ORIENTAL FINANCIAL GROUP INC
Form 10-Q
November 04, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2010

or

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

For the transition period from __________ to __________

Commission File Number 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 Offices Park
San Juan, Puerto Rico 00926
Telephone Number: (787) 771-6800

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

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

Large Accelerated Filer o	Accelerated Filer þ	Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Number of shares outstanding of the registrant s common stock, as of the latest practicable date:

46,317,008 common shares ($1.00 par value per share) outstanding as of October 31, 2010

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FORWARD-LOOKING STATEMENTS

When used in this Form 10-Q 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, 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 local, 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.

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
SEPTEMBER 30, 2010 AND DECEMBER 31, 2009

	September 30, 2010	December 31, 2009
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents		
Cash and due from banks	$ 89,703	$ 247,691
Money market investments	53,233	29,432
Total cash and cash equivalents	**142,936**	**277,123**
Investments:		
Trading securities, at fair value, with amortized cost of $100 (December 31, 2009 - $522)	102	523
Investment securities available-for-sale, at fair value, with amortized cost of $4,304,055 (December 31, 2009 - $5,044,017)	4,317,088	4,953,659
Other investments	150	150
Federal Home Loan Bank (FHLB) stock, at cost	22,496	19,937
Total investments	**4,339,836**	**4,974,269**
Securities sold but not yet delivered	**317,209**	
Loans:		
Mortgage loans held-for-sale, at lower of cost or fair value	31,432	27,261
Loans not covered under shared loss agreements with the FDIC, net of allowance for loan and lease losses of $29,640 (December 31, 2009 - $23,272)	1,107,338	1,112,808
Loans covered under shared loss agreements with the FDIC	722,858	
Total loans, net	**1,861,628**	**1,140,069**
FDIC shared-loss indemnification asset	562,364	
Foreclosed real estate covered under shared loss agreements with the FDIC	19,322	
Foreclosed real estate not covered under shared loss agreements with the FDIC	13,765	9,347
Accrued interest receivable	30,644	33,656
Deferred tax asset, net	30,650	31,685
Premises and equipment, net	17,125	19,775
Core deposit intangible	1,363	
Servicing asset	9,647	7,120
Other assets	56,568	57,789
Total assets	**$ 7,403,057**	**$ 6,550,833**

LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Demand deposits	$ 888,011	$ 693,506
Savings accounts	234,501	86,792
Certificates of deposit	1,472,763	965,203
Total deposits	**2,595,275**	**1,745,501**
Borrowings:		
Short-term borrowings	29,959	49,179
Securities sold under agreements to repurchase	3,541,520	3,557,308
Advances from FHLB	281,753	281,753
FDIC-guaranteed term notes	105,112	105,834
Subordinated capital notes	36,083	36,083
Total borrowings	**3,994,427**	**4,030,157**
Securities purchased but not yet received		413,359
FDIC net settlement payable	41,601	
Accrued expenses and other liabilities	54,694	31,650
Total liabilities	**6,685,997**	**6,220,667**
Stockholders equity:		
Preferred stock, $1 par value; 10,000,000 shares authorized; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding, $25 liquidation value	68,000	68,000
Common stock, $1 par value; 100,000,000 shares authorized as of September 30, 2010 (December 31, 2009 - 40,000,000); 47,807,734 shares issued; 46,317,008 shares outstanding (December 31, 2009 - 25,739,397; 24,235,088)	47,808	25,739
Additional paid-in capital	498,486	213,445
Legal surplus	46,958	45,279
Retained earnings	59,845	77,584
Treasury stock, at cost, 1,490,726 shares (December 31, 2009 - 1,504,309 shares)	(17,116)	(17,142)
Accumulated other comprehensive income (loss), net of tax of ($128) (December 31, 2009 - $7,445)	13,079	(82,739)
Total stockholders equity	**717,060**	**330,166**
Total liabilities and stockholders equity	**$ 7,403,057**	**$ 6,550,833**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2010 AND 2009

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2010	2009	2010	2009
	(In thousands, except per share data)			
Interest income:				
Loans	$ 34,347	$ 18,248	$ 81,382	$ 55,329
Mortgage-backed securities	40,429	48,750	125,542	151,179
Investment securities and other	6,445	11,552	24,476	38,078
Total interest income	**81,221**	**78,550**	**231,400**	**244,586**
Interest expense:				
Deposits	12,680	13,990	35,874	41,962
Securities sold under agreements to repurchase	25,128	27,209	75,900	90,937
Advances from FHLB and other borrowings	3,082	3,106	9,147	9,277
Note Payable to the FDIC	823		1,887	
FDIC-guaranteed term notes	1,021	1,021	3,063	2,154
Subordinated capital notes	327	333	930	1,158
Total interest expense	**43,061**	**45,659**	**126,801**	**145,488**
Net interest income	**38,160**	**32,891**	**104,599**	**99,098**
Provision for loan and lease losses	4,100	4,400	12,214	11,250
Net interest income after provision for loan and lease losses	**34,060**	**28,491**	**92,385**	**87,848**
Non-interest income:				
Wealth management revenues	4,554	3,764	13,157	10,163
Banking service revenues	3,414	1,424	8,030	4,330
Mortgage banking activities	3,418	2,232	7,555	7,191
Investment banking revenues (losses)	59		93	(4)
Total banking and wealth management revenues	**11,445**	**7,420**	**28,835**	**21,680**
Total loss on other-than-temporarily impaired securities	(14,739)	(44,737)	(39,674)	(107,331)
Portion of loss on securities recognized in other comprehensive income		36,478	22,508	94,656
	(14,739)	(8,259)	(17,166)	(12,675)

