,344)	(215,634)	—	(215,634)
Net interest income (expense)	51,433	(700)	22,997	73,730	—	73,730
Non-interest income (loss)	14,092	14,300	14,110	42,502	—	42,502
Non-interest expenses	(51,715)	(12,413)	(2,731)	(66,859)	—	(66,859)
Intersegment revenue	3,681	—	—	3,681	(3,681)	—
Intersegment expense	—	(2,944)	(737)	(3,681)	3,681	—
Provision for loan losses	(6,550)	—	—	(6,550)	—	(6,550)
Income (loss) before income taxes	\$ 10,941	\$ (1,757)	\$ 33,639	\$ 42,823	\$ —	\$ 42,823
Total assets as of December 31, 2007	\$1,604,690	\$ 11,082	\$4,738,719	\$6,354,491	\$(354,636)	\$5,999,855

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

18. ORIENTAL FINANCIAL GROUP INC. (HOLDING COMPANY ONLY) FINANCIAL INFORMATION

As a bank holding company subject to the regulations of the Federal Reserve Board, the Group must obtain approval from the Federal Reserve Board for any dividend if the total of all dividends declared by it in any calendar year would exceed the total of its consolidated net profits for the year, as defined by the Federal Reserve Board, combined with its retained net profits for the two preceding years. The payment of dividends by the Bank to the Group may also be affected by other regulatory requirements and policies, such as the maintenance of certain regulatory capital levels. For the year ended December 31, 2008, the Bank paid \$33.1 million in dividends to the Group. No dividends were paid during the years ended December 31, 2009 and 2007.

The following condensed financial information presents the financial position of the holding company only as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years ended December 31, 2009, 2008 and 2007:

ORIENTAL FINANCIAL GROUP INC.

CONDENSED STATEMENTS OF FINANCIAL POSITION INFORMATION (Holding Company Only)

	December 31,	
	2009	2008
	(In thousands)	
ASSETS		
Cash and cash equivalents	\$ 36,056	\$ 27,037
Investment securities available-for-sale, at fair value	112,565	344,610
Other investment securities	150	150
Investment in bank subsidiary, equity method	307,997	216,691
Investment in nonbank subsidiaries, equity method	8,817	9,065
Due from bank subsidiary, net	94	45
Deferred tax asset, net	595	428
Other assets	1,779	4,074
Total assets	<u>\$468,053</u>	<u>\$602,100</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Securities sold under agreements to repurchase	\$100,236	\$300,708
Subordinated capital notes	36,083	36,083
Dividend payable	972	3,402
Accrued expenses and other liabilities	596	590
Total liabilities	<u>137,887</u>	<u>340,783</u>
Stockholders' equity	330,166	261,317
Total liabilities and stockholders' equity	<u>\$468,053</u>	<u>\$602,100</u>

ORIENTAL FINANCIAL GROUP INC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

CONDENSED STATEMENTS OF OPERATIONS INFORMATION
(Holding Company Only)

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Income (loss):			
Dividends from bank subsidiary	\$ —	\$33,000	\$ —
Interest income	10,501	18,148	6,968
Loss on early extinguishment of repurchase agreements . . .	(17,551)	—	—
Investment and trading activities, net and other	24,643	4,350	3,972
Total income	17,593	55,498	10,940
Expenses:			
Interest expense	10,810	15,939	7,234
Operating expenses	4,817	4,084	4,767
Total expenses	15,627	20,023	12,001
Income (loss) before income taxes	1,966	35,475	(1,061)
Income tax (expense) benefit	(1,400)	41	33
Income (loss) before changes in undistributed earnings (losses) of subsidiaries	566	35,516	(1,028)
Equity in undistributed earnings (losses) from:			
Bank subsidiary	22,626	(8,566)	43,238
Nonbank subsidiaries	(247)	(160)	(945)
Net income	\$ 22,945	\$26,790	\$41,265

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

**CONDENSED STATEMENTS OF COMPREHENSIVE INCOME INFORMATION
(Holding Company Only)**

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Net Income	\$22,945	\$ 26,790	\$41,265
Other comprehensive income (loss):			
Unrealized gain (loss) on securities available-for-sale arising during the year.	4,521	(3,748)	4,965
Realized gain on securities available-for-sale arising during the year	(6,620)	(1,558)	(719)
Other comprehensive income (loss) from bank subsidiary . . .	55,929	(104,873)	(333)
Income tax effect related to unrealized loss (gain) on securities available-for-sale	(23)	1,007	(829)
Total other comprehensive income (loss) for the year	53,807	(109,172)	3,084
Total comprehensive income (loss)	\$76,752	\$ (82,382)	\$44,349

ORIENTAL FINANCIAL GROUP INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

**CONDENSED STATEMENTS OF CASH FLOWS INFORMATION
(Holding Company Only)**

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Cash flows from operating activities:			
Net income	\$ 22,945	\$ 26,790	\$ 41,265
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Equity in undistributed (earnings) losses from banking subsidiary	(22,626)	8,566	(43,239)
Equity in undistributed losses (earnings) from non-banking subsidiaries	247	160	945
Amortization of premiums, net of accretion discounts on investment securities	79	(649)	(454)
Write-down of other investment securities	—	—	330
Loss (gain) on derivative activities	—	—	(1,620)
Loss on early extinguishment of repurchase agreements	17,551	—	—
Realized gain (loss) on sale of investments	(6,620)	(1,575)	(1,049)
Stock based compensation	742	559	86
Deferred income tax (benefit) expense	(190)	(229)	(33)
(Increase) decrease in other assets	2,294	2,225	(2,028)
Increase (decrease) in accrued expenses, other liabilities, and dividend payable	(2,746)	316	762
Net cash provided by (used in) operating activities	11,676	36,163	(5,035)
Cash flows from investing activities:			
Purchase of securities available for sale	(1,562,012)	(1,016,855)	(944,199)
Redemptions and sales of securities available-for-sale	337,600	671,809	314,692
Proceeds from sale of investment securities available-for-sale	1,463,149	316,575	317,774
Transfer of security held-to-maturity to a subsidiary	—	—	10,792
Redemptions of securities held-to-maturity	—	—	11,100
Redemptions and sales of other securities	—	1,525	28,944
Net (increase) decrease in due from bank subsidiary, net	(49)	1,388	(982)
Net (increase) decrease in due from non bank subsidiary, net	—	—	(451)
Capital contribution to banking subsidiary	(15,000)	(5,000)	—
Net cash provided by (used in) investing activities	223,688	(30,558)	(262,330)
Cash flows from financing activities:			
Net increase (decrease) in securities sold under agreements to repurchase	(217,551)	—	300,000
Proceeds from exercise of stock options	—	2,175	1,080
Net (decrease) increase in due to bank subsidiaries, net	—	(656)	(3,528)
Proceeds from termination of derivative instruments	—	—	1,620
Purchase of treasury stock	(182)	(86)	(4,067)
Capital contribution	78	—	—
Dividends paid	(8,690)	(18,410)	(18,413)
Net cash provided by (used in) financing activities	(226,345)	(16,977)	276,692
Increase in cash and cash equivalents	9,019	(11,372)	9,327
Cash and cash equivalents at beginning of year	27,037	38,409	29,082
Cash and cash equivalents at end of year	\$ 36,056	\$ 27,037	\$ 38,409

ORIENTAL FINANCIAL GROUP INC.

**SELECTED FINANCIAL DATA
YEARS ENDED DECEMBER 31, 2009, 2008, 2007, 2006 AND 2005
AND FOR THE FISCAL YEAR PERIOD ENDED JUNE 30, 2005**

	Year Ended December 31,					Fiscal Year Ended June 30, 2005
	2009	2008	2007	2006	2005	
	(In thousands, except per share data)					(Unaudited)
EARNINGS:						
Interest income	\$319,401	\$339,039	\$289,364	\$232,311	\$201,534	\$189,312
Interest expense	188,468	227,728	215,634	188,185	127,456	102,899
Net interest income	130,933	111,311	73,730	44,126	74,078	86,413
Provision for loan losses	15,650	8,860	6,550	4,388	3,412	3,315
Net interest income after provision for loan losses	115,283	102,451	67,180	39,738	70,666	83,098
Non-interest income (loss)	(1,988)	(12,242)	42,502	17,238	28,920	34,885
Non-interest expenses	83,378	72,742	66,859	63,713	57,856	59,963
Income (loss) before taxes	29,917	17,467	42,823	(6,737)	41,730	58,020
Income tax (benefit) expense	6,972	(9,323)	1,558	(1,631)	(2,168)	(1,649)
Net Income (loss)	22,945	26,790	41,265	(5,106)	43,898	59,669
Less: dividends on preferred stock	(4,802)	(4,802)	(4,802)	(4,802)	(4,802)	(4,802)
Income available (loss) to common shareholders	\$ 18,143	\$ 21,988	\$ 36,463	\$ (9,908)	\$ 39,096	\$ 54,867
PER SHARE AND DIVIDENDS DATA(1):						
Earnings (loss) per common shares (basic)	\$ 0.75	\$ 0.91	\$ 1.50	\$ (0.40)	\$ 1.58	\$ 2.23
Earnings (loss) per common shares (diluted)	\$ 0.75	\$ 0.90	\$ 1.50	\$ (0.40)	\$ 1.56	\$ 2.14
Average common shares outstanding . . .	24,289	24,260	24,326	24,562	24,750	24,571
Average potential common share- options	17	67	41	101	333	1,104
Average shares and shares equivalents . .	24,306	24,327	24,367	24,663	25,083	25,675
Book value per common share	\$ 10.82	\$ 7.96	\$ 12.08	\$ 10.98	\$ 11.13	\$ 10.88
Market price at end of period	\$ 10.80	\$ 6.05	\$ 13.41	\$ 12.95	\$ 12.36	\$ 15.26
Cash dividends declared per common share	\$ 0.16	\$ 0.56	\$ 0.56	\$ 0.56	\$ 0.56	\$ 0.55
Cash dividends declared on common shares	\$ 3,888	\$ 13,608	\$ 13,611	\$ 13,753	\$ 13,583	\$ 13,522

	December 31,					June 30,
	2009	2008	2007	2006	2005	2005
					(unaudited)	
PERIOD END BALANCES:						
Investments and loans						
Investment securities	\$4,974,269	\$3,945,626	\$4,585,610	\$2,992,236	\$3,476,767	\$3,231,580
Loans and leases (including loans held-for-sale), net . .	1,140,069	1,219,112	1,179,566	1,212,370	903,308	903,604
Securities sold but not yet delivered	—	834,976	—	6,430	44,009	1,034
	<u><u>\$6,114,338</u></u>	<u><u>\$5,999,714</u></u>	<u><u>\$5,765,176</u></u>	<u><u>\$4,211,036</u></u>	<u><u>\$4,424,084</u></u>	<u><u>\$4,136,218</u></u>
Deposits and Borrowings						
Deposits	\$1,745,501	\$1,785,300	\$1,246,420	\$1,232,988	\$1,298,568	\$1,252,897
Repurchase agreements	3,557,308	3,761,121	3,861,411	2,535,923	2,427,880	2,191,756
Other borrowings	472,849	373,718	395,441	247,140	404,921	399,476
Securities purchased but not yet received	413,359	398	111,431	—	43,354	22,772
	<u><u>\$6,189,017</u></u>	<u><u>\$5,920,537</u></u>	<u><u>\$5,614,703</u></u>	<u><u>\$4,016,051</u></u>	<u><u>\$4,174,723</u></u>	<u><u>\$3,866,901</u></u>
Stockholders' equity						
Preferred equity	\$ 68,000	\$ 68,000	\$ 68,000	\$ 68,000	\$ 68,000	\$ 68,000
Common equity	262,166	193,317	291,461	268,426	273,791	270,755
	<u><u>\$ 330,166</u></u>	<u><u>\$ 261,317</u></u>	<u><u>\$ 359,461</u></u>	<u><u>\$ 336,426</u></u>	<u><u>\$ 341,791</u></u>	<u><u>\$ 338,755</u></u>
Capital ratios						
Leverage capital	<u>6.52%</u>	<u>6.38%</u>	<u>6.69%</u>	<u>8.42%</u>	<u>10.13%</u>	<u>10.59%</u>
Tier 1 risk-based capital . . .	<u>18.79%</u>	<u>17.11%</u>	<u>18.59%</u>	<u>21.57%</u>	<u>34.70%</u>	<u>36.97%</u>
Total risk-based capital . . .	<u>19.84%</u>	<u>17.73%</u>	<u>19.06%</u>	<u>22.04%</u>	<u>35.22%</u>	<u>37.51%</u>
SELECTED FINANCIAL RATIOS AND OTHER INFORMATION:						
Return on average assets (ROA)	<u>0.35%</u>	<u>0.43%</u>	<u>0.76%</u>	<u>—0.11%</u>	<u>0.77%</u>	<u>1.46%</u>
Return on average common equity (ROE)	<u>7.16%</u>	<u>9.51%</u>	<u>13.52%</u>	<u>—3.59%</u>	<u>11.54%</u>	<u>21.34%</u>
Equity-to-assets ratio	<u>5.04%</u>	<u>4.21%</u>	<u>5.99%</u>	<u>7.69%</u>	<u>7.52%</u>	<u>7.98%</u>
Efficiency ratio	<u>51.74%</u>	<u>52.65%</u>	<u>65.93%</u>	<u>84.69%</u>	<u>66.12%</u>	<u>51.39%</u>
Expense ratio	<u>0.87%</u>	<u>0.77%</u>	<u>0.77%</u>	<u>0.73%</u>	<u>0.85%</u>	<u>0.75%</u>
Interest rate spread	<u>2.00%</u>	<u>1.62%</u>	<u>1.27%</u>	<u>0.70%</u>	<u>1.33%</u>	<u>2.00%</u>
Number of financial centers . .	<u>21</u>	<u>23</u>	<u>25</u>	<u>25</u>	<u>24</u>	<u>24</u>
Trust assets managed	\$1,818,498	\$1,706,286	\$1,962,226	\$1,848,596	\$1,875,300	\$1,823,292
Broker-dealer assets gathered	<u>1,269,284</u>	<u>1,195,739</u>	<u>1,281,168</u>	<u>1,143,668</u>	<u>1,132,286</u>	<u>1,135,115</u>
Assets managed	<u>3,087,782</u>	<u>2,902,025</u>	<u>3,243,394</u>	<u>2,992,264</u>	<u>3,007,586</u>	<u>2,958,407</u>
Assets owned	<u>6,550,833</u>	<u>6,205,536</u>	<u>5,999,855</u>	<u>4,371,986</u>	<u>4,546,949</u>	<u>4,246,865</u>
Total financial assets managed and owned	<u><u>\$9,638,615</u></u>	<u><u>\$9,107,561</u></u>	<u><u>\$9,243,249</u></u>	<u><u>\$7,364,250</u></u>	<u><u>\$7,554,535</u></u>	<u><u>7,205,272</u></u>

(1) Per share related information has been retroactively adjusted to reflect stock splits and stock dividends, when applicable.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE YEAR ENDED DECEMBER 31, 2009**

OVERVIEW OF FINANCIAL PERFORMANCE

The following discussion of our financial condition and results of operations should be read in conjunction with Item 6, "Selected Financial Data," and our consolidated financial statements and related notes in Item 8. This discussion and analysis contains forward-looking statements. Please see "Forward Looking Statements" and "Risk Factors" for discussions of the uncertainties, risks and assumptions associated with these statements.

From time to time, the Group uses certain non-GAAP measures of financial performance to supplement the financial statements presented in accordance with GAAP. The Group presents non-GAAP measures when its management believes that the additional information is useful and meaningful to investors. Non-GAAP measures do not have any standardized meaning and are therefore unlikely to be comparable to similar measures presented by other companies. The presentation of non-GAAP measures is not intended to be a substitute for, and should not be considered in isolation from, the financial measures reported in accordance with GAAP. The Group's management has reported and discussed the results of operations herein both on a GAAP basis and on a pre-tax operating income basis. The Group's management believes that, given the nature of the items excluded from the definition of pre-tax operating income, it is useful to state what the results of operations would have been without them so that investors can see the financial trends from the Group's continuing business.

