ORIENTAL FINANCIAL GROUP INC
Form 10-K
March 15, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the Fiscal Year Ended December 31, 2012

or

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

For the Transition Period from to 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:

254 Muñoz Rivera Avenue

Oriental Center, 15th Floor

San Juan, Puerto Rico 00918

Telephone Number: (787) 771-6800

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

Common Stock ($1.00 par value per share)

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

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

8.75% Noncumulative Convertible Perpetual Preferred Stock, Series C ($1,000.00 liquidation preference per share)

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

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

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

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 þ

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 ¨

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

The aggregate market value of the common stock held by non-affiliates of Oriental Financial Group Inc. (the "Group") was approximately $451.3 million as of June 30, 2012 based upon 40,730,831 shares outstanding and the reported closing price of $11.08 on the New York Stock Exchange on that date.

As of February 28, 2013, the Group had 45,618,099 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Group's definitive proxy statement relating to the 2013 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, 2012

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FORWARD-LOOKING STATEMENTS

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

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

- the rate of growth in the economy and employment levels, as well as general business and economic conditions;
- changes in interest rates, as well as the magnitude of such changes;
- the fiscal and monetary policies of the federal government and its agencies;
- a credit default by the U.S. or Puerto Rico governments or a downgrade in the credit ratings of the U.S. or Puerto Rico governments;
- changes in federal bank regulatory and supervisory policies, including required levels of capital;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") on the Group's businesses, business practices and cost of operations;
- the relative strength or weakness of the consumer and commercial credit sectors and of the real estate market in Puerto Rico;
- the performance of the stock and bond markets;
- competition in the financial services industry;
- additional Federal Deposit Insurance Corporation ("FDIC") assessments;
- possible legislative, tax or regulatory changes; and

- difficulties in integrating the acquired Puerto Rico operations of Banco Bilbao Vizcaya Argentaria, S. A. ("BBVAPR") into the Group's operations.

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

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

ITEM 1. *BUSINESS*

General

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 banking and 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 banking and financial services to its clients through a complete range of banking and financial solutions, including commercial, consumer and mortgage lending; leasing; checking and savings accounts; financial planning, insurance, financial service, 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 provides these services through various subsidiaries including, a commercial bank, Oriental Bank (formerly known as Oriental Bank and Trust), two securities broker-dealers, Oriental Financial Services Corp. ("Oriental Financial Services") and OFS Securities, Inc. ("OFS Securities"), an insurance agency, Oriental Insurance, Inc. ("Oriental Insurance") and a retirement plan administrator, Caribbean Pension Consultants, Inc. ("CPC"). All of our subsidiaries are based in San Juan, Puerto Rico, except for CPC which is based in Boca Raton, Florida. The Group has 64 branches in Puerto Rico. 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, maintaining effective asset-liability management, growing non-interest revenue from banking and financial services, and improving operating efficiencies.

The Group's strategy involves:

- Strengthening its banking and financial services franchise by expanding its ability to attract deposits and build relationships with individual customers and professionals and mid-market commercial businesses through aggressive marketing and expansion of its sales force;

- Focusing on greater growth in commercial, consumer and mortgage lending, trust and financial services and insurance products; and increasing the level of integration in the marketing and delivery of banking and financial services;

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

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

- 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 and the benefits from the acquisitions of Eurobank and BBVAPR, this strategy has resulted in sustained growth in the Group's deposit-taking activities, commercial, consumer and mortgage lending and financial service 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 branch deposits, securities sold under agreements to repurchase, Federal Home Loan Bank ("FHLB") advances, Federal Reserve Bank ("FRB") advances, wholesale deposits, and subordinated capital notes. Through its branch network, Oriental Bank offers personal non-interest and interest-bearing checking accounts, savings accounts, certificates of deposit, individual retirement accounts ("IRAs") and commercial non-interest bearing checking accounts. The FDIC insures Oriental Bank's deposit accounts up to applicable limits. Management makes retail deposit pricing decisions periodically, adjusting the rates paid on retail deposits in response to general market conditions and local competition. Pricing decisions take into account the rates being offered by other local banks, the London Interbank Offered Rate ("LIBOR"), and mainland U.S. market interest rates.

Significant Transactions During 2012 – The BBVAPR Acquisition

On December 18, 2012, the Group purchased from Banco Bilbao Vizcaya Argentaria, S. A. ("BBVA"), all of the outstanding common stock of each of (i) BBVAPR Holding Corporation ("BBVAPR Holding"), the sole shareholder of Banco Bilbao Vizcaya Argentaria Puerto Rico ("BBVAPR Bank"), a Puerto Rico chartered commercial bank, and BBVA Seguros, Inc. ("BBVA Seguros"), an insurance agency, and (ii) BBVA Securities of Puerto Rico, Inc. ("BBVA Securities"), a registered broker-dealer. This transaction is referred to as the "BBVAPR Acquisition" and BBVAPR Holding, BBVAPR Bank, BBVA Seguros and BBVA Securities are collectively referred to as "BBVAPR" or the "BBVAPR Companies."

The Group acquired all of the outstanding common stock of BBVAPR Holding and BBVA Securities for an aggregate purchase price of $500 million. Since the BBVAPR Acquisition, the Group has pursued the legal integration of the BBVAPR Companies with its various subsidiaries. Immediately following the closing of the BBVAPR Acquisition, the Group merged BBVAPR Bank with and into Oriental Bank, with Oriental Bank continuing as the surviving entity. Shortly thereafter, BBVAPR Holding was merged with and into the Group, with the Group continuing as the surviving entity, in January 2013 BBVA Seguros (now known as Oriental Seguros) was liquidated and its assets were contributed by the Group to Oriental Insurance, and the Group has applied to the Financial Industry Regulatory Authority ("FINRA") for approval to merge BBVA Securities (now known as OFS Securities) with and into Oriental Financial Services, with Oriental Financial Services to continue as the surviving entity. The audited consolidated financial statements contemplate the effect of the BBVAPR Acquisition.

In connection with the BBVAPR Acquisition, the Group sold:

(i) 84,000 shares of its 8.750% Non-Cumulative Convertible Perpetual Preferred Stock, Series C (the "Convertible Preferred Stock"), on July, 3, 2012 at a purchase price of $1,000 per share in a private placement;

(ii) 4,829,267 shares of its common stock on October 31, 2012 at a per share offering price of $11.10 in a registered public offering; and

(iii) 960,000 shares of its 7.125% Non-Cumulative Perpetual Preferred Stock, Series D (the "Series D Preferred Stock") on November 5, 2012 at a per share offering price of $25 in a registered public offering.

The Group used the net proceeds of the foregoing issuances together with its own excess capital to fund the purchase price of the BBVAPR Acquisition.

Based on the closing of the BBVAPR Acquisition as of December 18, 2012, the Group (a) acquired (at an estimated fair value) $3.560 billion in loans, $561.6 million in investment securities, $41.6 million in foreclosed or repossessed assets, $394.6 million in cash and cash equivalents, $66.5 million in premises and equipment, $13.5 million in a core deposit and customer relationship intangibles, and $191.8 million in other assets, and (b) assumed $3.494 billion in deposits, $818.1 million in borrowings, and $79.0 million in other liabilities.

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 rate spread, loan production, and fees generated. The operations and results of BBVAPR for the period from December 18, 2012 to December 31, 2012 are considered a separate segment from those reportable segments detailed above. During that period, management evaluated the performance of this acquired business as a stand-alone segment rather than allocated to the aforementioned reportable segments. The Group is in the process of assessing the distribution of said operations into existing or new reportable segments as deemed applicable.

For detailed information regarding the performance of the Group’s operating segments, please refer to Note 21 to the Group’s accompanying consolidated financial statements.

Banking Activities

Oriental Bank (“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 64 branches throughout Puerto Rico and was incorporated in October 1964 as a federal mutual savings and loan association. It became a federal mutual savings bank in July 1983 and converted to a federal stock savings bank in

April 1987. Its conversion from a federally-chartered savings bank to a commercial bank chartered under the banking law of the Commonwealth of Puerto Rico, on June 30, 1994, allowed the Bank to more effectively pursue opportunities in its market and obtain more flexibility in its businesses. As a Puerto Rico-chartered commercial bank, it is subject to examination by the 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, leasing and consumer lending, 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. The Bank operates two international banking entities ("IBE") pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended (the "IBE Act"), one is a unit operating within the Bank named Oriental Overseas (the "IBE Unit"), and the other is a wholly-owned subsidiary of the Bank, named Oriental International Bank, Inc. (the "IBE Subsidiary"). The IBE Unit and Subsidiary offer the Bank certain Puerto Rico tax advantages, and their services are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.

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

The Group's mortgage banking activities are conducted through a division of the Bank. The mortgage banking activities include the origination of mortgage loans for the Bank's own portfolio, and the sale of loans directly into the secondary market or the securitization of conforming loans into mortgage-backed securities. The Bank originates Federal Housing Administration ("FHA")-insured mortgages, Veterans Administration ("VA")-guaranteed mortgages, and Rural Housing Service ("RHS")-guaranteed loans that are primarily securitized for issuance of Government National Mortgage Association ("GNMA") mortgage-backed securities which can be resold to individual or institutional investors in the secondary market. Conventional loans that meet the underwriting requirements for sale or exchange under standard Federal National Mortgage Association (the "FNMA") or the Federal Home Loan Mortgage Corporation (the "FHLMC") programs are referred to as conforming mortgage loans and are also securitized for issuance of FNMA or FHLMC mortgage-backed securities. The Bank is an approved seller of FNMA, as well as FHLMC, mortgage loans for issuance of FNMA and FHLMC mortgage-backed securities. The Bank 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 its residential mortgage loan portfolio.

Loan Underwriting

Residential mortgage loans: 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. For the residential mortgage loans originated by the BBVAPR's operations, in the short period from December 18, 2012 through December 31, 2012, the Group followed similar underwriting standards as the legacy portfolio, as the majority of the loans are conforming that need to comply with relative underwriting standards for the authorities cited above.

Commercial loans: Commercial loans include lines of credit and term facilities to finance business operations and to provide working capital for specific purposes, such as to finance the purchase of assets, equipment or inventory. Since a borrower's cash flow from operations is generally the primary source of repayment, the 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, LIBOR, or another established index. There were no significant commercial loan originations for the short period December 18, 2012 through December 31, 2012 from the BBVAPR's operations.

Auto loans: The Group provides financing for the purchase of new or used motor vehicles for private or public use. These loans are

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granted mainly through dealers authorized and approved by the auto credit department committee of the Group. The auto credit department has the specialized structure and resources to provide the service required for this product according to market demands.

The auto loan credit policy establishes specific guidance and parameters for the underwriting and origination process. Underwriting procedures, lending limits, interest rate approval, insurance coverage, and automobile brand restrictions are some parameters and internal controls implemented to ensure the quality and profitability of the auto loan portfolio. The credit scoring system is a fundamental part of the decision process.

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. At December 31, 2012, the Group has integrated secondary market activities of BBVAPR into its processes.

Financial Service Activities

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

Oriental Financial Services and OFS Securities are Puerto Rico corporations and the Group's subsidiaries 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. Oriental Financial Services and OFS Securities, both members of FINRA and the Securities Investor Protection Corporation, are registered securities broker-dealers pursuant to Section 15(b) of the Securities Exchange Act of 1934. Both broker-dealers do not carry customer accounts and are, accordingly, exempt from the Customer Protection Rule (SEC Rule 15c3-3) pursuant to subsection (k)(2)(ii) of such rule. They clear securities transactions through Pershing LLC, a clearing agent that carries the accounts of their customers on a "fully disclosed" basis.

Both broker-dealers offer securities brokerage services covering various investment alternatives such as tax-advantaged fixed income securities, mutual funds, stocks, and bonds to retail and institutional clients. They also offer 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.

Oriental Financial Services 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 includes gains, losses, and fees, net of syndicate expenses, arising from securities offerings in which it acts as an underwriter or agent. Investment banking revenue also includes fees earned from providing merger-and-acquisition and financial restructuring advisory services.

As a result of the BBVAPR Acquisition, the Bank acquired a municipal securities division (the "MSD") and succeeded to the registration as a municipal securities dealer of BBVAPR División de Valores Municipales. The MSD is a separately identifiable division of the Bank and is registered with the SEC. The FDIC is the appropriate regulatory agency of the MSD's municipal securities activities.

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.

CPC, 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 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 financial services at most of its branch locations. Recent consolidations among Puerto Rico banks have created an environment for more rational loan and deposit pricing. 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 and the Dodd-Frank Act. The qualification requirements and the process for a bank holding company that elects to be treated as a financial holding company requires that a bank holding company and all of the subsidiary banks controlled by it at the time of election must be and remain at all times “well capitalized” and “well managed.”

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. A financial holding company may generally commence any activity, or acquire any company, that is financial in nature without prior approval of the Federal Reserve Board. As provided by the Dodd-Frank Act, a financial holding company may not acquire a company, without prior Federal Reserve Board approval, in a transaction in which the total consolidated assets to be acquired by the financial holding company exceed $10 billion.

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

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, the Truth-in-Lending Act, the Real Estate Settlement Procedures Act and the regulations promulgated thereunder which, among other things, prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. 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. Oriental Financial Services and OFS Securities, as registered broker-dealers, are subject to the supervision, examination and regulation of FINRA, the SEC, and the OCFI in matters relating to the conduct of their securities business, including record keeping and reporting requirements, supervision and licensing of employees, and obligations to customers.

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

Dodd-Frank Wall Street Reform and Consumer Protection Act

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

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

Holding Company Structure

The Bank is subject to restrictions under federal laws that limit the transfer of funds to its affiliates (including 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 the Dodd-Frank Act, a bank holding company, such as the Group, must serve as a source of financial strength for any subsidiary depository institution. The term "source of financial strength" is defined as the ability of a company to provide financial assistance to its insured depository institution subsidiaries in the event of financial distress at such subsidiaries. This support may be required at times when, absent such requirement, the bank holding company might not otherwise provide such support. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. The Bank is currently the only depository institution subsidiary of 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 the Bank) 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 Federal Deposit Insurance Act, as amended (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. In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding a bank.

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

Federal Home Loan Bank System

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

As a system member, the Bank is entitled to borrow from the FHLB of New York (the "FHLB-NY") and is required to invest in FHLB-NY stock in an amount equal to the greater of 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. The Bank is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances.

Federal Deposit Insurance Corporation Improvement Act

Under FDICIA, the federal banking regulators must take prompt corrective action with 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 1 risk-based capital ratio of 6.0% or more, has a Tier 1 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 1 risk-based capital ratio of 4.0% or more and a Tier 1 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 1 risk-based ratio that is less than 4.0% or a Tier 1 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 1 risk-based capital ratio that is less than 3.0% or a Tier 1 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: capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. 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.

The Dodd-Frank Act contains several important deposit insurance reforms, including the following: (i) the maximum deposit insurance amount was permanently increased to $250,000; (ii) the deposit insurance assessment is now based on the insured depository institution’s average consolidated assets minus its average tangible equity, rather than on its deposit base; (iii) the minimum reserve ratio for the Deposit Insurance Fund was raised from 1.15% to 1.35% of

estimated insured deposits by September 30, 2020; (iv) the FDIC is required to "offset the effect" of increased assessments on insured depository institutions with total consolidated assets of less than $10 billion; (v) the FDIC is no longer required to pay dividends if the Deposit Insurance Fund's reserve ratio is greater than the minimum ratio; and (vi) the FDIC temporarily insured the full amount of qualifying "noninterest-bearing transaction accounts" for 2011 and 2012. As defined in the Dodd-Frank Act, a "noninterest-bearing transaction account" is a deposit or account maintained at a depository institution with respect to which interest is neither accrued nor paid, on which the depositor or account holder is permitted to make withdrawals by negotiable or transferrable instrument, payment orders of withdrawals, telephone or other electronic media transfers, or other similar items for the purpose of making payments or transfers to third parties or others, and on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal.

Effective April 1, 2011, the FDIC amended its regulations under the FDIA, as amended by the Dodd-Frank Act, to modify the definition of a depository institution's insurance assessment base; to revise the deposit insurance assessment rate schedules in light of the new assessment base and altered adjustments; to implement the dividend provisions of the Dodd-Frank Act; and to revise the large insured depository institution assessment system to better differentiate for risk and better take into account losses from large institution failures that the FDIC may incur. Since the new assessment base under the Dodd-Frank Act is larger than the current assessment base, the new assessment rates adopted by the FDIC are lower than the former rates.

The Temporary Liquidity Guarantee Program (“TLGP”) of the FDIC provided two limited guarantee programs: the Debt Guarantee Program (“DGP”) and the Transaction Account Guarantee Program (“TAGP”). The DGP guaranteed 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, in the period from October 14, 2008 through October 31, 2009. For eligible debt issued in that period, the FDIC provided the guarantee coverage until the earlier of the maturity date of the debt or December 31, 2012. The TAGP offered a full guarantee for non interest-bearing transaction accounts held at FDIC-insured depository institutions. The unlimited deposit coverage was voluntary for eligible institutions and in addition to the $250,000 FDIC deposit insurance per depositor that was included as part of the Emergency Economic Stabilization Act of 2008. The TAGP coverage became effective on October 14, 2008 and continued for participating institutions until December 31, 2011. The Group opted to become a participating entity on both of these programs and paid applicable fees for participation. Participants in the DGP program had a fee structure based on a sliding scale, depending on length of maturity. Shorter-term debt had a lower fee structure and longer-term debt had a higher fee. The range was 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 did not choose to opt out of the TAGP was assessed, on a quarterly basis, an annualized 10 cents per $100 fee on balances in non-interest bearing transaction accounts that exceeded the existing deposit insurance limit of $250,000. In March 2009, the Bank issued $105 million in notes guaranteed under the TLGP. These notes matured on March 16, 2012.

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, 2012, 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 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. Except as otherwise discussed below in light of the Dodd-Frank Act in connection with certain debt or equity instruments issued on or after May 19, 2010, not more than 25% of qualifying Tier 1 Capital may consist of qualifying cumulative 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 regulations with respect to risk-based and leverage capital ratios that require most intangibles, including goodwill and core deposit intangibles, to be deducted from Tier 1 Capital. The only types of identifiable intangible assets that may be included in, that is, not deducted from, an organization's capital are readily marketable mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships.

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.

Under the Dodd-Frank Act, federal banking regulators are required to establish minimum leverage and risk-based capital requirements, on a consolidated basis, for insured institutions, depository institution holding companies, and non-bank financial companies supervised by the Federal Reserve Board. The minimum leverage and risk-based capital requirements are to be determined

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based on the minimum ratios established for insured depository institutions under prompt corrective action regulations. In effect, such provision of the Dodd-Frank Act, which is commonly known as the Collins Amendment, applies to bank holding companies the same leverage and risk-based capital requirements that will apply to insured depository institutions. Because the capital requirements must be the same for insured depository institutions and their holding companies, the Collins Amendment generally excludes certain debt or equity instruments, such as cumulative perpetual preferred stock and trust preferred securities, from Tier 1 Capital, subject to a three-year phase-out from Tier 1 qualification for such instruments issued before May 19, 2010, with the phase-out commencing on January 1, 2013. However, such instruments issued before May 19, 2010, by a bank holding company, such as the Group, with total consolidated assets of less than $15 billion as of December 31, 2009, are not affected by the Collins Amendment and may continue to be included in Tier 1 Capital as a restricted core capital element. Although the Dodd-Frank Act required federal banking regulators to implement the Collins Amendment by January 2012, the Federal Reserve Board, on June 7, 2012, issued three notices of proposed rulemaking addressing the implementation of Basel III regulatory capital reforms as well as the capital requirements under the Dodd-Frank Act, including the Collins Amendment.

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, 2012, the Group was in compliance with all capital requirements. For more information, please refer to the accompanying consolidated financial statements.

Safety and Soundness Standards

Section 39 of the FDIA, as amended by FDICIA, requires each federal banking agency to prescribe for all insured depository institutions standards relating to internal control, information systems, and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, and such other operational and managerial standards as the agency deems appropriate. In addition, each federal banking agency 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, including that it is owned exclusively by other banks.

Under the FDIC regulations governing the activities and investments of insured state banks which further implemented Section 24 of the FDIA, as amended by FDICIA, an insured state-chartered bank may not, directly, or indirectly through a subsidiary, engage as "principal" in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the Deposit Insurance Fund and the bank is in compliance with applicable regulatory capital requirements. 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, including investment funds for which the bank or any of its affiliates is an investment advisor. Generally, sections 23A and 23B (i) limit the extent to which a bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of the bank's capital stock and surplus, and limit such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus, and (ii) require that all such transactions be on terms that are consistent with safe and sound banking practices. The term "covered transactions" includes the making of loans, purchase of or investment in securities issued by the affiliate, purchase of assets, acceptance of securities issued by the affiliate as collateral for a loan or extension of credit, issuance of guarantees and other similar types of transactions. The Dodd-Frank Act expanded the scope of transactions treated as "covered transactions" to include credit exposure to an affiliate on derivatives transactions, credit exposure resulting from a securities borrowing or lending transaction, or derivative transaction, and acceptances of affiliate-issued debt obligations as collateral for a loan or extension of credit. Most loans by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100 to 130 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 22(h) of the Federal Reserve Act place restrictions on loans by a bank to executive officers, directors, and principal shareholders. Regulation O of the Federal Reserve Board implements these provisions. Under Section 22(h) and Regulation O, loans to a director, an executive officer and 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 his 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 that oversees the planning of products and services offered to the community, especially those aimed to serve low and moderate income communities.

USA Patriot Act

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

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

Failure of a financial institution to comply with the USA Patriot Act's requirements could have serious legal consequences for the institution. 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 the US Treasury's regulations.

Privacy Policies

Under the Gramm-Leach-Bliley Act, all financial institutions are required to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request, and establish procedures and practices to protect customer data from unauthorized access. 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 control over financial reporting.

The Group has included in this annual report on Form 10-K management's 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, 2012, the Group's management concluded that its internal control over financial reporting was effective.

As allowed by SEC guidance, management excluded from its assessment of the effectiveness of the Group's internal control over financial reporting as of December 31, 2012, the recently acquired BBVAPR Companies, which included total assets of $4.472 billion, total liabilities of $3.969 billion and net interest income of $7.8 million in the Group's consolidated financial statements as of and for the year ended December 31, 2012.

Puerto Rico Banking Act

As a Puerto Rico-chartered commercial bank, the Bank is subject to regulation and supervision by the OCFI under the Banking Act, which contains provisions governing the 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, 2012, legal surplus amounted to $52.1 million (December 31, 2011 — $50.2 million). The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders.

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

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

The Banking Act also requires change of control filings. When any person or entity will own, directly or indirectly, upon consummation of a transfer, 5% or more of the outstanding voting capital stock of a bank, the acquiring parties must inform the OCFI of the details not less than 60 days prior to the date said transfer is to be consummated. The transfer will require the approval of the

OCFI if it results in a change of control of the bank. Under the Banking Act, a change of control is presumed if an acquirer who did not own more than 5% of the voting capital stock before the transfer exceeds such percentage after the transfer.

The Banking Act permits Puerto Rico commercial banks to make loans to any one person, firm, partnership or corporation, up to an aggregate amount of 15% of the sum of: (i) the bank's paid-in capital; (ii) the bank's reserve fund; (iii) 50% of the bank's retained earnings, subject to certain limitations; and (iv) any other components that the OCFI may determine from time to time. If such loans are secured by collateral worth at least 25% more than the amount of the loan, the aggregate maximum amount will include 33.33% of 50% of the bank's retained earnings. 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.

The current regulations of the Puerto Rico Finance Board provide that the applicable interest rate on loans to individuals and unincorporated businesses is to be determined by free competition. The Puerto Rico Finance Board also has the authority to regulate maximum finance charges on retail installment sales contracts and for credit card purchases. There is presently no maximum rate for retail installment sales contracts and for credit card purchases.