Other-than-temporary impairments on securities				
Net gain (loss) on:				
Sale of securities	13,954	35,528	37,807	56,388
Derivatives	(22,580)	(64)	(59,832)	19,778
Early extinguishment of repurchase agreements		(17,551)		(17,551)
Trading securities	4	(505)	2	12,427
Bargain purchase from FDIC-assisted acquisition			9,940	
Fair value adjustment on FDIC equity appreciation instrument			909	
Accretion of FDIC loss-share indemnification asset	1,756		3,314	
Foreclosed real estate	(140)	(278)	(283)	(576)
Other	(8)	31	61	94
Total non-interest income (loss), net	**(10,308)**	**16,322**	**3,587**	**79,565**
Non-interest expenses:				
Compensation and employee benefits	11,732	7,882	30,440	23,626
Occupancy and equipment	5,620	3,747	13,815	10,994
Professional and service fees	5,480	2,459	11,552	7,461
Insurance	1,651	1,273	5,218	5,560
Taxes, other than payroll and income taxes	1,611	834	3,759	2,129
Advertising and business promotion	1,275	1,097	3,339	3,329
Electronic banking charges	1,322	471	3,112	1,607
Communication	826	382	1,905	1,163
Loan servicing expenses	443	397	1,321	1,167
Clearing and wrap fees expenses	579	293	1,217	860
Foreclosure and repossession expenses	545	204	1,117	650
Director and investors relations	396	348	1,098	1,029
Printing, postage, stationery and supplies	299	194	795	665
Training and travel	167	194	639	444
Other	759	710	1,623	1,287
Total non-interest expenses	**32,705**	**20,485**	**80,950**	**61,971**
Income (loss) before income taxes	**(8,953)**	**24,328**	**15,022**	**105,442**
Income tax expense (benefit)	(2,358)	3,001	(262)	8,452
Net income (loss)	**(6,595)**	**21,327**	**15,284**	**96,990**
Less: Dividends on preferred stock	(1,200)	(1,201)	(4,134)	(3,602)
Less: Deemed dividend on preferred stock beneficial conversion feature	(22,711)		(22,711)	
Income available (loss) to common shareholders	**$ (30,506)**	**$ 20,126**	**$ (11,561)**	**$ 93,388**
Income (loss) per common share:				

Basic	$	**(0.67)**	$	**0.83**	$	**(0.33)**	$	**3.85**
Diluted	$	**(0.67)**	$	**0.83**	$	**(0.33)**	$	**3.84**
Average common shares outstanding		45,354		24,303		34,823		24,284
Average potential common shares-options		128		65		105		17
Average diluted common shares outstanding		**45,482**		**24,368**		**34,928**		**24,301**
Cash dividends per share of common stock	$	**0.04**	$	**0.04**	$	**0.12**	$	**0.12**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2010 AND 2009

	Nine-Month Period Ended September 30,	
	2010	2009
	(In thousands)	
Preferred stock:		
Balance at beginning of period	$ 68,000	$ 68,000
Issuance of preferred stock	177,289	
Conversion of preferred stock to common stock	(177,289)	
Balance at end of period	**68,000**	**68,000**
Additional paid-in capital from beneficial conversion feature		
Balance at beginning of period		
Issuance of preferred stock beneficial conversion feature	22,711	
Conversion of preferred stock to common stock beneficial conversion feature	(22,711)	
Balance at end of period		
Common stock:		
Balance at beginning of period	25,739	25,739
Issuance of common stock	8,740	
Conversion of preferred stock to common stock	13,320	
Exercised stock options	9	
Balance at end of period	**47,808**	**25,739**
Additional paid-in capital:		
Balance at beginning of period	213,445	212,625
Issuance of common stock	90,896	
Conversion of preferred stock to common stock	186,680	
Deemed dividend on preferred stock beneficial conversion feature	22,711	
Exercised stock options	64	
Stock-based compensation expense	865	550
Capital contribution		89
Common stock issuance costs	(5,250)	
Preferred stock issuance costs	(10,925)	
Balance at end of period	**498,486**	**213,264**
Legal surplus:		
Balance at beginning of period	45,279	43,016
Transfer from retained earnings	1,679	9,643
Balance at end of period	**46,958**	**52,659**

Retained earnings:		
Balance at beginning of period	77,584	51,233
Cumulative effect on initial adoption of accounting principle		14,359
Net income	15,284	96,990
Cash dividends declared on common stock	(4,499)	(2,916)
Cash dividends declared on preferred stock	(4,134)	(3,602)
Deemed dividend on preferred stock beneficial conversion feature	(22,711)	
Transfer to legal surplus	(1,679)	(9,643)
Balance at end of period	**59,845**	**146,421**
Treasury stock:		
Balance at beginning of period	(17,142)	(17,109)
Stock purchased		(182)
Stock used to match defined contribution plan	26	144
Balance at end of period	**(17,116)**	**(17,147)**
Accumulated other comprehensive income (loss), net of tax:		
Balance at beginning of period	(82,739)	(122,187)
Cumulative effect on initial adoption of accounting principle		(14,359)
Other comprehensive income, net of tax	95,818	30,179
Balance at end of period	**13,079**	**(106,367)**
Total stockholders equity	**$ 717,060**	**$ 382,569**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2010 AND 2009

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2010	**2009**	**2010**	**2009**
	(In thousands)			
Net income (loss)	**$ (6,595)**	**$ 21,327**	**$ 15,284**	**$ 96,990**
Other comprehensive income:				
Unrealized gain (loss) on securities available-for-sale arising during the period	(15,072)	30,026	124,302	75,015
Realized gain on investment securities included in net income	(14,224)	(35,528)	(38,077)	(56,388)
Total loss on other- than-temporarily impaired securities	14,739	44,737	39,674	107,331
Portion of loss on securities recognized in other comprehensive income		(36,478)	(22,508)	(94,656)
Income tax effect related to unrealized gain on securities available-for-sale	2,274	716	(7,573)	(1,123)
Other comprehensive income (loss) for the period	**(12,283)**	**3,473**	**95,818**	**30,179**
Comprehensive income (loss)	**$ (18,878)**	**$ 24,800**	**$ 111,102**	**$ 127,169**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2010 AND 2009