Comparison of the years ended December 31, 2009 and 2008:

During the year ended December 31, 2009, the Group continued to perform well despite the turbulent credit market and the recession in Puerto Rico. Highlights of the year included:

- Pre-tax operating income (net interest income after provision for loan losses, core non-interest income from banking and financial service revenues, less non-interest expenses) of approximately \$62.1 million increased 9.9% compared to \$56.6 million in the previous year. Pre-tax operating income is calculated as follows:

	Year Ended December 31,		
	2009	2008	2007
<u>PRE-TAX OPERATING INCOME</u>			
Net interest income after provision for loan losses	\$115,283	\$102,451	\$ 67,180
Core non-interest income			
Financial service revenues	14,473	16,481	17,295
Banking service revenues	6,020	5,726	7,862
Investment banking revenues (losses)	(4)	950	126
Mortgage banking activities	9,728	3,685	2,401
Total core non-interest income	30,217	26,842	27,684
Less non interest expenses	(83,378)	(72,742)	(66,859)
Total Pre-tax operating income	<u>\$ 62,122</u>	<u>\$ 56,551</u>	<u>\$ 28,005</u>

- Net interest income increased 17.6%, to \$130.9 million, due to an improvement in the net interest margin to 2.14% from 1.86%, primarily reflecting lower cost of funds.
- Core banking and financial service revenues increased 12.6%, to \$30.2 million, primarily reflecting a \$6.0 million increase in mortgage banking activities, to \$9.7 million.
- Retail deposits, benefiting from expanded market share, grew 29.8% or \$323.0 million, to \$1.4 billion, enabling the Group to reduce higher cost deposits.
- Higher cost brokered deposits decreased 60.8% or \$315.2 million, and other wholesale institutional deposits decreased 25.8% or \$47.6 million.

- Non-interest expenses increased 14.6%, to \$83.4 million, largely the result of the industry-wide increase in Federal Deposit Insurance Corporation (FDIC) insurance assessments.
- Results for the year also include gains on: (i) sales of agency securities of \$78.3 million, (ii) derivative activities of \$28.9 million, and (iii) trading activities of \$12.6 million.
- In December 2009, the Group made the strategic decision to sell \$116.0 million of CDOs at a loss of \$73.9 million, including non-credit portion of impairment value previously recorded as unrealized loss in other comprehensive loss.
- For the same strategic reasons, in early January 2010, the Group sold \$420.1 million of non-agency CMOs at a loss of \$45.8 million. This loss was accounted for as other-than-temporary impairment in the fourth quarter of 2009 and no additional gain or loss was realized on the sale in January 2010, since these assets were sold at the same value reflected at December 31, 2009.
- After giving effect to these transactions approximately 96% of the Group's investment securities portfolio consist of fixed-rate mortgage-backed securities or notes, guaranteed or issued by FNMA, FHLMC or GNMA, and U.S. agency senior debt obligations, backed by a U.S. government sponsored entity or the full faith and credit of the U.S. government. This compares to 85% at September 30, 2009.
- Stockholders' equity increased \$68.8 million or 26.3%, to \$330.2 million, at December 31, 2009, compared to a year ago, due to earnings retention and improved mark to market valuation of the Group's investment portfolio.

Income Available to Common Shareholders

For the year ended December 31, 2009, the Group's income available to common shareholders totaled \$18.1 million, compared to \$22.0 million a year-ago. Earnings per basic and fully diluted common share were \$0.75, for the year ended December 31, 2009, compared to earnings per basic and fully diluted common share of \$0.91 and \$0.90, respectively, in the year ended December 31, 2008.

Return on Average Assets and Common Equity

Return on average common equity (ROE) for the year ended December 31, 2009 was 7.16%, down from 9.51% for the year ended December 31, 2008. Return on average assets (ROA) for the year ended December 31, 2009 was 0.35%, down from 0.43% for the year ended December 31, 2008. The decrease is mostly due to a 14.4% decrease in net income from \$26.8 million in the year ended December 31, 2008 to \$22.9 million the year 2009.

Net Interest Income after Provision for Loan Losses

Net interest income after provision for loan losses increased 12.5% for the year ended December 31, 2009, totaling \$115.3 million, compared with \$102.5 million last year. Growth reflects the significant reduction in cost of funds, which has declined more rapidly than the yield on interest-earning assets.

Non-Interest Expenses

Non-interest expenses increased 14.6% to \$83.4 million for the year ended December 31, 2009, compared to \$72.7 million in the previous year, largely the result of the industry-wide increase in FDIC insurance assessments, resulting in an efficiency ratio of 51.74% for the year ended December 31, 2009 (compared to 52.65% for the year ended December 31, 2008).

Income Tax Expense

As a result of increased operating income, investment gains, and income tax rates for financial institutions and international banking entities doing business in Puerto Rico, the income tax expense was \$7.0 million for the year ended December 31, 2009, compared to a benefit of \$9.3 million in the year ended December 31, 2008.

Assets Managed

Assets managed by the trust division, the pension plan administration subsidiary, and the broker-dealer subsidiary increased from \$2.902 billion as of December 31, 2008 to \$3.088 billion as of December 31, 2009. The Group's trust division offers various types of individual retirement accounts ("IRA") and manages 401(K) and Keogh retirement plans and custodian and corporate trust accounts, while Caribbean Pension Consultants, Inc. ("CPC") manages the administration of private pension plans. At December 31, 2009, total assets managed by the Group's trust division and CPC amounted to \$1.819 billion, compared to \$1.706 billion at December 31, 2008. The Group's broker-dealer subsidiary offers a wide array of investment alternatives to its client base, such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money management wrap-fee programs. At December 31, 2009, total assets gathered by the broker-dealer from its customer investment accounts increased to \$1.269 billion, compared to \$1.196 billion at December 31, 2008.

Interest Earning Assets

The investment portfolio amounted to \$4.974 billion at December 31, 2009, a 26.1% increase compared to \$3.946 billion at December 31, 2008, while the loan portfolio decreased 6.5% to \$1.140 billion at December 31, 2009, compared to \$1.219 billion at December 31, 2008. The increase in assets owned is mostly due to securities purchased but not yet received at December 31, 2009 amounting to \$413.4 million and securities sold but not yet delivered at December 31, 2008 amounting to \$835.0 million.

The mortgage loan portfolio totaled \$918.9 million at December 31, 2009, an 8.1% decrease from \$1.0 billion at December 31, 2008. Mortgage loan production for the year ended December 31, 2009, totaled \$243.7 million, which represents an increase of 6.0% from the preceding year. The Group sells most of its conforming mortgages, which represented 89% of 2009 production, into the secondary market, retaining servicing rights.

Interest Bearing Liabilities

Total deposits amounted to \$1.746 billion at December 31, 2009, a decrease of 2.2% compared to \$1.785 billion at December 31, 2008, primarily due to decreased brokered and wholesale deposits.

Stockholders' Equity

Stockholders' equity at December 31, 2009, was \$330.2 million, compared to \$261.3 million at December 31, 2008, mainly due to earnings retention and improved mark to market valuation on the Group's investment portfolio.

Tangible common equity to risk-weighted assets and total equity to risk-weighted assets at December 31, 2009 increased to 11.79% and 14.96%, respectively, from 8.40% and 11.47% respectively, at December 31, 2008.

The Group maintains capital ratios in excess of regulatory requirements. At December 31, 2009, Tier 1 Leverage Capital Ratio was 6.52% (1.63 times the requirement of 4.00%), Tier 1 Risk-Based Capital Ratio was 18.79% (4.70 times the requirement of 4.00%), and Total Risk-Based Capital Ratio was 19.84% (2.48 times the requirement of 8.00%).

Due to the initial adoption of FASB ASC 320-10-65-1, in the second quarter of 2009 the Group reclassified the noncredit-related portion of other-than-temporary impairment losses previously recognized in earnings in the third quarter of 2008 for an amount of \$14.4 million that increased retained earnings and accumulated other comprehensive loss. This reclassification had a positive impact on regulatory capital, but no impact on stockholders' equity.

Financial Service-Banking Franchise

The Group's niche market approach to the integrated delivery of services to mid and high net worth clients performed well as Oriental expanded market share based on its service proposition and capital strength, as opposed to using rates to attract loans or deposits.

Lending

Total loan production and purchases of \$323.3 million for the year remained strong compared to \$297.1 million in previous year, as the Group's capital levels and low credit losses enabled it to continue prudent lending.

The Group sells most of its conforming mortgages, which represented 90% of 2009 production, into the secondary market, and retains servicing rights. As a result, mortgage banking activities now reflect originations as well as a growing servicing portfolio, a source of recurring revenue.

Deposits

Retail deposits, benefiting from expanded market share grew 29.8% to \$1.406 billion in December 31, 2009 from \$1.083 billion in 2008, enabling the Group to reduce higher cost deposits. Higher cost brokered deposits and other wholesale institutional deposits decreased 60.8% and 25.8%, respectively, to \$203.3 million and \$136.7 million, respectively, in December 31, 2009, from \$518.4 million and \$184.3 million, respectively, in December 31, 2008.

Assets Under Management

Total client assets managed increased 6.4%, to \$3.088 billion as of December 31, 2009, with the opening of new trust, Keogh, 401K and wealth management accounts.

Credit Quality

Net credit losses increased \$1.9 million, to \$6.7 million, representing 0.57% of average loans outstanding, versus 0.39% in 2008. The allowance for loan losses stood at \$23.3 million (2.00% of total loans) at December 31, 2009, compared to \$14.3 million (1.15% of total loans) a year ago.

Non-performing loans (NPLs) increased 34.7% or \$26.9 million in the year. The Group's NPLs generally reflect the economic environment in Puerto Rico. Nonetheless, the Group does not expect non-performing loans to result in significantly higher losses as most are well-collateralized with adequate loan-to-value ratios. In residential mortgage lending, more than 90% of the Group's portfolio consists of fixed-rate, fully amortizing, fully documented loans that do not have the level of risk generally associated with subprime loans. In commercial lending, more than 90% of all loans are collateralized by real estate.

The Investment Securities Portfolio

Results for the year included gains on: (i) sales of agency securities of \$78.3 million, (ii) derivative activities of \$28.9 million, and (iii) trading activities of \$12.6 million.

Also during December 2009, the Group made the strategic decision to sell \$116.0 million of CDOs at a loss of \$73.9 million, including non-credit portion of impairment value previously recorded as unrealized loss in other comprehensive loss

For the same strategic reasons, in early January 2010, the Group sold \$420.1 million of non-agency CMOs at a loss of \$45.8 million. This loss was accounted for as other-than-temporary impairment in the fourth quarter of 2009 and no additional gain or loss was realized on the sale in January 2010, since these assets were sold at the same value reflected at December 31, 2009.

After giving effect to the aforementioned transactions, approximately 96% of the Group's investment securities portfolio consists of fixed-rate mortgage-backed securities or notes, guaranteed or issued by FNMA, FHLMC or GNMA, and U.S. agency senior debt obligations, backed by a U.S. government sponsored entity or the full faith and credit of the U.S. government. This compares to 85% at September 30, 2009.

Comparison of the years ended December 31, 2008 and 2007

For the year ended December 31, 2008, the Group reported income available to common shareholders of \$22.0 million compared to \$36.5 million in 2007, with income per common share (diluted) of \$0.90 compared to \$1.50. Excluding the other-than-temporary impairment (OTTI) non-cash loss of \$55.8 million, net of tax (\$2.29 per diluted share), reported in the third quarter of 2008, the Group had income available to common shareholders of \$77.8 million, with income per common share (basic and diluted) of \$3.19.

Return on common equity (ROE) and return on assets (ROA) for the year ended December 31, 2008 were 9.51% and 0.43%, respectively, from 13.52% and 0.76%, respectively, in the same period of 2007.

Net interest income represented 112.4% of the Group's total revenues (defined as net interest income plus non-interest income) in the year ended December 31, 2008. During the year ended December 31, 2008, net interest income was \$111.3 million, an increase of 51.0% from the \$73.7 million recorded for the same period of 2007. Higher interest income reflected increased investment securities and loan volume and lower average costs of deposits and borrowings. Interest rate spread for the year ended December 31, 2008 was 1.62% compared to 1.19% in the same period of 2007. At December 31, 2008 average interest earning assets increased 16.9% to \$6.0 billion, compared to \$5.1 billion at December 31, 2007, reflecting a 21.2% increase in investments from \$3.9 billion to \$4.8 billion.

The provision for loan losses for the year ended December 31, 2008 increased 35.27% to \$8.9 million from \$6.6 million for the same period of 2007, reflecting higher allowance requirements related to increased mortgage and commercial loan business in the period and local economic conditions. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for loan losses for the year ended December 31, 2008 was adequate in order to maintain the allowance for loan losses at an appropriate level.

Assets under management, which generate recurring fees for the Group's financial service businesses, stood at \$2.9 billion at December 31, 2008, down 10.5% from December 31, 2007. A relatively high proportion of fixed income investments in the mix helped to offset the general decline in equity markets.

Non-interest expenses for the year ended December 31, 2008 increased 8.8% to \$72.7 million, compared to \$66.9 million for the same period of 2007. Effective cost control has enabled the Group to restrain the growth of overhead costs. Refer to Table 3 for additional information on the Group's non-interest expenses.

Loan production of \$290.1 million was up 43.0% compared to 2007, as Oriental's low credit losses and capital levels enabled it to continue prudent lending. Mortgage originations of \$229.9 million increased 56.5% year over year. Commercial originations of \$55.8 million increased 14.5% year over year to an average of about \$14.0 million a quarter.

Total deposits of \$1.8 billion increased 43.2% from the year 2007, representing 30.2% of interest bearing liabilities, versus 22.6% at December 31, 2007. The increase was primarily due to an increase in brokered certificates of deposit. Total borrowings decreased 2.9%, from \$4.3 billion at December 31, 2007, to \$4.1 at December 31, 2008.

Stockholders' equity as of December 31, 2008 was \$261.3 million, a decrease of 28.0% from \$359.5 million as of December 31, 2007 reflecting a decreased mark-to-market valuation on the available for sale investment securities portfolio. The Group's capital ratios are above regulatory capital requirements. At December 31, 2008, the Tier 1 Leverage Capital Ratio was 6.38%, Tier 1 Risk-Based Capital Ratio was 17.11%, and Total Risk-Based Capital Ratio was 17.73%.