Puerto Rico Internal Revenue Code

On January 31, 2011, the Governor of Puerto Rico signed into law the second and last phase of the Administration's tax reform bill. It creates the Internal Revenue Code for a New Puerto Rico, which has been subsequently amended several times (the "2011 Code"). The 2011 Code provides for the gradual repeal of the Puerto Rico Internal Revenue Code of 1994 (the "1994 Code"), as its provisions started to take effect, with some exceptions, as of January 1, 2011. For corporate taxpayers, the 2011 Code retains the 20% flat rate on "normal-tax net income" but establishes significantly lower rates applicable to "surtax net income" which is the "normal-tax net income" less the allowed surtax deduction. The 2011 Code provides a surtax rate from 5% to 10% for the 2011, 2012 and 2013 taxable years. As of the 2014 taxable year, the surtax rate may be reduced to 5% if certain economic and budgetary control tests are met by the Government of Puerto Rico. If such economic tests are not met, the reduction of the surtax rate will be postponed until the year when such economic tests are met. In the case of a controlled group of corporations, the determination of which surtax rate applies will be made by adding the "normal-tax net income" of each of the entities that are members of the controlled group reduced by the surtax deduction. The 2011 Code also increased the surtax deduction to $750,000. In the case of a controlled group of corporations, the surtax deduction should be distributed among the members of the controlled group. The 2011 Code reduces the alternative minimum tax ("AMT") from 22% to 20%. It also eliminates the 5% additional surtax which was established by Act No. 7 of March 9, 2009, and the 5% recapture of the benefit of the income tax tables, except for the income earned by international banking entities, which is currently fully exempt, but was subject to a 5% income tax for the 2009, 2010 and 2011 taxable years. Under the 2011 Code, a corporate taxpayer had a one-time option of determining its income tax liability and filing its income tax return pursuant to the 1994 Code. This election was required with the filing of the 2011 income tax return and, once

made, was irrevocable for such taxable year and for each of the next four taxable years. The Group elected to implement and file its income tax returns pursuant to the 2011 Code. Under the 2011 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 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.

International Banking Center Regulatory Act of Puerto Rico

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

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

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

Employees

At December 31, 2012, the Group had 1,654 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 "Investor Relations" link of the Group's internet website at www.orientalbank.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 principles and guidelines, code of business conduct and ethics, and the charters of its audit and compliance 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 other information set forth in this report, you should carefully consider the following risk factors, as updated by other filings the Group makes with the SEC under the Exchange Act. Additional risks and uncertainties not presently known to us at this time or that the Group currently deems immaterial may also adversely affect the Group's business, financial condition or results of operations.

Most of our business is conducted in Puerto Rico, which in recent years has experienced a downturn in the economy and in the real estate market.

Because most of our business activities are conducted in Puerto Rico and a significant portion of our credit exposure on our loan portfolio, which is the largest component of our interest-earning assets, is concentrated in Puerto Rico, our profitability and financial condition may be adversely affected by an extended economic 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 our loans and loan servicing portfolio.

The economy of Puerto Rico entered into a recession in the fourth quarter of the government's fiscal year ended June 30, 2006. For fiscal years 2007, 2008, 2009, 2010 and 2011, Puerto Rico's real gross national product decreased by 1.2%, 2.9%, 3.8%, 3.4% and 1.5%, respectively.

On March 13, 2013, Standard & Poor's Rating Services ("S&P") downgraded Puerto Rico's general obligation debt ratings from "BBB" to "BBB-" with a negative outlook. In taking such action, S&P stated that the downgrade reflects a significantly larger estimated budget deficit in 2013 than was originally expected, which will make it difficult for Puerto Rico to achieve a structurally balanced budget within the next two years.

On February, 21, 2013, Fitch Ratings ("Fitch") placed the Puerto Rico general obligation bonds and other debt rated BBB-plus on a negative watch. Fitch stated that the negative rating watch is based on the economic and revenue underperformance which Fitch believes has meaningfully increased the size of the Commonwealth's operating budget imbalance for the current fiscal year and the gap the Commonwealth will need to address as it develops a balanced budget for 2014. Fitch does not believe that a balanced budget will be achieved in fiscal 2014, and meeting this goal will remain challenging thereafter.

On December 13, 2012, Moody's Investors Service ("Moody's") downgraded the rating of Puerto Rico's general obligation debt to Baa3 from Baa1 and assigned a negative outlook. In taking such action, Moody's stated, in part, that economic growth prospects remain weak after six years of recession and could be further dampened by the Commonwealth's efforts to control spending and reform its retirement system, both of which are needed to stabilize the Commonwealths financial results. It also stated that the lack of significant economic growth drivers and the Commonwealth's declining population have also reduced prospects for a strong economic recovery, and that debt levels are very high and continue to grow, while financial performance has been weak, including lackluster revenue growth and large structural budget gaps that have led to a persistent reliance on deficit financings and serial debt restructurings to support operations in recent years. It further said that reform of the Commonwealth's severely underfunded retirement systems is needed to avoid asset depletion and future budget pressure.

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 default 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. For a discussion of the impact of the economy on our loan portfolios, see "—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 prolonged recessionary economic environment accelerated the devaluation of properties and 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 business activities of the BBVAPR Companies are similarly concentrated in the Puerto Rico market. Moreover, as a result of the BBVAPR Acquisition and the deleveraging of our balance sheet in the last quarter of 2012, our loan portfolio has become the largest component of our interest-earning assets. Consequently, the BBVAPR Acquisition has increased the risk we face in the event of a continued downturn in the Puerto Rico economy.

Our decisions regarding credit risk and the allowance for loan and lease 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 the loans will not be repaid. This default risk is affected by a number of factors, including:

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

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

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

As a result of the BBVAPR Acquisition, we acquired a significant portfolio of commercial and auto loans. If we are unable to accurately predict loan losses with respect to these loan categories, we may have to increase the allowance for loan and lease losses. See "—Loans that we acquired in the BBVAPR Acquisition may be subject to greater than anticipated impairment."

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

From the time that we fund the mortgage loans originated to the time that they are sold, we are generally at risk for any mortgage loan defaults. Once we sell the mortgage loans, the risk of loss from mortgage loan defaults and foreclosures passes to the purchaser or insurer of the mortgage loans. However, in the ordinary course of business, we make representations and warranties to the purchasers and insurers of mortgage loans relating to the validity of such loans. If there is a breach of any of these representations or warranties, we may be required to repurchase the mortgage loan and bear any subsequent loss on the mortgage loan. We also may be required to repurchase mortgage loans in the event that there was improper underwriting or fraud or in the event that the loans become delinquent shortly after they are originated. For the year ended December 31, 2012, we repurchased $12.5 million of loans from GNMA. Any such repurchases in the future may negatively impact our liquidity and operating results. Termination of our ability to sell mortgage products to the government-sponsored entities would have a material adverse effect on our results of operations and financial condition. In addition, we may be required to indemnify certain purchasers and others against losses they incur in the event of breaches of representations and warranties and in various other circumstances, including securities fraud claims, and the amount of such losses could exceed the purchase amount of the related loans. Consequently, we may be exposed to credit risk associated with sold loans. In addition, we incur higher liquidity risk with respect to mortgage loans not eligible to be insured by FNMA, GNMA or FHLMC, due to a lack of secondary market in which to sell these loans.

We have established reserves in our consolidated financial statements for potential losses that are considered to be both probable and reasonably estimable related to the mortgage loans sold by us. The adequacy of the reserve and the ultimate amount of losses incurred will depend on, among other things, the actual future mortgage loan performance, the actual level of future repurchase and indemnification requests, the actual success rate of claimants, developments in litigation related to us and the industry, actual recoveries on the collateral and macroeconomic conditions (including unemployment levels and housing prices). Due to uncertainties relating to these factors, there can be no assurance that our reserves will be adequate or that the total amount of losses incurred will not have a material adverse effect upon our financial condition or results of operations. For additional information related to our allowance for loan and lease losses, see "Note 6—Allowance for Loan and Lease Losses" to our audited consolidated financial statements included in this annual report on Form 10-K for the year ended December 31, 2012.

Our earnings could decrease due to increases to the provision for credit losses

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

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

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

Our intangible assets could be determined to be impaired in the future and could decrease the Group’s earnings

In future periods, as a result of the BBVAPR Acquisition, we will be required to test our goodwill, core deposit and customer relationship intangible assets for impairment on a periodic basis. The impairment testing process considers a variety of factors, including the current market price of our common shares, the estimated net present value of our assets and liabilities, and information concerning the terminal

valuation of similarly situated insured depository institutions. If an impairment determination is made in a future reporting period, our earnings and the book value of these intangible assets will be reduced by the amount of the impairment. If an impairment loss is recorded, it will have little or no impact on the tangible book value of our common shares or our regulatory capital levels, but such an impairment loss could significantly restrict the Group's ability to make dividend payments to us without prior regulatory approval.

We may not be able to realize the anticipated benefits of the BBVAPR Acquisition.

Our future growth and profitability depend, in part, on the ability to successfully manage the combined operations. The success of the BBVAPR Acquisition will depend on, among other things, our ability to assess the quality of assets acquired, to realize anticipated cost savings and to integrate the acquired companies in a manner that permits growth opportunities and does not materially disrupt our or BBVAPR's existing customer relationships or result in decreased revenue resulting from any loss of customers. If we are not able to successfully achieve these objectives, the anticipated benefits of the BBVAPR Acquisition may not be realized fully or at all or may take longer to realize than expected.

Loans that we acquired in the BBVAPR Acquisition may be subject to greater than anticipated impairment.

We have made fair value estimates of certain assets and liabilities in recording the BBVAPR Acquisition. Actual values of these assets and liabilities could differ from our estimates, which could result in us not achieving the anticipated benefits of the BBVAPR Acquisition. In addition, BBVAPR's loan scoring system is different than ours, and as we evaluate their loan portfolio using our systems, we may have to make additional adjustments.

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

We may not be able to integrate BBVAPR's business into our operations.

The successful integration of BBVAPR's banking operations and our future growth and profitability depend in part on our ability to successfully manage the combined operations. Integration of an acquired business can be complex and costly, sometimes including combining relevant accounting and data processing systems and management controls

and policies, as well as managing relevant relationships with employees, clients, suppliers and other business partners. Integration efforts could divert management attention and resources, which could adversely affect our operations or results. The loss of key employees in connection with this acquisition could adversely affect our ability to successfully conduct the combined operations. There can be no assurance that any of these executives will choose to continue working with us, or if they do, that we will be able to successfully integrate these executives as part of our management team in the combined business.

The BBVAPR Acquisition may also result in business disruptions that cause us to lose customers or cause customers to move their accounts or business to competing financial institutions. It is possible that the integration process related to the acquisition could disrupt our ongoing business or result in inconsistencies in customer service that could adversely affect our ability to maintain relationships with clients, customers, depositors and employees. Our inability to overcome these risks could have a material adverse effect on our business or financial condition, results of operations and future prospects. There is no assurance that our integration efforts will not result in other unanticipated costs.

We will incur in significant costs related to the BBVAPR Acquisition.

We expect to incur certain one-time restructuring charges of approximately $35 million in connection with the BBVAPR acquisition. The substantial majority of non-recurring expenses resulting from the BBVAPR Acquisition will be comprised of transaction costs related to the BBVAPR Acquisition, financing arrangements and employment-related costs. We also will incur transaction fees and costs related to formulating and implementing integration plans. We continue to assess the magnitude of these costs, and additional unanticipated costs may be incurred in the business integration of the two groups of companies. Although we expect that the elimination of duplicative costs, as well as the realization of other efficiencies or synergies related to the integration of the businesses should allow us to offset incremental transaction and acquisition-related costs over time, this net benefit may not be achieved in the near term, or at all.

Our financial results are constantly exposed to market risk, in particular to changes in interest rates.

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

Changes in interest rates are one of the principal market risks affecting us. Our 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. Net interest income is the difference between the revenue generated on interest-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 program to project future movements in the 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. In addition, the interest 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 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, our mortgage-backed securities portfolios 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 implements strategies to reduce future interest rate exposure.

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

We use derivatives, such as interest rate swaps and options on interest rate swaps, to manage part of our exposure to market risk caused by changes in interest rates. We have also offered certificates of deposit with an option tied to the performance of the Standard & Poor 500 stock market index and use derivatives, such as option agreements with major broker-dealer companies, to manage our exposure to changes in the value of the index. The derivative instruments that we may utilize also have their own risks, which include: (i) 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; (ii) 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 (iii) 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 the counterparty to a derivative contract fails to perform, our credit risk is equal to the net fair value of the contract. We deal with counterparties that have high quality credit ratings at the time we enter into the counterparty relationships. However, there can be no assurances that the counterparties will have the ability to perform under their contracts. If the counterparty fails to perform, including as a result of the bankruptcy or insolvency of such counterparty, we would incur losses as a result.

We may incur a significant impairment charge in connection with a decline in the market value of our investment securities portfolio.

A substantial part of our earnings come from the treasury business segment, which encompasses the 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. The term “other-than-temporary impairment” is not intended to indicate that the decline is permanent, but indicates that the prospect 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 the adjusted amortized cost of such assets at the time of sale. We consider numerous factors in our review of whether a decline in fair value is other-than-temporary, many of which involve complex judgment.

A decline in the market value of our investment securities portfolio could adversely impact our regulatory capital ratios.

In June 2012, the Federal Reserve Board, together with other federal banking regulatory agencies, recently issued proposed capital rules to implement the so-called "Basel III" capital framework in the United States. Among other things, the proposed rules would require banking organizations such as ourselves to include gains and losses on our securities holdings classified as available-for-sale ("AFS") in our common equity tier 1 capital ("CET1"). This aspect of the rules would be phased in over six years with full gain and loss flow-through to capital starting in 2018. Currently, unrealized losses on AFS equity securities are counted against Tier 1 capital, unrealized gains on AFS equity securities are partially included in Tier 2 capital and unrealized gains and losses on AFS debt securities are excluded from regulatory capital. However, these unrealized gains and losses are reflected in stockholders' equity under accounting principles generally accepted in the United States ("GAAP"). The agencies' proposals introduce the concept of CET1—which is comprised of qualifying common stock instruments, retained earnings, accumulated other comprehensive income ("AOCI"), certain qualifying minority interests in consolidated subsidiaries and other adjustments, and establish a new minimum ratio of CET1 to total risk-weighted assets of 4.5% and a capital conservation buffer of 2.5% to be phased in over several years. Because of the inclusion of AOCI, unlike the current general risk-based capital rules, unrealized gains and losses on all AFS-classified securities would flow through to CET1 capital, after the transition period, if the proposals are adopted in their current form. Our CET1 levels are likely to be significantly more volatile under the agencies' proposals than previously because unrealized gains and losses on AFS classified securities recognized in stockholders' equity on the balance sheet for accounting purposes would also be incorporated for regulatory capital purposes. Accordingly, a decline in the market value of our investment securities portfolio could adversely impact our regulatory capital ratios.

Market conditions and actions by governmental authorities may upset the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our investment portfolio.

Our success depends in part on our ability to analyze the relationship of changing interest rates on prepayments of the mortgage loans that underlie our mortgage-backed securities ("MBS") portfolio. Changes in interest rates and prepayments affect the market price of MBS that we may purchase and any MBS that we may hold at a given time. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. In conducting this analysis, we depend on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. U.S. government programs aimed at assisting homeowners, including the Homeowner Affordability and Stability Plan announced by the US Treasury in February 2009, the "Operation Twist" program announced by the Federal Reserve Board on September 21, 2011, the expansion of the Home Affordable Refinancing Program ("HARP") announced by the Federal Housing Finance Agency ("FHFA"), FNMA and the FHLMC on October 24, 2011, and other expansions to the US Treasury's Home Affordable Modification Program ("HAMP"), including proposals to allow FNMA and FHLMC to use principal reductions when modifying loans under HAMP, could cause an increase in prepayment rates. Bills to implement these proposals, which were opposed by the FHFA, are currently under consideration in both chambers of Congress. On February 1, 2012, President Obama proposed legislation to expand HARP in order to allow a greater number of homeowners to refinance their mortgages at historically low interest rates. If the dislocations in the residential mortgage market, recent or future government actions, or other developments change the way that prepayment trends have historically responded to interest rate changes, it would significantly affect our ability to (i) assess the market value of our investment portfolio, (ii) implement our hedging strategies, and (iii) adopt techniques to reduce our prepayment rate volatility. This could adversely affect our results of operations, financial position or perception of financial health.

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 significant trend of decreasing values in certain housing segments in Puerto Rico 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.

The decline in Puerto Rico's economy has had an adverse effect in the credit quality of our loan portfolios. Among other things, during the recession, we experienced an increase in the level of non-performing assets and loan loss provision, which adversely affected our profitability. Although the delinquency rates have decreased in the short term, they may increase if the economy falls back into a recession. If there is another decline in economic activity, additional increases in the allowance for loan and lease losses could be necessary with further adverse effects on our profitability.

Any sustained period of increased delinquencies, foreclosures or losses could harm our ability to sell loans, the price received on the sale of such loans, and the value of the mortgage loan portfolio, all of which could have a negative impact on our results of operations and financial condition. In addition, any material decline in real estate values would weaken our collateral loan-to-value ratios and increase the possibility of loss if a borrower defaults. For a discussion of the impact of the Puerto Rico economy on our business operations, see "—Most of our business is conducted in Puerto Rico, which in recent years has experienced a downturn in the economy and in the real estate market."

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 U.S. residential real estate market has most recently shown signs of recovery driven by lower interest rates, fewer foreclosures, high affordability of home ownership, and satisfying demand that has built up during a period of economic uncertainty. However, we cannot predict whether the recovery will continue or if and when the market and related economic forces will return the U.S. residential real estate industry to a period of sustained growth. Diverse macroeconomic developments could also

slow or impair a housing recovery and if the real estate market or the economy as a whole does not improve, we may experience material adverse effects on our business or financial condition and liquidity, including our investment securities and wholesale funding portfolios. Furthermore, any concern regarding the long-term sovereign credit rating of the United States, including due to concerns related to U.S. federal fiscal policy or difficulties in addressing federal debt levels, could stress the capital markets in the United States and globally and could have a negative impact on our investment securities and wholesale funding portfolios.

Significant concern regarding the creditworthiness of some of the governments in Europe has also contributed to volatility in the financial markets and led to greater economic uncertainty worldwide. Sovereign debt concerns in Europe could diminish economic recovery and lead to further stress in the capital markets, both globally and in the United States, which could also have a negative impact on our investment securities and wholesale funding portfolios.

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

Our business requires continuous access to various funding sources. We are able to fund our operations through deposits as well as through advances from the FHLB-NY and other alternative sources; however, our business is significantly dependent upon other wholesale funding sources, such as repurchase agreements and brokered deposits, which consisted of approximately 32% of our total interest-bearing liabilities as of December 31, 2012. While most of our repurchase agreements have been structured with initial terms to maturity of between three and ten years, most of 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.

We expect to have continued access to credit from the foregoing sources of funds. However, there can be no assurance that such financing sources will continue to be available or will be available on favorable terms. In a period of financial disruption, or if negative developments occur with respect to us, the availability and cost of funding sources could be adversely affected. In that event, our cost of funds may increase, thereby reducing the net interest income, or we may need to dispose of a portion of the investment portfolio, which, depending upon market conditions, could result in realizing a loss or experiencing other adverse accounting consequences upon the dispositions. The interest rates that we pay on our securities are also influenced by, among other things, applicable credit ratings from

recognized rating agencies. A downgrade to any of these credit ratings could affect our ability to access the capital markets, increase our borrowing costs and have a negative impact on our results of operations. Our efforts to monitor and manage liquidity risk may not be successful to deal with dramatic or unanticipated changes in the global securities markets or other reductions in liquidity driven by us or market related events. In the event that such sources of funds are reduced or eliminated and we are not able to replace them on a cost-effective basis, we may be forced to curtail or cease our loan origination business and treasury activities, which would have a material adverse effect on our operations and financial condition.

Our 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, technological and organizational 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 these risks. There can be no assurance that those policies, procedures and systems are adequate to identify and mitigate all risks inherent in our various businesses. Our businesses and the markets in which we operate are also continuously evolving. If we fail to fully understand the implications of changes in our business or the financial markets and to adequately or timely enhance the risk framework to address those changes, we could incur losses. In addition, in a difficult or less liquid market environment, our risk management strategies may not be effective because other market participants may be attempting to use the same or similar strategies to deal with the challenging market conditions. In such circumstances, it may be difficult for us to reduce our risk positions due to the activity of such other market participants.

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 paid on deposits or lower the rates charged on loans which could adversely affect our profitability.

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

We are a separate and distinct legal entity from our subsidiaries. Dividends to us from our subsidiaries have represented a major source of funds for us to pay dividends on our common and preferred stock, make payments on corporate debt securities and meet other obligations. There are various U.S. federal and Puerto Rico law limitations on the extent to which Oriental Bank, our main subsidiary, can finance or otherwise supply funds to us through dividends and loans. These limitations include minimum regulatory capital requirements, U.S. federal and Puerto Rico banking law requirements concerning the payment of dividends out of net profits or surplus, Sections 23A and 23B of the Federal Reserve Act of 1913 and Regulation W of the Federal Reserve Board governing transactions between an insured depository institution and its affiliates, as well as general federal regulatory oversight to prevent unsafe or unsound practices.

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

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

Loans that we acquired in the FDIC-assisted acquisition of Eurobank may not be covered by the shared-loss agreements if the FDIC determines that we have not adequately performed under these agreements or if the shared-loss agreements have ended.

Although the FDIC has agreed to reimburse us for 80% of qualifying losses on covered loans, we are not protected from all losses resulting from charge-offs with respect to such loans. Also, the FDIC has the right to refuse or delay payment for loan and lease losses if the shared-loss agreements are not performed by us in accordance with their terms. Additionally, the shared-loss agreements have limited terms, and therefore, any charge-offs that we experience after the terms of the shared-loss agreements have ended would not be recoverable from the FDIC.

Certain provisions of the shared-loss agreements entered into with the FDIC may have anti-takeover effects and could limit our ability to engage in certain strategic transactions that our board of directors believes would be in the best interests of shareholders.

The FDIC's agreement to bear 80% of qualifying losses on single family residential loans for ten years and commercial loans for five years is one of our significant assets and a feature of the FDIC-assisted acquisition without which we would not have entered into such transaction. Our agreement with the FDIC requires that we receive prior FDIC consent, which may be withheld by the FDIC in its sole discretion, prior to us or our shareholders engaging in certain transactions. If any such transaction is completed without prior FDIC consent, the FDIC would have the right to discontinue the loss-sharing arrangement.

Among other things, prior FDIC consent is required for: (i) a merger or consolidation of us with or into another company if our shareholders will own less than 2/3 of the combined company and (ii) a sale of shares by one or more of our shareholders that will effect a change in control of Oriental Bank, as determined by the FDIC with reference to the standards set forth in the Change in Bank Control Act of 1978 (generally, the acquisition of between 10% and 25% of our voting securities where the presumption of control is not rebutted, or the acquisition of more than 25% of our voting securities). Such a sale by shareholders may occur beyond our control. If we or any shareholder desires to enter into any such transaction, there can be no assurances that the FDIC would grant its consent in a timely manner, without conditions, or at all. If one of these transactions were to occur without prior FDIC consent and the FDIC withdrew its loss-share protection, there could be a material adverse impact on us.

Loans that we acquired in the FDIC-assisted acquisition may be subject to impairment.

Although the loan portfolios acquired by us were initially accounted for at fair value, certain of such loans have become impaired and we have recorded $54.1 million in allowance for loan losses related to this portfolio. There is no assurance that loans in this portfolio

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will not become impaired or further impaired, which may result in additional provision for loan and lease losses related to these portfolios. The fluctuations in economic conditions, including those related to the Puerto Rico residential and commercial real estate and construction markets, may increase the level of provision for credit losses that we make to our loan portfolio and portfolios acquired in the FDIC-assisted acquisition, and consequently, reduce our net income. These fluctuations are not predictable, cannot be controlled, and may have a material adverse impact on our operations and financial condition even if other favorable events occur.

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

Our operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to regular modification and change. For example, the Dodd-Frank Act has a broad impact on the financial services industry, including significant regulatory and compliance changes, such as: (i) enhanced resolution authority of troubled and failing banks and their holding companies; (ii) enhanced lending limits strengthening the existing limits on a depository institution’s credit exposure to one borrower and to affiliates; (iii) increased capital and liquidity requirements; (iv) increased regulatory examination fees; (v) changes to assessments to be paid to the FDIC for federal deposit insurance; (vi) prohibiting bank holding companies, such as us, from including in regulatory Tier 1 capital future issuances of trust preferred securities or other hybrid debt and equity securities; (vii) caps on the interchange fees that banks are able to charge merchants for debit card transactions pursuant to the “Durbin Amendment”; and (viii) numerous other provisions designed to improve supervision and oversight of the financial services industry. Additionally, the Dodd-Frank Act established a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the FDIC. It also creates a new consumer financial protection regulator, the Consumer Financial Protection Bureau, which assumed most of the consumer financial protection regulatory responsibilities that were exercised by federal banking regulators and other agencies. Further, the Dodd-Frank Act addresses many corporate governance and executive compensation matters that affect most U.S. publicly-traded companies, including us.