	Nine-Month Period Ended September 30,	
	2010	**2009**
	(In thousands)	
Cash flows from operating activities:		
Net income	$ **15,284**	$ **96,990**
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of deferred loan origination fees, net of costs	565	151
Amortization of premiums, net of accretion of discounts	24,663	9,070
Amortization of core deposit intangible	60	
Accretion of FDIC loss-share indemnification asset	(3,314)	
Amortization of accretable yield on loans covered by FDIC shared-loss agreements	(28,592)	
Other-than-temporary impairments on securities	17,166	12,675
Depreciation and amortization of premises and equipment	4,152	4,505
Deferred income tax expense (benefit)	(6,538)	750
Provision for loan and lease losses	12,214	11,250
Stock-based compensation	865	550
Fair value adjustment of servicing asset	(1,538)	(4,430)
Bargain purchase gain from FDIC assisted acquisition	(9,940)	
(Gain) loss on:		
Sale of securities	(37,807)	(56,388)
Sale of mortgage loans held for sale	(4,332)	(2,761)
Derivatives	59,832	(19,778)
Early extinguishment of repurchase agreements		17,551
Sale of foreclosed real estate	283	576
Sale of premises and equipment	44	(60)
Originations and purchases of loans held-for-sale	(169,205)	(169,598)
Proceeds from sale of loans held-for-sale	58,646	88,838
Net (increase) decrease in:		
Trading securities	422	217
Accrued interest receivable	3,012	3,944
Other assets	(226)	(4,679)
Net increase (decrease) in:		
Accrued interest on deposits and borrowings	(260)	(3,525)
Accrued expenses and other liabilities	34,808	10,954
Net cash used in operating activities	**(29,735)**	**(3,198)**
Cash flows from investing activities:		
Purchases of:		
Investment securities available-for-sale	(5,308,688)	(9,290,454)
FHLB stock	(2,560)	(13,355)

Equity options		(1,747)		(3,738)
Maturities and redemptions of:				
Investment securities available-for-sale		2,370,912		3,251,327
FHLB stock		10,077		14,431
Proceeds from sales of:				
Investment securities available-for-sale		3,052,533		6,090,572
Foreclosed real estate		5,197		6,594
Premises and equipment		573		114
Origination and purchase of loans, excluding loans held-for-sale		(101,595)		(60,370)
Principal repayment of loans		180,140		92,437
Additions to premises and equipment		(1,483)		(3,577)
Cash and cash equivalents received in FDIC-assisted transaction		89,777		
Net cash provided by investing activities		**293,137**		**83,981**
Cash flows from financing activities:				
Net increase (decrease) in:				
Deposits		119,544		142,761
Securities sold under agreements to repurchase		(15,000)		(217,551)
Short term borrowings		(19,220)		6,135
Proceeds from:				
Issuance of FDIC-guaranteed term notes				105,000
Advances from FHLB				761,380
Exercise of stock options		73		
Issuance of common stock, net		94,386		
Issuance of preferred stock, net		189,075		
Capital contribution				89
Repayments of advances from FHLB				(788,080)
Repayments of advances from note payable to the FDIC		(715,970)		
Purchase of treasury stock				(182)
Termination of derivative instruments		(42,727)		20,254
Dividends paid on preferred stock		(2,934)		(3,602)
Dividends paid on common stock		(4,816)		(2,916)
Net cash provided by (used in) financing activities		**(397,589)**		**23,288**
Net change in cash and cash equivalents		**(134,187)**		**104,071**
Cash and cash equivalents at beginning of period		277,123		66,372
Cash and cash equivalents at end of period	**$**	**142,936**	**$**	**170,443**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT.)
FOR THE NINE-MONTH PERIOD ENDED SEPTEMBER 30, 2010 AND 2009

	Nine-Month Period Ended September 30,			
	2010		2009	
	(In thousands)			
Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:				
Interest paid	$	126,569	$	149,012
Income taxes paid	$	6,281	$	74
Mortgage loans securitized into mortgage-backed securities	$	109,386	$	105,676
Securities sold but not yet delivered	$	317,209	$	417,280
Securities purchased but not yet received	$		$	30,945
Transfer from loans to foreclosed real estate	$	11,693	$	6,327
Reclassification of loans held for investment portfolio to the held for sale portfolio	$		$	19,832
Supplemental Schedule of Non-cash Investing Activities:				
Acquisitions:				
Non-cash assets acquired:				
FHLB stock	$	10,077	$	
Loans covered under shared-loss agreements with FDIC		787,177		
Loans not covered under shared-loss agreements with FDIC		2,987		
Foreclosed real estate covered under shared-loss agreements with FDIC		17,527		
Other repossessed assets covered under shared-loss agreements with FDIC		3,062		
FDIC loss-share indemnification asset		559,050		
Core deposit intangible		1,423		
Other assets		5,301		
Total non-cash assets acquired		1,386,604		
Liabilities assumed:				
Deposits		729,546		
Deferred income tax liability, net		3,876		
Other liabilities		9,426		
Total liabilities assumed		742,848		
Net non-cash assets acquired		643,756		
Cash and cash equivalents received in the FDIC-assisted transaction		89,777		

Net assets acquired	$	733,533	$
Consideration at fair value:			
Note payable issued to the FDIC		715,970	
Net settlement payable to the FDIC		10,590	
Equity appreciation instrument		909	
		727,469	
Net after tax bargain purchase gain from FDIC-assisted acquisition		6,064	
	$	733,533	$

See notes to unaudited consolidated financial statements.

ORIENTAL FINANCIAL GROUP INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
NOTE 1 BASIS OF PRESENTATION

The accounting and reporting policies of Oriental Financial Group Inc. (the Group or Oriental) conform with U.S. generally accepted accounting principles (GAAP) and to financial services industry practices.

The unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). All significant intercompany balances and transactions have been eliminated in consolidation. These unaudited statements are, in the opinion of management, a fair statement of the results for the periods reported and include all necessary adjustments, all of a normal recurring nature, for a fair statement of such results. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations. Management believes that the disclosures made are adequate to make the information presented not misleading. The results of operations and cash flows for the periods ended September 30, 2010 and 2009 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2009, included in the Group s 2009 annual report on Form 10-K, as amended.