**TABLE 1 — ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE:
For the Years Ended December 31, 2009 and 2008**

	Interest		Average rate		Average balance	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
	(Dollars in thousands)					
A — TAX EQUIVALENT SPREAD						
Interest-earning assets	\$319,401	\$339,039	5.22%	5.68%	\$6,117,104	\$5,973,225
Tax equivalent adjustment	<u>105,407</u>	<u>112,077</u>	<u>1.72%</u>	<u>1.88%</u>	<u>—</u>	<u>—</u>
Interest-earning assets — tax equivalent	<u>424,808</u>	<u>451,116</u>	<u>6.94%</u>	<u>7.56%</u>	<u>6,117,104</u>	<u>5,973,225</u>
Interest-bearing liabilities	<u>188,467</u>	<u>227,728</u>	<u>3.22%</u>	<u>4.06%</u>	<u>5,859,249</u>	<u>5,602,622</u>
Tax equivalent net interest income / spread	<u>\$236,341</u>	<u>\$223,388</u>	<u>3.72%</u>	<u>3.50%</u>	<u>\$ 257,855</u>	<u>\$ 370,603</u>
Tax equivalent interest rate margin			<u>3.86%</u>	<u>3.74%</u>		
B — NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	\$244,815	\$257,947	5.11%	5.49%	\$4,792,378	\$4,702,428
Trading securities	940	20	3.69%	3.70%	25,441	540
Money market investments	570	1,907	0.47%	3.35%	120,395	56,856
	<u>246,325</u>	<u>259,874</u>	<u>4.99%</u>	<u>5.46%</u>	<u>4,938,214</u>	<u>4,759,824</u>
Loans:						
Mortgage	60,664	66,087	6.26%	6.44%	968,400	1,026,779
Commercial	10,437	10,610	5.49%	6.57%	189,951	161,541
Consumer	1,975	2,468	9.62%	9.84%	20,539	25,081
	<u>73,076</u>	<u>79,165</u>	<u>6.20%</u>	<u>6.52%</u>	<u>1,178,890</u>	<u>1,213,401</u>
	<u>319,401</u>	<u>339,039</u>	<u>5.22%</u>	<u>5.68%</u>	<u>6,117,104</u>	<u>5,973,225</u>
Interest-bearing liabilities:						
Deposits:						
Non-interest bearing deposits	—	—	—	—	46,750	36,697
Now accounts	17,205	4,197	2.92%	2.44%	588,219	171,725
Savings	910	10,199	1.43%	3.36%	63,439	303,298
Certificates of deposit	36,578	35,385	3.49%	3.96%	1,047,634	894,209
	<u>54,693</u>	<u>49,781</u>	<u>3.13%</u>	<u>3.54%</u>	<u>1,746,042</u>	<u>1,405,929</u>
Borrowings:						
Repurchase agreements	115,653	161,363	3.16%	4.25%	3,659,442	3,800,673
Interest rate risk management	1,102	—	0.03%	—	—	—
Total repurchase agreements	<u>116,755</u>	<u>161,363</u>	<u>3.19%</u>	<u>4.25%</u>	<u>3,659,442</u>	<u>3,800,673</u>
FHLB advances	12,074	13,457	4.18%	4.20%	288,830	320,594
Subordinated capital notes	1,465	2,304	4.06%	6.39%	36,083	36,083
FDIC-guaranteed term notes	3,175	—	3.58%	—	88,713	—
Other borrowings	306	823	0.76%	2.09%	40,139	39,343
	<u>133,775</u>	<u>177,947</u>	<u>3.25%</u>	<u>4.24%</u>	<u>4,113,207</u>	<u>4,196,693</u>
	<u>188,468</u>	<u>227,728</u>	<u>3.22%</u>	<u>4.06%</u>	<u>5,859,249</u>	<u>5,602,622</u>
Net interest income/spread	<u>\$130,933</u>	<u>\$111,311</u>	<u>2.00%</u>	<u>1.62%</u>		
Interest rate margin			<u>2.14%</u>	<u>1.86%</u>		
Excess of interest-earning assets over interest-bearing liabilities					<u>\$ 257,855</u>	<u>\$ 370,603</u>
Interest-earning assets over interest- bearing liabilities ratio					<u>104.40%</u>	<u>106.61%</u>

C. CHANGES IN NET INTEREST INCOME DUE TO:

	December 31, 2009 versus December 31, 2008		
	<u>Volume</u>	<u>Rate</u>	<u>Total</u>
Interest Income:			
Investments	\$ 8,898	\$(22,447)	\$(13,549)
Loans	(2,139)	(3,950)	(6,089)
	<u>6,759</u>	<u>(26,397)</u>	<u>(19,638)</u>
Interest Expense:			
Deposits	10,654	(5,742)	4,912
Repurchase agreements	(4,506)	(40,102)	(44,608)
Other borrowings	2,166	(1,730)	436
	<u>8,314</u>	<u>(47,574)</u>	<u>(39,260)</u>
	<u>\$ (1,555)</u>	<u>\$ 21,177</u>	<u>\$ 19,622</u>

TABLE 1A — ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE:
For the Years Ended December 31, 2008 and 2007

	Interest		Average rate		Average balance	
	December 31, 2008	December 31, 2007	December 31, 2008	December 31, 2007	December 31, 2008	December 31, 2007
	(Dollars in thousands)					
A — TAX EQUIVALENT SPREAD						
Interest-earning assets	\$339,039	\$289,364	5.68%	5.66%	\$5,973,225	\$5,108,910
Tax equivalent adjustment	<u>112,077</u>	<u>96,460</u>	<u>1.88%</u>	<u>1.89%</u>	<u>—</u>	<u>—</u>
Interest-earning assets — tax equivalent	451,116	385,824	7.56%	7.55%	5,973,225	5,108,910
Interest-bearing liabilities	227,728	215,634	4.06%	4.47%	5,602,622	4,822,058
Tax equivalent net interest income / spread	<u><u>\$223,388</u></u>	<u><u>\$170,190</u></u>	<u><u>3.50%</u></u>	<u><u>3.08%</u></u>	<u><u>\$ 370,603</u></u>	<u><u>\$ 286,852</u></u>
Tax equivalent interest rate margin			<u><u>3.74%</u></u>	<u><u>3.33%</u></u>		
B — NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	\$257,947	\$200,057	5.49%	5.18%	\$4,702,428	\$3,863,221
Investment management fees	<u>—</u>	<u>(210)</u>	<u>—</u>	<u>−0.01%</u>	<u>—</u>	<u>—</u>
Total investment securities	257,947	199,847	5.49%	5.17%	4,702,428	3,863,221
Trading securities	20	27	3.70%	3.33%	540	810
Money market investments	<u>1,907</u>	<u>3,688</u>	<u>3.35%</u>	<u>5.78%</u>	<u>56,856</u>	<u>63,818</u>
	<u><u>259,874</u></u>	<u><u>203,562</u></u>	<u><u>5.46%</u></u>	<u><u>5.18%</u></u>	<u><u>4,759,824</u></u>	<u><u>3,927,849</u></u>
Loans:						
Mortgage	66,087	66,343	6.44%	6.59%	1,026,779	1,007,391
Commercial	10,610	16,061	6.57%	11.17%	161,541	143,819
Consumer	<u>2,468</u>	<u>3,398</u>	<u>9.84%</u>	<u>11.38%</u>	<u>25,081</u>	<u>29,851</u>
	<u><u>79,165</u></u>	<u><u>85,802</u></u>	<u><u>6.52%</u></u>	<u><u>7.26%</u></u>	<u><u>1,213,401</u></u>	<u><u>1,181,061</u></u>
	<u><u>339,039</u></u>	<u><u>289,364</u></u>	<u><u>5.68%</u></u>	<u><u>5.66%</u></u>	<u><u>5,973,225</u></u>	<u><u>5,108,910</u></u>
Interest-bearing liabilities:						
Deposits:						
Non-interest bearing deposits	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>36,697</u>	<u>35,589</u>
Now accounts	4,197	818	2.44%	1.28%	171,725	64,010
Savings	10,199	13,958	3.36%	4.39%	303,298	318,207
Certificates of deposit	<u>35,385</u>	<u>38,018</u>	<u>3.96%</u>	<u>4.90%</u>	<u>894,209</u>	<u>775,315</u>
	<u><u>49,781</u></u>	<u><u>52,794</u></u>	<u><u>3.54%</u></u>	<u><u>4.42%</u></u>	<u><u>1,405,929</u></u>	<u><u>1,193,121</u></u>
Borrowings:						
Repurchase agreements	161,363	147,847	4.25%	4.45%	3,800,673	3,323,696
Interest rate risk management	<u>—</u>	<u>(773)</u>	<u>0.00%</u>	<u>−0.02%</u>	<u>—</u>	<u>—</u>
Financing fees	<u>—</u>	<u>586</u>	<u>0.00%</u>	<u>0.02%</u>	<u>—</u>	<u>—</u>
Total repurchase agreements	161,363	147,660	4.25%	4.44%	3,800,673	3,323,696
FHLB advances	13,457	10,883	4.20%	4.45%	320,594	244,445
Subordinated capital notes	2,304	3,138	6.39%	8.70%	36,083	36,083
Term notes	<u>—</u>	<u>176</u>	<u>—</u>	<u>5.04%</u>	<u>—</u>	<u>3,493</u>
Other borrowings	<u>823</u>	<u>983</u>	<u>2.09%</u>	<u>4.63%</u>	<u>39,343</u>	<u>21,220</u>
	<u><u>177,947</u></u>	<u><u>162,840</u></u>	<u><u>4.24%</u></u>	<u><u>4.49%</u></u>	<u><u>4,196,693</u></u>	<u><u>3,628,937</u></u>
	<u><u>227,728</u></u>	<u><u>215,634</u></u>	<u><u>4.06%</u></u>	<u><u>4.47%</u></u>	<u><u>5,602,622</u></u>	<u><u>4,822,058</u></u>
Net interest income/spread	<u><u>\$111,311</u></u>	<u><u>\$ 73,730</u></u>	<u><u>1.62%</u></u>	<u><u>1.19%</u></u>		
Interest rate margin			<u><u>1.86%</u></u>	<u><u>1.44%</u></u>		
Excess of interest-earning assets over interest-bearing liabilities					<u><u>\$ 370,603</u></u>	<u><u>\$ 286,852</u></u>
Interest-earning assets over interest- bearing liabilities ratio					<u><u>106.61%</u></u>	<u><u>105.95%</u></u>

C. CHANGES IN NET INTEREST INCOME DUE TO:

December 31, 2008 versus December 31, 2007			
	<u>Volume</u>	<u>Rate</u>	<u>Total</u>
Interest Income:			
Investments	\$43,118	\$ 13,194	\$56,312
Loans	2,349	(8,986)	(6,637)
	<u>45,467</u>	<u>4,208</u>	<u>49,675</u>
Interest Expense:			
Deposits	9,417	(12,430)	(3,013)
Repurchase agreements	21,191	(7,488)	13,703
Other borrowings	4,514	(3,110)	1,404
	<u>35,122</u>	<u>(23,028)</u>	<u>12,094</u>
	<u>\$10,345</u>	<u>\$ 27,236</u>	<u>\$37,581</u>

Net Interest Income

Comparison of the years ended December 31, 2009 and 2008:

Net interest income is a function of the difference between rates earned on the Group's interest-earning assets and rates paid on its interest-bearing liabilities (interest rate spread) and the relative amounts of its interest-earning assets and interest-bearing liabilities (interest rate margin). As further discussed in the Risk Management section of this report, the Group constantly monitors the composition and re-pricing of its assets and liabilities to maintain its net interest income at adequate levels. Table 1 shows the major categories of interest-earning assets and interest-bearing liabilities, their respective interest income, expenses, yields and costs, and their impact on net interest income due to changes in volume and rates for the years ended December 31, 2009 and 2008.

Net interest income amounted to \$130.9 million for the year ended December 31, 2009, an increase of 17.6% from \$111.3 million in the same period of 2008. The increase for the year 2009 reflects a 17.2% decrease in interest expense, due to a negative rate variance of interest-bearing liabilities of \$47.6 million, partially offset by a positive volume variance of interest-bearing liabilities of \$8.3 million. The decrease of 5.8% in interest income for the year ended December 31, 2009 was primarily the result of a decrease of \$26.4 million in rate variance, partially offset by an increase of \$6.8 million in volume variance. Interest rate spread increased 38 basis points to 2.0% for the year ended December 31, 2009 from 1.62% for the same period of 2008. This increase reflects a 84 basis point decrease in the average cost of funds to 3.22% for the year ended December 31, 2009 from 4.06% for the same period of 2008, partially offset by a 46 basis point decrease in the average yield of interest earning assets to 5.22% for the year ended December 31, 2009 from 5.68% for the same period of 2008.

Interest income decreased 5.8% to \$319.4 million for the year ended December 31, 2009, as compared to \$339.0 million for the period of 2008, reflecting the decrease in yields. Interest income is generated by investment securities, which accounted for 77.1% of total interest income, and from loans, which accounted for 22.9% of total interest income. Interest income from investments decreased 5.2% to \$246.3 million, due to a decrease in yield of 47 basis points from 5.46% to 4.99%. Interest income from loans decreased 7.7% to \$73.1 million, mainly due to a 47.2% increase in loans on which the accrual of interest has been discontinued, which grew to \$57.1 million from \$38.8 million. In addition, yields on loans decreased from 6.52% in 2008 to 6.20% in 2009.

Interest expense decreased 17.2%, to \$188.5 million for the year ended December 31, 2009, from \$227.7 million for the same period of 2008. The decrease is due to a significant reduction in cost of funds, which has decreased 84 basis points from 4.06% to 3.25%. Reduction in the cost of funds is mostly due to structured repurchase agreements amounting to \$1.25 billion, which reset at the put date at a formula which is based on the three-month LIBOR rate less fifteen times the difference between the ten-year SWAP rate and the two-year SWAP rate, with a minimum of 0.00% on \$1.0 billion and 0.25% on \$250 million, and a maximum of 10.6%. These repurchase agreements bear the respective minimum rates of 0.0% (from March 6, 2009) and 0.25% (from March 2, 2009) to at least their next put dates scheduled for March 2010. For the year 2009 the cost of deposits decreased 41 basis points to 3.13%, as compared to the period of 2008. The decrease reflects lower average rates paid on higher balances, most significantly in savings and certificates of deposit accounts. For the year 2009 the cost of borrowings decreased 99 basis points to 3.25% from the same period of 2008.

Comparison of the years ended December 31, 2008 and 2007:

Net interest income increased 51.0% to \$111.3 million in the year ended December 31, 2008, from \$73.7 million in the same period of 2007. This increase was due to a positive volume variance of \$10.4 million, and a positive rate variance of \$27.2 million, as average interest earning assets increased 16.9% to \$6.0 billion as of December 31, 2008, from \$5.1 billion as of December 31, 2007. The interest rate margin increased 42 basis points to 1.86% for the year ended December 31, 2008, from 1.44% for the same period of 2007. The interest rate spread increased 43 basis points to 1.62% for the year ended December 31, 2008, from 1.19% for the same period of 2007, due to a 41 basis point decrease in the average cost of funds to 4.06% from 4.47%, and a 2 basis point increase in the average yield of interest earning assets to 5.68% from 5.66%.

Interest income increased 17.2% to \$339.0 million for the year ended December 31, 2008, as compared to \$289.4 million for the period of 2007, reflecting the increase in the average balance of interest earning assets and

yields. Interest income is generated by investment securities, which accounted for 76.7% of total interest income, and from loans, which accounted for 23.3% of total interest income. Interest income from investments increased 27.7% to \$259.9 million, due to a 21.2% increase in the average balance of investments, which grew to \$4.8 billion from \$3.9 billion, mostly due to an increase in yield of 28 basis points from 5.18% to 5.46%. Interest income from loans decreased 7.7% to \$79.2 million, mainly due to a 41.8% increase in loans on which the accrual of interest has been discontinued, which grew to \$38.8 million from \$27.3 million. Yields decreased from 7.26% in 2007 to 6.52% in 2008.

Interest expense increased 5.6%, to \$227.7 million for year ended December 31, 2008, from \$215.6 million for the same period of 2007. The increase is due to higher average interest-bearing liabilities which grew to \$5.6 billion, from \$4.8 billion, year over year, in order to fund the growth of the Group's investment and loan portfolios, which was partially offset by a 41 basis point decrease in the average cost of retail and wholesale funds, to 4.06% for 2008, from 4.47% for the same period of 2007. The average cost of retail deposits decreased 88 basis points, to 3.54% for the year ended December 31, 2008, from 4.42% for the same period of 2007, and the average cost of wholesale funding sources decreased 25 basis points, to 4.24%, from 4.49%, specifically reflected in repurchase agreements, which decreased 19 basis points, to 4.25% from 4.44% due to the strategic repositioning of the repurchase agreements portfolio and the increase in broker certificates of deposit that are used as a more economical and flexible alternative for replacing higher cost deposits and short-term repurchase agreements.