Certain recent regulatory changes under the Dodd-Frank Act and otherwise apply only to depository institutions with more than $10 billion in total assets, including requirements to undergo regular “stress testing” of capital under hypothetical adverse economic scenarios, “large bank” adjustments to assessments paid to the FDIC for deposit insurance, supervision and examination by the Bureau, and requirements to establish a risk committee on a company’s board of directors. In addition, financial institutions with more than $10 billion in assets will not be eligible for the “commercial end user” exemption to Dodd-Frank Act’s mandatory clearing requirements for swaps and security-based swaps transactions used to hedge commercial risk. Although we have less than $10 billion in assets as of December 31, 2012, we may still be treated for certain regulatory and supervisory purposes as an institution with more than $10 billion in assets based on the combined total assets of the Group and BBVAPR prior to the merger until such time as the Bank (or the Group, as applicable) has closed four consecutive quarters with $10 billion or less in total assets. If

we grow to have more than $10 billion in assets through additional acquisitions or organic growth, our costs of doing business would be likely to increase permanently as a result of these requirements.

Given that many of the provisions of the Dodd-Frank Act are being implemented over time and are subject to implementing regulations, the full extent of the impact that such requirements, and other legislative and regulatory developments, will have on our operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. In particular, the potential impact of the Dodd-Frank Act on our operations and activities, both currently and prospectively, include, among others:

- a reduction in our ability to generate or originate revenue-producing assets as a result of compliance with heightened capital standards;

- increased cost of operations due to greater regulatory oversight, supervision and examination of banks and bank holding companies, and higher deposit insurance premiums;

- the limitation on our ability to raise capital through the use of trust preferred securities as these securities will no longer be included as Tier 1 capital going forward; and

- the limitation on our ability to expand consumer product and service offerings due to anticipated stricter consumer protection laws and regulations.

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

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 the IBE Unit and Subsidiary pursuant to the IBE Act that provide us with significant tax advantages. An IBE 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 IBEs. In 2012, a new Puerto Rico law was enacted in this area. Although it did not repeal the IBE Act, the new law does not allow new license applications under the IBE Act to organize and operate an IBE. Any newly organized entity (now called an "international financial entity") must be licensed under the new law and such entity (as opposed to existing IBEs organized under the IBE Act, including the Bank's IBE Unit and Subsidiary, which are "grandfathered") will generally be subject to a 4% Puerto Rico income tax rate. In the event other legislation is passed in Puerto Rico to eliminate or modify the tax exemption enjoyed by IBEs, the consequences could have a materially adverse impact on us, including increasing the tax burden or otherwise adversely affecting our financial condition, results of operations or cash flows.

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

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

Competition in attracting talented people could adversely affect our operations.

We depend on our ability to attract and retain key personnel and we rely heavily on our management team. The inability to recruit and retain key personnel or the unexpected loss of key managers may adversely affect our operations. Our success to date has been influenced strongly by the ability to attract and retain senior management experienced in banking and financial services. Retention of senior managers and appropriate succession planning will continue to be critical to the successful implementation of our strategies. For a discussion of retention risk with respect to former BBVAPR employees, see "—We may not be able to integrate BBVAPR's assets into our operations."

Reputational risk and social factors may impact our results.

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

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

We could incur increased costs or reductions in revenue or suffer reputational damage in the event of misuse of information.

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

Information security risks for financial institutions like us have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions and the increased sophistication and activities of organized crime, hackers and other external parties. Our technologies and systems may become the target of cyber-attacks or other attacks that could result in the misuse or destruction of our or our customers' confidential, proprietary or other information or that could result in disruptions to the business operations of us or our customers or other third parties. Further, a breach or attack affecting one of our third-party service providers or partners could impact us through no fault of our own. In addition, because the methods and techniques employed by perpetrators of fraud and others to attack systems and applications change frequently and often are not fully recognized or understood until after they have been launched, we and our third-party service providers and partners may be unable to anticipate certain attack methods in order to implement effective preventative measures.

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

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

None.

ITEM 2. ***PROPERTIES***

The Group owns the property located at 254 Muñoz Rivera Avenue, San Juan Puerto Rico, known as Oriental Center, where its executive offices are located since the BBVAPR Acquisition. The Group also leases offices at 997 San Roberto Street, Professional Offices Park, San Juan, Puerto Rico, known as Oriental Tower. The Group is

currently consolidating its operations at both properties.

The Bank owns eleven branch premises and leases fifty three 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, 2012, the aggregate future rental commitments under the terms of the leases, exclusive of taxes, insurance and maintenance expenses payable by the Group was $66.1 million.

The Group's investment in premises and equipment, exclusive of leasehold improvements at December 31, 2012, was $71.0 million, gross of accumulated depreciation.

As part of the BBVAPR Acquisition on December 18, 2012, the Group acquired four branch premises and the Oriental Center, which is the principal property owned by the Group for banking operations and other services.

The Oriental Center is a fifteen-story office building located at 254 Muñoz Rivera Avenue, San Juan, Puerto Rico that was previously BBVAPR's headquarters. The Group operates a full service branch at the plaza level and our centralized units and subsidiaries occupy approximately 54% of the office floor space. Approximately 34% of the office space is leased to outside tenants and 12% is available for leasing.

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.

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, 2012 and 2011, as well as cash dividends declared for such periods are set forth 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, 2012, the Group had approximately 3,104 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.

Stock Performance Graph

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

The cumulative total stockholder return was obtained by dividing (i) the cumulative amount of dividends per share, assuming dividend reinvestment, for the measurement period beginning December 31, 2007, plus (ii) the difference between the share price at the beginning and the end of the measurement period, by the share price at the beginning of the measurement period.

Comparison of 5 Year Cumulative Total Return

Assumes Initial Investment of $100

	Period Ending					
Index	**12/31/2007**	**12/31/2008**	**12/31/2009**	**12/31/2010**	**12/31/2011**	**12/31/2012**
Oriental Financial Group Inc.	100.00	47.24	85.98	100.74	99.51	111.99
Russell 2000	100.00	66.21	84.20	106.82	102.36	119.09
SNL Bank	100.00	57.06	56.47	63.27	49.00	66.13

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

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

ORIENTAL FINANCIAL GROUP INC.
SELECTED FINANCIAL DATA
YEARS ENDED DECEMBER 31, 2012, 2011, 2010, 2009, AND 2008

	Year Ended December 31,				
	2012	**2011**	**2010**	**2009**	**2008**
EARNINGS DATA:	(In thousands, except per share data)				
Interest income	$ 260,780	$ 297,029	$ 303,801	$ 319,480	$ 339,114
Interest expense	105,471	155,523	168,601	188,722	228,173
Net interest income	**155,309**	**141,506**	**135,200**	**130,758**	**110,941**
Provision for non-covered loan and lease losses	13,854	15,200	15,914	15,650	8,860
Provision for (recapture of) covered loan and lease losses, net	9,827	(1,387)	6,282	-	-
Total provision for loan and lease losses, net	**23,681**	**13,813**	**22,196**	**15,650**	**8,860**
Net interest income after provision for loan and lease losses	**131,628**	**127,693**	**113,004**	**115,108**	**102,081**
Non-interest income	24,006	30,131	4,061	(1,813)	(11,875)
Non-interest expenses	127,778	122,508	111,529	83,377	72,739
Income before taxes	**27,856**	**35,316**	**5,536**	**29,918**	**17,467**
Income tax expense (benefit)	3,301	866	(4,298)	6,973	(9,323)
Net Income	**24,555**	**34,450**	**9,834**	**22,945**	**26,790**
Less: dividends on preferred stock	(9,939)	(4,802)	(5,335)	(4,802)	(4,802)
Less: deemed dividend on preferred stock beneficial conversion feature	-	-	(22,711)	-	-
Income (loss) available to common shareholders	**$ 14,616**	**$ 29,648**	**$ (18,212)**	**$ 18,143**	**$ 21,988**
PER SHARE DATA:					
Basic	**$ 0.35**	**$ 0.67**	**$ (0.50)**	**$ 0.75**	**$ 0.91**
Diluted	**$ 0.35**	**$ 0.67**	**$ (0.50)**	**$ 0.75**	**$ 0.90**
Average common shares outstanding	**41,626**	**44,433**	**36,704**	**24,289**	**24,260**
Average common shares outstanding and equivalents	**45,304**	**44,524**	**36,810**	**24,306**	**24,327**
Book value per common share	**$ 15.31**	**$ 15.28**	**$ 14.39**	**$ 10.93**	**$ 8.07**
Tangible book value per common share	**$ 13.59**	**$ 15.19**	**$ 14.30**	**$ 10.84**	**$ 7.98**

Market price at end of period	**$**	**13.35**	**$**	**12.11**	**$**	**12.49**	**$**	**10.80**	**$**	**6.05**
Cash dividends declared per common share	**$**	**0.24**	**$**	**0.21**	**$**	**0.17**	**$**	**0.16**	**$**	**0.56**
Cash dividends declared on common shares	**$**	**10,067**	**$**	**9,153**	**$**	**6,820**	**$**	**3,888**	**$**	**13,608**
PERFORMANCE RATIOS:										
Return on average assets (ROA)		**0.38%**		**0.48%**		**0.14%**		**0.36%**		**0.43%**
Return on average common equity (ROE)		**3.18%**		**4.50%**		**-3.63%**		**7.14%**		**9.51%**
Equity-to-assets ratio		**9.39%**		**10.39%**		**10.02%**		**5.04%**		**4.21%**
Efficiency ratio		**62.58%**		**66.26%**		**64.31%**		**51.82%**		**52.88%**
Interest rate spread		**2.58%**		**2.15%**		**2.00%**		**2.13%**		**1.62%**
Interest rate margin		**2.65%**		**2.19%**		**2.03%**		**2.17%**		**1.86%**

	December 31,				
	2012	**2011**	**2010**	**2009**	**2008**
PERIOD END BALANCES AND CAPITAL RATIOS:	**(In thousands, except per share data)**				
Investments and loans					
Investments securities	$ 2,233,265	$ 3,867,970	$ 4,413,957	$ 4,974,269	$ 3,945,626
Loans and leases not covered under shared-loss agreements with the FDIC, net	4,786,718	1,169,916	1,145,320	1,138,730	1,218,235
Loans and leases covered under shared-loss agreements with the FDIC, net	395,307	496,276	620,711	-	-
Securities sold but not yet delivered	-	-	-	-	834,976
Total investments and loans	**$ 7,415,290**	**$ 5,534,162**	**$ 6,179,988**	**$ 6,112,999**	**$ 5,998,837**
Deposits and borrowings					
Deposits	$ 5,689,559	$ 2,436,143	$ 2,635,599	$ 1,791,046	$ 1,821,212
Securities sold under agreements to repurchase	1,695,247	3,056,238	3,456,781	3,557,308	3,761,121
Other borrowings	792,437	429,670	425,432	432,696	349,771
Securities purchased but not yet received	-	-	-	-	398
Total deposits and borrowings	**$ 8,177,243**	**$ 5,922,051**	**$ 6,517,812**	**$ 5,781,050**	**$ 5,932,502**
Stockholders' equity					
Preferred stock	$ 176,000	$ 68,000	$ 68,000	$ 68,000	$ 68,000
Common stock	52,671	47,809	47,808	25,739	25,739
Additional paid-in capital	537,453	499,096	498,435	213,445	212,624
Legal surplus	52,143	50,178	46,331	45,279	43,016
Retained earnings	70,734	68,149	51,502	77,584	51,233
Treasury stock, at cost	(81,275)	(74,808)	(16,732)	(17,142)	(17,109)
Accumulated other comprehensive income (loss)	55,880	37,131	36,987	(82,739)	(122,186)
Total stockholders' equity	**$ 863,606**	**$ 695,555**	**$ 732,331**	**$ 330,166**	**$ 261,317**
Capital ratios					
Leverage capital	**6.42%**	**9.65%**	**9.56%**	**6.52%**	**6.38%**
Tier 1 risk-based capital	**12.94%**	**31.84%**	**30.98%**	**18.79%**	**17.08%**

Total risk-based capital	**15.15%**	**33.12%**	**32.26%**	**19.85%**	**17.71%**
Tier 1 common equity to risk-weighted assets	**9.11%**	**27.01%**	**28.08%**	**15.83%**	**14.21%**
Financial assets managed					
Trust assets managed	$ 2,514,401	$ 2,216,088	$ 2,175,270	$ 1,818,498	$ 1,706,286
Broker-dealer assets gathered	2,722,197	1,926,148	1,695,634	1,269,284	1,195,739
Total assets managed	**$ 5,236,598**	**$ 4,142,236**	**$ 3,870,904**	**$ 3,087,782**	**$ 2,902,025**

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:

	Year Ended December 31,				
	2012	**2011**	**2010**	**2009**	**2008**
Consolidated Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends					
Excluding Interests on Deposits	1.21x	1.26x	(A)	1.18x	1.07x
Including Interests on Deposits	1.15x	1.19x	(A)	1.13x	1.05x

(A) In 2010, earnings were not sufficient to cover preferred stock dividends, and the ratio was less than 1:1. The Group would have had to generate additional earnings of $22.0 million to achieve a ratio of 1:1 in 2010.

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 perpetual preferred stock issued and outstanding amounting to $176.0 million, as follows: (i) Series A amounting to $33.5 million or 1,340,000 shares at a $25 liquidation value; (ii) Series B amounting to $34.5 million or 1,380,000 shares at a $25 liquidation value; (iii) Series C amounting to $84.0 million or 84,000 shares at a $1,000 liquidation value; and (iv) Series D amounting to $24.0 million or 960,000 shares at a $25 liquidation value.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2012

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The accounting and reporting policies followed by the Group conform with generally accepted accounting principles ("GAAP") in the United States of America and general practices within the financial services industry. The Group's significant accounting policies are described in detail in Note 1 to the audited consolidated financial statements and should be read in conjunction with this section.

Critical accounting policies require management to make estimates and assumptions, which involve significant judgment about the effect of matters that are inherently uncertain and that involve a high degree of subjectivity. These estimates are made under facts and circumstances at a point in time and changes in those facts and circumstances could produce actual results that differ from those estimates. The following MD&A section is a summary of what management considers the Group's critical accounting policies.

Business Combinations

The Group accounted for the BBVAPR Acquisition and the FDIC-assisted acquisition of Eurobank under the accounting guidance of ASC Topic No. 805, Business Combinations, which requires the use of the purchase method of accounting. All identifiable assets and liabilities acquired were initially recorded at fair value. No allowance for loan losses related to the acquired loans was recorded on the acquisition date. Loans acquired were recorded at fair value in accordance with the fair value methodology prescribed in ASC Topic 820, exclusive of the shared-loss agreements with the FDIC applicable to the FDIC-assisted acquisition. These fair value estimates associated with the loans included estimates related to expected prepayments and the amount and timing of expected principal, interest and other cash flows. Because the FDIC has agreed to reimburse the Group for losses related to the acquired loans in the FDIC-assisted acquisition, subject to certain provisions specified in the agreements, an indemnification asset was recorded at fair value at the acquisition date. The indemnification asset was recognized at the same time as the loans covered under FDIC shared-loss agreements, and is measured on the same basis, subject to collectability or contractual limitations. The loss share indemnification asset on the acquisition date reflected the reimbursements expected to be received from the FDIC, using an appropriate discount rate, which reflected counterparty credit risk and other uncertainties. The initial valuation of these loans and related indemnification asset required management to make subjective judgments concerning estimates about how the acquired loans would perform in the future using valuation methods, including discounted cash flow analyses and independent third-party appraisals. Factors that may significantly affect the initial valuation include, among others, market-based and industry data related to expected changes in interest rates, assumptions related to probability and severity of credit losses, estimated timing of credit losses including the timing of foreclosure and liquidation of collateral, expected prepayment rates, the specific terms and provisions of any shared-loss agreements, and specific industry and market conditions that may impact independent third-party appraisals. The Group applied the guidance of ASC Subtopic 310-30 – "Loans and Debt Securities Acquired with Deteriorated Credit Quality" ("ASC 310-30") to most of the loans acquired in the FDIC-assisted

acquisition (including applying 310-30 by analogy to loans that do not meet the scope of ASC 310-30 but meet certain other criteria as outlined below), except for credit cards. Also, the Group applied the guidance of ASC 310-30 to most of the loans from the BBVAPR Acquisition, except for credit cards, retail and commercial lines of credits, floor plans and performing auto loans with Fair Isaac Corporation ("FICO") scores over 660 which were acquired at a premium.

ASC 310-30 provides two specific criteria that have to be met in order for a loan to be within its scope: (1) credit deterioration on the loan from its inception until the acquisition date and (2) that it is probable that not all of the contractual cash flows will be collected on the loan. Once in the scope of ASC 310-30, the credit portion of the fair value discount on an acquired loan cannot be accreted into income until the acquirer has assessed that it expects to receive more cash flows on the loan than initially anticipated. Acquired loans that meet the definition of nonaccrual status fall within the Group's definition of impaired loans under ASC 310-30. Performing loans would generally not meet either criteria and therefore not fall within the scope of ASC 310-30. Many of the acquired loans that did not meet the Group's definition of non-accrual status also resulted in the recognition of a discount attributable to credit quality. The Group elected to analogize to ASC 310-30 and only accrete the portion of the fair value discount unrelated to credit pursuant to the

provisions of the AICPA letter dated December 18, 2009, where the AICPA summarized the SEC Staff's view regarding the accounting in subsequent periods for discount accretion associated with loan receivables acquired in a business combination or asset purchase. The Group adopted an accounting policy coincident with the Eurobank acquisition to consistently apply by analogy the expected cash flow approach under 310-30 to acquired loan portfolios.

The fair values initially assigned to assets acquired and liabilities assumed are 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 becomes available, for example there may be changes in loans pooling under ASC 310-30 and the reserve for unfunded commitments.

Allowance for Loan and Lease Losses for Non-covered Loans and Leases

Originated loans

The Group determined the allowance for loan and lease losses by portfolio segment, which consist of mortgage loans, commercial loans, consumer loans and leasing, as follows:

Mortgage Loans: These loans are further divided into four classes: traditional mortgages, non-traditional mortgages, loans in loan modification programs and home equity secured personal loans. Traditional mortgage loans include loans secured by a dwelling, fixed coupons and regular amortization schedules. Non-traditional mortgages include loans with interest-first amortization schedules and loans with balloon considerations as part of their terms. Mortgages in loan modification programs are loans that are being serviced under such programs. Home equity loans are mainly equity lines of credit. The allowance factor on these loans is impacted by the historical loss factors on the sub-segments, vintages, the environmental risk factors described above and by delinquency buckets. During the second quarter of 2012, the traditional mortgage loan portfolio was further segregated by vintages.

Commercial loans: These loans are further divided into two classes: commercial loans secured by existing commercial real estate properties and other commercial loans. The allowance factor assigned to these loans is impacted by historical loss factors, by the environmental risk factors described above and by the credit risk ratings assigned to the loans. These credit risk ratings are based on relevant information about the ability of borrowers to service their debt, such as economic conditions, portfolio risk characteristics, prior loss experience, and the results of periodic credit reviews of individual loans.

Consumer loans: These consist of smaller retail loans such as retail credit cards, overdrafts, unsecured personal lines of credit, and personal unsecured loans. The allowance factor on these loans is impacted by the historical loss factors

on the segment, the environmental risk factors described above and by delinquency buckets.

Leasing: This segment consists of personal loans guaranteed by vehicles in the form of lease financing. The allowance factor on these loans is impacted by the historical losses on the segment, the environmental risk factors described above and by delinquency buckets.

The Group establishes its allowance for loan losses through a provision for credit losses based on our evaluation of the credit quality of the loan portfolio. This evaluation, which includes a review of loans on which full collectability may not be reasonably assured, considers, among other matters, the estimated fair value of the underlying collateral, economic conditions, historical net loan loss experience, and other factors that warrant recognition in determining our allowance for loan losses. The Group continues to monitor and modify the level of the allowance for loan losses to ensure it is adequate to cover losses inherent in our loan portfolio.

For our originated loans, our allowance for loan losses consists of the following elements: (i) specific valuation allowances based on probable losses on specifically identified impaired loans; and (ii) valuation allowances based on net historical loan loss experience for similar loans with similar inherent risk characteristics and performance trends, adjusted, as appropriate, for qualitative risk factors specific to respective loan types.

For our originated loans, when current information and events indicate that it is probable that we will be unable to collect all amounts of principal and interest due under the original terms of a business or commercial real estate loan greater than $250 thousand, such loan will be classified as impaired. Additionally, all loans modified in a TDR are considered impaired. The need for specific valuation allowances are determined for impaired loans and recorded as necessary. For impaired loans, we consider the fair value of the underlying collateral, less estimated costs to sell, if the loan is collateral dependent, or we use the present value of estimated future cash flows in determining the estimates of impairment and any related allowance for loan losses for these loans. Confirmed losses are charged off immediately. Prior to a loan becoming impaired, we typically would obtain an appraisal through our internal loan grading process to use as the basis for the fair value of the underlying collateral.

Loan loss ratios and credit risk categories are updated at least quarterly and are applied in the context of GAAP as prescribed by 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.

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

We establish our allowance for loan losses through a provision for credit losses based upon an evaluation process that is similar to our evaluation process used for originated loans. This evaluation, which includes a review of loans on which full collectability may not be reasonably assured, considers, among other matters, the estimated fair value of the underlying collateral, economic conditions, historical net loan loss experience, carrying value of the loans, which includes the remaining net purchase discount or premium, and other factors that warrant recognition in determining our allowance for loan losses. These loans were recorded on acquisition date at their fair value. Such fair value includes a credit discount which accounts for expected loan losses over the estimated life of these loans. Management will take into consideration this credit discount when determining the necessary allowance for acquired loans that are accounted for under the provisions of ASC 310-20. These loans are divided in the following four segments:

Commercial and Industrial Loans ("C&I") – C&I loans include commercial credit lines, overdrafts, revolving unsecured commercial loans, and revolving commercial loans secured by real estate and by other types of collateral. These loans are granted mainly to corporate clients, to automobile dealers to finance their inventory, to the government and to small and medium size enterprises. In the underwriting process of C&I loans, the overall economic and financing situation and the repayment capacity of the borrower are taken into consideration. Lending limits, term, required documentation, interest rate approval, collateral, and guarantees are also considered. C&I loans are composed of different markets.

As part of the monitoring system, an alert system has been adopted for C&I loans to ensure an early identification of problem loans. This system is a tool for credit classification and mitigation of credit losses. Monitoring reports are prepared to follow up on delinquent, nonperforming loans, and classified loans.

Construction and Commercial Real Estate Loans ("CRE") — The main products of CRE loans are interim construction, land, and permanent loans (rental properties). The repayment of an interim financing construction loan generally depends on success of the project. Therefore, its viability is the main consideration during the evaluation process. Additional considerations are also evaluated, such as technical and financial capacity of the developer and the contractor. The parameters for land loans are based primarily on the loan to value and debt service coverage ratio. The main parameters for permanent loans are the occupancy and the debt-service coverage ratio.

Monitoring system and reports explained in the C&I loans section are also part of the CRE loans monitoring process. In addition, new appraisal reports are requested periodically for CRE loans.

Consumer Loans — Consists of revolving retail products, such as credit cards, and lines of credit, among others. The credit scoring system is used for personal loans and credit card loan originations. The Bank determines from time to time maximum amounts of credit limits, monthly payments, charges and fees, and interest rates. Also, lending limits and underwriting procedures are part of the structure and controls.

Auto loans — The financing for the purchase of new or used motor vehicles for private or public use. These loans are granted mainly through dealers authorized and approved by the auto department credit committee of the Bank. The auto credit department has the specialized structure and resources to provide the service required for this product according to market demands.

The portfolio segments and classes will continue to change as the BBVAPR integration takes place during 2013, and the Group re-assesses its allowance methodology.

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

For our acquired loans accounted for under ASC 310-30, our allowance for loan losses is estimated based upon our expected cash flows for these loans. To the extent that we experience a deterioration in borrower credit quality resulting in a decrease in our expected cash flows (which are used as a proxy to identify probable incurred losses) subsequent to the acquisition of the loans, an allowance for loan losses is established based on our estimate of future credit losses over the remaining life of the loans.

Acquired loans accounted for under ASC Subtopic 310-30 are not considered non-performing and continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected. Also, loans charged-off against the non-accretable difference established in purchase accounting are not reported as charge-offs. Charge-offs on loans accounted under ASC Subtopic 310-30 are recorded only to the extent that losses exceed the non-accretable difference established with purchase accounting.

Allowance for Loan and Lease Losses for Covered Loans and Leases

Cover loans are accounted for under ASC Subtopic 310-30. For covered loans, the portion of the loss on covered loans reimbursable from the FDIC is recorded as an offset to the 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 assets 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 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.