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, leasing, 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 is subject to the supervision, examination and regulation of the Office of the Commissioner of Financial Institutions of Puerto Rico (OCFI) and the Federal Deposit Insurance Corporation (FDIC). The Bank offers banking services such as commercial and consumer lending, leasing, savings 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 OCFI. 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 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 or originates and of its mortgage loan portfolio.

Effective April 30, 2010, the Bank assumed all of the retail deposits and other liabilities and acquired certain assets and substantially all of the operations of Eurobank from the FDIC as receiver for Eurobank, pursuant to the terms of a purchase and assumption agreement entered into by the Bank and the FDIC on April 30, 2010. This transaction is referred to as the FDIC-assisted acquisition .

Pursuant to a waiver granted by the SEC to the Group on May 28, 2010, and in accordance with the guidance provided in the SEC Staff Accounting Bulleting Topic 1.K, Financial Statements of Acquired Troubled Financial Institutions (SAB 1:K), the Group has omitted certain financial information of the FDIC-assisted acquisition otherwise required by Rule 3-05 of Regulation S-X. SAB 1:K provides relief from the requirements of Rule 3-05 of Regulation S-X under certain circumstances, including a transaction such as the Eurobank acquisition, in which the registrant engages in an acquisition of a troubled financial institution for which audited financial statements are not reasonably available and in which federal assistance is so pervasive as to substantially reduce the relevance of such information to an assessment of future operations.

Significant Accounting Policies

The unaudited consolidated financial statements of the Group are prepared in accordance with GAAP as prescribed by the Financial Accounting Standards Board Accounting Standards Codification (ASC) and with the general practices within the financial services industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Group believes that, of its significant accounting policies, the following may involve a higher degree of judgment and complexity.

Loans and Allowance for Loan and Lease Losses

Because of the loss protection provided by the FDIC, the risks of the Eurobank FDIC-assisted transaction acquired loans are significantly different from those loans not covered under the FDIC loss sharing agreements. Accordingly, the Group presents loans subject to the loss sharing agreements as covered loans and loans that are not subject to the FDIC loss sharing agreements as non-covered loans . Non-covered loans include any loans made outside of the FDIC shared-loss agreements before or after the April 30, 2010 FDIC-assisted acquisition. Non-covered loans also include credit cards balances acquired in the FDIC-assisted acquisition.

Non-covered loans

Non-covered 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 non-covered loan and lease losses, unamortized discount related to mortgage servicing right 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 the interest method. When a loan is paid off or sold, any unamortized deferred fee (cost) is credited (charged) to income.

Credit cards balances acquired as part of the FDIC-assisted acquisition are to be accounted for under the guidance of ASC 310-20, which requires that any differences between the contractually required loan payment in excess of the Group s initial investment in the loans be accreted into interest income on a level-yield basis over the life of the loan. Loans accounted for under ASC 310-20 are placed on non-accrual status when past due in accordance with the Group s non-accruing policy and any accretion of discount is discontinued. These assets were written-down to their estimated fair value on their acquisition date, incorporating an estimate of future expected cash flows. To the extent actual or projected cash flows are less than originally estimated, additional provisions for loan and lease losses will be recognized.

Interest recognition is discontinued when loans are 90 days or more in arrears on principal and/or interest based on contractual terms, except for well collateralized residential mortgage loans in process of collection 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.

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The Group follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan and lease losses to provide for inherent losses in the non-covered 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 and lease losses charged to current operations is based on such methodology. Loan and lease losses are charged and recoveries are credited to the allowance for loan and lease losses on non-covered loans.

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 90-days past-due. The portfolios of mortgage, leases 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 non-covered 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 and lease 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 at least quarterly and are applied in the context of GAAP as prescribed by the Financial Accounting Standards Board Accounting Standards Codification (ASC) 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 possible loan and lease losses, factors beyond the Group s control such as those affecting general economic conditions may require future changes to the allowance.

Covered loans

Covered loans acquired in the FDIC-assisted acquisition are accounted under the provisions of ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality , which are applicable when (a) the Group acquires loans deemed to be impaired when there is evidence of credit deterioration and it is probable, at the date of acquisition, that the Group would be unable to collect all contractually required payments and (b) as a general policy election for non-impaired loans that the Group acquires.

The acquired covered loans were recorded at their estimated fair value at the time of acquisition. Fair value of acquired loans is determined using a discounted cash flow model based on assumptions about the amount and timing of principal and interest payments, estimated prepayments, estimated default rates, estimated loss severity in the event of defaults, and current market rates. Estimated credit losses are included in the determination of fair value; therefore, an allowance for loan and lease losses is not recorded on the acquisition date.

In accordance with ASC 310-30 and in estimating the fair value of covered loans at the acquisition date, the Group (a) calculated the contractual amount and timing of undiscounted principal and interest payments (the undiscounted contractual cash flows) and (b) estimated the amount and timing of undiscounted expected principal and interest payments (the undiscounted expected cash flows). The difference between the undiscounted contractual cash flows and the undiscounted expected cash flows is the non-accretable difference. The non-accretable difference represents an estimate of the loss exposure in the covered loan portfolio, and such amount is subject to change over time based on the performance of the covered loans. The carrying value of covered loans is reduced by payments received and

increased by the portion of the accretable yield recognized as interest income.

The excess of undiscounted expected cash flows at acquisition over the initial fair value of acquired loans is referred to as the accretable yield and is recorded as interest income over the estimated life of the loans using the effective yield method if the timing and amount of the future cash flows is reasonably estimable. Subsequent to acquisition, the Group aggregates loans into

pools of loans with common risk characteristics to account for the acquired loans. Increases in expected cash flows over those originally estimated increase the accretable yield and are recognized as interest income prospectively. Decreases in expected cash flows compared to those originally estimated decrease the accretable yield and are recognized by recording a provision for loan and lease losses and establishing an allowance for loan and lease losses. Loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest income may be recognized on a cash basis or as a reduction of the principal amount outstanding.