**TABLE 2 — NON-INTEREST INCOME (LOSS) SUMMARY
FOR THE YEARS ENDED ENDED DECEMBER 31, 2009, 2008, AND 2007**

	Year Ended December 31,			
	2009	2008	Variance%	2007
	(Dollars in thousands)			
Financial service revenues	\$ 14,473	\$ 16,481	−12.2%	\$17,295
Banking service revenues	6,020	5,726	5.1%	7,862
Investment banking revenues (losses)	(4)	950	−100.4%	126
Mortgage banking activities	9,728	3,685	164.0%	2,401
Total banking and financial service revenues . . .	30,217	26,842	12.6%	27,684
Excess of amortized costs over fair value on other-than-temporarily impaired securities	(101,472)	(58,804)	−72.6%	—
Non-credit related unrealized loss on securities recognized in other comprehensive income	41,398	—	100.0%	—
Other-than-temporary impairments on securities . . .	(60,074)	(58,804)	2.2%	—
Net gain (loss) on:				
Sale of securities	4,385	35,070	−87.5%	2,953
Derivatives	28,927	(12,943)	323.5%	10,997
Early extinguishment of repurchase agreements . .	(17,551)	—	−100.0%	—
Mortgage tax credits	—	(2,480)	100.0%	—
Trading securities	12,564	(13)	100.0%	23
Foreclosed real estate	(570)	(670)	14.9%	(349)
Other investments	43	148	71.0%	1,174
Other	71	608	−88.3%	20
	(32,205)	(39,084)	−17.6%	14,818
Total non-interest income (loss)	\$ (1,988)	\$ (12,242)	−83.8%	\$42,502

Non-Interest Income

Comparison of the years ended December 31, 2009 and 2008:

Non-interest income is affected by the amount of securities, derivatives and trading transactions, the level of trust assets under management, transactions generated by the gathering of financial assets by the securities broker-dealer subsidiary, the level of investment and mortgage banking activities, and the fees generated from loans, deposit accounts, and insurance activities. As shown in Table 2, the Group recorded a loss in non-interest income in the amount of \$2.0 million for the year ended December 31, 2009, compared to a loss of \$12.2 million during 2008.

Financial services revenues, which consist of commissions and fees from fiduciary activities, and commissions and fees from securities brokerage and insurance activities, decreased 12.2%, to \$14.5 million in the year ended December 31, 2009, from \$16.5 million in the same period of 2008. Banking service revenues, which consist primarily of fees generated by deposit accounts, electronic banking services, and customer services, increased 5.1% to \$6.0 million in the year ended December 31, 2009, from \$5.7 million in the same period of 2008. Income generated from mortgage banking activities increased 164.0% in the year ended December 31, 2009, from \$3.7 million in the year ended December 31, 2008, to \$9.7 million in the same period of 2009 mainly the result of increased mortgage banking revenues due to the securitization and sale of mortgage loans held-for-sale into the secondary market and increase in residential mortgage loan production.

For the year ended December 31, 2009 a loss from securities, derivatives, trading activities and other investment activities was \$32.2 million, compared to a loss of \$39.1 million in the same period of 2008. During the year ended December 31, 2009, a gain of \$28.9 million was recognized in derivatives, compared to a loss of \$12.9 million in the year 2008. Gains for the year ended December 31, 2009 were mainly due to several interest-rate swap contracts that the Group entered to manage its interest rate risk exposure, which were terminated before December 31, 2009. During the third quarter of 2008, the Group charged \$4.9 million as a loss in connection with equity indexed option agreements. Results for the year ended December 31, 2008 include an interest-rate swap contract that the Group entered into on January 2008 to manage the Group's interest rate risk exposure with a notional amount of \$500.0 million, which was subsequently terminated resulting in a loss to the Group of approximately \$7.9 million.

Keeping with the Group's investment strategy, during the year ended December 31, 2009 and 2008, there were certain sales of available-for-sale securities because the Group felt at the time of such sales that gains could be realized while at the same time having good opportunities to invest the proceeds in other investment securities with attractive yields and terms that would allow the Group to continue to protect its net interest margin. Sale of securities available-for-sale, which generated gains of \$4.4 million for the year ended December 31, 2009, decreased 87.5% when compared to \$35.1 million for the same period a year ago. Benefitting from the strategic positioning of its investment securities portfolio, the Group made the strategic decision to sell \$116.0 million of CDOs at a loss of \$73.9 million, including non-credit portion of impairment value previously recorded as unrealized loss in other comprehensive loss. For the same strategic reasons, in early January 2010, the Group sold \$420.1 million of non-agency CMOs at a loss of \$45.8 million. This loss was accounted for as other-than-temporary impairment in the fourth quarter of 2009 and no additional gain or loss was realized on the sale in January 2010, since these assets were sold at the same value reflected at December 31, 2009. During the year ended December 31, 2009, a gain of \$12.6 million was recognized in trading securities, compared to a loss of \$13 thousand in the previous year. During the year ended December 31, 2009 and 2008 the Group recorded an other-than-temporary impairment loss of \$60.1 million and \$58.8 million, respectively.

The Group adopted the provisions of FASB ASC 320-10-65-1 as of April 1, 2009. For those debt securities for which the fair value of the security is less than its amortized cost, the Group does not intend to sell such security and it is more likely than not that it will not be required to sell such security prior to the recovery of its amortized cost basis less any current period credit losses. These provisions require that the credit-related portion of other-than-temporary impairment losses be recognized in earnings while the noncredit-related portion is recognized in other comprehensive income, net of related taxes. As a result of the adoption of FASB ASC 320-10-65-1, in the year 2009 a \$60.1 million net credit-related impairment loss was recognized in earnings and a \$41.4 million noncredit-related impairment loss was recognized in other comprehensive income for a non-agency collateralized mortgage obligation pool not expected to be sold. Also, during the second quarter of 2009 the Group reclassified the noncredit-related portion of an other-than-temporary impairment loss previously recognized in earnings in the third

quarter of 2008. This reclassification was reflected as a cumulative effect adjustment of \$14.4 million that increased retained earnings and increased accumulated other comprehensive loss. The amortized cost basis of this non-agency collateralized mortgage obligation pool for which other-than-temporary impairment losses was recognized in the third quarter of 2008 was adjusted by the amount of the cumulative effect adjustment. These other-than-temporary impairment losses are not anticipated to have an income tax effect because the impaired securities are held in the Group's IBE, and potential recoveries of these losses, if any, are expected to occur in a period in which the income earned by the Group's IBE would be 100% exempt from income taxes.

Comparison of the years ended December 31, 2008 and 2007:

The Group recorded non-interest losses in the amount of \$12.2 million for the year ended December 31, 2008, a decrease of 128.8% when compared to income of \$42.5 during the same period in 2007.

Financial services revenues, which consist of commissions and fees from fiduciary activities, and commissions and fees from securities brokerage, and insurance activities, decreased 4.7%, to \$16.5 million in the year ended December 31, 2008, from \$17.3 million in the same period of 2007, mainly the result of reduced financial service revenues. Banking service revenues, which consist primarily of fees generated by deposit accounts, electronic banking and customer services, decreased 27.2% to \$5.7 million in the year ended December 31, 2008, from \$7.9 million in the same period of 2007, mainly driven by reduced consumer banking activity. Investment banking revenues increased due to more transactions in 2008 as compared to 2007. Income generated from mortgage banking activities increased 53.5% in the year ended December 31, 2008, from \$2.4 million in the year ended December 31, 2007, to \$3.7 million in the same period of 2008 mainly the result of increased mortgage banking revenues due to the securitization and sale of conventional mortgages into the secondary market and increased financial services revenues from brokerage activity. Year ended December 31, 2008 results also included a loss of \$2.5 million, representing a provision for loss on mortgage loan tax credits for new homeowners. The credits were instituted by the Commonwealth of Puerto Rico in 2008, but it is now doubtful whether they will be granted.

Securities, derivatives and trading activities revenues for the year ended December 31, 2008 amounted to a loss of \$36.5 million compared to a gain of approximately \$15.1 million in the same period of 2007. During the third quarter of 2008, the Group recorded other-than-temporary non cash losses of \$58.8 million. This loss was partially offset by a gain of \$35.1 million on the sale of securities.

**TABLE 3 — NON-INTEREST EXPENSES SUMMARY
FOR THE YEARS ENDED ENDED DECEMBER 31, 2009, 2008, AND 2007**

	Year Ended December 31,			2007
	2009	2008	Variance %	
	(Dollars in thousands)			
Compensation and employees' benefits	\$31,971	\$30,572	4.6%	\$28,376
Occupancy and equipment	14,763	13,843	6.6%	12,624
Professional and service fees	10,428	9,203	13.3%	7,161
Insurance	7,233	2,421	198.8%	848
Advertising and business promotion	4,208	3,970	6.0%	4,472
Taxes, other than payroll and income taxes	3,004	2,514	19.5%	2,151
Electronic banking charges	2,194	1,726	27.1%	1,826
Loan servicing expenses	1,586	1,383	14.7%	1,740
Communication	1,567	1,292	21.3%	1,302
Director and investors relations	1,374	1,159	18.6%	2,103
Clearing and wrap fees	1,177	1,250	−5.8%	1,070
Other operating expenses	3,873	3,409	13.6%	3,186
Total non-interest expenses	\$83,378	\$72,742	14.6%	\$66,859
Relevant ratios and data:				
Efficiency ratio	51.74%	52.65%		65.93%
Expense ratio	0.87%	0.77%		0.77%
Compensation and benefits to non-interest expenses	38.3%	42.0%		42.4%
Compensation to total assets	0.49%	0.50%		0.47%
Average compensation per employee	\$ 59.1	\$ 56.9		\$ 53.5
Average number of employees	541	537		522
Assets owned per average employee	\$12,109	\$11,552		\$11,320
Total workforce	526	539		518

Non-Interest Expenses

Comparison of the years ended December 31, 2009 and 2008:

Non-interest expenses for the year ended December 31, 2009 increased 14.6% to \$83.4 million, compared to \$72.7 million for the same period of 2008, primarily as a result of higher insurance expense, compensation and employees' benefits, professional services fees, and occupancy and equipment. During the year ended December 31, 2009, insurance expense increased 198.8% to \$7.2 million from \$2.4 million, as the result of the industry-wide increase in FDIC insurance assessments. Compensation and employees' benefits increased 4.6% to \$32.0 million from \$30.6 million in the year ended December 31, 2008. Professional fees increased 13.3% from \$9.2 million in the year ended December 31, 2008 to \$10.4 million in the year ended December 31, 2009. Occupancy and equipment increased 6.6% from \$13.8 million in the year ended December 31, 2008 to \$14.8 million in the year ended December 31, 2009. In the year ended December 31, 2009, taxes, other than payroll and income taxes, electronic banking charges, communication, loan servicing expenses, director and investor relations expenses, and other operating expenses increased 19.5%, 27.1%, 21.3%, 14.7%, 18.6% and 13.6%, respectively, compared to the year ended December 31, 2008.

The non-interest expense results reflect an efficiency ratio of 51.74% for the year ended December 31, 2009, compared to 52.65% in 2008. The efficiency ratio measures how much of a company's revenue is used to pay operating expenses. The Group computes its efficiency ratio by dividing non-interest expenses by the sum of its net

interest income and non-interest income, but excluding gains on sale of investments securities, derivatives gains or losses, credit-related other-than-temporary impairment losses, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permit greater comparability. Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to \$32.2 million and \$39.1 million for years ended December 31, 2009 and 2008, respectively.

Comparison of the years ended December 31, 2008 and 2007:

Non-interest expenses for the year ended December 31, 2008 increased 8.8% to \$72.7 million, compared to \$66.9 million for the same period of 2007. During the year ended December 31, 2008, compensation and employees' benefits increased 7.7% to \$30.6 million from \$28.4 million in the year ended December 31, 2007. Professional fees increased 28.5% from \$7.2 million in the year ended December 31, 2007 to \$9.2 million in the year ended December 31, 2008.

In the year ended December 31, 2008, advertising and business promotion, electronic banking charges, loan servicing expenses, director and investor relations expenses, and other operating expenses decreased 11.2%, 5.5%, 20.5%, 44.9% and 11.7%, respectively, compared to the year ended December 31, 2007.

Provision for Loan Losses

Comparison of the years ended December 31, 2009 and 2008:

The provision for loan losses for the year ended December 31, 2009 totaled \$15.7 million, a 76.6% increase from the \$8.9 million reported for 2008. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for 2009 was adequate in order to maintain the allowance for loan losses at an adequate level.

Net credit losses increased \$1.9 million, to \$6.7 million, representing 0.57% of average loans outstanding, versus 0.39% in 2008. The allowance for loan losses stood at \$23.3 million (2.00% of total loans) at December 31, 2009, compared to \$14.3 million (1.16% of total loans) a year ago.

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

The Group follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan losses to provide for inherent losses in the loan portfolio. This methodology includes the consideration of factors such as economic conditions, portfolio risk characteristics, prior loss experience, and results of periodic credit reviews of individual loans. The provision for loan losses charged to current operations is based on such methodology. Loan losses are charged and recoveries are credited to the allowance for loan losses.

Larger commercial loans that exhibit potential or observed credit weaknesses are subject to individual review and grading. Where appropriate, allowances are allocated to individual loans based on management's estimate of the borrower's ability to repay the loan given the availability of collateral, other sources of cash flow and legal options available to the Group.

Included in the review of individual loans are those that are impaired. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or as a practical expedient, at the observable market price of the loan or the fair value of the collateral, if the loan is collateral dependent. Loans are individually evaluated for impairment, except large groups of small balance homogeneous loans that are collectively evaluated for impairment, and loans that are recorded at fair value or at the lower of cost or market. The portfolios of mortgage and consumer loans are considered homogeneous, and are evaluated collectively for impairment. For the commercial loans portfolio, all loans over \$250 thousand and over 90-days past due are evaluated for impairment. At December 31, 2009, the total investment in impaired commercial loans was \$15.6 million, compared to \$4.6 million at December 31, 2008. Impaired commercial loans are measured

based on the fair value of collateral method, since all impaired loans during the period were collateral dependent. The valuation allowance for impaired commercial loans amounted to approximately \$709 thousand and \$1.1 million at December 31, 2009 and December 31, 2008, respectively. Net credit losses on impaired commercial loans for the year ended December 31, 2009 were \$776 thousand. There were no credit losses on impaired commercial loans for the years ended December 31, 2008 and 2007. At December 31, 2009, the total investment in impaired mortgage loans was \$10.7 million (December 31, 2008 — \$3.0 million). Impairment on mortgage loans assessed as troubled debt restructuring was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately \$683 thousand and \$45 thousand at December 31, 2009 and 2008, respectively.

The Group, using a rating system, applies an overall allowance percentage to each loan portfolio category based on historical credit losses adjusted for current conditions and trends. This calculation is the starting point for management's systematic determination of the required level of the allowance for loan losses. Other data considered in this determination includes: the credit grading assigned to commercial loans, delinquency levels, loss trends and other information including underwriting standards and economic trends.

Loan loss ratios and credit risk categories are updated quarterly and are applied in the context of GAAP and the Joint Interagency Guidance on the importance of depository institutions having prudent, conservative, but not excessive loan loss allowances that fall within an acceptable range of estimated losses. While management uses available information in estimating probable loan losses, future changes to the allowance may be necessary, based on factors beyond the Group's control, such as factors affecting general economic conditions.

In the current year, the Group has not substantively changed in any material respect of its overall approach in the determination of the allowance for loan losses. The Group refined its methods of quantifying the environmental facts affecting the loan loss experience. There have been no material changes in criteria or estimation techniques as compared to prior periods that impacted the determination of the current period allowance for loan losses.

Please refer to the Allowance for Loan Losses and Non-Performing Assets section on Table 8 through Table 13 for a more detailed analysis of the allowances for loan losses, net credit losses and credit quality statistics.

Comparison of the years ended December 31, 2008 and 2007:

The provision for loan losses for the year ended December 31, 2008 totaled \$8.9 million, a 35.3% increase from the \$6.6 million reported for 2007, which is in line with the increase in non-performing loans of the Group. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for 2008 was adequate in order to maintain the allowance for loan losses at an adequate level.

Net credit losses increased 7.4% during 2008 primarily due to the overall deterioration of the economy in Puerto Rico. Recoveries decreased from \$501 thousand for 2007 to \$376 thousand for 2008. As a result, the recoveries to charge-offs ratio decreased from 10.2% in 2007, to 7.4% in 2008. Mortgage loan charge-offs in 2008 remained constant at \$2.0 million compared to 2007. Commercial loans net credit losses increased to \$407 thousand in 2008, when compared with \$253 thousand in 2007. The commercial loans that the Group originates are mainly collateralized by mortgages.