OVERVIEW OF FINANCIAL PERFORMANCE

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

The Group is a publicly-owned financial holding company that provides a full range of banking and financial services through its subsidiaries. It provides comprehensive banking and financial services through a complete range of banking and financial solutions, including mortgage, commercial and consumer lending; financing leases; checking and savings accounts; financial planning, insurance, financial service, 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 64 branches in Puerto Rico and a subsidiary 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, maintaining effective asset-liability management, growing non-interest revenue from banking and financial services, and improving operating efficiencies.

The Group's diversified mix of businesses and products generates both the interest income traditionally associated with a banking institution and non-interest income traditionally associated with a financial services institution (generated by such businesses as securities brokerage, fiduciary services, investment banking, insurance agency, and retirement plan administration). Although all of these businesses, to varying degrees, are affected by interest rate and financial market fluctuations and other external factors, the Group's commitment is to continue producing a balanced and growing revenue stream.

In December 18, 2012, the Group completed the BBVAPR Acquisition. By acquiring the BBVAPR Companies, we accelerated our longstanding goal of creating a more stable balance sheet, with a larger and more diversified loan portfolio, a greater retail deposit funding base, and a smaller investment securities portfolio, improving earnings stability. Furthermore, in connection with the BBVAPR Acquisition, we completed the sale of approximately $1.403 billion of the Group's investment securities and used the proceeds from such sales, together with available cash, to repay approximately $1.698 billion of wholesale funding. In addition to reducing the sensitivity of our balance sheet to interest rates, the deleveraging has improved our capital ratios by reducing the size of our balance sheet.

To finance in part the BBVAPR Acquisition, the Group raised in 2012 an aggregate amount of approximately $158.5 million (before expenses) through the private placement of $84 million in Convertible Preferred Stock, which closed on July 3, 2012, the underwritten public offering of approximately $51.5 million in common stock, which closed on October 31, 2012, and the underwritten public offering of approximately $23 million in Series D Preferred Stock, which closed on November 5, 2012.

During 2012, we focused on two main initiatives: continuing to grow our banking operations, and achieving the milestones necessary to successfully close the BBVAPR Acquisition before the end of the year. Operating revenue for 2012 increased 4.5%, or $7.7 million, to $179.3 million when compared to the same period in 2011.

The table below presents the Group's operating revenue for the years ended December 31, 2012, 2011 and 2010:

	Year Ended December 31,		
	2012	2011	2010
	(In thousands)		
OPERATING REVENUE			
Net interest income	$ 155,309	$ 141,506	$ 135,200
Non-interest income, net	24,006	30,131	4,061
Total operating revenue	**$ 179,315**	**$ 171,637**	**$ 139,261**

Interest Income

Total interest income for 2012 decreased 12.2% to $260.8 million, as compared to the same period in 2011. Such decrease primarily reflects a 40.8% decrease on interest income from investments for 2012, primarily related to lower yields and a lower balance in the investment securities portfolio as a result of the sale of $1.510 billion in mortgage-backed securities. Also, there was an increase in premium amortization due to increased prepayment speeds. The yield on investments decreased from 3.41% for 2011 to 2.34% for 2012.

The decrease in interest income on investments was mitigated by an increase in interest income from covered loans from $67.7 million for 2011 to $85.4 million in 2012. The yield on covered loans increased from 12.12% in 2011 to 19.0% in 2012. This increase in yield is the result of higher projected cash flows on certain pools of covered loans, as credit losses have been lower than initially estimated for these loan pools. The accretable yield amounted to $188.0 million at December 31, 2012 compared to $188.8 million at December 31, 2011. In addition, interest income from non-covered loans increased from $68.3 million for 2011 to $80.0 million for 2012.

Interest Expense

Total interest expense for 2012 decreased 32.2% to $105.5 million as compared to 2011. This reflects the lower cost of both, securities sold under agreements to repurchase (2.10% vs. 2.74%) and deposits (1.33% vs. 1.80%) for 2012 as compared to 2011, which reflects continuing progress in the repricing of the Group's core retail deposits and further reductions in its cost of funds.

In December 2011, $600 million in repurchase agreements, with an average cost of 4.23%, matured. The Group paid off $300 million of these repurchase agreements. The remaining balance of $300 million was renewed for an average period of approximately 3.5 years at an effective fixed rate of 2.36%. To further reduce its cost of borrowings, in May 2012, the Group renewed $350 million in repurchase agreements, with an average cost of 4.26%, at a new effective rate of approximately 1.90%. During the second half of 2012, the Group terminated repurchase agreements amounting to $1.357 billion with an average cost of 1.31%. As a result of the aforementioned transactions, total interest expense on securities sold under agreements to repurchase declined 35.1% in 2012 as compared to 2011.

Net Interest Income

Net interest income for 2012 was $155.3 million, an increase of 9.8% when compared with 2011. The increase for 2012 was mostly due to the net effect of a 26.2% increase in interest income from covered loans as a result of higher yields and a 32.2% decrease in interest expense due to lower cost of funds, partially offset by a decrease of 40.8% on interest income from investments, related to lower yields and a lower balance in the investment securities portfolio.

Net interest margin of 2.65% for 2012 increased 46 basis points when compared to 2011.

Provision for Loan and Lease Losses

Provision for non-covered loans and lease losses for 2012 decreased $1.3 million when compared to 2011, reflecting improvement in credit quality. Provision for covered loans and lease losses for 2012 was $9.8 million, reflecting the Group's revision to the expected cash flows in the covered loan portfolio considering actual experiences and changes in the Group's expectations for the remaining terms of the loan pools. During the first quarter of 2012, some covered construction and development and commercial real estate loan pools underperformed, which required a provision amounting to $7.2 million, net of the estimated reimbursement from the FDIC. Additional net provisions of $1.5 million, $221 thousand and $982 thousand were recorded for the second, third and fourth quarters of 2012, respectively, as quarterly reviews of credit assumptions for covered loans are reflecting some delays in the expected cash flows, mainly in pools of real estate collateralized loans. Significant judgement is made in timing the collection of nonperforming loans that are being actively worked out.

Non-Interest Income

In 2012, core banking and financial services revenue increased 12.7% to $48.9 million as compared to 2011, primarily reflecting $4.8 million increase in financial services revenue to $25.4 million, attributed to an increase of 26.4% in assets under management.

Net amortization of the FDIC shared-loss indemnification asset of $28.0 million for 2012 compared to a $3.4 million for 2011 resulted from the ongoing evaluation of expected cash flows of the loan portfolio acquired in the FDIC-assisted acquisition. As a result of such evaluation, the Group expects a decrease in losses to be collected from the FDIC and the improved re-yielding of the accretable yield on the covered loans. This reduction in claimable

losses amortizes the shared-loss indemnification asset through the life of the shared-loss agreements. This amortization is net of the accretion of the discount recorded to reflect the expected claimable loss at its net present value.

In 2012, the Group had a gain on the sale of investment securities of $74.2 million, as the Group took advantage of market opportunities and executed a balance sheet deleverage following the BBVAPR Acquisition. The purpose of the deleverage plan was to reduce the Group's capital needs for the BBVAPR Acquisition; to enhance its returns going forward; and to have a more traditional bank balance sheet after the BBVAPR Acquisition. As part of this deleverage, in 2012, the Group sold $1.403 billion of investment securities. At the same time, the Group terminated prior to maturity $1.357 billion of repurchase agreements. In accordance with the terms of the repurchase agreements the Group had to pay cancellation fees amounting to $26.1 million.

Non-Interest Expense

Non-interest expense increased to $127.8 million for 2012 compared to $122.5 million in 2011 as a result of approximately $7.1 million in expenses related to the BBVAPR Acquisition.

The efficiency ratio for 2012 was 62.58% compared to 66.26% for 2011.

Income Tax Expense

Income tax expense was $3.3 million for 2012 compared to $866 thousand for 2011.

At December 31, 2012 and 2011, the IBE Subsidiary had $504 thousand and $2.9 million, respectively, in income tax effect of unrecognized gain on available-for-sale securities included in other comprehensive income. Following the change in its applicable tax rate from 5% to 0% as a result of a Puerto Rico law adopted in 2011, this remaining tax balance will flow through income as these securities are repaid or sold in future period. During 2012, income tax expense included $2.4 million related to this residual tax effect from the IBE Subsidiary. It had no effect during 2011.

Income Available to Common Shareholders

For 2012, the Group's income available to common shareholders amounted to $14.6 million compared to $29.6 million for 2011. Income per basic common share and fully diluted common share was $0.35 for 2012 compared to income per basic and fully diluted common share of $0.67 for 2011. Dividends declared on preferred stock for 2012 amounted to $9.9 million as compared to $4.8 million for 2011.

Interest Earning Assets

The loan portfolio increased 211.0% to $5.182 billion at December 31, 2012 compared to $1.666 billion at December 31, 2011. The increase in the loan portfolio is mostly due to the acquisition of BBVAPR's loan portfolio amounting to $3.574 billion at December 31, 2012. The investment portfolio amounted to $2.233 billion at December 31, 2012, a 42.3% decrease compared to $3.868 billion at December 31, 2011. The decrease in the investment portfolio reflects a reduction of 25.9%, or $765.6 million, in the available-for-sale portfolio, due to the sale of approximately $1.403 billion in investment securities due to the aforementioned balance sheet deleverage in connection with the BBVAPR

Acquisition. The change in portfolio composition resulted in the transfer of all the securities in the held-to-maturity portfolio to the available-for-sale portfolio at a fair value of $797.5 million with net combined unrealized gains of $35.1 million in 2012.

Interest Bearing Liabilities

Total deposits amounted to $5.690 billion at December 31, 2012, an increase of 133.5% compared to $2.436 billion at December 31, 2011, as a result of the deposits assumed as part of the BBVAPR Acquisition. Core deposits, which exclude brokered deposits, increased $2.582 billion, or 118.5%, compared to December 31, 2011, while brokered deposits increased $671.6 million or 261.7% when compared to December 31, 2011. Non-interest bearing deposits, interest-bearing deposits, individual retirement accounts, retail certificates of deposit and institutional deposits increased $598.4 million, $1.204 billion, $15.2 million, $324.1 and $441.5 million, respectively.

Using available cash, in March 2012, the Bank repaid at maturity $105.0 million in senior unsecured notes issued in March 2009 under the FDIC's Temporary Liquidity Guarantee Program ("TLGP") with an all-in cost of 3.75%.

In December 2011, $600 million in repurchase agreements, with an average cost of 4.23%, matured. The Group paid off $300 million of these repurchase agreements. The remaining balance of $300 million was renewed for an average period of approximately 3.5 years at an effective fixed rate of 2.36%. To further reduce its cost of borrowings, in May 2012, the Group renewed $350 million in repurchase agreements, with an average cost of 4.26%, at a new effective rate of approximately 1.90%. During the second half of 2012, the Group terminated repurchase agreements amounting to $1.36 billion. Due to the repayment of the TLGP notes and the termination of the repurchase agreements, total borrowings decreased 28.6% to $2.488 billion at December 31, 2012, compared to $3.486 billion at December 31, 2011. This increase was partially offset by borrowings assumed as part of the BBVAPR Acquisition, which amounted to $315.1 million at December 31, 2012.

Stockholders' Equity

Stockholders' equity at December 31, 2012 was $863.6 million compared to $695.6 million at December 31, 2011, an increase of 24.2%. This increase is mainly due to the $160 million capital raise from the issuance of preferred stock and common stock during 2012 in connection with the BBVAPR Acquisition.

Book value per share was $15.31 at December 31, 2012 compared to $15.28 at December 31, 2011.

The Group maintains capital ratios in excess of regulatory requirements. At December 31, 2012, Tier 1 Leverage Capital Ratio was 6.42% (1.61 times the requirement of 4.00%), Tier 1 Risk-Based Capital Ratio was 12.94% (3.24 times the requirement of 4.00%), and Total Risk-Based Capital Ratio was 15.15% (1.89 times the requirement of 8.00%).

Return on Average Assets and Common Equity

Return on average common equity ("ROE") for 2012 was 2.27%, down from 4.50% for 2011. The decrease in ROE is mainly due to the 28.7% decrease in net income combined with a 107.0% increase in dividends on preferred stock during 2012 when compared to 2011. Return on average assets ("ROA") for 2012 decreased to 0.38% from 0.48% for the same period in 2011, mainly due to the 28.7% decrease in net income during 2012 when compared to 2011.

Assets under Management

Assets managed by the Group's trust division, the retirement plan administration subsidiary (CPC), and broker-dealer subsidiaries increased from $4.142 billion as of December 31, 2011 to $5.237 billion as of December 31, 2012. The 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 CPC manages the administration of private retirement plans. At December 31, 2012, total assets managed by the Group's trust division and CPC increased to $2.514 billion, compared to $2.216 billion at December 31, 2011, mainly related to account contributions and capital market appreciation. At December 31, 2012, total assets managed by the Group's broker-dealer subsidiaries from its customer investment accounts increased to $2.722 billion, compared to $1.926 billion at December 31, 2011, mainly because of the addition of $504.8 million in assets managed at December 31, 2012 by the broker-dealer subsidiary acquired as part of the BBVAPR Acquisition.

Lending

Total loan production of $460.8 million for 2012 increased 16.4% year over year. Total commercial loan production of $191.0 million for 2012 increased 36.7% from the year ago.

The Group sells most of its conforming mortgages in the secondary market and retains servicing rights. As a result, mortgage banking activities reflect originations as well as a growing servicing portfolio which is a source of recurring revenue.

Mortgage loan production and purchases of $202.7 million for 2012 decreased 4.7% from 2011. Auto and consumer loans production for 2012 totalled $67.1 million, up 54.6% from 2011.

Credit Quality on Non-Covered Loans

Net credit losses increased $1.3 million to $10.9 million in 2012, representing 0.91% of average non-covered loans originated, versus 0.82% in 2011. Our allowance coverage however, remained stable compared to prior year. The allowance for loan and lease losses on non-covered loans increased to $39.9 million (3.17% of total non-covered originated loans) at December 31, 2012 compared to $37.0 million (3.12% of total non-covered loans) at December 31, 2011.

Non-performing loans ("NPLs"), which excludes loans covered under shared-loss agreements with the FDIC and loans acquired from BBVAPR Acquisition accounted under ASC 310-30, remained stable in 2012 compared to 2011. The Group does not expect NPLs to result in significantly higher losses as most are well-collateralized with adequate loan-to-value ratios.

Non-GAAP Measures

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 that management believes are useful and meaningful to investors. Non-GAAP measures do not have any standardized meaning, are not required to be uniformly applied, and are not audited. Therefore, they are 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 pre-provision operating income basis (defined as net interest income, plus banking and financial services revenue, less non-interest expenses, as calculated on the table below). The Group's management believes that, given the nature of the items excluded from the definition of pre-tax pre-provision 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.

During the year ended December 31, 2012, the Group's pre-tax pre-provision operating income was approximately $76.4 million, an increase of 22.5% from $62.4 million in the last year. Pre-tax pre-provision operating income is calculated as follows:

	Year Ended December 31,		
	2012	2011	2010
	(In thousands)		
PRE-TAX PRE-PROVISION OPERATING INCOME			
Net interest income	$ 155,309	$ 141,506	$ 135,200
Core non-interest income:			
Financial service revenue	25,350	20,571	17,967
Banking service revenue	13,824	12,930	10,662
Mortgage banking activities	9,705	9,876	9,554
Total core non-interest income	**48,879**	**43,377**	**38,183**

Less non interest expenses		(127,778)		(122,508)		(111,529)
Total pre-tax pre-provision operating income	**$**	**76,410**	**$**	**62,375**	**$**	**61,854**

Tangible common equity consists of common equity less goodwill and core deposit intangibles. Tier 1 common equity consists of common equity less goodwill, core deposit intangibles, net unrealized gains on available for sale securities, net unrealized losses on cash flow hedges, and disallowed deferred tax asset and servicing assets. Ratios of tangible common equity to total assets, tangible common equity to risk-weighted assets, total equity to risk-weighted assets and Tier 1 common equity to risk-weighted assets are non-GAAP measures.

Ratios calculated based upon Tier 1 common equity have become a focus of regulators and investors, and management believes ratios based on Tier 1 common equity assist investors in analyzing the Group's capital position. Furthermore, management and many stock analysts use tangible common equity in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations. Neither Tier 1 common equity nor tangible common equity or related measures should be considered in isolation or as a substitute for stockholders' equity, total assets or any other measure calculated in accordance with GAAP.

At December 31, 2012, tangible common equity to total assets and tangible common equity to risk-weighted assets increased to 6.74% and 11.82%, respectively, from 9.36% and 30.14% at December 31, 2011. Total equity to risk-weighted assets and Tier 1 common equity to risk-weighted assets at December 31, 2012 decreased to 16.48% and 9.11%, respectively, from 33.48% and 27.01% at December 31, 2011.

Comparison of the years ended December 31, 2011 and 2010

Operating revenue for 2011 increased 23.2% or $32.4 million to $171.6 million from 2010. Following is a tabular presentation of the Group’s operating revenue for the years ended December 31, 2011 and 2010.

	2011	2010
OPERATING REVENUE		
Net interest income…………………………………………….	$ 141,506	$ 135,200
Non-interest income, net……………………………….………...	30,131	4,061
Total operating revenue………………………………….	**$ 171,637**	**$ 139,261**

Interest Income

Total interest income for 2011 decreased 2.2% to $297.0 million as compared to 2010. Such decrease from 2010 primarily reflects a 14.5% decrease on interest income from investments related to an increase in premium amortization due to the decline in interest rates that caused an increase in prepayment speeds and a lower balance in the investment securities portfolio. Excluding a $1.8 million negative adjustment to interest income from non-covered residential mortgage loans as certain interest receivable accrued in prior years was deemed to be uncollectible during the second quarter of 2011, interest income from non-covered loans remained level.

Interest income from covered loans increased from $44.2 million for 2010 to $67.7 million for 2011 partially due to a full year of ownership of covered loans in 2011. Also, the yield on covered loans increased from 8.93% for 2010 to 12.12% in 2011. Covered loans are accounted for under the provisions of ASC 310-30. This increase in yield is the result of the Group’s assessment of higher projected cash flows on certain pools of covered loans as credit losses are expected to be lower than initially estimated and the Group will benefit from a full year impact of interest income from covered loans (which were acquired on April 30, 2010). The accretable yield amounted to $188.8 million at December 31, 2011 compared to $148.6 million at December 31, 2010.

Interest Expense

Total interest expense for 2011 fell 7.8% to $155.5 million as compared 2010. This reflects both lower cost of deposits (1.80% vs. 2.12%) and of securities sold under agreements to repurchase (2.74% vs. 2.84%).

Net Interest Income

Net interest income for 2011 was $141.5 million, up 4.7% from 2010. Such increase from 2010 primarily reflects a 17.8% increase in interest income from loans, mainly as a result of the continued improved performance of covered loans and growth of the Group’s non-covered commercial, auto leasing and consumer loan portfolio.

Net interest margin of 2.19% for 2011 increased 8 basis points when compared with 2010.

Provision for Loan and Lease Losses

Provision for non-covered loans for 2011 decreased 4.5% as compared to 2010. Recapture for covered loans for 2011 was $1.4 million. This recapture is mainly due to an improvement in expected cash flows on the loan portfolio acquired in the FDIC-assisted acquisition.

Non-Interest Income

The Group's niche market approach to the integrated delivery of services to mid and high net worth clients performed well as the Group expanded market share in light of the FDIC-assisted acquisition and the Group's service proposition and capital strength, as opposed to using rates to attract loans or deposits. During 2011, core banking and financial services revenue increased 13.6% to $43.4 million as compared to 2010, primarily reflecting a $2.9 million increase in financial services revenue to $20.6 million and a $2.3 million increase in banking service revenue to $12.9 million.

The Group recorded an other than temporary impairment of $15.0 million on a $26.0 million collateralized debt obligation. This security was later sold in January 2012 at its recorded value, and therefore no additional gain or loss was realized on the sale.

The net amortization of the FDIC loss-share indemnification asset of $3.4 million for 2011, compared to net accretion of $4.3 million for 2010, resulted from the ongoing evaluation of expected cash flows of the loan portfolio acquired in the FDIC-assisted acquisition, which resulted in reduced losses expected to be collected from the FDIC and the improved re-yielding of the accretable yield on the covered loans. This reduction in claimable losses amortized the loss-share indemnification asset at a rate that mirrored the aforementioned re-yielding on the covered loans. This amortization was net of the accretion of the discount recorded to reflect the expected claimable loss at its net present value.

Results for the year also include a $28.0 million gain on the sale of investment securities with a book value of $592.3 million as the Group took advantage of market opportunities. This was partially offset by losses of $13.2 million in derivative activities and a $4.8 million loss on the early extinguishment of a $100 million repurchase agreement.

During 2011, losses of $13.2 million were recognized and reflected as “Derivative Activities” in the consolidated statements of operations. These losses were mainly due to realized losses of $4.3 million from terminations of forward-settlement swaps with a notional amount of $1.25 billion, and to realized losses of $2.2 million from terminations of options to enter into interest rate swaps that were purchased in November 2010 with a notional amount of $250 million. These terminations allowed the Group to enter into new forward-settlement swap contracts with a notional amount of $1.2 billion, all of which were designated as hedging instruments. In May 2011, the Group entered into forward-settlement swap contracts with a notional amount of $475 million, all of which were also designated as hedging instruments. Prior to the acquisition of the new forward-settlement swap contracts, these derivatives were not being designated for hedge accounting. In December 2011, $600 million in repurchase agreement funding with an average cost of 4.23% matured. Utilizing cash on hand and proceeds from the sale of approximately $77 million of mortgage backed securities, the Group paid off $300 million of these repurchase agreements. The remaining balance of $300 million was renewed for an average period of approximately three and a half years at an effective fixed rate of 2.36%. These transactions enabled the Group to eliminate $300 million in wholesale funding, reduce cost of funds on an additional $300 million of borrowings, and deploy cash at higher return in net interest income on an annualized basis. During 2010, losses of $36.8 million were recognized and reflected as “Derivative Activities” in the consolidated statements of operations. These losses included realized losses of $42.0 million due to the terminations of forward settlement swaps with a notional amount of $900.0 million. These terminations allowed the Group to enter into new forward-settlement swap contracts with the same notional amount and maturity, and effectively reduce the interest rate of the pay-fixed side of such deals.

Non-Interest Expenses

Non-interest expenses increased 9.8% to $122.5 million for 2011, compared to $111.5 million in the previous year, largely due to the integration of Eurobank operations which contained a full year of operations in 2011 as opposed to eight months in 2010, resulting in an efficiency ratio of 66.26% for 2011 (compared to 64.54% for 2010).

Income Tax Expense (Benefit)

Income tax expense was $866 thousand for 2011, compared to an income tax benefit of $4.3 million for 2010. This increase was mainly due to an increase in taxable income of $29.8 million and the effect in deferred taxes of a reduction in tax rates which amounted to $5.2 million, partially offset by an increase in the tax effect of exempt income of $4.9 million and a decrease of $2.8 million on the income tax contingencies provision.

Income Available (Loss) to Common Shareholders

For 2011, the Group’s income available to common shareholders totaled $29.6 million, compared to a loss to common shareholders of $18.2 million a year-ago. Earnings per basic and fully diluted common share were $0.67 for 2011 compared to loss per basic and fully diluted common share of $0.50 for 2010.

Interest Earning Assets

The investment portfolio amounted to $3.868 billion at December 31, 2011, a 12.4% decrease compared to $4.414 billion at December 31, 2010, while the loan portfolio decreased 5.9% to $1.666 billion at December 31, 2011, compared to $1.773 billion at December 31, 2010. The decrease in the investment portfolio reflected a reduction of 20.0%, or $740.2 million, in the available-for-sale portfolio, due to the sale of approximately $592.3 million in investment securities and the maturity of FNMA and FHLMC certificates, which was partially offset by an increase of 28.1%, or $194.1 million, in the held-to-maturity portfolio. The decrease in the loan portfolio was due to a decrease in covered loans of 20.0% as they continued to pay down, which was partially offset by an increase of 1.9% in non-covered loans.

Interest Bearing Liabilities

Total deposits amounted to $2.436 billion at December 31, 2011, a decrease of 7.3% compared to $2.630 billion at December 31, 2010. Core retail deposits, which exclude institutional and brokered deposits, remained approximately level compared to December 31, 2010, while wholesale deposits decreased 40.4% as higher cost deposits matured during the year. Interest-bearing savings and demand deposits increased 1.8%, while retail deposits decreased 20.8%.