Under the accounting guidance of ASC 310-30 for acquired loans, the allowance for loan and lease losses on covered loans is measured at each financial reporting period, or measurement date, based on expected cash flows. Accordingly, decreases in expected cash flows on the acquired covered loans as of the measurement date compared to those initially estimated are recognized by recording a provision for credit losses on covered loans. The portion of the loss on covered loans reimbursable from the FDIC is recorded as an offset to provision for credit losses and increases the FDIC shared-loss indemnification asset.

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.

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. The Group follows 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 corresponding review takes into consideration current market conditions, issuer rating changes and trends, the creditworthiness of the obligor 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;
- 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.

FDIC Shared-Loss Indemnification Asset

The Group has determined that the FDIC shared-loss indemnification asset will be accounted for as an indemnification asset measured separately from the covered loans acquired in the FDIC-assisted acquisition as it is not contractually embedded in any of the covered loans. The shared-loss indemnification asset related to estimated future loan and lease losses is not transferable should the Group sell a loan prior to foreclosure or maturity. The fair value of the shared-loss indemnification asset represents the present value of the estimated cash payments expected to be received from the FDIC for future losses on covered assets, based on the credit adjustment estimated for each covered asset and the loss sharing percentages. These cash flows are then discounted at a market-based rate to reflect the uncertainty of the timing and receipt of the loss sharing reimbursements from the FDIC. The amount ultimately collected for this asset is dependent upon the performance of the underlying covered assets, the passage of time, and claims submitted to the FDIC. The time value of money incorporated into the present value computation is accreted into earnings over the shorter of the life of the shared-loss agreements or the holding period of the covered assets.

The FDIC shared-loss indemnification asset will be reduced as losses are recognized on covered loans and loss sharing payments are received from the FDIC. Realized credit losses in excess of acquisition-date estimates will result in an increase in the FDIC shared-loss indemnification asset. Conversely, if realized credit losses are less than acquisition-date estimates, the FDIC shared-loss indemnification asset will be reduced.

Core Deposit Intangible

Core deposit intangible (CDI) is a measure of the value of checking and savings deposits acquired in a business combination. The fair value of the CDI stemming from any given business combination is based on the present value of the expected cost savings attributable to the core deposit funding, relative to an alternative source of funding. CDI is amortized straight-line over a 10 year period. The Group evaluates such identifiable intangibles for impairment when an indication of impairment exists. No impairment charges were required to be recorded in the nine-month period ended September 30, 2010. If an impairment loss is determined to exist in the future, the loss would be reflected as a non-interest expense in the consolidated statement of operations for the period in which such impairment is identified.

Foreclosed Real Estate and Other Repossessed Property

Non-covered 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 and lease losses on non-covered loans. After foreclosure, these properties are carried at the lower of cost or fair value less estimated cost 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 non-interest expense. The costs and expenses associated to holding these properties in portfolio are expensed as incurred.

Covered Foreclosed Real Estate and Other Repossessed Property

Covered foreclosed real estate and other repossessed property were initially recorded at their estimated fair value on the acquisition date based on appraisal value less estimated selling costs. Any subsequent write downs due to declines in fair value are charged to non-interest expense with a partially offsetting non-interest income for the loss reimbursement under the FDIC shared-loss agreement. Any recoveries of previous write downs are credited to non-interest expense with a corresponding charge to non-interest income for the portion of the recovery that is due to the FDIC.

Income Taxes

In preparing the unaudited 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 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 the 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 unaudited consolidated statements of operations.

Equity-Based Compensation Plans

The Group s 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 units and dividend equivalents, as well as equity-based performance awards. The Omnibus Plan was adopted in 2007, amended and restated in 2008, and it was further amended in 2010.

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 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 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, as amended (the Exchange Act). Only the Committee may exercise authority in respect of Awards granted to such participants.

The Omnibus Plan replaced and superseded the Group s 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 expected term of stock options granted represents the period of time that such options are expected to be outstanding. Expected volatilities are based on historical volatility of the Group s shares of common stock over the most recent period equal to the expected term of the stock options.

Subsequent Events

The Group has evaluated other events subsequent to the balance sheet date and prior to the filing of this Quarterly Report on Form 10-Q and has adjusted and disclosed those events that have occurred that would require adjustment or disclosure in the consolidated financial statements.

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Reclassifications

When necessary, certain reclassifications have been made to prior year amounts to conform to the current year presentation.

Recent Accounting Developments:

Derivatives and Hedging In March 2010, FASB issued a clarification on the scope exception for embedded credit derivatives. The guidance eliminates the scope exception for bifurcation of embedded credit derivatives in interests in securitized financial assets, unless they are created solely by subordination of one financial debt instrument to another. The guidance is effective beginning in the first reporting period after June 15, 2010, with earlier adoption permitted for the quarter beginning after March 31, 2010. This clarification did not have a material impact on the Group s financial position or results of operations.

Loan Modification In April 2010, FASB issued an update affecting accounting for loan modifications for those loans that are acquired with deteriorated credit quality and are accounted for on a pool basis. It clarifies that the modifications of such loans do not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change. The new guidance is effective prospectively for modifications occurring in the first interim or annual period ending on or after July 15, 2010. Early application is permitted. The Group adopted this guidance for loans acquired on the FDIC-assisted acquisition accounted for under ASC 310-30. Its adoption did not have a material effect on the Group s unaudited consolidated financial statements.

Credit Quality and Allowance for Credit Losses Disclosures In July 2010, FASB issued ASU No. 2010-20, Disclosures about Credit Quality of Financing Receivables and Allowance for Credit Losses. The ASU requires a greater level of disaggregated information about the allowance for credit losses and the credit quality of financing receivables. The period-end balance disclosure requirements for loans and the allowance for loan and lease losses will be effective for reporting periods ending on or after December 15, 2010, while disclosures for activity during a reporting period that occurs in the loan and allowance for loan and lease losses accounts will be effective for reporting periods beginning on or after December 15, 2010.