Net credit losses on consumer loans increased when compared to 2007. In 2008, net credit losses on consumer loans were \$2.3 million, an increase of 9.6% when compared to 2007 in which the Group had net credit losses of \$2.1 million.

Income Taxes

The income tax expense was \$7.0 million for the year ended December 31, 2009, as compared to a benefit of \$9.3 million for 2008, as a result of increased operating income, investment gains, and income tax rates for financial institutions and international banking entities doing business in Puerto Rico. The effective income tax rate in 2009 was lower than the 40.95% statutory tax rate for the Group, due to the high level of tax-advantaged interest income earned on certain investments and loans, net of the disallowance of related expenses attributable to exempt income. Exempt interest relates principally to interest earned on obligations of the United States and Puerto Rico

governments and certain mortgage-backed securities, including securities held by the Group's international banking entity.

FINANCIAL CONDITION

Assets Owned

At December 31, 2009, the Group's total assets amounted to \$6.6 billion, an increase of 5.6% when compared to \$6.2 billion at December 31, 2008, and interest-earning assets reached \$6.1 billion, up 1.9%, versus \$6.0 billion at December 31, 2008. This increase is mostly due to securities purchased but not yet received at December 31, 2009 amounting to \$413.4 million.

As detailed in Table 4, investments are the Group's largest interest-earning assets component. Investments principally consist of money market instruments, U.S. government and agency bonds, mortgage-backed securities and Puerto Rico government and agency bonds. At December 31, 2009, the investment portfolio increased 26.1% from \$3.9 billion to \$5.0 billion. This increase is mostly due to securities purchased but not yet received at December 31, 2009 amounting to \$413.4 million and securities sold but not yet delivered at December 31, 2008 amounting to \$835.0 million.

**TABLE 4 — ASSETS SUMMARY AND COMPOSITION
AS OF DECEMBER 31, 2009, 2008 AND 2007**

	<u>December 31, 2009</u>	<u>December 31, 2008</u>	<u>Variance %</u>	<u>December 31, 2007</u>
	(Dollars in thousands)			
Investments:				
FNMA and FHLMC certificates	\$2,764,173	\$1,546,750	78.7%	\$1,632,733
Obligations of US Government sponsored agencies . .	1,007,091	941,916	6.9%	1,713,690
Non-agency collateralized mortgage obligations	446,037	529,664	−15.8%	620,529
CMO's issued by US Government sponsored agencies	286,509	351,027	−18.4%	136,865
GNMA certificates	346,103	335,961	3.0%	212,179
Structured credit investments	38,383	136,181	−71.8%	174,531
Puerto Rico Government and agency obligations . . .	65,732	82,927	−20.7%	72,667
FHLB stock	19,937	21,013	−5.1%	20,658
Other investments	304	187	62.6%	1,758
	<u>4,974,269</u>	<u>3,945,626</u>	<u>26.1%</u>	<u>4,585,610</u>
Loans:				
Loans receivable	1,136,080	1,206,843	−5.9%	1,173,055
Allowance for loan losses	(23,272)	(14,293)	−62.8%	(10,161)
Loans receivable, net	<u>1,112,808</u>	<u>1,192,550</u>	<u>−6.7%</u>	<u>1,162,894</u>
Mortgage loans held for sale	27,261	26,562	2.6%	16,672
Total loans	<u>1,140,069</u>	<u>1,219,112</u>	<u>−6.5%</u>	<u>1,179,566</u>
Securities sold but not yet delivered	<u>—</u>	<u>834,976</u>	<u>−100.0%</u>	<u>—</u>
Total securities and loans	<u>6,114,338</u>	<u>5,999,714</u>	<u>1.9%</u>	<u>5,765,176</u>
Other assets:				
Cash and due from banks	247,691	14,370	1623.7%	22,858
Money market investments	29,432	52,002	−43.4%	66,125
Accrued interest receivable	33,656	43,914	−23.4%	52,315
Premises and equipment, net	19,775	21,184	−6.7%	21,779
Deferred tax asset, net	31,685	28,463	11.3%	10,362
Foreclosed real estate	9,347	9,162	2.0%	4,207
Investment in equity indexed options	6,464	12,801	−49.5%	40,709
Other assets	58,445	23,926	144.3%	16,324
Total other assets	<u>436,495</u>	<u>205,822</u>	<u>112.1%</u>	<u>234,679</u>
Total assets	<u>\$6,550,833</u>	<u>\$6,205,536</u>	<u>5.6%</u>	<u>\$5,999,855</u>
Investments portfolio composition:				
FNMA and FHLMC certificates	55.6%	39.2%		35.6%
Obligations of US Government sponsored agencies . .	20.2%	23.9%		37.4%
Non-agency collateralized mortgage obligations	9.0%	13.4%		13.5%
CMO's issued by US Government sponsored agencies	5.8%	8.9%		3.0%
GNMA certificates	7.0%	8.5%		4.6%
Structured credit investments	0.8%	3.5%		3.8%
Puerto Rico Government and agency obligations . . .	1.3%	2.1%		1.6%
FHLB stock	0.4%	0.5%		0.5%
	<u>100.0%</u>	<u>100.0%</u>		<u>100.0%</u>

At December 31, 2009, approximately 96% of the Group's investment securities portfolio consists of fixed-rate mortgage-backed securities or notes, guaranteed or issued by FNMA, FHLMC or GNMA, and U.S. agency senior debt obligations, backed by a U.S. government sponsored entity or the full faith and credit of the U.S. government. This compares to 85% at September 30, 2009.

At December 31, 2009, the Group's loan portfolio, the second largest category of the Group's interest-earning assets, amounted to \$1.1 billion, a decrease of 6.5% when compared to the \$1.2 billion at December 31, 2008. The Group's loan portfolio is mainly comprised of residential loans, home equity loans, and commercial loans collateralized by mortgages on real estate located in Puerto Rico. As shown in Table 5, the mortgage loan portfolio amounted to \$942.7 million or 81.0% of the loan portfolio as of December 31, 2009, compared to \$1.0 billion or 83.0% of the loan portfolio at December 31, 2008. Mortgage production and purchases of \$256.3 million for the year ended December 31, 2009 increased 8.2%, from \$236.9 million, when compared to the year ended December 31, 2008. The Group sells most of its conforming mortgages into the secondary market, retaining servicing rights. Therefore, the mortgage loan portfolio decreased 7.9% from \$1.0 billion in December 31, 2008 to \$942.7 million December 31, 2009.

The second largest component of the Group's loan portfolio is commercial loans. At December 31, 2009, the commercial loan portfolio totaled \$197.8 million (17.0% of the Group's total loan portfolio), in comparison to \$187.1 million at December 31, 2008 (15.2% of the Group's total loan portfolio).

The consumer loan portfolio totaled \$22.9 million (2.0% of total loan portfolio at December 31, 2009), in comparison to \$23.1 million at December 31, 2008 (1.9% total loan portfolio at such date). Consumer loan production increased 108.3% for the year ended December 31, 2009 from \$4.4 million in 2008 to \$9.2 million in 2009.

The following table summarizes the remaining contractual maturities of the Group's total loans segmented to reflect cash flows as of December 31, 2009. Contractual maturities do not necessarily reflect the actual term of a loan, considering prepayments.

	Balance Outstanding at December 31, 2009	One Year or Less	Maturities			
			After One Year to Five Years		After Five Years	
			Fixed Interest Rates	Variable Interest Rates	Fixed Interest Rates	Variable Interest Rates
			(In thousands)			
Mortgage, mainly residential	\$ 942,700	\$11,785	\$19,569	\$ —	\$911,346	\$ —
Commercial, mainly real estate	197,777	75,991	50,308	43,080	17,324	11,074
Consumer	22,864	3,991	13,692	1,200	2,571	1,410
Total	<u>\$1,163,341</u>	<u>\$91,767</u>	<u>\$83,569</u>	<u>\$44,280</u>	<u>\$931,241</u>	<u>\$12,484</u>

TABLE 5 — LOANS RECEIVABLE COMPOSITION:
Selected Financial Data
As of December 31, 2009, 2008 and 2007

	December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Mortgage, mainly residential	\$ 915,439	\$ 996,712	\$ 986,612
Commercial, mainly real estate.	197,777	187,077	157,198
Consumer	22,864	23,054	29,245
Loans receivable.	1,136,080	1,206,843	1,173,055
Allowance for loan losses.	(23,272)	(14,293)	(10,161)
Loans receivable, net	1,112,808	1,192,550	1,162,894
Mortgage loans held for sale	27,261	26,562	16,672
Total loans, net	\$1,140,069	\$1,219,112	\$1,179,566
Loans portfolio composition percentages:			
Mortgage, mainly residential	81.0%	83.0%	84.3%
Commercial, mainly real estate.	17.0%	15.2%	13.2%
Consumer	2.0%	1.9%	2.5%
Total loans	100.0%	100.0%	100.0%

Liabilities and Funding Sources

As shown in Table 6, at December 31, 2009, the Group's total liabilities reached \$6.2 billion, 4.7% higher than the \$5.9 billion reported at December 31, 2008. This increase is mostly due to securities purchased but not yet received at December 31, 2009 amounting to \$413.4 million. Deposits and borrowings, the Group's funding sources, amounted to \$5.8 billion at December 31, 2009 versus \$5.9 billion at December 31, 2008, a 2.4% decrease. Borrowings represented 69.8% of interest-bearing liabilities and deposits represented 30.2%.

Borrowings consist mainly of funding sources through the use of repurchase agreements, FHLB advances, FDIC-guaranteed term notes, subordinated capital notes, and other borrowings. At December 31, 2009, borrowings amounted to \$4.0 billion, 2.5% lower than the \$4.1 billion recorded at December 31, 2008. Repurchase agreements as of December 31, 2009 amounted to \$3.6 billion, a 5.4% decrease when compared to \$3.8 billion as of December 31, 2008. As part of the Group's general banking and asset and liability management strategies, in July 2009 the Group executed a \$200 million deleverage of its balance sheet at the holding company level by terminating certain repurchase agreements at a cost of approximately \$17.6 million (before taxes).

The FHLB system functions as a source of credit for financial institutions that are members of a regional Federal Home Loan Bank. As a member of the FHLB, the Group can obtain advances from the FHLB, secured by the FHLB stock owned by the Group, as well as by certain of the Group's mortgage loans and investment securities. FHLB funding amounted to \$281.8 million at December 31, 2009, versus \$308.4 million at December 31, 2008. These advances mature from May 2012 through May 2014.

The Group's banking subsidiary issued in March 2009 \$105 million in notes guaranteed under the FDIC Temporary Liquidity Guarantee Program. These notes are due on March 16, 2012, bear interest at a 2.75% fixed rate, and are backed by the full faith and credit of the United States. Interest on the note is payable on the 16th of each March and September, beginning September 16, 2009. Shortly after issuance of the notes, the Group paid \$3.2 million (equivalent to an annual fee of 100 basis points) to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes. This cost has been deferred and is being amortized over the term of the notes. The total cost of the notes for 2009, including the amount of the debt issuance costs, was 3.58%.

At December 31, 2009, deposits, the second largest category of the Group's interest-bearing liabilities reached \$1.7 billion, down 2.2% from \$1.8 billion at December 31, 2008. Retail deposits, benefiting from expanded market share, grew 29.8% to \$1.4 billion in December 31, 2009 from \$1.1 billion in previous year, enabling the Group to reduce higher cost deposits. Higher cost brokered deposits decreased \$315.2 million or 60.8%, and other wholesale institutional deposits decreased \$47.6 million or 25.8%.

At December 31, 2009, the scheduled maturities of time deposits and individual retirement accounts (IRAs) of \$100 thousand or more were as follows:

	<u>(In thousands)</u>
3 months or less	\$ 97,568
Over 3 months through 6 months	55,775
Over 6 months through 12 months	126,426
Over 12 months	<u>79,367</u>
Total	<u><u>\$359,136</u></u>

**TABLE 6 — LIABILITIES SUMMARY AND COMPOSITION
AS OF DECEMBER 31, 2009, 2008 AND 2007**

	<u>December 31, 2008</u>	<u>December 31, 2008</u>	<u>Variance %</u>	<u>December 31, 2007</u>
		(Dollars in thousands)		
Deposits:				
Non-interest bearing deposits	\$ 73,548	\$ 53,165	38.3%	\$ 50,149
Now accounts	619,947	400,623	54.7%	68,994
Savings accounts	86,791	50,152	73.1%	387,788
Certificates of deposit	961,344	1,274,862	–24.6%	736,186
	<u>1,741,630</u>	<u>1,778,802</u>	–2.1%	<u>1,243,117</u>
Accrued interest payable	3,871	6,498	–40.4%	3,303
	<u>1,745,501</u>	<u>1,785,300</u>	–2.2%	<u>1,246,420</u>
Borrowings:				
Federal funds purchases and other short term borrowings	49,179	29,193	68.5%	27,460
Securities sold under agreements to repurchase	3,557,308	3,761,121	–5.4%	3,861,411
Advances from FHLB	281,753	308,442	–8.7%	331,898
FDIC-guaranteed term notes	105,834	—	100.0%	—
Subordinated capital notes	36,083	36,083	—	36,083
	<u>4,030,157</u>	<u>4,134,839</u>	–2.5%	<u>4,256,852</u>
Total deposits and borrowings	<u>5,775,658</u>	<u>5,920,139</u>	–2.4%	<u>5,503,272</u>
Securities and loans purchased but not yet received . .	413,359	398	100.0%	111,431
Other liabilities	31,650	23,682	33.6%	25,691
Total liabilities	<u>\$6,220,667</u>	<u>\$5,944,219</u>	<u>4.7%</u>	<u>\$5,640,394</u>
Deposits portfolio composition percentages:				
Non-interest bearing deposits	4.2%	3.0%		4.0%
Now accounts	35.6%	22.5%		5.6%
Savings accounts	5.0%	2.8%		31.2%
Certificates of deposit	55.2%	71.7%		59.2%
	<u>100.0%</u>	<u>100.0%</u>		<u>100.0%</u>
Borrowings portfolio composition percentages:				
Federal funds purchases and other short term borrowings	1.2%	0.7%		0.7%
Securities sold under agreements to repurchase	88.3%	91.0%		90.7%
Advances from FHLB	7.0%	7.5%		7.8%
FDIC-guaranteed term notes	2.6%	—		—
Subordinated capital notes	0.9%	0.8%		0.8%
	<u>100.0%</u>	<u>100.0%</u>		<u>100.0%</u>
Securities sold under agreements to repurchase				
Amount outstanding at year-end	\$3,557,308	\$3,761,121		\$3,861,411
Daily average outstanding balance	\$3,659,442	\$3,800,673		\$3,323,696
Maximum outstanding balance at any month-end . . .	\$3,762,353	\$3,858,680		\$3,861,411
Weighted average interest rate:				
For the year	3.16%	4.25%		4.45%
At year end	2.85%	4.34%		4.20%

Stockholders' Equity

At December 31, 2009, the Group's total stockholders' equity was \$330.2 million, a 26.4% increase, when compared to \$261.3 million at December 31, 2008, due to earnings retention and improved mark to market valuation of the Group's investment portfolio. Tangible common equity to risk-weighted assets and total equity to risk-weighted assets at December 31, 2009 increased to 11.79% and 14.96%, respectively, from 8.40% and 11.47%, respectively at December 31, 2008. The Group maintains capital ratios in excess of regulatory requirements. At December 31, 2009, the Tier 1 Leverage Capital Ratio was 6.52%, the Tier 1 Risk-Based Capital Ratio was 18.79%, and the Total Risk-Based Capital Ratio was 19.84%.