In December 2011, $600 million in repurchase agreement funding, with an average cost of 4.23%, matured. Utilizing cash on hand and proceeds from the sale of approximately $77 million of mortgage backed securities, the Group paid off $300 million of these repurchase agreements. The remaining balance of $300 million was renewed for an average period of approximately three and a half years at an effective fixed rate of 2.36%. These transactions enabled the Group to eliminate $300 million in wholesale funding, reduce cost of funds on an additional $300 million of borrowings, and deploy cash at a significantly higher return, all of which is expected to generate approximately $13 million more in net interest income during the year 2012. Mainly as a result of the aforementioned transactions and the early extinguishment of a $100 million repurchase agreement during the third quarter of 2011, total borrowings declined 10.3% as compared to December 31, 2010.

Stockholders' Equity

Stockholders' equity at December 31, 2011 was $695.6 million compared to $732.3 million at December 31, 2010, a decrease of 5.0%. This decrease reflects stock repurchases under the aforementioned stock repurchase programs, partially offset by the net income for the year.

There were 41.2 million common shares outstanding at December 31, 2011, a decrease of 11.0% from December 31, 2010 due to the Group's stock repurchase programs. Under the $30 million program, initiated in February 2011, the Group purchased a total of 2,406,303 shares at an average price of $12.10 per share. On June 29, 2011, the Group announced completion of its $30 million common stock repurchase program and the adoption of a new program to purchase an additional $70 million in shares in the open market. The Group purchased approximately 2,783,000 shares under the $70 million program for a total of $29.4 million as of December 31, 2011, at an average price of $10.57 per share.

Book value per share was $15.28 at December 31, 2011 compared to $14.39 at December 31, 2010.

The Group has maintained capital ratios in excess of regulatory requirements. At December 31, 2011, Tier 1 Leverage Capital Ratio was 9.65% (2.41 times the requirement of 4.00%), Tier 1 Risk-Based Capital Ratio was 31.84% (7.96 times the requirement of 4.00%), and Total Risk-Based Capital Ratio was 33.12% (4.14 times the requirement of 8.00%).

Return on Average Assets and Common Equity

Return on average common equity (ROE) for the year ended December 31, 2011 was 4.50%, up from a loss of 3.63% for 2010. Return on average assets (ROA) for 2011 was 0.48%, up from 0.14% for 2010. The increase was mostly due to a 250.4% increase in net income from $9.8 million in the year ended December 31, 2010 to $34.5 million in 2011.

Assets Under Management

Assets managed by the trust division, the pension plan administration subsidiary, and the broker-dealer subsidiary increased from $3.871 billion as of December 31, 2010 to $4.142 billion as of December 31, 2011. At December 31, 2011, total assets managed by the Group's trust division and CPC amounted to $2.216 billion, compared to $2.175 billion at December 31, 2010. At December 31, 2011, total assets managed by the broker-dealer from its customer investment accounts increased to $1.926 billion, compared to $1.696 billion at December 31, 2010.

Lending

Total loan production and purchases of $396.0 million for 2011 remained strong compared to $371.6 million in the previous year, as the Group's capital levels and low credit losses enabled it to continue prudent lending.

Mortgage loan production for 2011 of $212.8 million decreased 13.2% from 2010. Commercial loan production for 2011 of $139.8 million increased 38.3% from 2010. Leasing and consumer loans production for 2011 totaled $43.4 million, up 70.9% from 2010.

Credit Quality on Non-Covered Loans Accounted for Under ASC 310-20

Net credit losses increased $1.9 million to $9.6 million, representing 0.81% of average non-covered loans outstanding, versus 0.67% in 2010. The allowance for loan and lease losses on non-covered loans increased to $37.0 million (3.06% of total non-covered loans) at December 31, 2011, compared to $31.4 million (2.66% of total non-covered loans) at December 31, 2010. NPLs increased 9.7%, or $12.0 million, in 2011. The Group's NPLs generally reflected the recessionary economic environment in Puerto Rico.

ANALYSIS OF RESULTS OF OPERATIONS

TABLE 1 - YEAR-TO-DATE ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	Interest		Average rate		Average balance	
	December 2012	December 2011	December 2012	December 2011	December 2012	December 2011
	(Dollars in thousands)					
A - TAX EQUIVALENT SPREAD						
Interest-earning assets	**$ 260,780**	**$ 297,029**	**4.46%**	**4.60%**	**$ 5,851,318**	**$ 6,457,317**
Tax equivalent adjustment	111,749	107,630	1.91%	1.67%	-	-
Interest-earning assets - tax equivalent	**372,529**	**404,659**	**6.37%**	**6.27%**	**5,851,318**	**6,457,317**
Interest-bearing liabilities	105,471	155,523	1.87%	2.46%	5,631,607	6,341,688
Tax equivalent net interest income / spread	**267,058**	**249,136**	**4.49%**	**3.81%**	**219,711**	**115,629**
Tax equivalent interest rate margin			**4.56%**	**3.86%**		
B - NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	93,728	159,924	2.82%	3.73%	3,324,575	4,283,442
Trading securities	1	-	0.23%	0.00%	426	740
Money market investments	1,680	1,106	0.23%	0.25%	745,172	437,014
Total investments	**95,409**	**161,030**	**2.34%**	**3.41%**	**4,070,173**	**4,721,196**
Loans not covered under shared-loss agreements with the FDIC:						

Mortgage	50,040	48,672	5.91%	5.58%	847,101	872,966
Commercial	20,672	14,564	5.61%	5.72%	368,763	254,617
Consumer	4,131	3,600	8.53%	10.85%	48,426	33,177
Leasing	2,411	1,498	7.83%	8.79%	30,788	17,036
Auto	2,741	-	7.39%	-	37,083	-
Total non-covered loans	**79,995**	**68,334**	**6.00%**	**5.80%**	**1,332,161**	**1,177,796**
Loans covered under shared-loss agreements with the FDIC:						
Loans secured by residential properties	20,641	15,880	14.39%	9.58%	143,412	165,681
Commercial and construction	53,427	41,829	19.54%	13.05%	273,484	320,490
Leasing	9,569	8,419	46.61%	14.49%	20,529	58,088
Consumer	1,739	1,537	15.04%	10.93%	11,559	14,066
Total covered loans	**85,376**	**67,665**	**19.02%**	**12.12%**	**448,984**	**558,325**
Total loans	**165,371**	**135,999**	**9.28%**	**7.83%**	**1,781,145**	**1,736,121**
Total interest earning assets	**260,780**	**297,029**	**4.46%**	**4.60%**	**5,851,318**	**6,457,317**
Interest-bearing liabilities:						
Deposits:						
Non-interest bearing deposits	-	-	0.00%	0.00%	206,209	185,368
NOW accounts	8,593	12,812	0.96%	1.56%	893,583	819,911
Savings and money market	2,639	3,476	1.02%	1.43%	258,206	243,896
Individual retirement accounts	8,343	9,719	2.27%	2.71%	368,004	358,809
Retail certificates of deposit	6,784	10,197	1.94%	2.37%	349,084	430,221
Institutional certificates of deposit	1,642	3,706	1.60%	1.81%	102,716	204,574
Total core deposits	**28,001**	**39,910**	**1.29%**	**1.78%**	**2,177,802**	**2,242,779**
Brokered deposits	3,601	4,749	1.78%	2.03%	201,836	234,312
Total deposits	**31,602**	**44,659**	**1.33%**	**1.80%**	**2,379,638**	**2,477,091**
Borrowings:						
Securities sold under agreements to repurchase	60,575	93,280	2.10%	2.74%	2,885,678	3,406,218
Advances from FHLB and other borrowings	10,906	12,270	3.58%	4.27%	304,407	287,361
	909	4,084	4.16%	3.89%	21,875	105,000

FDIC-guaranteed term notes										
Subordinated capital notes		1,479		1,230	3.70%	3.41%		40,009		36,083
Total borrowings		**73,869**		**110,864**	**2.27%**	**2.89%**		**3,251,969**		**3,834,662**
Total interest bearing liabilities		**105,471**		**155,523**	**1.87%**	**2.46%**		**5,631,607**		**6,311,753**
Net interest income / spread	**$**	**155,309**	**$**	**141,506**	**2.58%**	**2.15%**				
Interest rate margin					**2.65%**	**2.19%**				
Excess of average interest-earning assets over average interest-bearing liabilities							**$**	**219,711**	**$**	**145,564**
Average interest-earning assets to average interest-bearing liabilities ratio								**103.90%**		**102.31%**

C - CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
		(In thousands)	
Interest Income:			
Investments	$ (22,205)	$ (43,416)	$ (65,621)
Loans	(4,295)	33,667	29,372
Total interest income	(26,500)	(9,749)	(36,249)
Interest Expense:			
Deposits	(1,869)	(11,389)	(13,258)
Securities sold under agreements to repurchase	(14,525)	(18,179)	(32,704)
Other borrowings	(3,375)	(715)	(4,090)
Total interest expense	(19,769)	(30,283)	(50,052)
Net Interest Income	**$** (6,731)	**$** 20,534	**$** 13,803

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TABLE 1/A - YEAR-TO-DATE ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	Interest		Average rate		Average balance	
	December 2011	December 2010	December 2011	December 2010	December 2011	December 2010
	(Dollars in thousands)					
A - TAX EQUIVALENT SPREAD						
Interest-earning assets	**$ 297,029**	**$ 303,801**	**4.60%**	**4.57%**	**$ 6,457,317**	**$ 6,651,956**
Tax equivalent adjustment	107,630	147,015	1.67%	2.21%	-	-
Interest-earning assets - tax equivalent	**404,659**	**450,816**	**6.27%**	**6.78%**	**6,457,317**	**6,651,956**
Interest-bearing liabilities	155,523	168,601	2.46%	2.57%	6,311,753	6,551,268
Tax equivalent net interest income / spread	**249,136**	**282,215**	**3.81%**	**4.20%**	**145,564**	**100,688**
Tax equivalent interest rate margin			**3.86%**	**4.24%**		
B - NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	159,924	187,930	3.73%	4.03%	4,283,442	4,664,683
Money market investments	1,106	403	0.25%	0.12%	437,754	333,270
Total investments	**161,030**	**188,333**	**3.41%**	**3.77%**	**4,721,196**	**4,997,953**
Loans not covered under shared-loss agreements						
with the FDIC:						
Mortgage	48,672	56,031	5.58%	6.07%	872,966	923,317
Commercial	14,564	12,022	5.72%	5.83%	254,617	206,080
Consumer	3,600	2,938	10.85%	11.66%	33,177	25,201
Leasing	1,498	319	8.79%	6.22%	17,036	5,129
	68,334	**71,310**	**5.80%**	**6.15%**	**1,177,796**	**1,159,727**

Total non-covered loans						
Loans covered under shared-loss agreements with the FDIC:						
Loans secured by residential properties	15,880	10,029	9.58%	7.66%	165,681	130,853
Commercial and construction	41,829	23,331	13.05%	8.37%	320,490	278,690
Leasing	8,419	9,280	14.49%	13.12%	58,088	70,710
Consumer	1,537	1,518	10.93%	10.83%	14,066	14,023
Total covered loans	**67,665**	**44,158**	**12.12%**	**8.93%**	**558,325**	**494,276**
Total loans	**135,999**	**115,468**	**7.83%**	**6.98%**	**1,736,121**	**1,654,003**
Total interest earning assets	**297,029**	**303,801**	**4.60%**	**4.57%**	**6,457,317**	**6,651,956**
Interest-bearing liabilities:						
Deposits:						
Non-interest bearing deposits	-	-	0.00%	0.00%	185,368	144,831
NOW accounts	12,812	15,028	1.56%	2.05%	819,911	732,107
Savings and money market	3,476	3,055	1.43%	1.67%	243,896	183,027
Individual retirement accounts	9,719	10,411	2.71%	3.08%	358,809	338,520
Retail certificates of deposit	10,197	10,611	2.37%	2.64%	430,221	401,527
Institutional deposits	3,706	4,737	1.81%	1.39%	204,574	341,565
Total core deposits	**39,910**	**43,842**	**1.78%**	**2.05%**	**2,242,779**	**2,141,577**
Brokered deposits	4,749	4,703	2.03%	2.50%	234,312	188,102
Total deposits	**44,659**	**48,545**	**1.80%**	**2.08%**	**2,477,091**	**2,329,679**
Borrowings:						
Securities sold under agreements to repurchase	93,280	100,609	2.74%	2.85%	3,406,218	3,533,998
Advances from FHLB and other borrowings	12,270	14,125	4.27%	2.58%	287,361	546,508
FDIC-guaranteed term notes	4,084	4,084	3.89%	3.89%	105,000	105,000
Subordinated capital notes	1,230	1,238	3.41%	3.43%	36,083	36,083
Total borrowings	**110,864**	**120,056**	**2.89%**	**2.84%**	**3,834,662**	**4,221,589**

Total interest bearing liabilities	**155,523**	**168,601**	**2.46%**	**2.57%**	**6,311,753**	**6,551,268**
Net interest income / spread	**$ 141,506**	**$ 135,200**	**2.15%**	**2.00%**		
Interest rate margin			**2.19%**	**2.03%**		
Excess of average interest-earning assets over average interest-bearing liabilities					**$ 145,564**	**$ 100,688**
Average interest-earning assets to average interest-bearing liabilities ratio					**102.31%**	**101.54%**

C - CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
	(In thousands)		
Interest Income:			
Investments	$ (10,430)	$ (16,873)	$ (27,303)
Loans	6,833	13,698	20,531
Total interest income	**(3,597)**	**(3,175)**	**(6,772)**
Interest Expense:			
Deposits	3,072	(6,958)	(3,886)
Securities sold under agreements to repurchase	(3,638)	(3,692)	(7,330)
Other borrowings	(7,329)	5,467	(1,862)
Total interest expense	**(7,895)**	**(5,183)**	**(13,078)**
Net Interest Income	**$ 4,298**	**$ 2,008**	**$ 6,306**

Net Interest Income

Comparison of the years ended December 31, 2012 and 2011

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). The Group constantly monitors the composition and re-pricing of its assets and liabilities to maintain its net interest income at adequate levels. Tables 1 and 1A above show 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 2012 and 2011.

Net interest income amounted to $155.3 million for 2012, a 9.8% increase from $141.5 million in 2011. These changes reflect a decrease of 32.2% in interest expense and an increase of 21.6% in interest income from loans, partially offset by a 40.8% decrease in interest income from investments for 2012 compared to 2011.

Interest rate spread for 2012 increased 43 basis points from 2.15% in 2011 to 2.58% in 2012. This increase is mainly due to the net effect of a 59 basis points decrease in the average cost of funds from 2.46% to 1.87%, and a 14 basis points decrease in the average yield of interest-earning assets from 4.60% to 4.46%.

The decrease in interest income was primarily the result of a decrease of $26.5 million in interest-earning assets volume variance, and a $9.7 million decrease in interest rate variance. Interest income on investments decreased 40.8% to $95.4 million in 2012, compared to 2011, reflecting a lower balance in the investment securities portfolio, a lower yield on investment securities and an increase in premium amortization due to increased prepayment speeds. Interest income from loans increased 21.6% to $165.4 million for 2012. In 2012, interest income from covered loans increased 26.2% to $85.4 million, compared to 2011, mainly due to the re-yielding of various pools of covered loans during the second half of 2011.

Interest expense decreased 32.2% to $105.5 million for 2012. This decrease was primarily the result of a $30.3 million decrease in interest rate variance, and a $19.8 million decrease in interest-bearing liabilities volume variance. These decreases are due to a reduction in the balance of interest bearing liabilities and the cost of funds. Interest-bearing liabilities interest rate spread decreased 59 basis points to 1.87% for 2012, compared to 2011. The cost of deposits decreased 47 basis points to 1.33% for 2012, compared to 1.80% for 2011, primarily due to continuing progress in repricing core deposits and to the maturity of higher cost wholesale deposits during the period. The cost of borrowings decreased by 62 basis points to 2.27% in 2012, compared to 2.89% for 2011. The decrease in the cost of

borrowings is attributable to the fact that in December 2011, as previously reported, $600 million in repurchase agreements, with an average cost of 4.23%, matured. The Group paid off $300 million of these repurchase agreements, and the remaining balance of $300 million was renewed for an average period of approximately three and a half years at an effective fixed rate of 2.36%. To further reduce cost of borrowings, in May 2012, the Group renewed $350 million in repurchase agreements, with an average cost of 4.26%, at a new effective rate of approximately 1.90%. In addition, during the second half of 2012, the Group terminated repurchase agreements amounting to $1.357 billion with an average cost of 1.31%. Also, interest bearing liabilities decreased due to the repayment in March 2012 of the TLGP notes at maturity.

For 2012, the average balance of total interest-earning assets was $5.851 billion, a decrease of 9.4% from 2011. The decrease in average balance of interest-earning assets was mainly attributable to a 13.8% decrease for 2012, in average investments, in addition to a 2.6% decrease in average loans compared to 2011 resulting from normal pay downs of covered loans and to the re-yielding of various pools of covered loans mainly during the second half of 2011. The decrease in the investment portfolio reflects a reduction in the available-for-sale portfolio, due to the sale of approximately $1.403 billion in investment securities during 2012 as part of the deleverage plan in connection with the BBVAPR Acquisition. As of December 31, 2012, the Group had $868.7 million in cash and cash equivalents and $80.0 million in securities purchased under agreements to resell, compared to $591.5 million in cash and cash equivalents and no securities purchased under agreements to resell as of December 31, 2011.

For 2012, the average yield on interest-earning assets was 4.46% compared to 4.60% for 2011. This was mainly due to a decrease in the investment portfolio yield from 3.41% to 2.34% for 2012. However, such decrease was partially offset by the higher average yields in the loan portfolio, mainly due to the covered loans that had an average yield of 19.02% for 2012, compared to 12.12% for 2011.

Comparison of the years ended December 31, 2011 and 2010

Table 1A 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 2011 and 2010.

Net interest income amounted to $141.5 million for 2011, an increase of 4.7% from $135.2 million for 2010. These changes reflected an increase of 17.8% in interest income from loans for 2011, as compared to 2010.

Interest rate spread increased 15 basis points to 2.15% for 2011 from 2.00% in 2010. This increase reflected a 3 basis point increase in the average yield of interest earning assets to 4.60% in 2011 from 4.57% for 2010, and a 11 basis point decrease in the average cost of funds to 2.46% in 2011 from 2.57% for 2010, as further explained below.

The decrease in interest income for 2011 was primarily the result of a decrease of $3.2 million in interest rate variance, and a $3.6 million decrease in interest-earning assets volume variance. Interest income from loans increased 17.8% to $136.0 million for 2011, mainly due to the continued improved performance of covered loans. Interest income on investments decreased 14.5% to $161.0 million for 2011, compared to $188.3 million for 2010, reflecting an increase in premium amortization due to the decline in interest rates that caused an increase in prepayment speeds, and lower balance in the investment securities portfolio.

Interest expense decreased 7.8% reaching $155.5 million for 2011. This decrease was primarily the result of a $5.2 million decrease in interest rate variance, and a $7.9 million decrease in interest-earning liabilities volume variance. These decreases were due to a reduction in the cost of funds, which decreased 11 basis points to 2.46% from 2010. The cost of deposits decreased by 28 basis points to 1.80% compared to 2.08% for 2010.

For 2011, the average balance of total interest-earning assets was $6.457 billion, a 2.9% decrease from 2010. This decrease in average balance of interest-earning assets was mainly attributable to a 5.5% decrease in average investments, partially offset by a 5.0% increase in average loans. As of December 31, 2011, the Group had $591.5 million in cash and cash equivalents versus $440.4 million as of December 31, 2010.

For 2011, the average yield on interest-earning assets was 4.60% compared to 4.57% for 2010. This was mainly due to a decrease in the investment portfolio yield to 3.41% versus 3.77% for 2010. However, this was offset by the higher average yields in the loan portfolio, mainly due to the covered loans acquired in the FDIC-assisted acquisition with an average yield of 12.12% for 2011 compared to 8.93% for 2010.

TABLE 2 - NON-INTEREST INCOME SUMMARY

	Year Ended December 31,			
	2012	**2011**	**Variance**	**2010**
Financial service revenue	$ 25,350	$ 20,571	23.2%	$ 17,967
Banking service revenue	13,824	12,930	6.9%	10,662
Mortgage banking activities	9,705	9,876	-1.7%	9,554
Total banking and financial service revenue	**48,879**	**43,377**	**12.7%**	**38,183**
Total other-than-temporarily impaired securities	-	(15,018)	100.0%	(39,674)
Portion of loss on securities recognized in other comprehensive income	-	-	0.0%	22,508
Other-than-temporary impairments on securities	**-**	**(15,018)**	100.0%	(17,166)
Net (amortization) accretion of FDIC shared-loss indemnification asset	(28,022)	(3,379)	-729.3%	4,330
Net gain (loss) on:				
Sale of securities available for sale	74,210	27,996	165.1%	15,032
Derivatives	(41,093)	(13,243)	-210.3%	(36,823)
Foreclosed real estate	(4,366)	(1,717)	-154.3%	(524)
Early extinguishment of repurchase agreements	(26,052)	(4,790)	-443.9%	-
Other	450	(3,095)	114.5%	1,029
	(24,873)	(13,246)	-87.8%	(34,122)
Total non-interest income, net	**$ 24,006**	**$ 30,131**	**-20.3%**	**$ 4,061**

Non-Interest Income

Comparison of the years ended December 31, 2012 and 2011

Non-interest income is affected by the amount of securities, derivatives and trading transactions, the level of trust assets under management, transactions generated by clients' financial assets serviced by the securities broker-dealer and insurance subsidiaries, the level of mortgage banking activities, and the fees generated from loans and deposit accounts. It is also affected by the net amortization of the FDIC shared-loss indemnification asset, which varies depending on the results of the on-going evaluation of expected cash flows of the loan portfolio acquired in the FDIC-assisted acquisition.

As shown in Table 2 above, the Group recorded non-interest income in the amount of $24.0 million for 2012, compared to $30.1 million for 2011, a decrease of $6.1 million.

In 2012, the Group had a $74.2 million gain on the sale of $1.828 billion in investment securities, partially offset by losses of $41.1 million on derivative activities and $26.1 million from early extinguishment costs of repurchase agreements. As part of our deleverage plan related to the BBVAPR Acquisition, the Group sold $1.403 billion in investment securities resulting in realized gains of $70.6 million, and the Group extinguished $1.698 billion of securities repurchase agreements prior to their contractual maturities resulting in realized losses of $26.1 million. During 2012, the Group also terminated forward settlement swaps with an aggregate notional amount of $900 million resulting in realized losses of $37.5 million. In 2011, the Group had a $28.0 million gain on the sale of $620.3 million in investment securities, partially offset by losses of $13.2 million on derivative activities and $4.8 million from early extinguishment costs of repurchase agreements.

The increase in the net amortization of the FDIC shared-loss indemnification asset to $28.0 million for 2012, compared to $3.4 million for 2011, resulted from the ongoing evaluation of expected cash flows of the covered loan portfolio, which resulted in reduced losses expected to be collected from the FDIC and the improved re-yielding of the accretable yield on the covered loans. The reduction in claimable losses amortizes the loss-share indemnification asset through the life of the shared loss agreement. This amortization is net of the accretion of the discount recorded to reflect the expected claimable loss at its net present value.

During 2012 there were no losses on other-than-temporary impairment of securities, compared to $15.0 million in 2011.

Financial service revenue, which consists of commissions and fees from fiduciary activities, and securities brokerage and insurance activities, increased 23.2% to $25.4 million in 2012, from $20.6 million for 2011, due to increased brokerage, trust and insurance business and transactions.

Banking service revenue, which consists primarily of fees generated by deposit accounts, electronic banking services, and customer services, increased 6.9% to $13.8 million in 2012, from $12.9 million in 2011. This increase for 2012 is attributable to an increase in transaction volume.

Income generated from mortgage banking activities decreased 1.7% to $9.7 million in 2012, compared to 2011. Such decrease is mainly a result of decrease activity of mortgages sold into the secondary market.

Comparison of the years ended December 31, 2011 and 2010

As shown in Table 2, the Group recorded non-interest income in the amount of $30.1 million for 2011, compared to $4.1 million during 2010, an increase of $26.1 million. This increase was mainly related to the effect of a decrease of $23.6 million in losses on derivatives activities and an increase of $13.0 million in gain on sale of securities. During 2011, the Group recorded $13.2 million in derivative losses, primarily as a result of the strategic decision to sell its remaining swap options. Following the sale, the Group entered into new swaps to manage interest rate risk with an aggregate notional amount of $1.425 billion designated as cash flow hedges. In December 2011, the Group cancelled $300 million of these cash flow hedges as the forecasted transaction was not deemed probable of occurring. This transaction resulted in a loss which was included in the previously mentioned loss on derivatives activities. An unrealized loss of $47.4 million was recognized in accumulated other comprehensive income related to the valuation of the remaining swaps which were deemed to be in effect at December 31, 2011.