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

NOTE 2 FDIC-ASSISTED ACQUISITION

On April 30, 2010 the Bank acquired certain assets and assumed certain deposits and other liabilities of Eurobank from the FDIC as receiver of Eurobank, San Juan, Puerto Rico. As part of the Purchase and Assumption Agreement between the Bank and the FDIC (the Purchase and Assumption Agreement), the Bank and the FDIC entered into shared-loss agreements (each, a shared-loss agreement and collectively, the shared-loss agreements), whereby the FDIC will cover a substantial portion of any future losses on loans (and related unfunded loan commitments), foreclosed real estate and other repossessed properties.

The acquired loans, foreclosed real estate, and other repossessed property subject to the shared-loss agreements are collectively referred as covered assets. Under the terms of the shared-loss agreements, the FDIC will absorb 80% of losses and share in 80% of loss recoveries on covered assets. The term for loss share on single family residential mortgage loans is ten years with respect to losses and loss recoveries, while the term for loss share on commercial loans is five years with respect to losses and eight years with respect to loss recoveries, from the April 30, 2010 acquisition date. The shared-loss agreements also provide for certain costs directly related to the collection and preservation of covered assets to be reimbursed at an 80% level.

The operating results of the Group for the nine-month period ended September 30, 2010 include the operating results produced by the acquired assets and liabilities assumed for the period of May 1, 2010 to September 30, 2010. The Group believes that given the nature of assets and liabilities assumed, the significant amount of fair value adjustments, the nature of additional consideration provided to the FDIC and the FDIC shared-loss agreements now in place, historical results of Eurobank are not meaningful to the Group s results, and thus no pro-forma information is presented.

The assets acquired and liabilities assumed as of April 30, 2010 were presented at their fair value. In many cases, the determination of these fair values required management to make estimates about discount rates, expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. The fair values initially assigned to the assets acquired and liabilities assumed were preliminary and subject to refinement for up to one year after the closing date of the acquisition as new information relative to closing date fair values became available. During the quarter ended September 30, 2010, the Group recorded preliminary measurement period adjustments to the carrying value of loans, FDIC shared-loss indemnification asset, and deferred income tax liability. This was the result of additional analysis on the estimates of fair value, and the Group s decision to account for all loans acquired in the FDIC-assisted acquisition, except for credit cards balances, in accordance with ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality . The Bank and the FDIC are engaged in ongoing discussions that may impact certain assets acquired or certain liabilities assumed by the Bank. The amount that the Group realizes on these assets could differ materially from the carrying value included in the unaudited consolidated statements of financial condition primarily as a result of changes in the timing and amount of collections on the acquired loans in future periods. Because of the shared-loss agreements with the FDIC on the covered assets, the Group does not expect to incur significant losses.

Preliminary net-assets acquired and the respective preliminary measurement period adjustments are reflected in the table below:

	Book value April 30, 2010	Fair Value Adjustments	April 30, 2010 (As initially reported)	Preliminary Measurement Period Adjustments	April 30, 2010 (As remeasured)
			(in thousands)		
Assets					
Cash and cash equivalents	$ 89,777	$	$ 89,777	$	$ 89,777
Federal Home Loan Bank stock	10,077		10,077		10,077
Loans covered by shared-loss agreements	1,536,416	(699,910)	836,506	(49,328)	787,178
Loans not covered by share-loss agreements	4,275	(1,298)	2,977	(9)	2,986
Foreclosed real estate covered by shared-loss agreements	26,082	(8,555)	17,527		17,527
Other repossessed properties covered by shared-loss agreements	3,401	(339)	3,062		3,062
FDIC loss-share indemnification asset		516,250	516,250	42,800	559,050
Core deposit intangible		1,423	1,423		1,423
Other assets	20,168	(14,867)	5,301		5,301
Total assets acquired	$ 1,690,196	$ (207,296)	$ 1,482,900	$ (6,519)	$ 1,476,381
Liabilities					
Deposits	$ 722,442	$ 7,104	$ 729,546	$	$ 729,546

Deferred income tax liability, net			6,419	(2,543)	3,876
Other liabilities	9,426		9,426		9,426
Total liabilities assumed	$ 731,868	$ 7,104	$ 745,391	$ (2,543)	$ 742,848
Net assets acquired	$ 958,328	$ (214,400)	$ 737,509	$ (3,976)	$ 733,533
Consideration					
Note payable issued to the FDIC	$ 715,536	$ 434	$ 715,970	$	$ 715,970
Net settlement payable to the FDIC	15,244	(4,654)	10,590		10,590
Equity appreciation instrument		909	909		909
	$ 730,780	$ (3,311)	$ 727,469	$	$ 727,469
Net after tax bargain purchase gain from the FDIC-assisted acquisition			$ 10,040	$ (3,976)	$ 6,064

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The preliminary measurement period adjustments affected the following items presented in the June 30, 2010 unaudited consolidated financial statements:

Net Income for the Six-Month Period Ended June 30, 2010 (As initially reported)	$ 29,285
Preliminary Measurement Period Adjustments:	
Interest income from covered loans accretable discount	(1,711)
Bargain purchase from FDIC-assisted acquisition	(6,519)
Accretion of FDIC loss-share indemnification asset	114
Income tax provision	710
Total Preliminary Measurement Period Adjustments	(7,406)
Net Income for the Six-Month Period Ended June 30, 2010 (As re-measured)	$ 21,879

	(As initially reported)	(As re-measured)
Earnings per share (for the six-month period ended June 30, 2010):		
Basic	0.79	0.15
Diluted	0.79	0.15
Total Stockholder s Equity at June 30, 2010	$ 746,042	$ 738,636

Fair Value of Assets Acquired and Liabilities Assumed

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting assumptions that a market participant would use when pricing an asset or liability. In some cases, the estimation of fair values requires management to make estimates about discount rates, future expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. The methods used to determine the fair values of the significant assets acquired and liabilities assumed are described below.