During December 2009, the Group made the strategic decision to sell \$116.0 million of CDOs at a loss of \$73.9 million, including non-credit related portion of impairment value previously recorded as unrealized loss in other comprehensive loss. For the same strategic reasons, in early January 2010, the Group sold \$420.1 million of non-agency CMOs at a loss of \$45.8 million. This loss was accounted for as other than temporary impairment in the fourth quarter of 2009 and no additional gain or loss was realized on the sale in January 2010, since these assets were sold at the same value reflected at December 31, 2009. These investments were below investment grade and for regulatory capital purposes were included in the risk weighted assets with a 200% risk weight before December 2009. The proceeds from these investments were used to purchase FNMA certificates, which have a risk weight of 20% for regulatory capital purposes. Therefore at December 31, 2009 the risk based capital ratios were calculated applying a 20% risk weight to these assets.

Due to the initial adoption of FASB ASC 320-10-65-1, in the second quarter of 2009 the Group reclassified the noncredit-related portion of an other-than-temporary impairment loss previously recognized in earnings in the third quarter of 2008 for an amount of \$14.4 million that increased retained earnings and accumulated other comprehensive loss. This reclassification had a positive impact on regulatory capital, but no impact on stockholders' equity.

The following are the consolidated capital ratios of the Group at December 31, 2009, 2008, and 2007:

TABLE 7 — CAPITAL, DIVIDENDS AND STOCK DATA

	<u>December 31, 2009</u>	<u>December 31, 2008</u>	<u>Variance %</u>	<u>December 31, 2007</u>
	<u>(In thousands, except for per share data)</u>			
Capital data:				
Stockholders' equity	\$ 330,166	\$ 261,317	26.3%	\$ 359,461
Regulatory Capital Ratios data:				
Leverage Capital Ratio	6.52%	6.38%	2.2%	6.69%
Minimum Leverage Capital Ratio Required	4.00%	4.00%		4.00%
Actual Tier 1 Capital	\$ 414,702	\$ 389,235	6.5%	\$ 396,309
Minimum Tier 1 Capital Required	\$ 254,323	\$ 244,101	4.2%	\$ 236,847
Excess over regulatory requirement	\$ 160,379	\$ 145,134	10.5%	\$ 159,462
Tier 1 Risk-Based Capital Ratio	18.79%	17.11%	9.8%	18.46%
Minimum Tier 1 Risk-Based Capital Ratio Required	4.00%	4.00%		4.00%
Actual Tier 1 Risk-Based Capital	\$ 414,702	\$ 389,235	6.5%	\$ 396,309
Minimum Tier 1 Risk-Based Capital Required	\$ 88,295	\$ 91,022	−3.0%	\$ 85,292
Excess over regulatory requirement	\$ 326,407	\$ 298,213	9.5%	\$ 311,017
Risk-Weighted Assets	\$2,207,383	\$2,275,550	−3.0%	\$2,146,901
Total Risk-Based Capital Ratio	19.84%	17.73%	11.9%	18.93%
Minimum Total Risk-Based Capital Ratio Required	8.00%	8.00%		8.00%
Actual Total Risk-Based Capital	\$ 437,975	\$ 403,523	8.5%	\$ 406,470
Minimum Total Risk-Based Capital Required	\$ 176,591	\$ 182,044	−3.0%	\$ 170,583
Excess over regulatory requirement	\$ 261,384	\$ 221,479	18.0%	\$ 235,887
Risk-Weighted Assets	\$2,207,383	\$2,275,550	−3.0%	\$2,146,901
Tangible common equity(1) to total assets	3.97%	3.08%	28.9%	4.82%
Tangible common equity to risk-weighted assets	11.79%	8.40%	40.4%	13.57%
Total equity to total assets	5.04%	4.21%	19.7%	5.99%
Total equity to risk-weighted assets	14.96%	11.48%	30.2%	16.74%
Stock data:				
Outstanding common shares, net of treasury	24,235	24,297	−0.3%	24,121
Book value per common share	\$ 10.82	\$ 7.96	35.9%	\$ 12.08
Market price at end of year	\$ 10.80	\$ 6.05	78.5%	\$ 13.41
Market capitalization	\$ 261,738	\$ 146,997	78.1%	\$ 323,463
Common dividend data:				
Cash dividends declared	\$ 3,888	\$ 13,608	(0.71)	\$ 13,612
Cash dividends declared per share	\$ 0.16	\$ 0.56	(0.71)	\$ 0.56
Payout ratio	21.33%	61.89%	−65.5%	37.33%
Dividend yield	1.48%	9.26%	−84.0%	4.18%

(1) Tangible common equity consists of common equity less goodwill.

The following provides the high and low prices and dividend per share of the Group's stock for each quarter of the last three periods:

	Price		Cash Dividend Per share
	High	Low	
2009			
December 31, 2009	\$13.69	\$ 9.43	\$0.04
September 30, 2009	\$15.41	\$ 7.48	\$0.04
June 30, 2009	\$11.27	\$ 4.88	\$0.04
March 31, 2009	\$ 7.38	\$ 0.91	\$0.04
2008			
December 31, 2008	\$18.56	\$ 5.37	\$0.14
September 30, 2008	\$20.99	\$14.21	\$0.14
June 30, 2008	\$20.57	\$14.26	\$0.14
March 31, 2008	\$23.28	\$12.79	\$0.14
2007			
December 31, 2007	\$14.56	\$11.01	\$0.14
September 30, 2007	\$11.63	\$ 8.39	\$0.14
June 30, 2007	\$12.42	\$10.58	\$0.14
March 31, 2007	\$14.04	\$11.25	\$0.14

The Bank is considered "well capitalized" under the regulatory framework for prompt corrective. The table below shows the Bank's regulatory capital ratios at December 31, 2009, 2008, and 2007:

	December 31, 2009	December 31, 2008	Variance %	December 31, 2007
	(Dollars in thousands)			
Oriental Bank and Trust Regulatory Capital Ratios:				
Total Tier 1 Capital to Total Assets	5.78%	5.42%	6.6%	5.80%
Actual Tier 1 Capital	\$359,339	\$311,300	15.4%	\$331,552
Minimum Capital Requirement (4)%	\$248,671	\$229,903	8.2%	\$228,768
Minimum to be well capitalized (5)%	\$310,839	\$287,378	8.2%	\$285,960
Tier 1 Capital to Risk-Weighted Assets	16.52%	14.21%	16.3%	16.61%
Actual Tier 1 Risk-Based Capital	\$359,339	\$311,300	15.4%	\$331,552
Minimum Capital Requirement (4)%	\$ 87,021	\$ 87,640	-0.7%	\$ 79,829
Minimum to be well capitalized (6)%	\$130,532	\$131,461	-0.7%	\$119,743
Total Capital to Risk-Weighted Assets	17.59%	14.86%	18.4%	17.12%
Actual Total Risk-Based Capital	\$382,611	\$325,593	17.5%	\$341,713
Minimum Capital Requirement (8)%	\$174,042	\$175,281	-0.7%	\$159,657
Minimum to be well capitalized (10)%	\$217,553	\$219,101	-0.7%	\$199,572

The Group's common stock is traded on the New York Stock Exchange (NYSE) under the symbol OFG. At December 31, 2009, the Group's market capitalization for its outstanding common stock was \$261.7 million (\$10.80 per share).

Group's Financial Assets

The Group's total financial assets include the Group's assets and the assets managed by the Group's trust division, the retirement plan administration subsidiary, and the securities broker-dealer subsidiary. At December 31, 2009, total financial assets reached \$9.6 billion, compared to \$9.1 billion at December 31, 2008, a 5.8% increase. When compared to December 31, 2008, there was a 5.6% increase in assets owned as of December 31, 2009, and assets managed by the trust division and the broker-dealer subsidiary increased from \$2.9 billion as of December 31, 2008 to \$3.1 billion as of December 31, 2009.

The Group's trust division offers various types of individual retirement accounts ("IRA") and manages 401(K) and Keogh retirement plans and custodian and corporate trust accounts, while Caribbean Pension Consultants, Inc. ("CPC") manages the administration of private pension plans. At December 31, 2009, total assets managed by the Group's trust division and CPC amounted to \$1.8 billion, compared to \$1.7 billion at December 31, 2008. The Group's broker-dealer subsidiary offers a wide array of investment alternatives to its client base, such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money management wrap-fee programs. At December 31, 2009, total assets gathered by the broker-dealer from its customer investment accounts increased to \$1.3 billion, compared to \$1.2 billion at December 31, 2008.

Allowance for Loan Losses and Non-Performing Assets

The Group maintains an allowance for loan losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. The Group's allowance for loan losses policy provides for a detailed quarterly analysis of probable losses. Tables 8 through 13 set forth an analysis of activity in the allowance for loan losses and present selected loan loss statistics. In addition, refer to Table 5 for the composition ("mix") of the loan portfolio.

At December 31, 2009, the Group's allowance for loan losses amounted to \$23.3 million or 2.0% of total loans versus \$14.3 million or 1.16% of total loans at December 31, 2008. The allowance for residential mortgage loans increased by 76.4% or \$6.5 million, when compared with balances recorded at December 31, 2008. The allowance for commercial loans increased by 68.4% or \$2.7 million, when compared with balances recorded at December 31, 2008. The allowance for consumer loans decreased by 38.7% or \$664 thousand, when compared with balances recorded at December 30, 2008.

The provision for loan losses for 2009 totaled \$15.7 million, a 76.6% increase from the \$8.9 million reported for 2008. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for 2009 was adequate in order to maintain the allowance for loan losses at an appropriate level.

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

The Group follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan losses to provide for inherent losses in the loan portfolio. This methodology includes the consideration of factors such as economic conditions, portfolio risk characteristics, prior loss experience, and results of periodic credit reviews of individual loans. The provision for loan losses charged to current operations is based on such methodology. Loan losses are charged and recoveries are credited to the allowance for loan losses.

Larger commercial loans that exhibit potential or observed credit weaknesses are subject to individual review and grading. Where appropriate, allowances are allocated to individual loans based on management's estimate of the borrower's ability to repay the loan given the availability of collateral, other sources of cash flow and legal options available to the Group.

Included in the review of individual loans are those that are impaired. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or

as a practical expedient, at the observable market price of the loan or the fair value of the collateral, if the loan is collateral dependent. Loans are individually evaluated for impairment, except large groups of small balance homogeneous loans that are collectively evaluated for impairment, and loans that are recorded at fair value or at the lower of cost or market. The portfolios of mortgage and consumer loans are considered homogeneous, and are evaluated collectively for impairment. For the commercial loans portfolio, all loans over \$250 thousand and over 90-days past due are evaluated for impairment. At December 31, 2009, the total investment in impaired commercial loans was \$15.6 million, compared to \$4.6 million at December 31, 2008. Impaired commercial loans are measured based on the fair value of collateral method, since all impaired loans during the period were collateral dependant. The valuation allowance for impaired commercial loans amounted to approximately \$709 thousand and \$1.1 million at December 31, 2009 and December 31, 2008, respectively. Net credit losses on impaired commercial loans for the year ended December 31, 2009 were \$776 thousand. There were no credit losses on impaired commercial loans for the years ended December 31, 2008 and 2007. At December 31, 2009, the total investment in impaired mortgage loans was \$10.7 million (December 31, 2008 — \$3.0 million). Impairment on mortgage loans assessed as troubled debt restructuring was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately \$683 thousand and \$45 thousand at December 31, 2009 and 2008, respectively.

The Group, using a rating system, applies an overall allowance percentage to each loan portfolio category based on historical credit losses adjusted for current conditions and trends. This calculation is the starting point for management's systematic determination of the required level of the allowance for loan losses. Other data considered in this determination includes: the credit grading assigned to commercial loans, delinquency levels, loss trends and other information including underwriting standards and economic trends.

Loan loss ratios and credit risk categories are updated quarterly and are applied in the context of GAAP and the Joint Interagency Guidance on the importance of depository institutions having prudent, conservative, but not excessive loan loss allowances that fall within an acceptable range of estimated losses. While management uses available information in estimating probable loan losses, future changes to the allowance may be necessary, based on factors beyond the Group's control, such as factors affecting general economic conditions.

In the current year, the Group has not substantively changed in any material respect of its overall approach in the determination of the allowance for loan losses. The Group refined its methods of quantifying the environmental facts affecting the loan loss experience. There have been no material changes in criteria or estimation techniques as compared to prior periods that impacted the determination of the current period allowance for loan losses.

During the year ended December 31, 2009, net credit losses amounted to \$6.7 million, a 41.1% increase when compared to \$4.7 million reported for the same period of 2008. The increase was primarily due to a \$1.4 million increase in net credit losses for mortgage loans, \$1.8 million increase in net credit losses for commercial loans, partially offset by a \$1.3 million decrease for consumer loans. Total recoveries decreased from \$376 thousand in 2008 to \$357 thousand in 2009, and total charge-offs increased from \$5.1 million in 2008 to \$7.0 million in 2009. As a result, the recoveries to charge-offs ratio decreased from 7.4% in 2008, to 5.1% in 2009.

The Group's non-performing assets include non-performing loans and foreclosed real estate (see Tables 11 and 12). At December 31 2009, the Group's non-performing assets totaled \$113.7 million (1.74% of total assets) versus \$86.7 million (1.40% of total assets) at December 31, 2008. The Group's non-performing loans generally reflect the economic environment in Puerto Rico. Nonetheless, the Group does not expect non-performing loans to result in significantly higher losses as most are well-collateralized with adequate loan-to-value ratios.

At December 31, 2009, the allowance for loan losses to non-performing loans coverage ratio was 22.3% (18.5% at December 31, 2008). Excluding the lesser-risk mortgage loans, the ratio is 144.3% (239.9% at December 31, 2008).

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

Detailed information concerning each of the items that comprise non-performing assets follows:

- **Mortgage loans** are placed on a non-accrual basis when they become 365 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan. At December 31, 2009, the Group's non-performing mortgage loans totaled \$88.2 million (84.5% of the Group's non-performing loans), a 23.4% increase from the \$71.5 million (92.3% of the Group's non-performing loans) reported at December 31, 2008. Non-performing loans in this category are primarily residential mortgage loans.
- **Commercial loans** are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the underlying collateral, if any. At December 31, 2009, the Group's non-performing commercial loans amounted to \$15.7 million (15.0% of the Group's non-performing loans), a 202.5% increase when compared to non-performing commercial loans of \$5.2 million reported at December 31, 2008 (6.7% of the Group's non-performing loans). Most of this portfolio is collateralized by commercial real estate properties.
- **Consumer loans** are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 120 days in personal loans and 180 days in credit cards and personal lines of credit. At December 31, 2009, the Group's non-performing consumer loans amounted to \$445 thousand (0.5% of the Group's total non-performing loans), a 42.4% decrease from the \$772 thousand reported at December 31, 2008 (1.0% of total non-performing loans).
- **Foreclosed real estate** is initially recorded at the lower of the related loan balance or fair value at the date of foreclosure. Any excess of the loan balance over the fair value of the property is charged against the allowance for loan losses. Subsequently, any excess of the carrying value over the estimated fair value less disposition cost is charged to operations. Proceeds from sales of foreclosed real estate properties during the year ended December 31, 2009, totaled approximately \$9.3 million.