Financial service revenue increased 14.5% to $20.6 million in 2011, from $18.0 million in 2010. Banking service revenue increased 21.3% to $12.9 million in 2011, from $10.7 million in 2010. These increases were attributable to an increase in electronic banking service fees.

Income generated from mortgage banking activities increased 3.4% to $9.9 million in 2011 from $9.6 million in 2010, mainly as a result of favorable pricing of mortgages sold into the secondary market.

During the 2011 and 2010, the Group recorded other-than-temporary impairment losses of $15.0 million and $17.2 million, respectively. The other-than-temporary impairment losses during 2011 were all recorded on a CDO that was sold in January 2012 at a loss of $15.0 million. No additional gain or loss was realized on the sale in January 2012, since this asset was sold at the same value reflected at December 31, 2011. During 2010, other-than-temporary impairment losses were recorded on the BALTA private label non-agency CMO that was sold in December 2010 at a loss of $22.8 million.

TABLE 3 - NON-INTEREST EXPENSES SUMMARY

	Year Ended December 31,			
	2012	2011	Variance %	2010
	(Dollars in thousands)			
Compensation and employee benefits	$ 45,778	$ 45,552	0.5%	$ 41,723
Professional and service fees	22,274	22,805	-2.3%	16,559
Occupancy and equipment	17,530	17,530	0.0%	18,548
Insurance	6,742	6,642	1.5%	7,006
Electronic banking charges	6,430	5,709	12.6%	4,504
Advertising, business promotion, and strategic initiatives	6,254	5,977	4.6%	4,978
Merger and restructuring charges	4,990	-	100.0%	-
Foreclosure, repossession and other real estate expenses	3,591	2,078	72.8%	1,691
Loan servicing and clearing expenses	3,309	3,978	-16.8%	3,055
Taxes, other than payroll and income taxes	3,502	4,721	-25.8%	5,106
Communication	1,627	1,500	8.5%	2,561
Printing, postage, stationery and supplies	1,254	1,264	-0.8%	1,188
Director and investors relations	1,039	1,305	-20.4%	1,463
Other operating expenses	3,458	3,447	0.3%	3,147
Total non-interest expenses	**$ 127,778**	**$ 122,508**	**4.3%**	**$ 111,529**
Relevant ratios and data:				
Efficiency ratio	**62.58%**	**66.26%**		**64.33%**
Compensation and benefits to non-interest expense	**35.83%**	**37.18%**		**37.41%**
Compensation to total assets owned	**0.50%**	**0.68%**		**0.57%**
Average number of employees	**781**	**724**		**725**
Average compensation per employee	**$ 58.6**	**$ 62.9**		**$ 57.5**
Assets owned per average employee	**$ 11,771**	**$ 9,246**		**$ 10,084**

Non-Interest Expense

Comparison of the years ended December 31, 2012 and 2011

Non-interest expense for 2012 reached $127.8 million, representing an increase of 4.3% compared to $122.5 million for 2011. During 2012, the Group incurred $7.1 million in expenses related to the BBVAPR Acquisition. Merger and restructuring charges amounted to $5.0 million and other integration expenses amounted to $2.1 million. These charges represent costs associated with these one-time activities and do not represent ongoing costs of the fully integrated combined organization.

Foreclosure, repossession and other real estate expenses for 2012 increased 72.8% to $3.6 million as compared to 2011, principally due to increase in foreclosures during 2012 as compared to 2011.

Electronic banking charges increased 12.6% to $6.4 million in 2012 from $5.7 million in 2011, mostly as a result in volume increase of POS transactions. Communication increased 8.5% to $1.6 million in 2012 compared to 2011 driven by increase in credit information systems. Advertising, business promotion, and strategic initiatives increased 4.6% to $6.3 million in 2012 compared to 2011 as a result in marketing initiatives during 2012 for identity refresh and rebranding in connection with the BBVAPR Acquisition.

Taxes, other than payroll and income taxes, for 2012 decreased 25.8% to $3.5 million as compared to 2011, principally due to a municipal license benefit of $1.4 million attributed to a settlement reached with the municipality of San Juan during the second quarter of 2012 in which the Group paid $60 thousand in full and final satisfaction of any and all claims for municipal license taxes for all fiscal years prior to and including 2011.

Directors and investor relations expenses decreased 20.4% to $1.0 million in 2012 compared to 2011, due to the departure of two directors during 2012.

Loan servicing and clearing expenses decreased by 16.8% in 2012 as a result of conversion expenses of the securities broker dealer clearing agent platform of approximately $250 thousand in 2011 and overall expenses savings related to these new clearing services.

The increase in the Group's net-interest income resulted in a decrease in the efficiency ratio to 62.58% for 2012 from 66.26% in the prior year. 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, net accretion or amortization of FDIC shared-loss indemnification assets, losses on early extinguishment of repurchase agreements, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permits greater comparability.

Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to losses of $24.9 million for 2012 compared to losses of $28.3 million for 2011. Revenue for purposes of the efficiency ratio for 2012 amounted to $204.2 million compared to $184.9 million for 2011.

Comparison of the years ended December 31, 2011 and 2010

Non-interest expenses for 2011 increased 8.6% to $122.3 million compared to $112.6 million for 2010. The increase in non-interest expenses for 2011 is primarily driven by the integration of former Eurobank employees after the FDIC-assisted acquisition on April 30, 2010 and, therefore, had only a partial impact on 2010.

Compensation and employee benefits increased 9.2% to $45.6 million from $41.7 million for 2010. Average employees remained at 725 for 2011 and 2010.

Professional and service fees for 2011 increased 31.8% to $21.7 million compared to $16.5 million for 2010. The increase for 2011 is mainly due to expenses for servicing the loans acquired in the FDIC-assisted acquisition, which commenced in late June 2010.

Occupancy and equipment expense decreased 6.2% to $17.4 million for 2011 compared to 2010. This decrease is mainly attributed to fewer branches when compared to 2010.

The decrease in insurance expenses for 2011 as compared to 2010 is principally due to the change in FDIC assessment rates and the change in the methodology applied to the Bank. This current methodology is based on average consolidated total assets less average tangible equity, instead of total deposits.

The increase in electronic banking charges for 2011 compared to 2010 is mainly due to increases in the volume of transactions as the result of new customers from the FDIC-assisted acquisition.

The decrease in taxes, other than payroll and income taxes, for 2011 as compared to 2010 is principally due to the effect of the Eurobank integration, which for 2010 contemplated property taxes for all of Eurobank's former facilities.

Advertising, business promotion, and strategic initiatives for 2011 increased 20.0% as compared to the same period in 2010, primarily to support the expansion of commercial banking and the Group's rebranding.

Loan servicing and clearing expenses increased 30.4%, foreclosure and repossession expenses increased 3.7%, printing, postage, stationery and supplies expenses increased 6.4%, and other operating expenses increased 9.7%, and communication expenses and director and investor relations expenses decreased 36.6% and 10.8%, respectively, for 2011 when compared to 2010.

The non-interest expense results reflected an efficiency ratio of 66.2% for 2011 compared to 64.5% for 2010. The efficiency ratio measures how much of a company's revenue is used to pay operating expenses. Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to a loss of $13.2 million for 2011 compared to a loss of $34.1 million for 2010.

Provision for Loan and Lease Losses

Comparison of the years ended December 31, 2012 and 2011

The provision for non-covered loan and lease losses for 2012 totaled $13.9 million, a decrease of 8.8% from the $15.2 million reported in 2011. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for 2012 was adequate in order to maintain the allowance for loan and lease losses at an adequate level to provide for probable losses based upon an evaluation of known and inherent risks. The decrease in the provision for loan and lease losses for 2012 is supported by the following observed trends:

- Loans that are 90 days past due to total gross loans decreased from 11.7% at December 31, 2011 to 6.6% at December 31, 2012.
- Non-accruing loans decreased from $167.7 million at December 31, 2011 to $147.4 million at December 31, 2012.

During 2012, net credit losses amounted to $10.9 million, an increase of 13.8% when compared $9.6 million in 2011. The increase for 2012 was primarily due to an increase in net credit losses for commercial loans of $1.6 million when compared to 2011. Total charge-offs increased 13.1% to $11.5 million in 2012 as compared to 2011, and total recoveries slightly increased from $506 thousand in 2011 to $508 thousand in 2012. As a result, the recoveries to

charge-offs ratio decreased from 5.00% in 2011 to 4.44% in 2012.

The loans covered by the FDIC shared-loss agreement were recognized at fair value as of April 30, 2010, which included the impact of expected credit losses. To the extent credit deterioration occurs in covered loans after the date of acquisition, the Group records an allowance for loan and lease losses. Also, the Group records an increase in the FDIC share-loss indemnification asset for the expected reimbursement from the FDIC under the shared-loss agreements. Provision for covered loans and lease losses for 2012 was $9.8 million, reflecting the Group's revision to the expected cash flows in the covered loan portfolio considering actual experiences and changes in the Group's expectations for the remaining terms of the loan pools. During the first quarter of 2012, some covered construction and development and commercial real estate loan pools underperformed, which required a provision amounting to $7.2 million, net of the estimated reimbursement from the FDIC. Additional net provisions of $1.5 million, $221 thousand and $982 thousand were recorded for the second, third and fourth quarters of 2012, respectively, as quarterly reviews of credit assumptions for covered loans are reflecting some delays in the expected cash flows, mainly in pools of real estate collateralized loans. Significant judgement is made in timing the collection of nonperforming loans that are being actively worked out.

Please refer to the "Allowance for Loan and Lease Losses and Non-Performing Assets" section in this MD&A and Table 8 through Table 13 below for more detailed information concerning the allowances for loan and lease losses, net credit losses and credit quality statistics.

Comparison of the years ended December 31, 2011 and 2010

The provision for non-covered loan and lease losses for 2011 totaled $15.2 million, a 4.5% decrease from the $15.9 million reported for 2010. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for 2011 was adequate in order to maintain the allowance for loan and lease losses at an adequate level.

Net credit losses increased $1.9 million to $9.6 million, representing 0.81% of average non-covered loans outstanding, versus 0.67% in 2010. The allowance for non-covered loan and lease losses increased to $37.0 million (3.06% of non-covered loans) at December 31, 2011, compared to $31.4 million (2.66% of non-covered loans) at December 31, 2010.

For the commercial loans portfolio, all loans over $250 thousand that are either over 90 days past due or adversely classified are evaluated for impairment, or when deemed necessary by management. At December 31, 2011, the total investment in impaired commercial loans was $46.4 million, compared to $25.9 million at December 31, 2010. Impaired commercial loans increased principally as a result of an increase of $10.9 million in commercial loans classified as troubled debt restructurings and $5.4 million in current loans adversely classified by management during its impairment analysis. Most of the impaired commercial loans were measured based on the fair value of collateral method, since most impaired loans during the period were collateral dependant, all other loans were measured using the present value of cash flows method. The valuation allowance for impaired commercial loans amounted to approximately $3.5 million and $823 thousand at December 31, 2011 and 2010, respectively. At December 31, 2011, the total investment in impaired mortgage loans was $51.5 million (December 31, 2010 — $36.1 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 $3.4 million and $2.4 million at December 31, 2011 and 2010, respectively.

The loans covered by the FDIC shared-loss agreement were recognized at fair value as of April 30, 2010, which included the impact of expected credit losses. As part of the Group's assessment of actual versus expected cash flows on covered loans, higher cash flows are expected for various pools of loans for which impairment has been previously recorded as an allowance for covered loan and lease losses. The resulting higher expected cash flows are recorded as a reduction in such previously recorded allowance and a recapture of covered loan and lease losses of $1.4 million for 2011, net of the effect from the FDIC shared-loss indemnification asset. A provision for covered loan and lease losses of $6.2 million was recorded in 2010, net of the effect from the FDIC shared-loss indemnification asset.

Income Taxes

Comparison of the years ended December 31, 2012 and 2011

Income tax expense was $3.3 million for 2012 compared to $886 thousand for 2011. The increase during 2012 was mainly due to a $2.4 million tax expense from the IBE Subsidiary. Following a change in its applicable tax rate from 5% to 0% as a result of a Puerto Rico law adopted in 2011, the remaining tax balance of the IBE Subsidiary's unrealized gain on securities recorded other comprehensive income will flow through income as these securities are

repaid or sold in future periods. This change in law had no effect during 2011. The tax benefit of the exempt interest income was reduced from $10.5 million to $3.5 million as a result of the reduced investment portfolio and the reduction in the IBE Subsidiary's income from $9.2 million in 2011 to $4.6 million in 2012.

Comparison of the years ended December 31, 2011 and 2010

For 2011, the Group recorded an income tax expense of $866 thousand, as compared to income tax benefit of $4.3 million for 2010. This increase reflected a $5.2 million expense related to the re-measurement of the net deferred tax assets due to a reduction in the marginal corporate income tax rate from 40.95% to 30% as a result of the 2011 Code, partially reduced by the various contingencies settled with the Puerto Rico Treasury Department during the second quarter of 2011 in which the Group paid $2.0 million, approximately $3.0 million less than what the Group had reserved for this purpose. As part of the settlement reached, all taxable years prior to 2010 are closed for purposes of any assessments of additional income taxes by the Puerto Rico Treasury Department. Also, mortgage tax credits amounting to $2.6 million became available for the years 2011 and 2012, $1.3 million of which were used during 2011 to offset any taxable income. The Group expects to obtain benefits from this reduction in tax rates on future corporate tax filings. For 2011, the effective tax rate of the Group reached 2.45% compared to an effective tax benefit of 77.64% for 2010. Included in the aforementioned effective tax rate is the net effect of the change in the enacted tax rate of 14.66%; the decrease in the tax liability rate of the IBE Subsidiary of 1.41%, which reduced its statutory tax rate from 5.00% to 0.00%; and a decrease in the income tax contingencies credit of 7.95%, which includes the benefits recorded from the settlement of contingencies with the Puerto Rico Treasury Department.

ANALYSIS OF FINANCIAL CONDITION

TABLE 4 - ASSETS SUMMARY AND COMPOSITION

	December 31,			
	2012	2011	Variance %	2010
	(Dollars in thousands)			
Investments:				
FNMA and FHLMC certificates	$ 1,693,448	$ 3,560,805	-52.4%	$ 3,972,107
Obligations of US Government sponsored agencies	21,847	-	100.0%	3,000
US Treasury securities	26,496	-	100.0%	-
CMOs issued by US Government sponsored agencies	291,400	130,046	124.1%	177,804
GNMA certificates	15,165	28,337	-46.5%	127,714
Structured credit investments	-	37,288	-100.0%	41,693
Puerto Rico Government and agency obligations	120,520	71,458	68.7%	67,663
FHLB stock	38,411	23,779	61.5%	22,496
Other debt securities	25,410	16,004	58.8%	-
Other investments	568	253	124.5%	1,480
Total investments	**2,233,265**	**3,867,970**	**-42.3%**	**4,413,957**
Loans:				
Loans not covered under shared-loss agreements with the FDIC	4,762,095	1,179,987	303.6%	1,149,319
Allowance for loan and lease losses on non covered loans	(39,921)	(37,010)	-7.9%	(31,430)
Non covered loans receivable, net	**4,722,174**	**1,142,977**	**313.1%**	**1,117,889**
Mortgage loans held for sale	64,544	26,939	139.6%	33,979
Total loans not covered under shared-loss agreements with the FDIC, net	**4,786,718**	**1,169,916**	**309.2%**	**1,151,868**
Loans covered under shared-loss agreements with	449,431	533,532	-15.8%	669,997

the FDIC						
Allowance for loan and lease losses on covered loans		(54,124)		(37,256)	-45.3%	(49,286)
Total loans covered under shared-loss agreements with the FDIC, net		**395,307**		**496,276**	-20.3%	**620,711**
Total loans, net		**5,182,025**		**1,666,192**	**211.0%**	**1,772,579**
Securities purchased under agreements to resell		**80,000**		**-**	**100.0%**	**-**
Total securities and loans		**7,495,290**		**5,534,162**	**35.4%**	**6,186,536**
Other assets:						
Cash and due from banks		855,490		587,624	45.6%	344,067
Money market investments		13,205		3,863	241.8%	104,869
FDIC shared-loss indemnification asset		286,799		392,367	-26.9%	473,629
Foreclosed real estate		81,531		27,679	194.6%	26,840
Accrued interest receivable		17,554		20,182	-13.0%	28,716
Deferred tax asset, net		117,201		32,023	266.0%	30,732
Premises and equipment, net		84,997		21,520	295.0%	23,941
Servicing assets		10,795		10,454	3.3%	-
Derivative assets		21,889		9,317	134.9%	28,315
Goodwill		64,021		2,701	2270.3%	2,701
Other assets		144,596		52,502	175.4%	60,660
Total other assets		**1,698,078**		**1,160,232**	**46.4%**	**1,124,470**
Total assets	**$**	**9,193,368**	**$**	**6,694,394**	**37.3%**	**$ 7,311,006**
Investments portfolio composition:						
FNMA and FHLMC certificates		75.8%		92.1%		90.0%
Obligations of US Government sponsored agencies		1.0%		0.0%		0.1%
US Treasury securities		1.2%		0.0%		0.0%
CMOs issued by US Government sponsored agencies		13.0%		3.4%		4.0%
GNMA certificates		0.7%		0.7%		2.9%
Structured credit investments		0.0%		1.0%		1.0%
Puerto Rico Government and agency obligations		5.4%		1.8%		1.5%
FHLB stock		1.7%		0.6%		0.5%
Other debt securities and other investments		1.2%		0.4%		0.0%
		100.0%		**100.0%**		**100.0%**

Assets Owned

At December 31, 2012, the Group's total assets amounted to $9.193 billion, an increase of 37.3% when compared to $6.694 billion at December 31, 2011, and interest-earning assets increase 35.4% from $5.534 billion at December 31, 2011 to $7.495 billion at December 31, 2012. This increase is the result of the BBVAPR Acquisition on December 18, 2012, partially offset by the deleverage plan executed in the second half of 2012 in connection with such acquisition.

As set forth in Table 4 above, as a result of the BBVAPR Acquisition in December 2012 and related deleverage plan, the Group accelerated its longstanding goal of creating a more stable balance sheet, with a larger and more diversified loan portfolio, and a smaller investment securities portfolio, improving earnings stability. Furthermore, in connection with the BBVAPR Acquisition, we completed the sale of approximately $1.4 billion of our and BBVAPR Bank's investment securities and used the proceeds from such sales, together with available cash, to repay approximately $1.7 billion of wholesale funding. The BBVAPR Acquisition and the change in portfolio composition as a result of the deleverage prompted management to consider the adequacy of maintaining securities classified as held-to-maturity in connection with the assessment of the overall asset-liability management process. In doing so, and in compliance with the applicable accounting guidance under ASC 320-10-25, management's considerations focused primarily on its ability and intent to hold the securities until maturity, as well as its asset-liability management strategy with its goal of maximizing net interest income and managing risk under the new consolidated balance sheet structure. As a result of such analysis, on December 31, 2012, the securities in the held-to-maturity portfolio were transferred to the available-for-sale portfolio at a fair value of $797.5 million with net combined unrealized gains of $35.1 million.

At December 31, 2012, investments represented 30.1% of total interest earning assets while loans represented 69.9%, compared to 69.9% and 30.1%, respectively, at December 31, 2011.

Investments principally consist of U.S. treasury securities, U.S. government and agency bonds, mortgage-backed securities and Puerto Rico government and agency bonds. At December 31, 2012, the investment portfolio decreased 42.3% to $2.233 billion from $3.868 billion at December 31, 2011. This decrease is mostly due to the effect of a decrease of $1.867 billion in FNMA and FHLMC certificates. During 2012, the Group had net realized gains of $74.2 million, mainly due to sales of mortgage-backed securities and CMOs of $1.509 billion with a book value at sale of $1.433 billion and investment securities of $319.3 million with a book value at sale of $322.2 million. During 2011, the Group had gross realized gains of $28.0 million, mainly due to sales of mortgage-backed securities of $606.2 million with a book value at sale of $578.2 million.

The Group's loan portfolio is comprised of residential loans, home equity loans, commercial loans collateralized by mortgages on real estate located in Puerto Rico, other commercial and industrial loans, consumer loans, leases, and auto loans, the latter were added as part of the recent BBVAPR Acquisition. At December 31, 2012, the Group's loan

portfolio, the largest category of the Group's interest-earning assets increased 211.0% to $5.182 billion compared to the loan portfolio of $1.666 billion at December 31, 2011. The loan portfolio increase was mainly attributable to the $3.560 billion in loans acquired in the BBVAPR Acquisition. The fair values initially assigned to the assets acquired and liabilities assumed are 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. The covered loan portfolio decreased $101.0 million, or 20.3%, mainly due to an increase of $16.9 million in the allowance for loan and lease losses on covered loans, and as a net effect of the repayment of loans and the portion of the accretable yield recognized as interest income. The non-covered loan portfolio increased $3.617 billion, or 309.2%.

At December 31, 2012, the Group's non-covered loan portfolio composition and trends were as follows:

- Mortgage loan portfolio amounted to $808.3 million (38.0% of the gross non-covered loan portfolio) compared to $821.1 million (69.3% of the gross non-covered loan portfolio) at December 31, 2011. Mortgage loan production totaled $202.7 million for 2012, a decrease of 4.7% from $212.8 million in 2011.

- Commercial loan portfolio amounted to $690.1 million (32.5% of the gross non-covered loan portfolio) compared to $301.6 million (25.5% of the gross non-covered loan portfolio) at December 31, 2011. Commercial loan production increased 36.7% to $191.0 million for 2012 from $139.8 million for 2011.

- Consumer loan portfolio amounted to $118.8 million (5.6% of the gross non-covered loan portfolio) compared to $36.1 million (3.1% of the gross non-covered loan portfolio) at December 31, 2011. Consumer loan production increased 46.4% to $31.8 million for 2012 from $21.7 million in 2011.

- Leasing portfolio amounted to $37.6 million (1.8% of the gross non-covered loan portfolio) compared to $25.8 million (2.2% of the gross non-covered loan portfolio) at December 31, 2011. Leasing production increased 2.3% to $22.1 million for 2012 from $21.6 million in 2011.

- Auto loan portfolio amounted to $471.1 million (22.2% of the gross non-covered loan portfolio). This business line was added as part of the BBVAPR Acquisition on December 18, 2012. Auto loan production was $13.1 million in 2012 since acquisition.

The FDIC shared-loss indemnification asset amounted to $286.8 million as of December 31, 2012 and $392.4 million as of December 31, 2011. The FDIC shared-loss indemnification asset is reduced as claims over losses recognized on covered loans are collected from the FDIC. Realized credit losses in excess of previously forecasted estimates result in an increase in the FDIC shared-loss indemnification asset. Conversely, if realized credit losses are less than previously forecasted estimates, the FDIC shared-loss indemnification asset is amortized through the term of the shared-loss agreements. The decrease in the FDIC shared-loss indemnification asset is mainly related to reimbursements received from the FDIC during 2012 of $96.7 million and net amortization of $28.0 million, which was partially offset by an increase of $7.0 million in expected net credit impairment losses to be covered under shared-loss agreements and $12.1 million in incurred expenses to be reimbursed under the shared-loss agreements.

Under the terms of the shared-loss agreements, the FDIC absorbs 80% of losses and shares 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.