Cash and cash equivalents Cash and cash equivalents include cash and due from banks, and interest-earning deposits with banks and the Federal Reserve Bank. Cash and cash equivalents have a maturity of 90 days or less at the time of purchase. The fair value of financial instruments that are short-term or re-price frequently and that have little or no risk were considered to have a fair value that approximates to carrying value.

Federal Home Loan Bank stock The fair value of acquired FHLB stock was estimated to be its redemption value. Subsequent to April 30, 2010 the FHLB stock was redeemed at its carrying amount.

Loans - Loans acquired in the FDIC-assisted acquisition, excluding extensions of credit pursuant to a credit card plan, are referred as covered loans as the Bank will be reimbursed by the FDIC for a substantial portion of any future credit losses on them under the terms of the shared-loss agreements. At the April 30, 2010 acquisition date, the estimated fair value of the FDIC-assisted acquisition loan portfolio was $790.2 million. Loans fair values were estimated by discounting the expected cash flows from the portfolio. In estimating such fair value and expected cash flows, management made several assumptions regarding prepayments, collateral cash flows, the timing of defaults, and the loss severity of defaults. Other factors expected by market participants were considered in determining the fair value of acquired loans, including loan pool level estimated cash flows, type of loan and related collateral, risk classification status (i.e. performing or nonperforming), fixed or variable interest rate, term of loan and whether or not the loan was amortizing and current discount rates.

The methods used to estimate fair value are extremely sensitive to the assumptions and estimates used. While management attempted to use assumptions and estimates that best reflected the acquired loan portfolios and current market conditions, a greater degree of subjectivity is inherent in these values than in those determined in active markets. Accordingly, readers are cautioned in using this information for purposes of evaluating the financial condition and/or value of the Group in and of itself or in comparison with any other company.

Foreclosed real estate and other repossessed properties Foreclosed real estate and other repossessed properties (primarily vehicles) are presented at their estimated fair value and are also subject to the FDIC shared-loss agreements. The fair values were determined using expected selling price, less selling and carrying costs, discounted to present value.

FDIC shared-loss indemnification asset The FDIC shared-loss indemnification asset, also known as the indemnification asset, is measured separately from each of the covered asset categories as it is not contractually embedded in any of the covered asset categories. The $559.1 million fair value of the FDIC shared-loss indemnification asset represents the present value of the estimated cash payments (net of amount owed to the FDIC) expected to be received from the FDIC for future losses on covered assets based on the credit assumptions on estimated cash flows for each covered asset pool and the loss sharing percentages. The ultimate collectability of the FDIC shared-loss indemnification asset is dependent upon the performance of the underlying covered loans, the passage of time and claims paid by the FDIC which are impacted by the Bank s adherence to certain guidelines established by the FDIC.

Core deposit intangible (CDI) CDI is a measure of the value of non-interest checking, savings, and NOW and money market deposits that are acquired in business combinations. The fair value of the CDI stemming from any given business combination was based on the present value of the expected cost savings attributable to the core deposit funding, relative to an alternative source of funding.

Deposit liabilities The fair values used for demand and savings deposits are, by definition, equal to the amount payable on demand at the reporting date. The fair values for time deposits were estimated using a discounted cash flow method that applies interest rates currently being offered on time deposits to a schedule of aggregated contractual maturities of such time deposits.

Deferred taxes Deferred income taxes relate to the differences between the financial statement and tax bases of assets acquired and liabilities assumed in this transaction. The Group s effective tax rate used in measuring deferred taxes resulting from the FDIC-assisted acquisition is 39%.

Other assets and other liabilities Given the short-term nature of these financial instruments the carrying amounts reflected in the statement of assets acquired and liabilities assumed approximated fair value.

NOTE 3 INVESTMENTS

Money Market Investments

The Group considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months of less at the date of acquisition. At September 30, 2010, and December 31, 2009, cash equivalents included as part of cash and due from banks amounted to $53.2 million and $29.4 million, respectively.

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Investment Securities

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the securities owned by the Group at September 30, 2010 and December 31, 2009, were as follows:

	September 30, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
			(In thousands)		
Available-for-sale					
Obligations of US Government sponsored agencies	$ 301,565	$	$ 15	$ 301,550	0.12%
Puerto Rico Government and agency obligations	71,318	89	3,002	68,405	5.37%
Structured credit investments	61,724		19,281	42,443	3.77%
Total investment securities	**434,607**	**89**	**22,298**	**412,398**	
FNMA and FHLMC certificates	3,469,102	41,989	1,965	3,509,126	4.06%
GNMA certificates	128,951	8,939		137,890	5.05%
CMOs issued by US Government sponsored agencies	185,641	8,793	6	194,428	5.03%
Non-agency collateralized mortgage obligations	85,754		22,508	63,246	4.87%
Total mortgage-backed-securities and CMOs	**3,869,448**	**59,721**	**24,479**	**3,904,690**	
Total securities available-for-sale	**$ 4,304,055**	**$ 59,810**	**$ 46,777**	**$ 4,317,088**	**3.89%**

	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%**

As of September 30, 2010, the Group s investment securities portfolio included $301.6 million of obligations of US Government sponsored agencies in the form of discount notes. These securities were all used as collateral for repurchase agreements, and had a remaining maturity of less than three months. In October 2010, such securities were sold at a minimum gain of less than $1 thousand and the proceeds reinvested in US agency mortgage-backed securities with a coupon of 4.50%, and an estimated yield of 4.04%.

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The amortized cost and fair value of the Group s investment securities at September 30, 2010, 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.

	September 30, 2010 Available-for-sale	
	Amortized Cost	Fair Value
	(In thousands)	
Investment securities		
Due less than 1 year		
Obligations of US Government sponsored agencies	**$ 301,476**	**$ 301,460**
Due from 1 to 5 years		
Puerto Rico Government and agency obligations	**382**	**388**
Due after 5 to 10 years		
Obligations of US Government sponsored agencies	89	89
Puerto Rico Government and agency obligations	13,662	12,669
Structured credit investments	11,976	8,344
Total due after 5 to 10 years	**25,727**	**21,102**
Due after 10 years		
Puerto Rico Government and agency obligations	57,274	55,349
Structured credit investments	49,748	34,099
Total due after 10 years	**107,022**	**89,448**
Total investment securities	**434,607**	**412,398**
Mortgage-backed securities		
Due after 5 to 10 years		
FNMA and FHLMC certificates	**14,998**	**15,781**
Due after 10 years		
CMOs issued by US Government sponsored agencies	185,641	194,427
FNMA and FHLMC certificates	3,454,104	3,493,346
GNMA certificates	128,951	137,890
Non-agency collateralized mortgage obligations	85,754	63,246
Total due after 10 years	**3,854,450**	**3,888,909**
Total mortgage-backed securities	**3,869,448**	**3,904,690**

Total securities available-for-sale	**$ 4,304,055**	**$ 4,317,088**

Keeping with the Group s investment strategy, during the nine-month periods ended September 30, 2010 and 2009, 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. 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 sale transactions until similar investment securities with attractive yields can be purchased. The discount notes are pledged as collateral for repurchase agreements. During the nine-month period ended September 30, 2010, the Group sold $282.5 million of discount notes with minimal aggregate gross gains amounting to $1 thousand and sold $387.9 million of discounted notes with minimal aggregate gross losses amounting to $1 thousand.

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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 of non-agency collateralized mortgage obligations with 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.
The tables below present an analysis of the gross realized gains and losses by category for the nine-month period ended September 30, 2010 and 2009:

	Nine-Month Period Ended September 30, 2010					
Description	**Face Value**	**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	$ 945,425	$ 968,451	$ 972,642	$ 967,926	$ 4,716	$ 1
Total investment securities	945,425	968,451	972,642	967,926	4,716	1
Mortgage-backed securities and CMOs						
FNMA and FHLMC certificates	2,070,159	1,940,384	1,783,631	1,755,808	27,823	
GNMA certificates	259,386	267,147	245,254	239,985	5,269	
Non-agency collateralized mortgage obligations	626,619	623,695	368,216	368,216		
Total mortgage-backed securities and CMOs	2,956,164	2,831,226	2,397,101	2,364,009	33,092	
Total	**$ 3,901,589**	**$ 3,799,677**	**$ 3,369,743**	**$ 3,331,935**	**$ 37,808**	**$ 1**

	Nine-Month Period Ended September 30, 2009					
Description	**Face Value**	**Cost**	**Sale Price**	**Sale Book Value**	**Gross Gains**	**Gross Losses**
		(In thousands)				
Sale of Securities Available-for-Sale						
Investment securities						
	$ 2,237,785	$ 2,238,556	$ 2,237,600	$ 2,237,414	$ 203	$ 17

Obligations of U.S. Government sponsored agencies						
Puerto Rico Government and agency obligations	90,000	90,612	90,000	90,000		
Total investment securities	2,327,785	2,329,168	2,327,600	2,327,414	203	17
Mortgage-backed securities and CMOs						
FNMA and FHLMC certificates	3,910,151	3,808,523	3,500,406	3,450,661	50,894	1,150
CMOs issued by U.S. Government sponsored agencies	330,000	330,938	336,993	330,584	6,410	
GNMA certificates	112,406	113,157	113,155	113,107	48	
Total mortgage-backed securities and CMOs	4,352,557	4,252,618	3,950,554	3,894,352	57,352	1,150
Total	**$ 6,680,342**	**$ 6,581,786**	**$ 6,278,154**	**$ 6,221,766**	**$ 57,555**	**$ 1,167**

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The following table shows the Group s gross unrealized losses and fair value of investment securities available-for-sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2010 and December 31, 2009:

September 30, 2010
Available-for-sale
(In thousands)

	Less than 12 months		
	Amortized Cost	**Unrealized Loss**	**Fair Value**
FNMA and FHLMC certificates	$ 311,297	$ 1,965	$ 309,332
Obligations of US Government sponsored agencies	301,476	15	301,461
CMOs issued by US Government sponsored agencies	2,588	6	2,582
	615,361	**1,986**	**613,375**

	12 months or more		
	Amortized Cost	**Unrealized Loss**	**Fair Value**
Non-agency collateralized mortgage obligations	85,754	22,508	63,246
Structured credit investments	61,723	19,281	42,442
Puerto Rico Government and agency obligations	50,964	3,002	47,962
	198,441	**44,791**	**153,650**

	Total		
	Amortized Cost	**Unrealized Loss**	**Fair Value**
FNMA and FHLMC certificates	311,297	1,965	309,332
Obligations of US Government sponsored agencies	301,476	15	301,461
Non-agency collateralized mortgage obligations	85,754	22,508	63,246
Structured credit investments	61,723	19,281	42,442
Puerto Rico Government and agency obligations	50,964	3,002	47,962
CMOs issued by US Government sponsored agencies	2,588	6	2,582
	$ 813,802	**$ 46,777**	**$ 767,025**

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December 31, 2009
Available-for-sale
(In thousands)

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

	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	61,722	23,340	38,382
	246,954	**70,944**	**176,010**

	Total		
	Amortized Cost	**Unrealized Loss**	**Fair Value**
FNMA and FHLMC certificates	1,773,180	24,298	1,748,882
Obligations of US 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 US Government sponsored agencies	2,701	3	2,698
	$ 2,780,072	**$ 127,254**	**$ 2,652,818**

The Group conducts quarterly 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.

ASC 320-10-5-1 requires the Group to consider various factors during its review, which include, but are not limited to:

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;

the financial condition of the issuer or issuers;

the creditworthiness of the obligor of the security;

actual collateral attributes;

any rating changes by a rating agency;

the payment structure of the debt security and the likelihood of the issuer being able to make payments;

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