**TABLE 8 — ALLOWANCE FOR LOAN LOSSES SUMMARY
YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007**

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Balance at beginning of year	\$14,293	\$10,161	\$ 8,016
Provision for loan losses	15,650	8,860	6,550
Net credit losses — see Table 10	(6,671)	(4,728)	(4,405)
Balance at end of year	<u>\$23,272</u>	<u>\$14,293</u>	<u>\$10,161</u>

**TABLE 9 — ALLOWANCE FOR LOAN LOSSES BREAKDOWN
AS OF DECEMBER 31, 2009, 2008 AND 2007**

	Year Ended December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Mortgage	\$15,044	\$ 8,514	\$ 5,958
Commercial	7,112	4,004	1,838
Consumer	864	1,714	2,006
Unallocated allowance	<u>252</u>	<u>61</u>	<u>359</u>
	<u>\$23,272</u>	<u>\$14,293</u>	<u>\$10,161</u>
Allowance composition:			
Mortgage	64.6%	59.6%	58.7%
Commercial	30.6%	28.0%	18.1%
Consumer	3.7%	12.0%	19.7%
Unallocated allowance	<u>1.1%</u>	<u>0.4%</u>	<u>3.5%</u>
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Allowance coverage ratio at end of period Applicable to:			
Mortgage	1.60%	0.83%	0.59%
Commercial	3.60%	2.14%	1.17%
Consumer	3.76%	7.43%	6.86%
Unallocated allowance to total loans	<u>0.02%</u>	<u>0.00%</u>	<u>0.03%</u>
Total allowance to total loans	<u>2.00%</u>	<u>1.16%</u>	<u>0.85%</u>
Other selected data and ratios:			
Allowance coverage ratio to:			
Non-performing loans	<u>22.3%</u>	<u>18.5%</u>	<u>15.4%</u>
Non-real estate non-performing loans	<u>144.3%</u>	<u>239.9%</u>	<u>314.5%</u>

**TABLE 10 — NET CREDIT LOSSES STATISTICS:
YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007**
(Dollars in thousands)

	Year Ended December 31,		
	2009	2008	2007
Mortgage			
Charge-offs	\$ (3,493)	\$ (1,977)	\$ (2,030)
Recoveries	<u>70</u>	<u>—</u>	<u>15</u>
	<u>(3,423)</u>	<u>(1,977)</u>	<u>(2,015)</u>
Commercial			
Charge-offs	(2,223)	(459)	(359)
Recoveries	<u>56</u>	<u>52</u>	<u>107</u>
	<u>(2,167)</u>	<u>(407)</u>	<u>(252)</u>
Consumer			
Charge-offs	(1,312)	(2,668)	(2,517)
Recoveries	<u>231</u>	<u>324</u>	<u>379</u>
	<u>(1,081)</u>	<u>(2,344)</u>	<u>(2,138)</u>
Net credit losses			
Total charge-offs	(7,028)	(5,104)	(4,906)
Total recoveries	<u>357</u>	<u>376</u>	<u>501</u>
	<u>\$ (6,671)</u>	<u>\$ (4,728)</u>	<u>\$ (4,405)</u>
Net credit losses (recoveries) to average loans outstanding:			
Mortgage	<u>0.35%</u>	<u>0.19%</u>	<u>0.20%</u>
Commercial	<u>1.14%</u>	<u>0.25%</u>	<u>0.18%</u>
Consumer	<u>5.26%</u>	<u>9.35%</u>	<u>6.91%</u>
Total	<u>0.57%</u>	<u>0.39%</u>	<u>0.37%</u>
Recoveries to charge-off's	<u>5.1%</u>	<u>7.4%</u>	<u>10.2%</u>
Average loans:			
Mortgage	\$ 968,400	\$1,026,779	\$1,005,751
Commercial	189,951	161,541	143,802
Consumer	<u>20,539</u>	<u>25,081</u>	<u>30,989</u>
Total	<u>\$1,178,890</u>	<u>\$1,213,401</u>	<u>\$1,180,542</u>

TABLE 11 — NON-PERFORMING ASSETS

	December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Non-performing assets:			
Non-accruing loans			
Troubled Debt Restructuring (TDR) loans	\$ 214	\$ 57	\$ 29
Other loans	56,854	38,722	27,318
Accruing loans			
Troubled Debt Restructuring (TDR) loans	443	882	—
Other loans	46,860	37,828	38,762
Total non-performing loans	104,371	77,489	66,109
Foreclosed real estate	9,347	9,162	4,207
	<u>\$113,718</u>	<u>\$86,651</u>	<u>\$70,316</u>
Non-performing assets to total assets	<u>1.74%</u>	<u>1.40%</u>	<u>1.17%</u>
	Year Ended December 31,		
	2009	2008	2007
Interest that would have been recorded in the period if the loans had not been classified as non-accruing loans	<u>\$3,571</u>	<u>\$2,545</u>	<u>\$2,043</u>

**TABLE 12 — NON-PERFORMING LOANS:
AS OF DECEMBER 31, 2009, 2008 AND 2007**

	December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Non-performing loans:			
Mortgage	\$ 88,238	\$71,531	\$62,878
Commercial, mainly real estate	15,688	5,186	2,413
Consumer	445	772	818
Total	<u>\$104,371</u>	<u>\$77,489</u>	<u>\$66,109</u>
Non-performing loans composition percentages:			
Mortgage	84.5%	92.3%	95.1%
Commercial, mainly real estate	15.0%	6.7%	3.7%
Consumer	0.4%	1.0%	1.2%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Non-performing loans to:			
Total loans	<u>8.97%</u>	<u>6.28%</u>	<u>5.56%</u>
Total assets	<u>1.59%</u>	<u>1.25%</u>	<u>1.10%</u>
Total capital	<u>31.61%</u>	<u>29.65%</u>	<u>18.39%</u>

**TABLE 13 — HIGHER RISK RESIDENTIAL MORTGAGE LOANS
AS OF DECEMBER 31, 2009**

	Higher-Risk Residential Mortgage Loans*							
	Junior Lien Mortgages		Interest Only Loans		High Loan-to-Value (LTV) Ratio Mortgages			
	Carrying Value	Allowance	Carrying Value	Allowance	LTV 90% to 100%		LTV Over 100%	
					Carrying Value	Allowance	Carrying Value	Allowance
	(In thousands)							
<u>Delinquency:</u>								
Current 90 days	\$6,467	\$ 72	\$38,474	\$398	\$131,709	\$1,451	\$2,434	\$27
91- 120 days	653	14	559	11	1,606	35	—	—
121- 180 days	209	7	1,824	56	3,190	106	—	—
181- 365 days	173	6	2,440	76	4,015	133	—	—
Over 365 days	309	28	2,576	210	9,031	780	—	—
Total	<u>\$7,811</u>	<u>\$127</u>	<u>\$45,873</u>	<u>\$751</u>	<u>\$149,551</u>	<u>\$2,505</u>	<u>\$2,434</u>	<u>\$27</u>
Percentage of total loans	<u>0.67%</u>		<u>3.94%</u>		<u>12.86%</u>		<u>0.21%</u>	
<u>Refinanced or Modified Loans:</u>								
Amount	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,928</u>	<u>\$ 51</u>	<u>\$1,436</u>	<u>\$16</u>
Percentage of Higher-Risk Loan Category	<u>—</u>		<u>—</u>		<u>1.96%</u>		<u>59.00%</u>	
<u>Current Loan-to-Value:</u>								
Under 70%	\$7,460	\$120	\$ 3,501	\$ 48	\$ —	\$ —	\$ —	\$—
70%- 79%	351	7	7,505	124	—	—	—	—
80%- 89%	—	—	13,317	243	—	—	—	—
90%- 100%	—	—	21,550	336	149,551	2,505	—	—
Over 100%	—	—	—	—	—	—	2,434	27
	<u>\$7,811</u>	<u>\$127</u>	<u>\$45,873</u>	<u>\$751</u>	<u>\$149,551</u>	<u>\$2,505</u>	<u>\$2,434</u>	<u>\$27</u>

* Loans may be included in more than one higher-risk loan category

Contractual Obligations and Commercial Commitments

As disclosed in the notes to the Group's consolidated financial statements, the Group has certain obligations and commitments to make future payments under contracts. At December 31, 2009, the aggregate contractual obligations and commercial commitments are:

	Payments Due by Period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	After 5 years
	(In thousands)				
CONTRACTUAL OBLIGATIONS:(1)					
Federal funds purchased and other short term borrowings	\$ 49,179	\$ 49,179	\$ —	\$ —	\$ —
Securities sold under agreements to repurchase	3,550,000	100,000	1,600,000	100,000	1,750,000
Advances from FHLB	280,000	—	225,000	55,000	—
FDIC-guaranteed term notes	150,000	—	150,000	—	—
Subordinated capital notes	36,083	—	—	—	36,083
Annual rental commitments under noncancelable operating leases	25,432	3,551	7,247	6,802	7,832
Total	<u>\$4,090,694</u>	<u>\$152,730</u>	<u>\$1,982,247</u>	<u>\$161,802</u>	<u>\$1,793,915</u>

Such commitments will be funded in the normal course of business from the Bank's principal sources of funds.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with U.S. generally accepted accounting principles in the United States of America which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature.

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

RISK MANAGEMENT

Background

The Group's risk management policies are established by its Board of Directors (the "Board"), implemented by management, through the adoption of a risk management program, which is overseen and monitored by the Chief Risk Officer and the Risk Management Committee (RMC). During 2009, the Group continued to refine and enhance its risk management program by strengthening policies, processes and procedures necessary to maintain effective risk management.

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

Market Risk

Market risk is the risk to earnings or capital arising from adverse movements in market rates or prices, such as interest rates or prices. The Group evaluates market risk together with interest rate risk (See "Interest Rate Risk" below).

The Group's financial results and capital levels are constantly exposed to market risk. The Board and management are primarily responsible for ensuring that the market risk assumed by the Group complies with the guidelines established by Board approved policies. The Board has delegated the management of this risk to the Asset and Liability Management Committee ("ALCO") which is composed of certain executive officers from the business, treasury and finance areas. One of ALCO's primary goals is to ensure that the market risk assumed by the Group is within the parameters established in the policies adopted by the Board.

Interest Rate Risk

Interest rate risk is the exposure of the Group's earnings or capital to adverse movements in interest rates. It is a predominant market risk in terms of its potential impact on earnings.

The Group manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income. ALCO is responsible for monitoring compliance with the market risk policies approved by the Board and adopting interest risk management strategies. In that role, ALCO oversees interest rate risk, liquidity management and other related matters.

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

Each quarter, the Group performs a net interest income simulation analysis on a consolidated basis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a

one-year time horizon, assuming gradual upward and downward interest rate movements of 200 basis points, achieved during a twelve-month period. Simulations are carried out in two ways:

- (1) using a static balance sheet as the Group had on the simulation date, and
- (2) using a growing balance sheet based on recent growth patterns and business strategies.

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

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

These simulations are highly complex, and use many simplifying assumptions that are intended to reflect the general behavior of the Group over the period in question. There can be no assurance that actual events will match these assumptions in all cases. For this reason, the results of these simulations are only approximations of the true sensitivity of net interest income to changes in market interest rates. The following table presents the results of the simulations at December 31, 2009, assuming a one-year time horizon:

<u>Change in interest rate</u> <i>(Dollars in thousands)</i>	<u>Net Interest Income Risk (one year projection)</u>			
	<u>Static Balance Sheet</u>		<u>Growing simulation</u>	
	<u>Amount Change</u>	<u>Percent Change</u>	<u>Amount Change</u>	<u>Percent Change</u>
+ 200 Basis points	\$ 15,437	12.70%	\$ 13,795	11.32%
+ 100 Basis points	\$ 13,208	10.86%	\$ 12,264	10.06%
– 100 Basis points	\$(24,263)	–19.96%	\$(21,822)	–17.91%
– 200 Basis points	\$(34,552)	–28.42%	\$(29,100)	–23.88%

Future net interest income could be affected by the Group's investments in callable securities, prepayment risk related to mortgage loans and mortgage-backed securities, and its structured repurchase agreements and advances from the FHLB. As part of the strategy to limit the interest rate risk and reduce the re-pricing gaps of the Group's assets and liabilities, the maturity and the re-pricing frequency of the liabilities has been extended to longer terms. The concentration of long-term fixed rate securities has also been reduced.

The Group uses derivative instruments and other strategies to manage its exposure to interest rate risk caused by changes in interest rates beyond management's control. The following summarizes strategies, including derivative activities, used by the Group in managing interest rate risk:

Interest rate swaps — Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying principal. The interest rate swaps have been utilized to convert short term repurchase agreements into fixed rate to better match the re-pricing nature of these borrowings. At December 31, 2009 there are open forward settled swaps with an aggregate notional amount of \$900 million. The forward settle date of these swaps is December 28, 2011 with final maturities raging from December 28, 2013 through December 28, 2014. A derivative asset of \$8.5 million is recognized in the consolidated statement of financial position related to the valuation of these swaps. There were no outstanding interest rate swaps as of December 31, 2008.

Structured borrowings — The Group uses structured repurchase agreements and advances from FHLB, with embedded put options, to reduce the Group's exposure to interest rate risk by lengthening the contractual maturities of its liabilities.

The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index. At the end of five years, the depositor receives a minimum return or a specified percentage of the average increase of the month-end value of the stock index. The Group uses option agreements with major money center banks and major broker-dealer companies to manage its exposure to changes in those indexes. Under the terms of the option agreements, the Group receives the average increase in the month-end value of the corresponding index in exchange for a fixed premium. The changes in fair value of the options purchased and the options embedded in the certificates of deposit are recorded in earnings.

Derivatives instruments are generally negotiated over-the-counter ("OTC") contracts. Negotiated OTC derivatives are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amount, exercise price and maturity.

At December 31, 2009 and 2008, the fair value the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of \$6.5 million, and \$12.8 million, respectively; and the options sold to customers embedded in the certificates of deposit represented a liability of \$9.5 million and \$16.6 million, respectively, recorded in deposits.

Credit Risk

Credit risk is the possibility of loss arising from a borrower or counterparty in a credit-related contract failing to perform in accordance with its terms. The principal source of credit risk for the Group is its lending activities.

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

The Group may also encounter risk of default in relation to its securities portfolio. The securities held by the Group are principally mortgage-backed securities and U.S. Treasury and agency securities. Thus, a substantial portion of these instruments are guaranteed by mortgages, a U.S. government-sponsored entity or the full faith and credit of the U.S. government, and are deemed to be of the highest credit quality. The available-for-sale securities portfolio also includes approximately \$446.0 million in non-government agency pass-through collateralized mortgage obligations and \$38.4 million in structured credit investments that are considered of a higher credit risk than agency securities.

Management's Credit Committee, composed of the Group's Chief Executive Officer, Chief Credit Risk Officer and other senior executives, has primary responsibility for setting strategies to achieve the Group's credit risk goals and objectives. Those goals and objectives are set forth in the Group's Credit Policy.

Liquidity Risk

Liquidity risk is the risk of the Group not being able to generate sufficient cash from either assets or liabilities to meet obligations as they become due, without incurring substantial losses. The Group's cash requirements principally consist of deposit withdrawals, contractual loan funding, repayment of borrowings as they mature, and funding of new and existing investment as required.

The Group's business requires continuous access to various funding sources. While the Group is able to fund its operations through deposits as well as through advances from the Federal Home Loan Bank of New York and other alternative sources, the Group's business is significantly dependent upon other wholesale funding sources, such as repurchase agreements and brokered deposits. While most of the Group's repurchase agreements have been structured with initial terms to maturity of between three and ten years, the counterparties have the right to exercise put options before the contractual maturities.

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

interest rates and will generally move funds from one depository institution to another based on small differences in interest rates offered on deposits.

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

As of December 31, 2009, the Group had approximately \$488.7 million in investment securities and \$396.2 million in mortgage loans available to cover liquidity needs.

Operational Risk

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

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

The Group classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate wide risks, such as information security, business recovery, legal and compliance, the Group has specialized groups, such as Information Security, Corporate Compliance, Information Technology and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups. All these matters are reviewed and discussed in the IT Steering Committee.

The Group is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has been significantly increasing over the last several years. The Group has established and continues to enhance procedures based on legal and regulatory requirements that are reasonably designed to ensure compliance with all applicable statutory and regulatory requirements. The Group has a corporate compliance function, headed by a Compliance Director who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of an enterprise-wide compliance program.

Concentration Risk

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

The Commonwealth of Puerto Rico government is currently facing a significant fiscal deficit. The Commonwealth's access to the municipal bond market and its credit ratings depend, in part, on achieving a balanced budget. In March 2009, the Legislature passed, and Governor signed, laws to reduce spending by 10% in an attempt to control expenditures, including public-sector employment, raise revenues through selective tax increases, and stimulate the economy. It is not possible to determine the impact on the economy of these measures at this time.

QUARTERLY FINANCIAL DATA (Unaudited)

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

TABLE 13A — SELECTED QUARTERLY FINANCIAL DATA:

<u>Year Ended December 31, 2009</u>	<u>Quarter Ended</u>			
	<u>March 31, 2009</u>	<u>June 30, 2009</u>	<u>September 30, 2009</u>	<u>December 31, 2009</u>
	<u>(In thousands, except for per share data)</u>			
Interest income	\$83,931	\$82,051	\$78,553	\$ 74,866
Interest expense	<u>53,266</u>	<u>46,563</u>	<u>45,659</u>	<u>42,980</u>
Net interest income	30,665	35,488	32,894	31,886
Provision for loan losses	<u>(3,200)</u>	<u>(3,650)</u>	<u>(4,400)</u>	<u>(4,400)</u>
Net interest income after provision for loan losses . .	27,465	31,838	28,494	27,486
Total non-interest income (loss)	17,246	46,051	16,320	(81,605)
Total non-interest expenses	<u>19,273</u>	<u>22,214</u>	<u>20,486</u>	<u>21,405</u>
Income before taxes	25,438	55,675	24,328	(75,524)
Income tax expense (benefit)	<u>690</u>	<u>4,761</u>	<u>3,001</u>	<u>(1,480)</u>
Net income (loss)	24,748	50,914	21,327	(74,044)
Less: Dividends on preferred stock	<u>(1,201)</u>	<u>(1,200)</u>	<u>(1,201)</u>	<u>(1,200)</u>
Income available to common shareholders	<u>\$23,547</u>	<u>\$49,714</u>	<u>\$20,126</u>	<u>\$(75,244)</u>
Per share data:				
Basic	<u>\$ 0.97</u>	<u>\$ 2.05</u>	<u>\$ 0.83</u>	<u>\$ (3.10)</u>
Diluted	<u>\$ 0.97</u>	<u>\$ 2.04</u>	<u>\$ 0.83</u>	<u>\$ (3.09)</u>

TABLE 13B — SELECTED QUARTERLY FINANCIAL DATA:

<u>Year Ended December 31, 2008</u>	<u>Quarter Ended</u>			
	<u>March 31, 2008</u>	<u>June 30, 2008</u>	<u>September 30, 2008</u>	<u>December 31, 2008</u>
	<u>(In thousands, except for per share data)</u>			
Interest income	\$82,101	\$85,158	\$ 84,744	\$87,036
Interest expense	<u>57,192</u>	<u>56,573</u>	<u>56,703</u>	<u>57,260</u>
Net interest income	24,909	28,585	28,041	29,776
Provision for loan losses	<u>1,650</u>	<u>1,980</u>	<u>1,950</u>	<u>3,280</u>
Net interest income after provision for loan losses . .	23,259	26,605	26,091	26,496
Total non-interest income	8,864	6,650	(57,167)	29,411
Total non-interest expenses	<u>17,730</u>	<u>18,080</u>	<u>18,197</u>	<u>18,735</u>
Income before taxes	14,393	15,175	(49,273)	37,172
Income tax expense	<u>(2,455)</u>	<u>598</u>	<u>(4,226)</u>	<u>(3,240)</u>
Net income	16,848	14,577	(45,047)	40,412
Less: Dividends on preferred stock	<u>(1,201)</u>	<u>(1,200)</u>	<u>(1,200)</u>	<u>(1,201)</u>
Income available to common shareholders	<u>\$15,647</u>	<u>\$13,377</u>	<u>\$(46,247)</u>	<u>\$39,211</u>
Per share data:				
Basic	<u>\$ 0.65</u>	<u>\$ 0.54</u>	<u>\$ (1.90)</u>	<u>\$ 1.61</u>
Diluted	<u>\$ 0.64</u>	<u>\$ 0.54</u>	<u>\$ (1.89)</u>	<u>\$ 1.61</u>

Critical Accounting Policies

Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

A transfer of financial assets is accounted for as a sale when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the transferor, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the transferor does not maintain effective control over the transferred assets through an agreement to repurchase them before maturity. As such, the Group recognizes the financial assets and servicing assets it controls and the liabilities it has incurred. At the same time, it ceases to recognize financial assets when control has been surrendered and liabilities when they are extinguished.

Financial Instruments

Certain financial instruments including derivatives, trading securities and investment securities available-for-sale are recorded at fair value and unrealized gains and losses are recorded in other comprehensive income or as part of non-interest income, as appropriate. Fair values are based on listed market prices, if available. If listed market prices are not available, fair value is determined based on other relevant factors, including price quotations for similar instruments. The fair values of certain derivative contracts are derived from pricing models that consider current market and contractual prices for the underlying financial instruments as well as time value and yield curve or volatility factors underlying the positions.

Effective January 1, 2008, the Group determines the fair value of its financial instruments based on the Fair Value Measurement framework, which establishes a fair value hierarchy that prioritizes the inputs of valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

- Level 1 — Level 1 asset and liabilities include equity securities that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. government agency securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 — Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on valuations obtained from third-party pricing services for identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments and (iii) derivative contracts and financial liabilities (e.g. callable brokered CDs and medium-term notes elected for fair value option under the fair value measurement framework, whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, for which the determination of fair value requires significant management judgment or estimation.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Impairment of Investment Securities

The Group conducts periodic reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairments. On April 1, 2009, the Group adopted FASB Accounting Standard Codification ("ASC") 320-10-65-1, which changed the accounting requirements for other than temporary impairments for debt

securities, and in certain circumstances, separates the amount of total impairment into credit and noncredit-related amounts. The review takes into consideration current market conditions, issuer rating changes and trends, the credit worthiness of the obligator of the security, current analysts' evaluations, failure of the issuer to make scheduled interest or principal payments, the Group's intent to not sell the security or whether it is more-likely-than-not that the Group will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term other than temporary impairments is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, computed using original yield as the discount rate, to the amortized cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the "credit loss."

The Group's review for impairment generally entails:

- intent to sell the debt security;
- if it is more likely than not that the entity will be required to sell the debt securities before the anticipated recovery;
- identification and evaluation of investments that have indications of possible other-than-temporary impairment;
- analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position and the expected recovery period;
- discussion of evidential matter, including an evaluation of factors or triggers that could cause individual investments to qualify as having other-than-temporary impairment and those that would not support other-than-temporary impairment; and
- documentation of the results of these analyses.

The extent of the Group's analysis regarding credit quality and the stress on assumptions used in the analysis for identifying securities for which all principal and interest contractually due might not be recovered have been refined for non-agency collateralized mortgage obligations and structured credit investments given the declines in fair values and length of time in which these securities have been in an unrealized loss position, general concerns regarding housing prices and the delinquency and default rates on the mortgage loans and credit spreads underlying these securities.

Derivative Financial Instruments

As part of the Group's asset and liability management, the Group may use option agreements and interest rate contracts, which include interest rate swaps to hedge various exposures or to modify interest rate characteristics of various statements of financial condition accounts.

The Group recognizes all derivative instruments as assets and liabilities at fair value. If certain conditions are met, the derivative may qualify for hedge accounting treatment and be designated as one of the following types of hedges: (a) hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment ("fair value hedge"); (b) a hedge of the exposure to variability of cash flows of a recognized asset, liability or forecasted transaction ("cash flow hedge") or (c) a hedge of foreign currency exposure ("foreign currency hedge").

In the case of a qualifying fair value hedge, changes in the value of the derivative instruments that have been highly effective are recognized in current period earnings along with the change in value of the designated hedged item. In the case of a qualifying cash flow hedge, changes in the value of the derivative instruments that have been highly

effective are recognized in other comprehensive income, until such time as those earnings are affected by the variability of the cash flows of the underlying hedged item. In either a fair value hedge or a cash flow hedge, net earnings may be impacted to the extent the changes in the fair value of the derivative instruments do not perfectly offset changes in the fair value or cash flows of the hedged items. If the derivative is not designated as a hedging instrument, the changes in fair value of the derivative are recorded in earnings.

Certain contracts contain embedded derivatives. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated and carried at fair value.

The Group uses several pricing models that consider current fair value and contractual prices for the underlying financial instruments as well as time value and yield curve or volatility factors underlying the positions to derive the fair value of certain derivatives contracts.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The Group follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan losses to provide for inherent losses in the loan portfolio. This methodology includes the consideration of factors such as economic conditions, portfolio risk characteristics, prior loss experience, and results of periodic credit reviews of individual loans. The provision for loan losses charged to current operations is based on such methodology. Loan losses are charged and recoveries are credited to the allowance for loan losses.

Larger commercial loans that exhibit potential or observed credit weaknesses are subject to individual review and grading. Where appropriate, allowances are allocated to individual loans based on management's estimate of the borrower's ability to repay the loan given the availability of collateral, other sources of cash flow and legal options available to the Group.

Income Taxes

In preparing the consolidated financial statements, the Group is required to estimate income taxes. This involves an estimate of current income tax expense together with an assessment of temporary differences resulting from differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The determination of current income tax expense involves estimates and assumptions that require the Group to assume certain positions based on its interpretation of current tax laws and regulations. Changes in assumptions affecting estimates may be required in the future and estimated tax assets or liabilities may need to be increased or decreased accordingly. The accrual for tax contingencies is adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation. When particular matters arise, a number of years may elapse before such matters are audited and finally resolved. Favorable resolution of such matters could be recognized as a reduction to the Group's effective rate in the year of resolution. Unfavorable settlement of any particular issue could increase the effective rate and may require the use of cash in the year of resolution.

Management evaluates the realizability of the deferred tax assets on a regular basis and assesses the need for a valuation allowance. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in valuation allowance from period to period are included in the Group's tax provision in the period of change.

Recent Accounting Developments:

In June 2009, the FASB issued FAS No. 168, *"The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles — a replacement of FASB Statement No. 162,"* ("FAS 168"). FAS 168 establishes the FASB Accounting Standards Codification ("Codification") as the source of authoritative GAAP for nongovernmental entities. The Codification does not change GAAP. Instead, it takes the thousand of individual

pronouncements that currently comprise GAAP and reorganizes them into approximately 90 accounting Topics, and displays all Topics using a consistent structure. Contents in each Topic are further organized first by Subtopic, then Section and finally Paragraph. The Paragraph level is the only level that contains substantive content. Citing particular content in the Codification involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure. FASB suggests that all citations begin with “FASB ASC,” where ASC stands for Accounting Standards Codification. Changes to the ASC subsequent to June 30, 2009 are referred to as Accounting Standards Updates (“ASU”).

In conjunction with the issuance of FAS 168, the FASB also issued its first Accounting Standards Update No. 2009-1, “*Topic 105 — Generally Accepted Accounting Principles*” (“ASU 2009-1”) which includes FAS 168 in its entirety as a transition to the ASC. ASU 2009-1 is effective for interim and annual periods ending after September 15, 2009 and did not have an impact on the Group’s financial position or results of operations but changed the referencing system for accounting standards. Certain of the following pronouncements were issued prior to the issuance of the ASC and adoption of the ASUs. For such pronouncements, citations to the applicable Codification by Topic, Subtopic and Section are provided where applicable in addition to the original standard type and number.

FAS 166 “*Accounting for Transfers of Financial Assets*” and FAS 167, “*Amendments to FASB Interpretation No. 46(R)*” (not yet reflected in FASB ASC) were issued in June 2009, and change the way entities account for securitizations and special-purpose entities, and will have a material effect on how banking organizations account for off-balance sheet vehicles. The new standards amend FAS 140, “*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*”, and FASB Interpretation No. 46(R), “*Consolidation of Variable Interest Entities*”. Both Statements 166 and 167 will be effective January 1, 2010 for companies reporting earnings on a calendar-year basis. The Group is evaluating the impact, if any, that the adoption of FAS 166 and 167 could have on the Group’s consolidated financial statements.

The FASB issued ASU 2009 — 05, “*Fair Value Measurements and Disclosures (Topic 820) — Measuring Liabilities at Fair Value*” in August 2009 to provide guidance when estimating the fair value of a liability. When a quoted price in an active market for the identical liability is not available, fair value should be measured using (a) the quoted price of an identical liability when traded as an asset; (b) quoted prices for similar liabilities or similar liabilities when traded as assets; or (c) another valuation technique consistent with the principles of Topic 820 such as an income approach or a market approach. If a restriction exists that prevents the transfer of the liability, a separate adjustment related to the restriction is not required when estimating fair value. The ASU was effective October 1, 2009 for the Group and had no impact on financial position or operations.

ASU 2009-12, “*Fair Value Measurements and Disclosures (Topic 820) — Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*” issued in September 2009, allows a company to measure the fair value of an investment that has no readily determinable fair market value on the basis of the investee’s net asset value per share as provided by the investee. This allowance assumes that the investee has calculated net asset value in accordance with the GAAP measurement principles of Topic 946 as of the reporting entity’s measurement date. Examples of such investments include investments in hedge funds, private equity funds, real estate funds and venture capital funds. The update also provides guidance on how the investment should be classified within the fair value hierarchy based on the value for which the investment can be redeemed. The amendment is effective for interim and annual periods ending after December 15, 2009 with early adoption permitted. The Group does not have investments in such entities and, therefore, there was no impact to its financial statements.

Issued October, 2009, ASU 2009-15, “*Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing*” amends ASC Topic 470 and provides guidance for accounting and reporting for own-share lending arrangements issued in contemplation of a convertible debt issuance. At the date of issuance, a share-lending arrangement entered into on an entity’s own shares should be measured at fair value in accordance with Topic 820 and recognized as an issuance cost, with an offset to additional paid-in capital. Loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs. The amendments also require several disclosures including a description and the terms of the arrangement and the reason for entering into the arrangement. The effective dates of the amendments are dependent upon the date the share-lending arrangement was entered into and include retrospective application for arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009. The Group has no plans to issue convertible debt and, therefore, does not expect the update to have an impact on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Group’s financial position, results of operations or cash flows.

THIS PAGE WAS INTENTIONALLY LEFT BLANK

THIS PAGE WAS INTENTIONALLY LEFT BLANK

General Information

Main Office

Oriental Group Tower

Marginal San Roberto #997
Professional Offices Park
San Juan, PR 00927
Telephone: (787) 771-6800

Transfer Agent and Register

American Stock Transfer & Trust Company
6201 15th Avenue
Brooklyn, NY 11219
Telephone: (718) 921-8275

Dividend Reinvestment Plan

Patrick J. Dunn
Oriental Financial Services
PO Box 195119
San Juan, PR 00919
Telephone: (787) 474-1993
E-mail: pdunn@orientalfg.com

Independent Certified Public Accountants

KPMG LLP
250 Munoz Rivera Avenue, Suite 1100
San Juan, PR 00918

Form 10-K

Annual Report on Form 10-K filed with
the SEC is available on request from:
www.proxyvote.com
Annual Meeting

The Annual Meeting of Stockholders

will be held April 30, 2010 at 9:30 am
Training Room - 8th Floor
Oriental Tower
Professional Office Park
Marginal San Roberto #997
San Juan, PR 00927

Branch Offices

METROPOLITAN AREA REGION

Bayamón - Plaza del Sol
Carolina
Carolina - Plaza Escorial
Galería San Patricio
Hato Rey - Ponce de León Ave.
Hato Rey - Torre Chardón
Las Cumbres
Miramar
Río Piedras - San Roberto

EASTERN REGION

The Outlet Mall-Canóvanas
Caguas - Bairoa
Caguas - Las Catalinas Mall
Ceiba
Humacao- Oriental Center
Las Piedras
San Lorenzo
Yabucoa

WESTERN REGION

Arecibo
Guayama
Mayaguez Mall
Ponce

Annual Certifications

Our President and CEO has submitted to the NYSE the Domestic Company Section 303A Annual CEO Certification for 2009 regarding our compliance with the corporate governance listing standards of the NYSE. Also, we have filed with the SEC, as exhibits 31.1 and 31.2 to our annual report on Form 10-K for fiscal 2009, the Sarbanes-Oxley Act Section 302 Certifications of both our CEO and CFO regarding the quality of our public disclosures."