TABLE 5 — LOANS RECEIVABLE COMPOSITION

	December 31,			
	2012	**2011**	**Variance %**	**2010**
	(In thousands)			
Loans not covered under shared-loss agreements with FDIC:				
Originated loans and leases:				
Mortgage	$ 804,942	$ 821,062	-2.0%	$ 873,932
Commercial	353,930	301,573	17.4%	234,992
Auto	13,143	-	100.0%	-
Consumer	48,136	36,130	33.2%	34,492
Leasing	37,577	25,768	45.8%	10,257

Deferred loan fees, net	(3,601)	(4,546)	20.8%	(4,354)
Total originated loans and leases	**1,254,127**	**1,179,987**	**6.3%**	**1,149,319**
Acquired loans:				
Accounted for under ASC 310-20				
Commercial and industrial	317,632	-	100.0%	-
Construction and commercial real estate	20,337	-	100.0%	-
Mortgage	1,591	-	100.0%	-
Auto	457,894	-	100.0%	-
Consumer	68,878	-	100.0%	-
Deferred loan costs, net	138	-	100.0%	
	866,470	**-**	**100.0%**	**-**
Accounted for under ASC 310-30				
Commercial and industrial	960,502	-	100.0%	-
Construction and commercial real estate	198,560	-	100.0%	-
Mortgage	808,644	-	100.0%	-
Auto	555,510	-	100.0%	-
Consumer	118,282	-	100.0%	-
	2,641,498	**-**	**100.0%**	**-**
	3,507,968	**-**	**100.0%**	**-**
Loans receivable	**4,762,095**	**1,179,987**	**303.6%**	**1,149,319**
Allowance for loan and lease losses on non-covered loans	(39,921)	(37,010)	-7.9%	(31,430)
Loans receivable, net	**4,722,174**	**1,142,977**	**313.1%**	**1,117,889**
Mortgage loans held-for-sale	64,544	26,939	139.6%	33,979
Total loans not covered under shared-loss agreements with FDIC, net	**4,786,718**	**1,169,916**	**309.2%**	**1,151,868**
Loans covered under shared-loss agreements with FDIC:				
Loans secured by 1-4 family residential properties	128,811	140,824	-8.5%	166,865
Construction and development secured by 1-4 family residential properties	15,969	16,976	-5.9%	17,232
Commercial and other construction	289,070	325,832	-11.3%	388,261
Leasing	7,088	36,122	-80.4%	79,093

Consumer		8,493		13,778	-38.4%		18,546
Total loans covered under shared-loss agreements with FDIC		**449,431**		**533,532**	**-15.8%**		**669,997**
Allowance for loan and lease losses on covered loans		(54,124)		(37,256)	-45.3%		(49,286)
Total loans covered under shared-loss agreements with FDIC, net		**395,307**		**496,276**	**-20.3%**		**620,711**
Total loans receivable, net	**$**	**5,182,025**	**$**	**1,666,192**	**211.0%**	**$**	**1,772,579**

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The following table summarizes the remaining contractual maturities of the Group's total gross non-covered loans segmented to reflect cash flows as of December 31, 2012. Contractual maturities do not necessarily reflect the actual term of a loan, considering prepayments.

	Balance Outstanding at December 31, 2012	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)					
Originated loans:						
Mortgage, mainly residential	$ 804,206	$ 6,770	$ 40,217	$ -	$ 757,219	$ -
Commercial, mainly real estate	353,930	119,285	144,469	52,950	24,348	12,878
Auto	13,143	-	-	-	13,143	-
Consumer	48,872	6,744	37,442	62	3,913	711
Leasing	37,577	172	32,094	-	5,311	-
Total	**$ 1,257,728**	**$ 132,971**	**$ 254,222**	**$ 53,012**	**$ 803,934**	**$ 13,589**
Acquired loans accounted under ASC 310-20:						
Commercial and Industrial	$ 317,632	$ 312,286	$ 312	$ 2,074	$ 932	$ 2,028
Commercial secured by real estate	20,337	16,441	356	750	681	2,109
Mortgage	1,591	-	-	-	1,591	-
Auto	457,894	15,582	237,589	-	204,723	-
Consumer	68,878	67,362	309	-	1,207	-
Total	**$ 866,332**	**$ 411,671**	**$ 238,566**	**$ 2,824**	**$ 209,134**	**$ 4,137**

TABLE 6 - LIABILITIES SUMMARY AND COMPOSITION

	December 31,			
	2012	2011	Variance %	2010
	(Dollars in thousands)			
Deposits:				
Non-interest bearing deposits	$ 799,667	$ 201,318	297.2%	$ 170,705
NOW accounts	1,647,072	847,940	94.2%	783,744
Savings and money market accounts	634,133	230,672	174.9%	235,690
Certificates of deposit	2,603,693	1,151,720	126.1%	1,393,743
Total deposits	**5,684,565**	**2,431,650**	**133.8%**	**2,583,882**
Accrued interest payable	4,994	4,493	11.2%	5,006
Total deposits and accrued interest payable	**5,689,559**	**2,436,143**	**133.5%**	**2,588,888**
Borrowings:				
Short term borrowings	92,222	-	100.0%	42,460
Securities sold under agreements to repurchase	1,695,247	3,056,238	-44.5%	3,456,781
Advances from FHLB	536,542	287,753	86.5%	281,753
FDIC-guaranteed term notes	-	105,834	-100.0%	105,834
Federal funds purchased	9,901	-	100.0%	-
Other term notes	7,734	-	100.0%	-
Subordinated capital notes	146,038	36,083	304.7%	36,083
Total borrowings	**2,487,684**	**3,485,908**	**-28.6%**	**3,922,911**
Total deposits and borrowings	**8,177,243**	**5,922,051**	**38.1%**	**6,511,799**
FDIC net settlement payable	**-**	115	-100.0%	22,954
Derivative liabilities	26,260	47,425	-44.6%	64
Acceptances outstanding	26,996	-	100.0%	-
Other liabilities	99,263	29,248	239.4%	43,858
Total liabilities	**$ 8,329,762**	**$ 5,998,839**	**38.9%**	**$ 6,578,675**
Deposits portfolio composition percentages:				
Non-interest bearing deposits	14.1%	8.3%		6.6%
NOW accounts	29.0%	34.9%		30.3%
Savings and money market accounts	11.2%	9.5%		9.1%
Certificates of deposit	45.7%	47.3%		54.0%
	100.0%	**100.0%**		**100.0%**

Borrowings portfolio composition percentages:			
Short term borrowings	3.7%	0.0%	1.1%
Securities sold under agreements to repurchase	68.1%	87.7%	88.1%
Advances from FHLB	21.6%	8.3%	7.2%
FDIC-guaranteed term notes	0.0%	3.0%	2.7%
Federal funds purchased	0.4%	0.0%	0.0%
Other term notes	0.3%	0.0%	0.0%
Subordinated capital notes	5.9%	1.0%	0.9%
	100.0%	**100.0%**	**100.0%**
Securities sold under agreements to repurchase			
Amount outstanding at year-end	$ 1,695,247	$ 3,056,238	$ 3,456,781
Daily average outstanding balance	$ 2,888,558	$ 3,417,892	$ 3,545,926
Maximum outstanding balance at any month-end	$ 3,060,578	$ 3,466,480	$ 3,566,588

Liabilities and Funding Sources

As shown in Table 6 above, at December 31, 2012, the Group's total liabilities were $8.330 billion, 37.8% higher than the $6.005 billion reported at December 31, 2011. This increase is the result of the BBVAPR Acquisition on December 18, 2012, partially offset by the deleverage plan executed in the second half of 2012. Deposits and borrowings, the Group's funding sources, amounted to $8.178 billion at December 31, 2012 versus $5.922 billion at December 31, 2011, a 38.1% increase.

At December 31, 2012, deposits represented 69.6% and borrowings represented 30.4% of interest-bearing liabilities, compared to 41.1% and 58.9%, respectively, at December 31, 2011. At December 31, 2012, deposits and accrued interest payable, the largest category of the Group's interest-bearing liabilities, were $5.690 billion, up 133.5% from $2.436 billion at December 31, 2011. The deposit increase was mainly attributable to the $3.494 billion in BBVAPR deposits assumed on December 18, 2012. The fair values initially assigned to the assets acquired and liabilities assumed are 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 becomes available. Core deposits increased 118.5% to $4.761 billion at December 31, 2012 from $2.180 billion at December 31, 2011, and brokered deposits increased 261.7% to $928.2 million as of December 31, 2012 from $256.6 million at December 31, 2011.

Borrowings consist mainly of funding sources through the use of repurchase agreements, FHLB advances, subordinated capital notes, and short-term borrowings. At December 31, 2012, borrowings amounted to $2.488 billion, 28.6% lower than the $3.486 billion reported at December 31, 2011. The TLGP notes totaling $105 million were repaid in full at maturity in March 2012. Repurchase agreements as of December 31, 2012 decreased approximately $1.361 billion to $1.695 billion from $3.056 billion at December 31, 2012, due to the early termination of repurchase agreements in connection with the deleverage plan executed in the second half of 2012.

As a member of the FHLB, the Bank can obtain advances from the FHLB, secured by the FHLB stock owned by the Bank, as well as by certain of the Bank's mortgage loans and investment securities. Advances from FHLB amounted to $536.5 million and $281.8 million as of December 31, 2012 and December 31, 2011, respectively. These advances mature from January 2013 through April 2017.

Stockholders' Equity

At December 31, 2012, the Group's total stockholders' equity was $863.6 million, a 24.2% increase when compared to $695.6 million at December 31, 2011. The increase reflects the issuance of common and preferred stock during 2012 amounting to $149.8 million, net of stock issuance costs, in connection with the BBVAPR Acquisition, an increase of 129.2% or $18.7 million in other comprehensive income, and the net income for 2012, partially offset by cash dividends declared on common and preferred stock amounting to $20.0 million.

Regulatory capital ratios for 2012 decreased mainly as a result of the BBVAPR Acquisition, as risk-weighted assets increased 152.6%, or $3.163 billion, partially offset by the increase of 24.2%, or $168.1 million, in total capital in 2012, compared to 2011. Tangible common equity to risk-weighted assets and total equity to risk-weighted assets at December 31, 2012 decreased to 11.82% from 30.14% and 16.48% from 33.48%, respectively, at December 31, 2011.

The Group maintains capital ratios in excess of regulatory requirements. At December 31, 2012, Tier 1 Leverage Capital Ratio was 6.42% (1.61 times the requirement of 4.00%), Tier 1 Risk-Based Capital Ratio was 12.94% (3.24 times the requirement of 4.00%), and Total Risk-Based Capital Ratio was 15.15% (1.89 times the requirement of 8.00%).

Taking into consideration our strong capital position, we increased the quarterly cash dividend per common share by 20% to $0.06 per share on November 30, 2011. This represents an annual increase from $0.20 to $0.24 per share.

The following are the consolidated capital ratios of the Group at December 31, 2012 and December 31, 2011:

TABLE 7 — CAPITAL, DIVIDENDS AND STOCK DATA

	December 31,						
					Variance		
		2012		2011	%		2010
	(Dollars in thousands, except per share data)						
Capital data:							
Stockholders' equity	$	863,606	$	695,555	24.2%	$	732,331
Regulatory Capital Ratios data:							
Leverage capital ratio		**6.42%**		**9.65%**	-33.4%		**9.50%**
Minimum leverage capital ratio required		4.00%		4.00%			4.00%
Actual tier 1 capital	$	678,127	$	661,614	2.5%	$	699,415
Minimum tier 1 capital required	$	422,307	$	274,230	54.0%	$	294,472
Excess over regulatory requirement	$	255,821	$	387,384	-34.0%	$	404,943
Tier 1 risk-based capital ratio		**12.94%**		**31.84%**	-59.4%		**31.04%**
Minimum tier 1 risk-based capital ratio required		4.00%		4.00%			4.00%
Actual tier 1 risk-based capital	$	678,127	$	661,614	2.5%	$	699,415
Minimum tier 1 risk-based capital required	$	209,634	$	83,110	152.2%	$	90,139
Excess over regulatory requirement	$	468,493	$	578,504	-19.0%	$	609,276
Risk-weighted assets	$	5,240,861	$	2,077,742	152.2%	$	2,253,487
Total risk-based capital ratio		**15.15%**		**33.12%**	-54.2%		**32.32%**
Minimum total risk-based capital ratio required		8.00%		8.00%			8.00%
Actual total risk-based capital	$	794,195	$	688,188	15.4%	$	728,241
Minimum total risk-based capital required	$	419,269	$	166,219	152.2%	$	180,279
Excess over regulatory requirement	$	374,926	$	521,969	-28.2%	$	547,962
Risk-weighted assets	$	5,240,861	$	2,077,742	152.2%	$	2,253,487
Tangible common equity to total assets		**6.74%**		**9.36%**	-28.0%		**9.03%**

Tangible common equity to risk-weighted assets		**11.82%**	**30.14%**	-60.8%	**29.30%**
Total equity to total assets		**9.39%**	**10.39%**	-9.6%	**10.02%**
Total equity to risk-weighted assets		**16.48%**	**33.48%**	-50.8%	**32.50%**
Tier 1 common equity to risk-weighted assets		**9.11%**	**27.01%**	-66.3%	**28.0%**
Tier 1 common equity capital	$	477,241	$ 561,275	-15.0%	$ 631,415
Stock data:					
Outstanding common shares		45,580,281	41,244,533	10.5%	46,348,667
Book value per common share	$	15.31	$ 15.28	0.2%	$ 14.33
Market price at end of period	$	13.35	$ 12.11	10.2%	$ 12.49
Market capitalization at end of period	$	608,497	$ 499,471	21.8%	$ 578,895

		2012	2011	Variance %	2010
		(Dollars in thousands, except per share data)			
Common dividend data:					
Cash dividends declared	$	10,066	$ 9,153	10.0%	$ 6,820
Cash dividends declared per share	$	0.24	$ 0.21	14.3%	$ 0.17
Payout ratio		68.36%	33.33%	105.1%	16.02%
Dividend yield		1.80%	1.73%	3.7%	1.36%

The table that follows presents a reconciliation of the Group's total stockholders' equity to tangible common equity and total assets to tangible assets at December 31, 2012 and December 31, 2011:

	December 31,		
	2012	**2011**	**2010**
	(In thousands, except share or per share information)		
Total stockholders' equity	$ 863,606	$ 695,555	$ 732,331
Preferred stock	(176,000)	(68,000)	(68,000)
Preferred stock issuance costs	10,115	2,662	-
Goodwill	(64,021)	(2,701)	(2,701)
Core deposit intangible	(9,462)	(1,185)	(1,328)
Customer relationship intangible	(5,027)	-	-
Total tangible common equity	**$ 619,211**	**$ 626,331**	**$ 660,302**
Total assets	9,193,368	6,694,394	7,311,006
Goodwill	(64,021)	(2,701)	(2,701)
Core deposit intangible	(9,462)	(1,185)	(1,328)
Customer relationship intangible	(5,027)	-	-
Total tangible assets	**$ 9,114,858**	**$ 6,690,508**	**$ 7,306,977**
Tangible common equity to tangible assets	**6.79%**	**9.36%**	**9.03%**
Common shares outstanding at end of period	45,580,281	41,244,533	46,348,667
Tangible book value per common share	**$ 13.59**	**$ 15.19**	**$ 14.25**

The tangible common equity ratio and tangible book value per common share are non-GAAP measures. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations. Neither tangible common equity nor tangible assets or related measures should be considered in isolation or as a substitute for stockholders' equity, total assets or any other measure calculated in accordance with GAAP. Moreover, the manner in which the Group calculates its tangible common equity, tangible assets and any other related measures may differ from that of other companies reporting measures with similar names.

The Tier 1 common equity to risk-weighted assets ratio is another non-GAAP measure. Ratios calculated based upon Tier 1 common equity have become a focus of regulators and investors, and management believes ratios based on Tier 1 common equity assist investors in analyzing the Group's capital position. In connection with the Supervisory Capital Assessment Program, the Federal Reserve Board began supplementing its assessment of the capital adequacy of a large bank holding company based on a variation of Tier 1 capital, known as Tier 1 common equity.

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

The table below presents a reconciliation of the Group's total common equity (GAAP) at December 31, 2012 and December 31, 2011 to Tier 1 common equity (non-GAAP):

	December 31,		
	2012	2011	2010
	(In thousands)		
Common stockholders' equity	$ 697,721	$ 630,217	$ 664,331
Unrealized gains on available-for-sale securities, net of income tax	(68,245)	(79,244)	(36,988)
Unrealized losses on cash flow hedges, net of income tax	12,365	42,113	-
Disallowed deferred tax assets	(85,009)	(26,879)	(25,930)
Disallowed servicing assets	(1,079)	(1,045)	(969)
Intangible assets:			
Goodwill	(64,021)	(2,701)	(2,701)
Other disallowed intangibles	(14,490)	(1,185)	(1,328)
Total Tier 1 common equity	**$ 477,242**	**$ 561,276**	**$ 596,415**
Tier 1 common equity to risk-weighted assets	**9.11%**	**27.01%**	**28.02%**

The following table presents the Group's capital adequacy information at December 31, 2012 and December 31, 2011:

	December 31,		
	2012	2011	2010
	(In thousands)		
Risk-based capital:			
Tier 1 capital	$ 678,127	$ 661,614	$ 699,415
Supplementary (Tier 2) capital	116,068	26,574	28,826
Total risk-based capital	**$ 794,195**	**$ 688,188**	**$ 728,241**
Risk-weighted assets:			
Balance sheet items	$ 4,927,919	$ 2,032,982	$ 2,216,120
Off-balance sheet items	312,942	44,760	37,367
Total risk-weighted assets	**$ 5,240,861**	**$ 2,077,742**	**$ 2,253,487**
Ratios:			
Tier 1 capital (minimum required - 4%)	12.94%	31.84%	31.04%
Total capital (minimum required - 8%)	15.15%	33.12%	32.32%
Leverage ratio	6.42%	9.65%	9.50%
Equity to assets	9.39%	10.39%	10.02%
Tangible common equity to assets	6.74%	9.36%	9.03%

The Federal Reserve Board has 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% of their Tier 1 Capital as common equity. Except as otherwise discussed below in light of the Dodd-Frank Act in connection with certain debt or equity instruments issued on or after May 19, 2010, not more than 25% of qualifying Tier 1 Capital may consist of qualifying cumulative 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. At December 31, 2012 and December 31, 2011, the Group was a "well capitalized" institution for regulatory purposes.

The Federal Reserve Board has regulations with respect to risk-based and leverage capital ratios that require most intangibles, including goodwill and core deposit intangibles, to be deducted from Tier 1 Capital. The only types of identifiable intangible assets that may be included in, that is, not deducted from, an organization's capital are readily marketable mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships.

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.

Under the Dodd-Frank Act, federal banking regulators are required to establish minimum leverage and risk-based capital requirements on a consolidated basis for insured institutions, depository institution holding companies, and non-bank financial companies supervised by the Federal Reserve Board. The minimum leverage and risk-based capital requirements are to be determined based on the minimum ratios established for insured depository institutions under prompt corrective action regulations. In effect, such provision of the Dodd-Frank Act (i.e., Section 171), which is commonly known as the Collins Amendment, applies to bank holding companies the same leverage and risk based capital requirements that apply to insured depository institutions. Because the capital requirements must be the same for insured depository institutions and their holding companies, the Collins Amendment generally excludes certain debt or equity instruments, such as cumulative perpetual preferred stock and trust preferred securities, from Tier 1 Capital, subject to a three-year phase-out from Tier 1 qualification for such instruments issued before May 19, 2010, with the phase-out commencing on January 1, 2013. However, such instruments issued before May 19, 2010 by a bank holding company, such as the Group, with total consolidated assets of less than $15 billion as of December 31, 2009, are not affected by the Collins Amendment and may continue to be included in Tier 1 Capital as a restricted core capital element.

On June 12, 2012, the Office of the Comptroller of the Currency (the "OCC"), the Federal Reserve Board, and the FDIC issued three notices of proposed rulemaking ("NPRs") that would revise and replace the agencies' current capital rules. The agencies also announced the finalization of the market risk capital rule that was proposed in 2011.

In the first Basel III NPR, "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions" (the "Basel III NPR"), the agencies are proposing to revise their risk-based and leverage capital requirements consistent with agreements reached by the Basel Committee on Banking Supervision ("Basel III"). The Basel III NPR would apply to all insured banks and savings associations, top-tier bank holding companies domiciled in the United States with more than $500 million in assets, and savings and loan holding companies that are domiciled in the United States. Provisions of the Basel III NPR that

would apply to such banking organizations include implementation of a new common equity Tier 1 minimum capital requirement, a higher minimum Tier 1 capital requirement, and, for banking organizations subject to the advanced approaches capital rules, a supplementary leverage ratio that incorporates a broader set of exposures. Additionally, consistent with Basel III, the agencies propose to apply limits on a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a specified "buffer" of common equity Tier 1 capital in addition to the minimum risk-based capital requirements. The revisions set forth in the Basel III NPR are consistent with Section 171 of the Dodd-Frank Act, which requires the agencies to establish minimum risk-based and leverage capital requirements.

The Basel III NPR also would revise the agencies' prompt corrective action framework by incorporating the new regulatory capital minimums and updating the definition of tangible common equity. Prompt corrective action is an enforcement framework that constrains the activities of insured depository institutions based on their level of regulatory capital.

The second Basel III NPR, "Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule" (the "Advanced Approaches and Market Risk NPR"), would revise the advanced approaches risk-based capital rules consistent with Basel III and other changes to the Basel Committee's capital standards. The agencies also propose revising the advanced approaches risk-based capital rules to be consistent with Section 939A and Section 171 of the Dodd-Frank Act. Additionally in the Advanced Approaches and Market Risk NPR, the OCC and the FDIC propose that the market risk capital rules apply to federal and state savings associations, and the Federal Reserve Board proposes that the advanced approaches and market risk capital rules apply to top-tier savings and loan holding companies domiciled in the United States, if stated thresholds for trading activity are met. Generally, the

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advanced approaches rules would apply to such institutions with $250 billion or more in consolidated assets or $10 billion or more in foreign exposure, and the market risk rule would apply to savings and loan holding companies with significant trading activity.

In the third capital NPR, “Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements” (the “Standardized Approach NPR”), the agencies propose to revise and harmonize rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses identified over recent years, including by incorporating aspects of the Basel II standardized framework, and alternatives to credit ratings, consistent with Section 939A of the Dodd-Frank Act. The revisions include methods for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. The Standardized Approach NPR also would introduce disclosure requirements that would apply to U.S. banking organizations with $50 billion or more in total assets. The Standardized Approach NPR would apply to the same set of institutions as the Basel III NPR.

The Group’s common stock is traded on the New York Stock Exchange (“NYSE”) under the symbol “OFG.” At December 31, 2012 and December 31, 2011, the Group’s market capitalization for its outstanding common stock was $608.5 million ($13.35 per share) and $499.5 million ($12.11 per share), respectively.

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

	Price		Cash Dividend
	High	**Low**	**Per share**
2012			
December 31, 2012	$ 13.35	$ 9.98	$ 0.06
September 30, 2012	$ 11.49	$ 10.02	$ 0.06
June 30, 2012	$ 12.37	$ 9.87	$ 0.06
March 31, 2012	$ 12.69	$ 11.25	$ 0.06
2011			
December 31, 2011	$ 12.35	$ 9.19	$ 0.06
September 30, 2011	$ 13.20	$ 9.18	$ 0.05
June 30, 2011	$ 13.07	$ 11.26	$ 0.05
March 31, 2011	$ 12.84	$ 11.40	$ 0.05
2010			
December 31, 2010	$ 13.72	$ 11.50	$ 0.05
September 30, 2010	$ 14.45	$ 12.13	$ 0.04
June 30, 2010	$ 16.72	$ 12.49	$ 0.04
March 31, 2010	$ 14.09	$ 10.00	$ 0.04

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The Bank is considered "well capitalized" under the regulatory framework for prompt corrective action. The table below shows the Bank's regulatory capital ratios at December 31, 2012 and at December 31, 2011:

	December 31,			
	2012	2011	Variance %	2010
	(Dollars in thousands)			
Oriental Bank and Trust Regulatory Capital Ratios:				
Total Tier 1 Capital to Total Assets	**5.75%**	**9.06%**	**-36.5%**	**9.22%**
Actual tier 1 capital	$ 604,997	$ 616,590	-1.9%	$ 666,531
Minimum capital requirement (4%)	$ 420,607	$ 272,177	54.5%	$ 289,083
Minimum to be well capitalized (5%)	$ 525,759	$ 340,221	54.5%	$ 361,354
Tier 1 Capital to Risk-Weighted Assets	**11.80%**	**29.79%**	**-60.4%**	**29.95%**
Actual tier 1 risk-based capital	$ 604,997	$ 616,590	-1.9%	$ 666,531
Minimum capital requirement (4%)	$ 205,134	$ 82,787	147.8%	$ 89,025
Minimum to be well capitalized (6%)	$ 307,701	$ 124,180	147.8%	$ 133,537
Total Capital to Risk-Weighted Assets	**14.03%**	**31.07%**	**-54.8%**	**31.23%**
Actual total risk-based capital	$ 719,675	$ 643,065	11.9%	$ 695,013
Minimum capital requirement (8%)	$ 410,268	$ 165,573	147.8%	$ 178,049
Minimum to be well capitalized (10%)	$ 512,835	$ 206,967	147.8%	$ 222,562

Group's Financial Assets Managed

The Group's financial assets managed include those managed by the Group's trust division, retirement plan administration subsidiary, and its broker-dealer subsidiaries. Assets managed by the trust division and the broker-dealer subsidiaries increased from $4.142 billion as of December 31, 2011 to $5.237 billion as of December 31, 2012, mainly as a result of assets managed by the broker-dealer subsidiary acquired in the BBVAPR Acquisition amounting to $504.8 million at December 31, 2012, and an increase in account contributions and capital market appreciation.

The Group's trust division offers various types of IRAs and manages 401(k) and Keogh retirement plans and custodian and corporate trust accounts, while the retirement plan administration subsidiary, CPC, manages private retirement plans. At December 31, 2012, total assets managed by the Group's trust division and CPC amounted to $2.514 billion, compared to $2.216 billion at December 31, 2011. Oriental Financial Services and OFS Securities offer a wide array of investment alternatives to their client base, such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money management wrap-fee programs. At December 31, 2012, total assets gathered by Oriental Financial

Services and OFS Securities from their customer investment accounts increased to $2.722 billion, compared to $1.926 billion in assets gathered only by Oriental Financial Services at December 31, 2011.

Allowance for Loan and Lease Losses and Non-Performing Assets

The Group maintains an allowance for loan and lease losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. The Group's allowance for loan and lease 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 and lease losses and present selected loan loss statistics. In addition, refer to Table 5 for the composition of the loan portfolio.

Non-covered Loans

Loans acquired in a business acquisition are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan losses is not recorded at the acquisition date. Credit cards, floor plans, revolving lines of credit, and certain auto loans acquired as part of the BBVAPR Acquisition will be accounted for under the guidance of ASC 310-20, which requires that any differences between contractually required loan payment receivable 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. Considering the short period elapsed between the date of the BBVAPR acquisition and the end of the Group's fiscal year, these loans did not have an allowance for loan and lease losses at December 31, 2012. The remaining loans acquired in the BBVAPR Acquisition are accounted

for under ASC-310-30 and were recognized at fair value as of December 18, 2012, which included the impact of expected credit losses and therefore, no allowance for credit losses was recorded at acquisition date. To the extent credit deterioration occurs after the date of acquisition, the Group would record an allowance for loan and lease losses. Management determined that there was no need to record an allowance for loan and lease losses on loans acquired in the BBVAPR Acquisition accounted for under ASC-310-30 as of December 31, 2012. Considering the short period elapsed from the acquisition date, the Group does not believe that the difference between cash flows expected to be collected on the loans acquired in the BBVAPR Acquisition accounted for under ASC-310-30 and those anticipated at December 18, 2012 need further assessment.

At December 31, 2012, the Group's allowance for non-covered loan and lease losses amounted to $39.9 million, corresponding to originated loans, or 3.17% of total gross originated loans at December 31, 2012 versus $37.0 million or 3.11% of total gross originated loans at December 31, 2011. The allowance for residential mortgage loans, consumer loans, and leases decreased by 2.6% (or $560 thousand), 39.8% (or $567 thousand), and 68.0% (or $575 thousand), respectively, when compared with balances recorded at December 31, 2011. The allowance for commercial loans increased by 36.1%, or $4.5 million, when compared with balances recorded at December 31, 2011. During 2012, the Group recorded an allowance of $263 thousand for originated auto loans, a new segment resulting from the BBVAPR Acquisition on December 18, 2012. The unallocated allowance decreased by 32.1%, or $174 thousand, when compared with balances recorded at December 31, 2011.

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

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 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 and lease 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 and 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 value. The portfolios of mortgage loans, leases and consumer loans are considered homogeneous, and are evaluated collectively for impairment. For the commercial loans portfolio, all loans over $250 thousand that are either over 90 days past due or adversely classified, or when deemed necessary by management, are evaluated for impairment. At December 31, 2012, the total investment in impaired commercial loans was $46.2 million, compared to $46.4 million at December 31, 2011. Most of the impaired commercial loans are measured based on the fair value of collateral method, since most impaired loans during the period were collateral dependent, all other loans are measured using the present value of cash flows method. The valuation allowance for impaired commercial loans amounted to approximately $4.1 million and $3.5 million at December 31, 2012 and December 31, 2011, respectively. At December 31, 2012, the total investment in impaired mortgage loans was $74.8 million, compared to $51.5 million at December 31, 2011. 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 $5.3 million and $3.4 million at December 31, 2012 and December 31, 2011, respectively.

The Group, using a rating system, applies an overall allowance percentage to each non-covered loan portfolio segment based on historical credit losses adjusted for current conditions and trends. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Group over the most recent twelve months. The actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures and practices; experience, ability, and depth of lending management and other relevant staff, including the bank's loan review system as graded by regulatory agencies in their last examination; local economic trends and industry

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conditions; effects of external factors such as competition and regulatory requirements on the level of estimated credit losses in the current portfolio; and effects of changes in credit concentrations and collateral value. The following portfolio segments have been identified: mortgage loans; commercial loans; consumer loans; and leasing.

Loan loss ratios and credit risk categories are updated quarterly and are applied in the context of GAAP and the 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses, which requires that depository institutions have 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.

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 and lease losses, except for the further segregation of the traditional residential mortgage portfolio by origination vintages made since the June 30, 2012 quarter. The new segregation allows management to perform more efficient assessment of the traditional mortgage portfolio historical losses and risk. Also, since the quarter ended June 30, 2012, the following changes were made to the current environmental factors consider for the determination of the allowance for loan and lease losses:

- consolidation of national and local economic trends and industry conditions as one factor;

- the addition of the quality of the Bank's loan review system as graded in the last FDIC report of examination to the factor dealing with management's experience, ability, and depth of lending management and other relevant staff; and

- the addition of the changes in the value of underlying collateral for collateral dependant loans.

The Group's non-performing assets include non-performing loans and foreclosed real estate (see Tables 11 and 12). At December 31, 2012 and December 31, 2011, the Group had $147.2 million and $147.1 million, respectively, of non-accrual non-covered loans including acquired loans accounted under ASC 310-20 (loans with revolving feature and/or acquired at a premium). Covered loans and loans purchased from BBVAPR with credit deterioration are considered to be performing due to the application of the accretion method under ASC 310-30. At December 31, 2012 and December 31, 2011, loans whose terms have been extended and which are classified as troubled-debt restructuring that are not included in non-performing assets amounted to $52.0 million and $41.3 million, respectively.

At December 31, 2012, the Group's non-performing assets increased 27.2% to $206.6 million (3.37% of total assets, excluding covered assets and acquired loans with deteriorated credit quality) from $162.4 million (2.63% of total assets, excluding covered loans) at December 31, 2011. The increase is mostly due to foreclosed real estate and other repossessed assets acquired in the BBVAPR Acquisition amounting to $35.8 million and $5.9 million, respectively, at December 31, 2012. 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, 2012, the allowance for non-covered loans and lease losses to non-performing loans coverage ratio was 27.13% (22.15% at December 31, 2011).

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 U.S. mortgage loan originators. Furthermore, the Group 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.

The following items comprise non-performing assets:

1. Originated loans:

• Mortgage loans — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan. At December 31, 2012, the Group’s originated non-performing mortgage loans totaled $115.0 million (78.1% of the Group’s non-performing loans), a 4.8% increase from $109.7 million (74.6% of the Group’s non-performing loans) at December 31, 2011. Non-performing loans in this category are primarily residential mortgage loans. On April 1, 2011, the Bank changed on a prospective basis its policy to place on non-accrual status residential mortgage loans well collateralized and in process of collection when reaching 90 days past due. All loans that were between 90 and 365 days past due when the policy was changed were also placed on non-accrual status. The interest receivable on such loans is evaluated on a periodic basis against the collateral underlying the loans, and written-down, if necessary. On December 31, 2011, the Bank further revised its policy to reverse against income all interest recorded on residential mortgage loans reaching 90 days past due, including

the remaining interest on loans that were between 90 and 365 days past due as of April 1, 2011. On December 31, 2011, the Bank also charged-off this remaining accrued interest on residential mortgage loans over 90 days past due. This change in estimate was considered necessary to comply with guidance received from the Group's regulators.

- 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, 2012, the Group's originated non-performing commercial loans amounted to $29.5 million (20.0% of the Group's non-performing loans), a 20.2% decrease when compared to non-performing commercial loans of $37.0 million at December 31, 2011 (25.1% 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, 2012, the Group's originated non-performing consumer loans amounted to $442 thousand (0.3% of the Group's total non-performing loans), a 28.1% increase from $345 thousand at December 31, 2011 (0.2% of total non-performing loans).

- Leases — are placed on non-accrual status when they become 90 days past due and partially written-off to collateral value when payments are delinquent 120 days, and fully written-off when payments are delinquent 180 days. At December 31, 2012, the Group's originated non-performing leases amounted to $131 thousand (0.1% of the Group's total non-performing loans), an increase of 28.4% from $102 thousand at December 31, 2011 (0.1% of total non-performing loans).

2. Acquired loans accounted for under ASC 310-20 (loans with revolving features and/or acquired at premium):

- Commercial lines of credit - 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, 2012, the Group's acquired non-performing commercial lines of credit accounted for under ASC 310-20 amounted to $193 thousand (0.1% of the Group's non-performing loans)

- Mortgage - are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan. At December 31, 2012, the Group's acquired non-performing mortgage loans accounted for under ASC 310-20 totaled $520 thousand (0.4% of the Group's non-performing loans)

• Auto loans - are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 120 days. At December 31, 2012, the Group's acquired non-performing auto loans accounted for under ASC 310-20 totaled $275 thousand (0.2% of the Group's non-performing loans)

• Consumer lines of credit and credit cards — are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 180 days. At December 31, 2012, the Group's acquired non-performing consumer lines of credit and credit cards accounted for under ASC 310-20 totaled $1.1 million (0.7% of the Group's non-performing loans)

3. Acquired loans accounted for under ASC 310-30: are considered to be performing due to the application of the accretion method, in which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analyses.

4. Foreclosed real estate: is initially recorded at the lower of the related loan balance or fair value less cost to sell as of the date of foreclosure. Any excess of the loan balance over the fair value of the property is charged against the allowance for loan and lease losses. Subsequently, any excess of the carrying value over the estimated fair value less disposition cost is charged to operations. Net losses on the sale of foreclosed real estate for 2012 amounted to $4.4 million, compared to $1.7 million in 2011.

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

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

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

There may not be a foreclosure sale scheduled within 60 days prior to a loan modification under any such programs. This requirement does not apply to loans where the foreclosure process has been stopped by the Group. In order to apply for any of the loan modification programs, the borrower may not be in active bankruptcy or have been discharged from Chapter 7 bankruptcy since the loan was originated. Loans in these programs will be evaluated by management for troubled debt restructuring classification if the Group grants a concession for legal or economic reasons due to the debtor's financial difficulties.

Covered Loans

The allowance for loan and lease losses on covered loans acquired in the FDIC-assisted acquisition of Eurobank is accounted under the provisions of ASC 310-30. Under this accounting guidance, the allowance for loan and lease losses on covered loans is evaluated at each financial reporting period, based on forecasted cash flows. Credit related decreases in expected cash flows, compared to those previously forecasted, are recognized by recording a provision for credit losses on covered loans when it is probable that all cash flows expected at acquisition will not be collected. The portion of the loss on covered loans reimbursable from the FDIC is recorded as an offset to the provision for credit losses and increases the FDIC shared-loss indemnification asset.

As part of the evaluation of actual versus expected cash flows, the Group assesses on a quarterly basis the credit quality of these loans based on delinquency, severity factors and risk ratings, among other assumptions. The credit quality assumptions for certain pools were updated to reflect an increase in default rates, severities and extension of

recovery lags resulting in an increase in the provision for covered loan and lease losses of $9.8 million for 2012. Such increase in provision was net of the effect of the increase in the FDIC shared-loss indemnification asset. As a result, the allowance for covered loans increased from $37.3 million at December 31, 2011 to $54.1 million at December 31, 2012.

TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES SUMMARY

	Year Ended December 31,			
	2012	2011	Variance %	2010
		(Dollars in thousands)		
Non-covered loans				
Originated loans:				
Balance at beginning of period	$ 37,010	$ 31,430	17.8%	$ 23,272
Provision for non-covered loan and lease losses	13,854	15,200	-8.9%	15,914
Charge-offs	(11,451)	(10,126)	13.1%	(8,235)
Recoveries	508	506	0.4%	479
Total non-covered loans balance at end of period	**$ 39,921**	**$ 37,010**	**7.9%**	**$ 31,430**
Allowance for loans and lease losses on originated loans to:				
Total originated loans	**3.23%**	**3.12%**	**3.5%**	**2.74%**
Non-performing originated loans	**27.52%**	**25.15%**	**9.4%**	**23.51%**
Covered loans				
Balance at beginning of period	$ 37,256	$ 49,286	-24.4%	$ -
Provision for (recapture of) covered loan and lease losses, net	9,827	(1,387)	-808.5%	6,282
FDIC shared-loss portion on provision for (recapture of) loan	7,041	(10,643)	-166.2%	43,004

and lease losses				
Balance at end of period	**$ 54,124**	**$ 37,256**	**45.3%**	**$ 49,286**

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TABLE 9 — ALLOWANCE FOR NON-COVERED LOAN AND LEASE LOSSES BREAKDOWN

	December 31,			
	2012	2011	Variance %	2010
	(Dollars in thousands)			
Allowance balance:				
Originated loans				
Mortgage	$ 21,092	$ 21,652	-2.6%	$ 16,179
Commercial	17,072	12,548	36.1%	11,153
Auto	263	-	100.0%	-
Consumer	856	1,423	-39.8%	2,286
Leasing	270	845	-68.0%	860
Unallocated allowance	368	542	-32.1%	952
Total allowance balance	**$ 39,921**	**$ 37,010**	**7.9%**	**$ 31,430**
Allowance composition:				
Originated loans				
Mortgage	52.83%	58.52%	-9.7%	51.47%
Commercial	42.76%	33.90%	26.1%	35.49%
Auto	0.66%	0.00%	100.0%	0.00%
Consumer	2.14%	3.84%	-44.3%	7.27%
Leasing	0.68%	2.28%	-70.2%	2.74%
Unallocated allowance	0.93%	1.46%	-36.3%	3.03%
	100.00%	**100.00%**		**100.00%**
Allowance coverage ratio at end of period applicable to:				
Originated loans				
Mortgage	2.62%	2.64%	-0.7%	1.85%
Commercial	4.82%	4.16%	16.0%	4.75%
Auto	2.00%	0.00%	100.0%	0.00%
Consumer	1.78%	3.57%	-50.2%	6.24%
Leasing	0.72%	3.28%	-78.1%	8.38%
Unallocated allowance to total originated loans	0.03%	0.05%	-41.5%	8.00%
Total allowance to total originated loans	**3.17%**	**3.11%**	**2.1%**	**2.72%**
Allowance coverage ratio to non-performing loans:				
Originated loans				
Mortgage	18.34%	19.74%	-7.1%	14.76%
Commercial	57.86%	33.92%	70.6%	47.22%
Auto loans	100.00%	-	100.0%	-
Consumer	193.67%	412.46%	-53.0%	541.71%
Leasing	206.11%	828.43%	-75.1%	2457.14%

Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)				
Commercial lines of credit	0.00%	-	-	-
Mortgage	0.00%	-	-	-
Auto loans	0.00%	-	-	-
Consumer lines of credit and credit cards	0.00%	-	-	-
Total	**27.13%**	**25.15%**	**7.8%**	**23.51%**

For loans acquired in the BBVAPR Acquisition accounted for under ASC 310-20 (loans with revolving feature and/or acquired at a premium), we establish our allowance for loan losses through a provision for credit losses based upon an evaluation process that is similar to our evaluation process used for originated loans. This evaluation, which includes a review of loans on which full collectability may not be reasonably assured, considers, among other matters, the estimated fair value of the underlying collateral, economic conditions, historical net loan loss experience, carrying value of the loans, which includes the remaining net purchase discount or premium, and other factors that warrant recognition in determining our allowance for loan losses. These loans were recorded on acquisition date at their fair value. Such fair value includes a credit discount which accounts for expected loan losses over the estimated life of these loans. Management will take into consideration this credit discount when determining the necessary

allowance for acquired loans that are accounted for under the provisions of ASC 310-20. Considering the short period elapsed from acquisition date, at December 31, 2012 there was no allowance for loan and lease losses recorded for these loans.

Loans acquired in the BBVAPR Acquisition accounted for under ASC 310-30 were recognized at fair value as of December 18, 2012, which included the impact of expected credit losses, and therefore, no allowance for credit losses was recorded at acquisition date. To the extent credit deterioration occurs after the date of acquisition, the Group would record an allowance for loan and lease losses. Management determined that there was no need to record an allowance for loan and lease losses on loans acquired in the BBVAPR Acquisition accounted for under ASC 310-30 as of December 31, 2012. Considering the short period elapsed from the acquisition date, the Group does not believe that the difference between cash flows expected to be collected on the loans acquired in the BBVAPR Acquisition accounted for under ASC 310-30 and those anticipated at December 18, 2012 need further assessment.

TABLE 10 — NET CREDIT LOSSES STATISTICS ON NON-COVERED ORIGINATED LOAN AND LEASES

	Year Ended December 31,			
	2012	2011	Variance %	2010
	(In thousands)			
Mortgage				
Charge-offs	$ (6,492)	$ (5,836)	11.2%	$ (3,867)
Recoveries	131	101	29.7%	93
Total	**(6,361)**	**(5,735)**	**10.9%**	**(3,774)**
Commercial				
Charge-offs	(4,081)	(2,506)	62.8%	(2,913)
Recoveries	156	161	-3.1%	160
Total	**(3,925)**	**(2,345)**	**67.4%**	**(2,753)**
Consumer				
Charge-offs	(739)	(1,587)	-53.4%	(1,455)
Recoveries	194	234	-17.1%	226
Total	**(545)**	**(1,353)**	**-59.7%**	**(1,229)**
Leasing				
Charge-offs	(139)	(197)	-29.4%	-
Recoveries	27	10	170.0%	-
Total	**(112)**	**(187)**	**-40.1%**	**-**
Net credit losses				
Total charge-offs	(11,451)	(10,126)	13.1%	(8,235)
Total recoveries	508	506	0.4%	479
Total	**$ (10,943)**	**$ (9,620)**	**13.8%**	**$ (7,756)**
Net credit losses to average loans outstanding:				
Mortgage	0.75%	0.66%	13.6%	0.41%
Commercial	1.06%	0.92%	15.2%	1.34%
Consumer	1.13%	4.08%	-72.3%	4.43%
Leasing	0.36%	1.10%	-67.3%	0.00%
Total	**0.82%**	**0.82%**	**0.0%**	**0.67%**
Recoveries to charge-offs	**4.44%**	**5.00%**	**-11.2%**	**5.82%**
Average loans not covered under shared-loss agreements with the FDIC:				
Mortgage	$ 847,101	$ 872,966	-3.0%	$ 923,345

Commercial		368,763		254,617	44.8%		206,090
Consumer		48,426		33,177	46.0%		27,735
Leasing		30,788		17,036	80.7%		5,129
Auto		37,083		-	100.0%		-
Total	**$**	**1,332,161**	**$**	**1,177,796**	**13.1%**	**$**	**1,162,299**

TABLE 11 — NON-PERFORMING ASSETS

	December 31,			
	2012	2011	Variance (%)	2010
	(Dollars in thousands)			
Non-performing assets:				
Non-accruing loans				
Troubled Debt Restructuring loans	$ 50,468	$ 28,889	74.7%	$ 2,327
Other loans	96,696	118,251	-18.2%	71,236
Accruing loans				
Troubled Debt Restructuring loans	-	-	0.0%	4,999
Other loans	-	-	0.0%	55,137
Total non-performing loans	$ 147,164	$ 147,140	0.0%	$ 133,699
Foreclosed real estate not covered under the shared-loss agreements with the FDIC	53,164	13,812	284.9%	11,969
Other repossessed asset	5,943	-	100.0%	-
Mortgage loans held for sale in non-accrual	319	1,472	-78.3%	381
	$ **206,590**	$ **162,424**	**27.2%**	$ **146,049**
Non-performing assets to total assets, excluding covered assets and acquired loans with deteriorated credit quality (including those by analogy)	**3.37%**	**2.63%**	**28.1%**	**2.19%**
Non-performing assets to total capital	**23.92%**	**23.35%**	**2.4%**	**19.94%**

	Year Ended December 31,		
	2012	2011	2010
	(In thousands)		
Interest that would have been recorded in the period if the loans had not been classified as non-accruing loans	$ 5,867	$ 5,415	$ 3,802

TABLE 12 — NON-PERFORMING LOANS

	December 31,			
	2012	2011	Variance %	2010
	(Dollars in thousands)			
Non-performing loans:				
Originated loans				
Mortgage	$ 115,002	$ 109,705	4.8%	$ 109,623
Commercial	29,506	36,988	-20.2%	23,619
Consumer	442	345	28.1%	422
Leasing	131	102	28.4%	35
Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)				
Commercial lines of credit	193	-	100.0%	-
Mortgage	520	-	100.0%	-
Auto loans	275	-	100.0%	-
Consumer lines of credit and credit cards	1,095	-	100.0%	-
Total	**$ 147,164**	**$ 147,140**	**0.0%**	**$ 133,699**
Non-performing loans composition percentages:				
Originated loans				
Mortgage	78.1%	74.6%		82.0%
Commercial	20.0%	25.1%		17.7%
Consumer	0.3%	0.2%		0.3%
Leasing	0.1%	0.1%		0.0%
Acquired loans accounted for under ASC 310-20 (Loans with revolving feature and/or acquired at a premium)				
Commercial lines of credit	0.1%	0.0%		0.0%
Mortgage	0.4%	0.0%		0.0%
Auto loans	0.2%	0.0%		0.0%
Consumer lines of credit and credit cards	0.7%	0.0%		0.0%
Total	**100.0%**	**100.0%**		**100.0%**
Non-performing loans to:				
	6.84%	**12.58%**	**-45.6%**	**11.67%**

Total loans, excluding covered loans and loans accounted for under ASC 310-30 (including those by analogy)				
Total assets, excluding covered assets and loans accounted for under ASC 310-30 (including those by analogy)	**2.40%**	**2.38%**	**0.8%**	**2.00%**
Total capital	**17.04%**	**21.15%**	**-19.4%**	**18.26%**
Non-performing loans with partial charge-offs to:				
Total loans, excluding covered loans and loans accounted for under ASC 310-30 (including those by analogy)	**1.99%**	**2.91%**	**-31.7%**	**1.67%**
Non-performing loans	**29.06%**	**23.15%**	**25.5%**	**14.28%**
Other non-performing loans ratios:				
Charge-off rate on non-performing loans to non-performing loans on which charge-offs have been taken	**27.86%**	**23.27%**	**19.7%**	**22.04%**
Allowance for loan and lease losses to non-performing loans on which no charge-offs have been taken	**38.24%**	**27.70%**	**38.0%**	**25.72%**

TABLE 13 — HIGHER RISK RESIDENTIAL MORTGAGE LOANS

	December 31, 2012								
	Higher-Risk Residential Mortgage Loans*								
	Junior Lien Mortgages			Interest Only Loans			High Loan-to-Value Ratio Mortgages LTV 90% and over		
	Carrying Value	Allowance	Coverage	Carrying Value	Allowance	Coverage	Carrying Value	Allowance	Coverage
	(In thousands)								
Delinquency:									
0 - 89 days	$ 15,063	$ 262	1.74%	$ 27,060	$ 836	3.09%	$ 67,440	$ 1,822	2.70%
90 - 119 days	48	1	2.08%	-	-	0.00%	5,241	58	1.11%
120 - 179 days	430	29	6.74%	1,125	181	16.09%	3,248	108	3.33%
180 - 364 days	563	36	6.39%	585	94	16.07%	6,961	289	4.15%
365+ days	1,968	168	8.54%	3,936	973	24.72%	16,010	1,325	8.28%
Total	$ 18,072	$ 496	2.74%	$ 32,706	$ 2,084	6.37%	$ 98,900	$ 3,602	3.64%
Percentage of total loans not covered by FDIC shared-loss agreements	1.44%			2.61%			7.90%		
Refinanced or Modified Loans:									
Amount	$ 2,403	$ 167	6.95%	$ -	$ -	0.00%	$ 20,478	$ 1,357	6.63%
Percentage of Higher-Risk Loan Category	13.30%			0.00%			20.71%		
Loan-to-Value Ratio:									
Under 70%	$ 13,616	$ 373	2.74%	$ 5,064	$ 275	5.43%	$ -	$ -	-
70% - 79%	2,950	53	1.80%	6,816	561	8.23%	-	-	-
80% - 89%	1,055	33	3.13%	8,670	468	5.40%	-	-	-
90% and over	451	37	8.20%	12,156	780	4.50%	98,900	3,602	3.64%
	$ 18,072	$ 496	2.74%	$ 32,706	$ 2,084	6.37%	$ 98,900	$ 3,602	3.64%

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

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, 2012, the aggregate contractual obligations and commercial commitments, excluding accrued interests and unamortized premiums (discounts), are as follows: