ORIENTAL FINANCIAL GROUP INC
Form 10-Q
November 07, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

or

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

For the transition period from to

Commission File Number 001-12647

Oriental Financial Group Inc.

Incorporated in the Commonwealth of Puerto Rico, IRS Employer Identification No. 66-0538893

Principal Executive Offices:

997 San Roberto Street

Oriental Center 10th Floor

Professional Offices Park

San Juan, Puerto Rico 00926

Telephone Number: (787) 771-6800

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

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

Large Accelerated Filer	¨	Accelerated Filer	x
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 x

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

43,075,786 common shares ($1.00 par value per share) outstanding as of October 31, 2011

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FORWARD-LOOKING STATEMENTS

The information included in this quarterly report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to Oriental Financial Group Inc s. (the Group) financial condition, results of operations, plans, objectives, future performance and business, including, but not limited to, statements with respect to the adequacy of the allowance for loan and lease 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 similar expressions and future or conditional verbs such as will, would, sh might, can, may, or similar expressions are generally intended to identify forward-looking statements.

These statements are not guarantees of future performance and involve certain risks, uncertainties, estimates and assumptions by management that are difficult to predict. Various factors, some of which, 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. government or a downgrade in the credit ratings of the U.S. government;
- 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 our 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; and
- possible legislative, tax or regulatory changes.

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 quarterly report on Form 10-Q 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.

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ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

SEPTEMBER 30, 2011 AND DECEMBER 31, 2010

	September 30, 2011	December 31, 2010
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents		
Cash and due from banks	$ 513,905	$ 344,067
Money market investments	3,431	104,869
Total cash and cash equivalents	**517,336**	**448,936**
Securities purchased under agreements to resell	**165,000**	
Investments:		
Trading securities, at fair value, with amortized cost of $343 (December 31, 2010 - $1,306)	346	1,330
Investment securities available-for-sale, at fair value, with amortized cost of $3,154,057 (December 31, 2010 - $3,661,146)	3,226,972	3,700,064
Investment securities held-to-maturity, at amortized cost, with fair value of $854,633 (December 31, 2010 - $675,721)	837,920	689,917
Federal Home Loan Bank (FHLB) stock, at cost	23,779	22,496
Other investments	75	150
Total investments	**4,089,092**	**4,413,957**
Loans:		
Mortgage loans held-for-sale, at lower of cost or fair value	33,619	33,979
Loans not covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of $35,869 (December 31, 2010 - $31,430)	1,125,769	1,117,889
Loans covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of $37,240 (December 31, 2010 - $49,286)	524,490	620,711
Total loans, net	**1,683,878**	**1,772,579**
FDIC shared-loss indemnification asset	392,096	473,629
Foreclosed real estate covered under shared-loss agreements with the FDIC	16,319	14,871
Foreclosed real estate not covered under shared-loss agreements with the FDIC	14,675	11,969
Accrued interest receivable	24,246	28,716
Deferred tax asset, net	33,102	30,732
Premises and equipment, net	22,498	23,941
Derivative assets	6,707	28,315
Other assets	58,339	63,361
Total assets	**$ 7,023,288**	**$ 7,311,006**
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Demand deposits	$ 979,326	$ 954,554
Savings accounts	256,611	235,690

Certificates of deposit	1,142,428	1,398,644
Total deposits	**2,378,365**	**2,588,888**
Borrowings:		
Short-term borrowings	46,619	42,460
Securities sold under agreements to repurchase	3,356,322	3,456,781
Advances from FHLB	281,753	281,753
FDIC-guaranteed term notes	105,112	105,834
Subordinated capital notes	36,083	36,083
Total borrowings	**3,825,889**	**3,922,911**
FDIC net settlement payable	41	22,954
Derivative liabilities	48,146	64
Accrued expenses and other liabilities	42,931	43,858
Total liabilities	**6,295,372**	**6,578,675**
Stockholders equity:		
Preferred stock, $1 par value; 10,000,000 shares authorized; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding, $25 liquidation value.	68,000	68,000
Common stock, $1 par value; 100,000,000 shares authorized; 47,808,284 shares issued; 44,014,791 shares outstanding (December 31, 2010 - 47,807,734; 46,348,667)	47,808	47,808
Additional paid-in capital	498,875	498,435
Legal surplus	51,274	46,331
Retained earnings	82,616	51,502
Treasury stock, at cost, 3,793,493 shares (December 31, 2010 - 1,459,067 shares)	(45,376)	(16,732)
Accumulated other comprehensive income, net of tax of $249 (December 31, 2010 $2,107)	24,719	36,987
Total stockholders equity	**727,916**	**732,331**
Total liabilities and stockholders equity	**$ 7,023,288**	**$ 7,311,006**

See notes to unaudited consolidated financial statements

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ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except per share data)			
Interest income:				
Loans				
Loans not covered under shared-loss agreements with the FDIC	$ 17,287	$ 17,700	$ 51,095	$ 53,150
Loans covered under shared-loss agreements with the FDIC	18,222	16,647	45,507	28,232
Mortgage-backed securities	33,515	40,429	128,275	125,542
Investment securities and other	2,638	6,445	6,895	24,476
Total interest income	71,662	81,221	231,772	231,400
Interest expense:				
Deposits	11,558	12,680	35,360	35,874
Securities sold under agreements to repurchase	23,206	25,128	70,878	75,900
Advances from FHLB and other borrowings	3,121	3,082	9,231	9,147
Note payable to the FDIC		823		1,887
FDIC-guaranteed term notes	1,021	1,021	3,063	3,063
Subordinated capital notes	305	327	916	930
Total interest expense	39,211	43,061	119,448	126,801
Net interest income	**32,451**	**38,160**	**112,324**	**104,599**
Provision for non-covered loan and lease losses	3,800	4,100	11,400	12,214
Recapture of covered loan and lease losses, net	(1,936)		(1,387)	
Total provision for loan and lease losses, net	**1,864**	**4,100**	**10,013**	**12,214**
Net interest income after provision for loan and lease losses	**30,587**	**34,060**	**102,311**	**92,385**
Non-interest income:				
Wealth management revenues	5,387	4,613	14,641	13,250
Banking service revenues	3,261	3,442	10,404	8,105
Mortgage banking activities	2,623	3,418	7,017	7,555
Total banking and wealth management revenues	**11,271**	**11,473**	**32,062**	**28,910**
Total loss on other-than-temporarily impaired securities		(14,739)		(39,674)
Portion of loss on securities recognized in other comprehensive income				22,508
Other-than-temporary impairments on securities		(14,739)		(17,166)
Net (amortization) accretion of FDIC loss-share indemnification asset	(2,422)	1,600	(191)	2,914
Fair value adjustment on FDIC equity appreciation instrument				909
Net gain (loss) on:				
Sale of securities	13,971	13,954	23,102	37,807

Derivatives	(564)	(22,580)	(8,135)	(59,832)
Early extinguishment of repurchase agreement	(4,790)		(4,790)	
Trading securities	14	4	(23)	2
Foreclosed real estate	(199)	(140)	(334)	(283)
Other	(93)	(35)	(113)	(18)
Total non-interest income (loss), net	**17,188**	**(10,463)**	**41,578**	**(6,757)**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except per share data)			
Non-interest expenses:				
Compensation and employee benefits	$ 11,593	$ 11,686	$ 34,511	$ 30,369
Professional and service fees	5,305	5,480	16,506	11,552
Occupancy and equipment	4,369	5,486	12,988	13,484
Insurance	1,302	1,651	4,933	5,218
Electronic banking charges	1,375	1,322	3,984	3,112
Taxes, other than payroll and income taxes	1,184	1,641	3,422	3,759
Advertising, business promotion, and strategic initiatives	1,686	1,275	4,386	3,339
Loan servicing and clearing expenses	975	1,022	3,072	2,538
Foreclosure and repossession expenses	813	694	2,303	1,520
Communication	391	826	1,212	1,905
Director and investor relations	352	396	977	1,098
Printing, postage, stationery and supplies	292	299	937	795
Other	770	927	2,661	2,261
Total non-interest expenses	30,407	32,705	91,892	80,950
Income (loss) before income taxes	**17,368**	**(9,108)**	**51,997**	**4,678**
Income tax expense (benefit)	580	(1,287)	5,661	(82)
Net income (loss)	**16,788**	**(7,821)**	**46,336**	**4,760**
Less: Dividends on preferred stock	(1,201)	(1,200)	(3,602)	(4,134)
Less: Deemed dividend on preferred stock beneficial conversion feature		(22,711)		(22,711)
Income available (loss) to common shareholders	**$ 15,587**	**$ (31,732)**	**$ 42,734**	**$ (22,085)**
Income (loss) per common share:				
Basic	$ 0.35	$ (0.75)	$ 0.95	$ (0.66)
Diluted	$ 0.35	$ (0.75)	$ 0.95	$ (0.66)
Average common shares outstanding and equivalents	44,105	42,288	45,141	33,645
Cash dividends per share of common stock	**$ 0.05**	**$ 0.04**	**$ 0.15**	**$ 0.12**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Net income (loss)	**$ 16,788**	**$ (7,821)**	**$ 46,336**	**$ 4,760**
Other comprehensive income (loss):				
Unrealized gain (loss) on securities available-for-sale	35,470	(15,072)	57,097	124,302
Realized gain on investment securities included in net income (loss)	(13,971)	(14,224)	(23,102)	(38,077)
Total loss on other- than-temporarily impaired securities		14,739		39,674
Portion of loss on securities recognized in other comprehensive income				(22,508)
Unrealized losses on cash flow hedges	(34,204)		(48,122)	
Income tax effect	2,550	2,274	1,859	(7,573)
Other comprehensive income (loss) for the period	**(10,155)**	**(12,283)**	**(12,268)**	**95,818**
Comprehensive income (loss)	**$ 6,633**	**$ (20,104)**	**$ 34,068**	**$ 100,578**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

	Nine-Month Period Ended September 30,	
	2011	2010
	(In thousands)	
Preferred stock:		
Balance at beginning of period	$ 68,000	$ 68,000
Issuance of preferred stock		177,289
Conversion of preferred stock to common stock		(177,289)
Balance at end of period	**68,000**	**68,000**
Additional paid-in capital from beneficial conversion feature		
Balance at beginning of period		
Issuance of preferred stock - beneficial conversion feature		22,711
Conversion of preferred stock - beneficial conversion feature		(22,711)
Balance at end of period		
Common stock:		
Balance at beginning of period	47,808	25,739
Issuance of common stock		8,740
Conversion of preferred stock to common stock		13,320
Exercised stock options		9
Balance at end of period	**47,808**	**47,808**
Additional paid-in capital:		
Balance at beginning of period	498,435	213,445
Issuance of common stock		90,896
Conversion of preferred stock to common stock		186,680
Deemed dividend on preferred stock beneficial conversion feature		22,711
Exercised stock options		64
Stock-based compensation expense	1,001	865
Common stock issuance costs		(5,250)
Preferred stock issuance costs		(10,925)
Exercised restricted stock units with treasury shares	(561)	
Balance at end of period	**498,875**	**498,486**
Legal surplus:		
Balance at beginning of period	46,331	45,279
Transfer from retained earnings	4,943	627
Balance at end of period	**51,274**	**45,906**
Retained earnings:		
Balance at beginning of period	51,502	77,584
Net income	46,336	4,760

Cash dividends declared on common stock		(6,677)		(4,498)
Cash dividends declared on preferred stock		(3,602)		(4,134)
Deemed dividend on preferred stock beneficial conversion feature				(22,711)
Transfer to legal surplus		(4,943)		(627)
Balance at end of period		**82,616**		**50,374**
Treasury stock:				
Balance at beginning of period		(16,732)		(17,142)
Stock purchased under the repurchase program		(29,242)		
Exercised restricted stock units with treasury shares		561		
Stock used to match defined contribution plan		37		26
Balance at end of period		**(45,376)**		**(17,116)**
Accumulated other comprehensive income (loss), net of tax:				
Balance at beginning of period		36,987		(82,739)
Other comprehensive income (loss), net of tax		(12,268)		95,818
Balance at end of period		**24,719**		**13,079**
Total stockholders equity	**$**	**727,916**	**$**	**706,537**

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

	Nine-Month Period Ended September 30,	
	2011	2010
	(In thousands)	
Cash flows from operating activities:		
Net income	$ **46,336**	$ **4,760**
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of deferred loan origination fees, net of costs	(151)	565
Amortization of premiums, net of accretion of discounts	18,983	24,663
Amortization of core deposit intangible	107	60
Net amortization (accretion) of FDIC loss-share indemnification asset	191	(2,914)
Other-than-temporary impairments on securities		17,166
Other impairments on securities	75	
Depreciation and amortization of premises and equipment	4,109	4,152
Deferred income taxes, net	4,485	(10,416)
Provision for covered and non covered loan and lease losses, net	10,013	12,214
Stock-based compensation	1,001	865
Fair value adjustment of servicing asset	(769)	(1,538)
(Gain) loss on:		
Sale of securities	(23,102)	(37,807)
Sale of mortgage loans held for sale	(3,971)	(4,332)
Derivatives	8,135	59,832
Early extinguishment of repurchase agreement	4,790	
Sale of foreclosed real estate	334	283
Sale of other repossessed assets	34	
Sale of premises and equipment	31	44
Originations and purchases of loans held-for-sale	(149,990)	(169,205)
Proceeds from sale of loans held-for-sale	55,243	58,646
Net (increase) decrease in:		
Trading securities	984	422
Accrued interest receivable	4,470	3,012
Other assets	5,158	(2,483)
Net increase (decrease) in:		
Accrued interest on deposits and borrowings	(1,097)	163
Accrued expenses and other liabilities	(31,378)	40,790
Net cash used in operating activities	**(45,979)**	**(1,058)**

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

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ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

	Nine-Month Period Ended September 30,	
	2011	2010
	(In thousands)	
Cash flows from investing activities:		
Purchases of:		
Securities purchased under agreements to resell	(165,000)	
Investment securities available-for-sale	(493,757)	(5,308,688)
Investment securities held-to-maturity	(209,112)	
FHLB stock	(1,283)	(2,560)
Equity options	(424)	(1,747)
Maturities and redemptions of:		
Investment securities available-for-sale	606,699	2,370,912
Investment securities held-to-maturity	57,509	
FHLB stock		10,077
Proceeds from sales of:		
Investment securities available-for-sale	506,481	3,052,533
Foreclosed real estate	8,875	5,197
Other repossessed assets	4,883	
Premises and equipment	287	573
Origination and purchase of loans, excluding loans held-for-sale	(138,692)	(101,595)
Principal repayment of loans, including covered loans	204,537	151,548
Reimbursements from the FDIC on shared-loss agreements	73,267	
Additions to premises and equipment	(2,984)	(1,483)
Cash and cash equivalents received in FDIC-assisted acquisition		89,777
Net cash provided by investing activities	**451,286**	**264,544**
Cash flows from financing activities:		
Net increase (decrease) in:		
Deposits	(206,850)	119,544
Short term borrowings	4,159	(18,881)
Securities sold under agreements to repurchase	(104,790)	(15,000)
Exercise of stock options		73
Issuance of common stock, net		94,386
Issuance of preferred stock, net		189,075
Repayments from purchase money note issued to the FDIC		(715,970)
Purchase of treasury stock	(29,242)	
Termination of derivative instruments	10,095	(42,727)
Dividends paid on preferred stock	(3,602)	(2,934)
Dividends paid on common stock	(6,677)	(4,816)
Net cash used in financing activities	**(336,907)**	**(397,250)**
Net change in cash and cash equivalents	**68,400**	**(133,764)**
Cash and cash equivalents at beginning of period	448,936	277,123
Cash and cash equivalents at end of period	**$ 517,336**	**$ 143,359**

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

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ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

	Nine-Month Period Ended September 30,			
	2011		2010	
	(In thousands)			
Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:				
Interest paid	$	120,544	$	126,569
Income taxes paid	$	4,021	$	6,281
Mortgage loans securitized into mortgage-backed securities	$	104,617	$	109,386
Securities sold but not yet delivered	$		$	317,209
Transfer from loans to foreclosed real estate and other repossessed assets	$	17,754	$	11,693

For the nine-month period ended September 30, 2010, the changes in operating assets and liabilities included in the reconciliation of net income to net cash provided by operating activities, as well as the changes in assets and liabilities presented in the investing and financing sections are net of the effect of the assets acquired and liabilities assumed from the Eurobank FDIC-assisted acquisition. Refer to Note 2 to the consolidated financial statements for the composition and balances of the assets and liabilities recorded at fair value by the Group on April 30, 2010. The cash received in the transaction, which amounted to $89.8 million, is presented in the investing activities section of the Consolidated Statements of Cash Flows as Cash and cash equivalents received in FDIC-assisted acquisition .

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

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

The unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). All significant intercompany balances and transactions have been eliminated in consolidation. These unaudited statements are, in the opinion of management, a fair statement of the results for the periods reported and include all necessary adjustments, all of a normal recurring nature, for a fair statement of such results. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations. Management believes that the disclosures made are adequate to make the information presented not misleading. The results of operations and cash flows for the periods ended September 30, 2011 and 2010 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2010, included in the Group s 2010 annual report on Form 10-K.

Nature of Operations

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

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

The Bank operates through 30 financial centers located throughout Puerto Rico and is subject to the supervision, examination and regulation of the Office of the Commissioner of Financial Institutions of Puerto Rico (OCFI) and the Federal Deposit Insurance Corporation (FDIC). The Bank offers banking services such as commercial and consumer lending, leasing, savings and time deposit products, financial planning, and corporate and individual trust services, and capitalizes on its commercial banking network to provide mortgage lending products to its clients. Oriental International Bank Inc. (OIB), a wholly-owned subsidiary of the Bank, operates as an international banking entity (IBE) pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended. OIB offers the Bank certain Puerto Rico tax advantages. OIB activities are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.

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

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

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

Significant Accounting Policies

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

Loans and Allowance for Loan and Lease Losses

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

Non-Covered Loans

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

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

Up to March 31, 2011, residential mortgage loans well collateralized and in process of collection, were placed on non-accrual status when reaching 365 days past due. On April 1, 2011, the Bank changed its policy on a prospective basis 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 at the time of changing the policy were also placed on non-accrual status, and the interest receivable on such loans at the time of changing the policy is evaluated at least on a quarterly basis against the collateral underlying the loans, and written-down, if necessary.

For all other loans, interest recognition is discontinued when loans are 90 days or more in arrears on principal and/or interest based on contractual terms. Loans for which the recognition of interest income has been discontinued are designated as non-accruing. Collections are accounted for on the cash method thereafter, until qualifying to return to accrual status. Such loans are not reinstated to accrual status until interest is received on a current basis and other factors indicative of doubtful collection cease to exist.

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

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

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

The Group, using a rating system, applies an overall allowance percentage to each non-covered loan portfolio 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 12 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: the credit grading assigned to commercial loans, 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; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: mortgage loans; commercial loans; consumer loans; and leasing.

Mortgage Loans: These loans are further divided into four classes: traditional mortgages, non-traditional mortgages, loans in loan modification programs and personal mortgage collateral loans. Traditional mortgage loans include loans secured by 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. The personal mortgage collateral loans are mainly equity lines of credit. The allowance factor on these loans is impacted by the historical loss factors on the sub-segments, the environmental risk factors described above and by delinquency buckets.

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 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. This is a new business line introduced in 2010 as result of the FDIC-assisted acquisition, and as such, the historical loss factor has been matched to consumer loans due to the lack of historical losses on leases.

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.

Covered Loans

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

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

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

The excess of undiscounted expected cash flows at acquisition over the initial fair value of acquired loans is referred to as the accretable yield and is recorded as interest income over the estimated life of the loans using the effective yield method if the timing and amount of the future cash flows is reasonably estimable. Subsequent to acquisition, the Group aggregates loans into pools of loans with common risk characteristics to account for the acquired loans. Increases in expected cash flows over those originally estimated increase the accretable yield and are recognized as interest income prospectively or reverse previously recognized allowance for loan and lease losses. Decreases in expected cash flows compared to those originally estimated decrease the accretable yield and are recognized by recording a provision for loan and lease losses and establishing an allowance for loan and lease losses.

ASC 310-30-40-1 states that, once a pool of loans is assembled, the integrity of the pool shall be maintained. A loan shall be removed from a pool of loans only if (a) the investor sells, forecloses, or otherwise receives assets in satisfaction of the loan or (b) the loan is written off. A refinancing or restructuring of a loan shall not result in the removal of a loan from a pool. Events that result in a loan being removed from a pool are often referred to as confirming events. When a confirming event occurs and a loan is removed from a pool, ASC 310-30 indicates that the loan should be removed at its carrying amount. ASC 310-30-35-15 states that, if a loan is removed from a pool of loans, the difference between the loan s carrying amount and the fair value of the collateral or other assets received shall not affect the percentage yield calculation used to recognize accretable yield on the pool of loans. That is, the pool s yield should be unaffected by the removal. The Group removes such loans on an as expected basis, which assumes cash or other assets received are equal to the original expectation of cash flows.

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

Lease Financing

The Group leases vehicles for personal and commercial use to individual and corporate customers. The direct finance lease method of accounting is used to recognize revenue on leasing contracts that meet the criteria specified in the guidance for leases in ASC Topic 840. Aggregate rentals due over the term of the leases less unearned income are included in

lease financing contracts receivable. Unearned income is amortized using a method over the average life of the leases as an adjustment to the interest yield.

Troubled Debt Restructuring

A troubled debt restructuring (TDR) is the restructuring of a receivable in which the Group, as creditor, grants a concession for legal or economic reasons due to the debtor s financial difficulties. A concession is granted when, as a result of the restructuring, the Group does not expect to collect all amounts due, including interest accrued at the original contract rate. These concessions may include a reduction of the interest rate, principal or accrued interest, extension of the maturity date or other actions intended to minimize potential losses.

For the assessment of whether the debtor is having financial difficulties, the Group evaluates whether it is probable that the debtor will default on any of its debt in the foreseeable future. If default is probable, then the debtor is considered to be experiencing financial difficulty even if there is no current default.

Receivables that are restructured in a TDR are presumed to be impaired and are subject to a specific impairment-measurement method. If the payment of principal at original maturity is primarily dependent on the value of collateral, the Group considers the current value of that collateral in determining whether the principal will be paid. For non-collateral dependent loans, the specific reserve is calculated based on the present value of expected cash flows discounted at the loan s effective interest rate. Loans modified in TDRs are placed on non-accrual status until the Group determines that future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrate performance according to the restructured terms for a period of at least six months.

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.

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

Impairment of Investment Securities

The Group conducts periodic reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairments. The Group follows ASC 320-10-65-1, which separates the amount of total impairment into credit and noncredit-related amounts. The term other-than-temporary impairment is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, discounted at the rate equal to the yield used to accrete current and prospective beneficial interest for the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the credit loss.

The Group s review for impairment generally entails, but is not limited to:

- identification and evaluation of investments that have indications of possible other-than-temporary impairment;
- analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position, and the expected recovery period;
- the financial condition of the issuer or issuers;
- the creditworthiness of the obligor of the security;
- actual collateral attributes;
- any rating changes by a rating agency;
- current analysts evaluations;
- the payment structure of the debt security and the likelihood of the issuer being able to make payments;
- current market conditions;
- adverse conditions specifically related to the security, industry, or a geographic area;
- the Group s intent to sell the debt security;
- whether it is more-likely-than-not that the Group will be required to sell the debt security before its anticipated recovery;

and other qualitative factors that could support or not an other-than-temporary impairment.

Derivative Instruments and Hedging Activities

The Group maintains an overall interest rate risk-management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The Group s goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not, on a material basis, adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. Also, for some fixed-rate assets or liabilities, the effect of this variability in earnings is expected to be substantially offset by the Group s gains and losses on the derivative instruments that are linked to the forecasted cash flows of these hedged assets and liabilities. The Group considers its strategic use of derivatives to be a prudent method of managing interest-rate sensitivity, as it reduces the exposure of earnings and the market value of its equity to undue risk posed by changes in interest rates. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the Group s gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result

of interest rate fluctuations is that the contractual interest income and interest expense of hedged variable-rate assets and liabilities, respectively, will increase or decrease.

Derivative instruments that are used as part of the Group s interest rate risk-management strategy include interest rate swaps, forward-settlement swaps, futures contracts, and option contracts that have indices related to the pricing of specific balance sheet assets and liabilities. Interest rate swaps generally involve the exchange of fixed and variable-rate interest payments between two parties, based on a common notional principal amount and maturity date. Interest rate futures generally involve exchange-traded contracts to buy or sell U.S. Treasury bonds and notes in the future at specified prices. Interest rate options represent contracts that allow the holder of the option to (1) receive cash or (2) purchase, sell, or enter into a financial instrument at a specified price within a specified period. Some purchased option contracts give the Group the right to enter into interest rate swaps and cap and floor agreements with the writer of the option. In addition, the Group enters into certain transactions that contain embedded derivatives. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated and carried at fair value.

The Group also offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor s 500 stock market index. The Group purchases options from major financial entities to manage its exposure to changes in this index. Under the terms of the option agreements, the Group receives a certain percentage of the increase, if any, in the initial month-end value of the index over the average of the monthly index observations in a five-year period in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings. The embedded option in the certificates of deposit is bifurcated, and the changes in the value of that option are also recorded in earnings.

When using derivative instruments, the Group exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract due to insolvency or any other event of default, the Group s credit risk will equal the fair value gain in a derivative plus any cash or securities that may have been delivered to the counterparty as part of the transaction terms. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the Group, thus creating a repayment risk for the Group. This risk is generally mitigated by requesting cash or securities from the counterparty to cover the positive fair value. When the fair value of a derivative contract is negative, the Group owes the counterparty and, therefore, assumes no credit risk other than the cash or value of the collateral delivered as part of the transactions in as far as it exceeds the fair value of the derivative. The Group minimizes the credit (or repayment) risk in derivative instruments by entering into transactions with high-quality counterparties.

The Group s derivative activities are monitored by its Asset/Liability Management Committee which is also responsible for approving hedging strategies that are developed through its analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the Group s overall interest rate risk-management and trading strategies.

The Group uses forward-settlement swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings, attributable to changes in LIBOR. Once the forecasted wholesale borrowing transactions occur, the interest rate swap will effectively lock-in the Group s interest rate payments on an amount of forecasted interest expense attributable to the one-month LIBOR corresponding to the swap notional amount. By employing this strategy, the Group minimizes its exposure to volatility in LIBOR.

As part of this new hedging strategy started in the first quarter of 2011, the Group formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash flow hedges to (1) specific assets and liabilities on the balance sheet or (2) specific firm commitments or forecasted transactions. The Group also formally assesses (both at the hedge s inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. The changes in fair value of the forward-settlement swaps are recorded in accumulated other comprehensive income to the extent there is no significant ineffectiveness.

The Group discontinues hedge accounting prospectively when (1) it determines that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; (4) a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designating the derivative as a hedging instrument is no longer appropriate or desired.

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FDIC Shared-Loss Indemnification Asset

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

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

Core Deposit Intangible

Core deposit intangible (CDI) is a measure of the value of checking and savings deposits acquired in a business combination. The fair value of the CDI stemming from any given business combination is based on the present value of the expected cost savings attributable to the core deposit funding, relative to an alternative source of funding. CDI is amortized straight-line over a 10-year period. The Group evaluates such identifiable intangible for impairment when an indication of impairment exists. No impairment charges were required to be recorded in the period ended September 30, 2011. If an impairment loss is determined to exist in the future, the loss would be reflected in the unaudited consolidated statement of operations for the period in which such impairment is identified.

Foreclosed Real Estate and Other Repossessed Property

Non-covered Foreclosed Real Estate

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

Covered Foreclosed Real Estate and Other Repossessed Property

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

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Income Taxes

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

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

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

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

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

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

On January 31, 2011, the Governor of Puerto Rico signed into law the Internal Revenue Code for a New Puerto Rico, which was subsequently amended (the 2011 Code). As such, the Puerto Rico Internal Revenue Code of 1994, as amended, (the 1994 Code) would be gradually repealed by the 2011 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% regular income tax rate but establishes significantly lower surtax rates. The 2011 Code provides a surtax rate from 5% to 10% for years starting after December 31, 2010, but before January 1, 2014. That surtax rate may be reduced to 5% after December 31, 2013, 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 net taxable income of each of the entities that are members of the controlled group reduced by the surtax deduction. The 2011 Code also provides a surtax deduction of $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 alternative minimum tax is 20%. The 2011 Code 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 was fully exempt and is subject to a 5% income tax for the years beginning after December 31, 2008 and ending before January 1, 2012. Under the 2011 Code, a corporate taxpayer has an irrevocable one-time election to defer the application of the 2011 Code for five years. This election must be made with the filing of the 2011 income tax return and, once made, is irrevocable for the taxable year when the election is made and for each of the next four taxable years.

Equity-Based Compensation Plan

The Group s Amended and Restated 2007 Omnibus Performance Incentive Plan (the Omnibus Plan) provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted units and dividend equivalents, as well as equity-based performance awards. The Omnibus Plan was adopted in 2007, amended and restated in 2008, and further amended in 2010.

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

The Board s Compensation Committee (the Committee), or such other committee as the Board may designate, has full authority to interpret and administer the Omnibus Plan in order to carry out its provisions and purposes. The Committee has the authority to determine those persons eligible to receive an Award and to establish the terms and conditions of any Award. The Committee may delegate, subject to such terms or conditions or guidelines as it shall determine, to any employee or group of employees any portion of its authority and powers under the Omnibus Plan with respect to participants who are not directors or executive officers subject to the reporting requirements under Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act). Only the Committee may exercise authority in respect of Awards granted to such participants.

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

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

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

Subsequent Events

The Group has evaluated other events subsequent to the balance sheet date and prior to the filing of this quarterly report on Form 10-Q for the quarter ended September 30, 2011, and has adjusted and disclosed those events that have occurred that would require adjustment or disclosure in the unaudited consolidated financial statements.

Reclassifications

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

Recent Accounting Developments:

Intangibles Goodwill and Other - FASB Accounting Standards Update (ASU) 2011-08, Intangibles Goodwill and Other (Topic 350) - Testing Goodwill for Impairment was issued in September 2011. This update allows an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance under Topic 350 required an entity to test goodwill for impairment, on at least an annual basis, by comparing the fair value of a reporting unit with its carrying amount, including goodwill (step one). If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must

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be performed to measure the amount of the impairment loss, if any. Under the amendments in this update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The Group believes that the implementation of this guidance will not have a material impact in the Group s unaudited consolidated financial statements.

Fair Value Measurements - FASB ASU 2011-04, Fair Value Measurement (FASB ASC Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, issued in May 2011, changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the FASB Board does not expect the amendments in this update to result in a change in the application of the requirements in Topic 820. Some of the amendments clarify the FASB Board s intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This update is effective for interim and annual reporting periods beginning after December 15, 2011. Early application by public entities is not permitted. The Group believes that the implementation of this guidance will not have a material impact on the Group s unaudited consolidated financial statements.

Troubled Debt Restructuring - In April 2011, FASB issued ASU No. 2011-02, A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. ASU No. 2011-02 requires that when evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession and (b) the debtor is experiencing financial difficulties. Also, the ASU sets the effective date when an entity should disclose the information deferred by ASU No. 2011-01 for interim and annual periods beginning on or after June 15, 2011. The Group adopted this guidance for the evaluation of loan modifications to determine if they qualify as troubled debt restructurings. Its adoption did not have a material effect on the Group s unaudited consolidated financial statements.

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

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NOTE 2 - FDIC-ASSISTED ACQUISITION

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

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

The assets acquired and liabilities assumed as of April 30, 2010 were presented at their fair value. In many cases, the determination of these fair values required management to make estimates about discount rates, expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. The fair values initially assigned to the assets acquired and liabilities assumed were preliminary and subject to refinement for up to one year after the closing date of the acquisition as new information relative to closing date fair values became available.

The Bank and the FDIC engaged in ongoing discussions and preliminary settlements that impacted certain assets acquired and certain liabilities assumed by the Bank on April 30, 2010, and that were included as measurement period adjustments in the table below. On April 29, 2011, the Bank and the FDIC reached a final settlement as part of the Purchase and Assumption Agreement. The final settlement did not have a material effect on the Bank s financial statements.

The Bank has agreed to make a true-up payment, also known as clawback liability, to the FDIC on the date that is 45 days following the last day (such day, the True-Up Measurement Date) of the final shared-loss month, or upon the final disposition of all covered assets under the shared-loss agreements in the event losses thereunder fail to reach expected levels. Under the shared-loss agreements, the Bank will pay to the FDIC 50% of the excess, if any, of: (i) 20% of the Intrinsic Loss Estimate of $906.0 million (or $181.2 million) (as determined by the FDIC) less (ii) the sum of: (A) 25% of the asset discount (per bid) (or ($227.5 million)); plus (B) 25% of the cumulative shared-loss payments (defined as the aggregate of all of the payments made or payable to the Bank minus the aggregate of all of the payments made or payable to the FDIC); plus (C) the sum of the period servicing amounts for every consecutive twelve-month period prior to and ending on the True-Up Measurement Date in respect of each of the shared-loss agreements during which the shared-loss provisions of the applicable shared-loss agreement is in effect (defined as the product of the simple average of the principal amount of shared-loss loans and shared-loss assets at the beginning and end of such period times 1%). The true-up payment represents an estimated liability of $12.8 million at September 30, 2011, net of discount. This estimated liability is accounted for as a reduction of the indemnification asset. The indemnification asset represents the portion of estimated losses covered by the shared-loss agreements between the Bank and the FDIC.

The operating results of the Group for the nine-month periods ended September 30, 2011 and 2010 include the operating results produced by the acquired assets and liabilities assumed since May 1, 2010. The Group believes that given the nature of assets and liabilities assumed, the significant amount of fair value adjustments, the nature of additional consideration provided to the FDIC (note payable and equity appreciation instrument) and the FDIC shared-loss agreements now in place, historical results of Eurobank are not meaningful to the Group s results, and thus no pro forma information is presented.

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Net-assets acquired and the respective measurement period adjustments are reflected in the table below:

	Book value April 30, 2010	Fair Value Adjustments	April 30, 2010 (As initially reported) (in thousands)	Measurement Period Adjustments	April 30 ,2010 (As remeasured)
Assets					
Cash and cash equivalents	$ 89,777	$	$ 89,777	$	$ 89,777
Federal Home Loan Bank (FHLB) stock	10,077		10,077		10,077
Loans covered under shared-loss agreements with the FDIC	1,536,416	(699,942)	836,474	(53,568)	782,906
Loans not covered under shared-loss agreements with the FDIC	4,275	(1,266)	3,009	7	3,016
Foreclosed real estate covered under shared-loss agreements with the FDIC	26,082	(8,555)	17,527	(4,032)	13,495
Other repossessed assets covered under shared-loss agreements with the FDIC	3,401	(339)	3,062		3,062
FDIC shared-loss indemnification asset		516,250	516,250	28,961	545,211
Core deposit intangible		1,423	1,423		1,423
Deferred tax asset, net				1,441	1,441
Goodwill				695	695
Other assets	20,168	(14,867)	5,301	949	6,250
Total assets acquired	$ 1,690,196	$ (207,296)	$ 1,482,900	$ (25,547)	$ 1,457,353
Liabilities					
Deposits	$ 722,442	$ 7,104	$ 729,546	$	$ 729,546
Deferred tax liability, net		6,419	6,419	(6,419)	
Other liabilities	9,426		9,426		9,426
Total liabilities assumed	$ 731,868	$ 13,523	$ 745,391	$ (6,419)	$ 738,972
Net assets acquired	$ 958,328	$ (220,819)	$ 737,509	$ (19,128)	$ 718,381
Consideration					
Note payable to the FDIC	$ 715,536	$ 434	$ 715,970	$	$ 715,970
FDIC settlement payable	15,244	(4,654)	10,590	(9,088)	1,502
FDIC equity appreciation instrument		909	909		909
	$ 730,780	$ (3,311)	$ 727,469	$ (9,088)	$ 718,381
Bargain purchase gain from the FDIC-assisted acquisition			$ 10,040	$ (10,040)	$

The FDIC shared-loss indemnification asset activity for the nine-month periods ended September 30, 2011 and 2010 is as follows:

	Nine-Month Period Ended September 30,	
	2011	2010
	(In thousands)	

Balance at beginning of period	$ 473,629	$ 545,213
Shared-loss agreements reimbursements from the FDIC	(73,267)	
Reduction of expected credit impairment losses to be covered under shared-loss agreements, net	(10,659)	
Accretion (amortization) of FDIC shared-loss indemnification asset, net	(191)	2,914
Incurred expenses to be reimbursed under shared loss agreements	2,584	427
Balance at end of period	$ 392,096	$ 548,554

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NOTE 3 - INVESTMENTS

Money Market Investments

The Group considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months or less at the date of acquisition. At September 30, 2011 and December 31, 2010, money market instruments included as part of cash and cash equivalents amounted to $3.4 million and $104.9 million, respectively.

Securities Purchased Under Agreements to Resell

Securities purchased under agreements to resell consist of short-term investments. At September 30, 2011, securities purchased under agreements to resell amounted to $165.0 million. At December 31, 2010, there were no securities purchased under agreements to resell.

The amounts advanced under those agreements are reflected as assets in the consolidated statement of financial condition. It is the Group s policy to take possession of securities purchased under agreements to resell. Agreements with third parties specify the Group s rights to request additional collateral based on its monitoring of the fair value of the underlying securities on a daily basis. The fair value of the collateral securities held by the Group on these transactions as of September 30, 2011 was approximately $167.4 million.

Investment Securities

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the securities owned by the Group at September 30, 2011 and December 31, 2010 were as follows:

	September 30, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
	(In thousands)				
Available-for-sale					
FNMA and FHLMC certificates	2,751,248	83,731		2,834,979	3.80%
GNMA certificates	29,526	1,840		31,366	5.01%
CMOs issued by US Government sponsored agencies	222,899	9,443	212	232,130	3.34%
Total mortgage-backed securities	**3,003,673**	**95,014**	**212**	**3,098,475**	
Obligations of Puerto Rico Government and political subdivisions	$ 82,520	$ 282	$ 1,447	$ 81,355	5.14%
Structured credit investments	61,905		20,929	40,976	3.53%
Other debt securities	5,959	207		6,166	3.33%
Total investment securities	**150,384**	**489**	**22,376**	**128,497**	
Total securities available-for- sale	**3,154,057**	**95,503**	**22,588**	**3,226,972**	**3.80%**
Held-to-maturity					
Mortgage-backed securities					
FNMA and FHLMC certificates	837,920	16,713		854,633	3.78%
Total	**$ 3,991,977**	**$ 112,216**	**$ 22,588**	**$ 4,081,605**	**3.80%**

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	December 31, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
			(In thousands)		
Available-for-sale					
FNMA and FHLMC certificates	3,238,802	45,446	2,058	3,282,190	3.70%
GNMA certificates	118,191	9,523		127,714	5.19%
CMOs issued by US Government sponsored agencies	168,301	9,524	21	177,804	5.01%
Total mortgage-backed securities	**3,525,294**	**64,493**	**2,079**	**3,587,708**	
Obligations of Puerto Rico Government and political subdivisions	$ 71,128	$ 160	$ 3,625	$ 67,663	5.37%
Structured credit investments	61,724		20,031	41,693	3.68%
Obligations of US Government sponsored agencies	3,000			3,000	0.01%
Total investment securities	**135,852**	**160**	**23,656**	**112,356**	
Total securities available-for-sale	**3,661,146**	**64,653**	**25,735**	**3,700,064**	**3.84%**
Held-to-maturity					
Mortgage-backed securities					
FNMA and FHLMC certificates	689,917		14,196	675,721	3.74%
Total	**$ 4,351,063**	**$ 64,653**	**$ 39,931**	**$ 4,375,785**	**3.82%**

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The amortized cost and fair value of the Group s investment securities at September 30, 2011, by contractual maturity, are shown in the next table. Securities not due on a single contractual maturity date, such as mortgage-backed securities, are classified in the period of final contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2011			
	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)		(In thousands)	
Investment securities				
Due from 1 to 5 years				
Obligations of Puerto Rico Government and political subdivisions	$ 10,255	$ 10,332	$	$
Total due from 1 to 5 years	**10,255**	**10,332**		
Due after 5 to 10 years				
Obligations of Puerto Rico Government and political subdivisions	23,716	22,977		
Structured credit investments	46,905	31,262		
Total due after 5 to 10 years	**70,621**	**54,239**		
Due after 10 years				
Obligations of Puerto Rico Government and political subdivisions	48,549	48,046		
Other debt securities	5,959	6,166		
Structured credit investments	15,000	9,714		
Total due after 10 years	**69,508**	**63,926**		
Total investment securities	**150,384**	**128,497**		
Mortgage-backed securities				
Due after 5 to 10 years				
FNMA and FHLMC certificates	**64,709**	**65,555**		
Due after 10 years				
FNMA and FHLMC certificates	2,686,539	2,769,424	837,920	854,633
GNMA certificates	29,526	31,366		
CMOs issued by US Government sponsored agencies	222,899	232,130		
Total due after 10 years	**2,938,964**	**3,032,920**	**837,920**	**854,633**
Total mortgage-backed securities	**3,003,673**	**3,098,475**	**837,920**	**854,633**
Total	**$ 3,154,057**	**$ 3,226,972**	**$ 837,920**	**$ 854,633**

Keeping with the Group s investment strategy, during the nine-month periods ended September 30, 2011 and 2010, there were certain sales of available-for sale securities because the Group felt at the time of such sales that gains could be realized while at the same time having good opportunities to invest the proceeds in other investment securities with attractive yields and terms that would allow the Group to continue to protect its net interest margin. Also, the Group, as part of its asset/liability management, purchases US government sponsored agencies discount

notes close to their maturities as a short term vehicle to reinvest the proceeds of sale transactions until investment securities with attractive yields can be purchased. During the nine-month periods ended September 30, 2011 and 2010, the Group sold approximately $5.1 million and $282.5 million, respectively, of discount notes with minimal aggregate gross gains which amounted to less than $1 thousand; and sold approximately $9.0 million and $387.9 million, respectively, of discount notes with minimal aggregate gross losses which amounted to less than $1 thousand.

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The tables below present the gross realized gains and losses by category for the nine-month periods ended September 30, 2011 and 2010:

	Nine-Month Period Ended September 30, 2011			
Description	**Sale Price**	**Book Value at Sale**	**Gross Gains**	**Gross Losses**
		(In thousands)		
Sale of Securities Available-for-Sale				
Investment securities				
Obligations of U.S. Government sponsored agencies	$ 14,100	$ 14,100	$	$
Total investment securities	14,100	14,100		
Mortgage-backed securities				
FNMA and FHLMC certificates	309,111	293,580	15,532	
GNMA certificates	183,269	175,700	7,571	1
Total mortgage-backed securities	492,380	469,280	23,103	1
Total	**$ 506,480**	**$ 483,380**	**$ 23,103**	**$ 1**

	Nine-Month Period Ended September 30, 2010			
Description	**Sale Price**	**Book Value at Sale**	**Gross Gains**	**Gross Losses**
		(In thousands)		
Sale of Securities Available-for-Sale				
Investment securities				
Obligations of U.S. Government sponsored agencies	$ 972,642	$ 967,926	$ 4,716	$ 1
Total investment securities	972,642	967,926	4,716	1
Mortgage-backed securities and CMOs				
FNMA and FHLMC certificates	1,783,631	1,755,808	27,823	
GNMA certificates	245,254	239,985	5,269	
Non-agency collateralized mortgage obligations	368,216	368,216		
Total mortgage-backed securities and CMOs	2,397,101	2,364,009	33,092	
Total	**$ 3,369,743**	**$ 3,331,935**	**$ 37,808**	**$ 1**

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The following table shows the Group s gross unrealized losses and fair value of investment securities available-for-sale and held-to-maturity, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2011 and December 31, 2010:

September 30, 2011

Available-for-sale

(In thousands)

	12 months or more		
	Amortized Cost	**Unrealized Loss**	**Fair Value**
Structured credit investments	61,905	20,929	40,976
CMOs issued by US Government sponsored agencies	2,498	212	2,286
Obligations of Puerto Rico Government and political subdivisions	50,665	1,447	49,218
	115,068	**22,588**	**92,480**

At September 30, 2011, there were no available for sale securities in a continuous unrealized loss position for less than 12 months. In addition, at September 30, 2011, there were no individual held-to-maturity securities in an unrealized loss position.

December 31, 2010

Available-for-sale

(In thousands)

	Less than 12 months		
	Amortized Cost	**Unrealized Loss**	**Fair Value**
FNMA and FHLMC certificates	$ 245,533	$ 2,058	$ 243,475
CMOs issued by US Government sponsored agencies	2,591	21	2,570
Obligations of US Government sponsored agencies	1,000		1,000
	249,124	**2,079**	**247,045**

	12 months or more		
	Amortized Cost	**Unrealized Loss**	**Fair Value**
Structured credit investments	61,724	20,031	41,693
Obligations of Puerto Rico Government and political subdivisions	50,773	3,625	47,148
	112,497	**23,656**	**88,841**

	Amortized Cost	Total Unrealized Loss	Fair Value
FNMA and FHLMC certificates	245,533	2,058	243,475
Structured credit investments	61,724	20,031	41,693
Obligations of Puerto Rico Government and political subdivisions	50,773	3,625	47,148
CMOs issued by US Government sponsored agencies	2,591	21	2,570
Obligations of US Government sponsored agencies	1,000		1,000
	$ 361,621	**$ 25,735**	**$ 335,886**

December 31, 2010

Held-to-maturity

(In thousands)

	Less than 12 months		
	Amortized Cost	Unrealized Loss	Fair Value
FNMA and FHLMC certificates	**$ 689,917**	**$ 14,196**	**$ 675,721**

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The Group conducts quarterly reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairment. ASC 320-10-65-1 requires the Group to consider various factors during its review, which include, but are not limited to:

- identification and evaluation of investments that have indications of possible other-than-temporary impairment;
- analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position, and the expected recovery period;
- the financial condition of the issuer or issuers;
- the creditworthiness of the obligor of the security;
- actual collateral attributes;
- any rating changes by a rating agency;
- current analysts evaluations;
- the payment structure of the debt security and the likelihood of the issuer being able to make payments;
- current market conditions;
- adverse conditions specifically related to the security, industry, or a geographic area;
- the Group s intent to sell the debt security;
- whether it is more-likely-than-not that the Group will be required to sell the debt security before its anticipated recovery;
- and other qualitative factors that could support or not an other-than-temporary impairment.

Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, discounted at the rate equal to the yield used to accrete current and prospective beneficial interest for the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the credit loss.

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

conditions could result in the need to recognize additional other-than-temporary impairment charges in the future.

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At September 30, 2011, the Group s portfolio of structured credit investments amounted to $61.9 million (amortized cost) in the available-for-sale portfolio, with net unrealized losses of approximately $20.9 million. The Group s structured credit investments portfolio consist of two types of instruments: synthetic collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs).

The CLOs are collateralized mostly by senior secured (via first liens) middle market commercial and industrial loans, which are securitized in the form of obligations. The Group invested in three of such instruments in 2007, and as of September 30, 2011, such instruments have an aggregate amortized cost of $36.4 million and unrealized losses of $10.9 million. These investments are all floating rate notes, which reset quarterly based on the three-month LIBOR rate.

The determination of the credit loss assumption in the discounted cash flow analysis related to the Group s structured credit investments is based on the underlying data for each type of security. In the case of the CLOs, the determination of the future cash flows is based on the following factors:

- Identification of the estimated fair value of the contractual coupon of the loans underlying the CLO. This information is obtained directly from the trustee s reports for each CLO security.

- Calculation of the yield-to-maturity for each loan in the CLO, and determination of the interest rate spread (yield less the risk-free rate).

- Estimated default probabilities for each loan in the CLO. These are based on the credit ratings for each company in the structure, and this information also is obtained directly from the trustee s reports for each CLO security. The default probabilities are adjusted based on the credit rating assuming the highest default probabilities for the loans of those entities with the lowest credit ratings. In addition to determining the current default probabilities, estimates are developed to calculate the cumulative default probabilities in successive years. To establish the reasonability of the default estimates, market-implied default rates are compared to historical credit ratings-based default rates.

- Once the default probabilities are estimated, the average numbers of defaults is calculated for the loans underlying each CLO security. In those cases where defaults are deemed to occur, a recovery rate is applied to the cash flow determination at the time in which the default is expected to occur. The recovery rate is based on average historical information for similar securities, as well as the actual recovery rates for defaults that have occurred within the pool of loans underlying the securities owned by the Group.

- One hundred simulations are carried out and run through a cash flow engine for the underlying pool of loans in each CLO security. Each one of the simulations uses different default estimates and forward yield curve assumptions.

The three CLOs held by the Group have face values of $12 million, $10 million and $15 million. In light of the other-than-temporary impairment analyses described below, the Group has determined that it will recover all interest and principal invested in the CLOs.

The cash flow analysis performed by the Group for the $12 million CLO did not reflect any scenario where there was a principal impairment. Moreover, on September 2, 2011 S&P assigned a positive watch to its A rating, while on June 22, 2011 Moody s assigned a positive watch to its Baa1 rating. In addition, the CLO s subordination level is 26.18%.

With respect to the $10 million CLO, the cash flow analysis performed by the Group also did not reflect any scenario where there was a principal impairment. On June 22, 2011, Moody s assigned a positive watch to its A3 rating, and S&P has maintained its A rating. Also, the CLO s subordination level is 20.64%.

The cash flow analysis performed by the Group for the $15 million CLO detected that there was a principal impairment in 35 out of 100 scenarios, with average losses of 17.51% and seven scenarios where the impairment amount is 100% of the Group s investment. The level of projected losses can be explained by the deterioration of macro-economic factors during the quarter ended September 30, 2011, as evidenced by the Euro-zone sovereign debt crisis and high unemployment in the United States, combined with low wage growth and a roughly 2% growth in GDP. There has also been a widening in the credit spreads of almost all the major investment sectors (investment grade, high yield, CMBS,

RMBS), including the type of loans that constitute the collateral of this CLO. Nonetheless, this situation is viewed as temporary, with some tightening credit spreads expected in the upcoming periods.

On August 3, 2011, Moody s upgraded its rating to Baa2 from Baa3 . There have been no other credit actions by S&P since March 4, 2010, when they lowered its rating from A- to BBB+, which is still investment grade. Also, the CLO s subordination level is 7.60%.

The Group estimates that it will recover all interest and principal for the Group s specific tranches of these securities. This assessment is based on the cash flow analysis mentioned above in which the credit quality of the Group s positions was evaluated through a determination of the expected losses on the underlying collateral. The model results show that the estimated future collateral losses, if any, are lower than the Group s subordination levels for each one of these securities. Therefore, these securities are deemed to have sufficient credit support to absorb the estimated collateral losses.

The Group owns a corporate bond that partially holds a synthetic CDO with an amortized cost of $25.5 million and unrealized losses of $10.0 million as of September 30, 2011. Due to the nature of this corporate bond, the Group s analysis focuses primarily on the CDO. The basis for the determination of other-than-temporary impairment on this security consists of a series of analyses that include: the ongoing review of the level of subordination (attachment and detachment) that the structure maintains at each quarter end to determine the level of protection that remains after events of default may affect any of the entities in the CDO s reference portfolio; simulations performed on such reference portfolio to determine the probability of default by any of the remaining entities; the determination of the default probabilities in the underlying reference portfolio of the CDO; and the constant monitoring of the CDO s credit rating.

During the quarter ended September 30, 2011, the Group revised the determination of default probabilities to incorporate and combine the use of two approaches, one which considered credit default spreads and another that considered cumulative default probability using the average historical ten year default rates for corporate securities of equivalent rating for each entity in the reference portfolio to monitor their specific performance. The reasons for using two methods to determine default probabilities were mainly related to the high level of market volatility observed near the end of the third quarter. In the case of the credit default spreads method, its main advantage is the use of real time information that may reflect the market s view of default probabilities, but at the same time, in situations of elevated market volatility, the long-term default rate expectations reflected by the credit spreads may be inflated. The cumulative default probability method provides a more stable input regarding the performance of the underlying securities.

The Group performed two analyses based on the credit default spreads method, one as of September 30, 2011, and another one as of October 20, 2011. The reason for performing an updated report was to measure the impact of credit spreads volatility in the determination of projected losses. The analysis as of September 30, 2011 resulted in losses occurring in 62% of the simulations. In contrast, the analysis as of October 20, 2011, showed that losses occurred in only 47% of the simulations. The Group also performed one analysis using cumulative default probability estimates for each of the reference credits in the CDO s portfolio. Such defaults probabilities were established as the average historical ten-year default rate for corporate securities of equivalent rating. This analysis resulted in losses occurring in 45.65% of the simulations.

Management decided to combine the results of two methods and thus include current market default indicators and historical default probability estimates in its analysis of this particular instrument. Based on the aforementioned analysis, the Group estimates that it will recover all interest and principal invested in the bond. This is based on the results of the analysis mentioned above which show that the subordination level (attachment/detachment) available under the structure of the CDO is sufficient to allow the Group to recover the value of its investment.

Other securities in an unrealized loss position at September 30, 2011 are mainly composed of highly liquid securities that in most cases have a large and efficient secondary market. Valuations are performed on a monthly basis. The Group s management believes that the unrealized losses of such other securities at September 30, 2011, are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuer or guarantor. At September 30, 2011, the Group does not have the intent to sell these investments in an unrealized loss position.

As a result of the aforementioned analyses, no other-than-temporary losses were recorded during the nine-month period ended September 30, 2011.

NOTE 4 - PLEDGED ASSETS

At September 30, 2011, residential mortgage loans, commercial loans and leases amounting to $565.8 million, $34.2 million and $8.4 million, respectively, were pledged to secure advances and borrowings from the Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB). Investment securities with fair values totaling $3.7 billion, $74.7 million and $52.1 million at September 30, 2011, were pledged to secure securities sold under agreements to repurchase, Puerto Rico public fund deposits and deposits of the Puerto Rico Cash & Money Market Fund, respectively. Also, at September 30, 2011, investment securities with fair values totaling $61.5 million were pledged against interest rate swaps contracts, while others with fair values of $125 thousand were pledged as a bond for the Bank s trust operations to the OCFI. At December 31, 2010, residential mortgage loans amounting to $512.0 million were pledged to secure advances and borrowings from the FHLB. Investment

securities with fair values totaling $3.8 billion, $73.4 million, $19.1 million, and $47.5 million at December 31, 2010, were pledged to secure securities sold under agreements to repurchase, Puerto Rico public fund deposits, Federal Reserve Bank of New York advances, and deposits of the Puerto Rico Cash & Money Market Fund, respectively. Also, at December 31, 2010, investment securities with fair values totaling $9.9 million were pledged against interest rate swaps contracts, while others with fair values of $124 thousand were pledged as a bond for the Bank s trust operations to the OCFI.

As of September 30, 2011, and December 31, 2010, investment securities available-for-sale not pledged amounted to $326.4 million and $422.1 million, respectively. As of September 30, 2011, and December 31, 2010, mortgage loans not pledged amounted to $444.5 million and $394.4 million, respectively. As of September 30, 2011, commercial loans not pledged amounted to $577.8 million; there were no commercial loans pledged as of December 31, 2010. As of September 30, 2011, leases not pledged amounted to $58.5 million. There were no leases pledged as of December 31, 2010.

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NOTE 5 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN AND LEASE LOSSES

Loans Receivable Composition

The composition of the Group s loan portfolio at September 30, 2011 and December 31, 2010 was as follows:

	September 30, 2011	December 31, 2010
	(In thousands)	
Loans not covered under shared-loss agreements with the FDIC:		
Loans secured by real estate:		
Residential	$ 837,164	$ 872,427
Home equity loans and other	1,536	1,505
Commercial	201,600	175,507
Deferred loan fees, net	(4,330)	(3,931)
	1,035,970	1,045,508
Other loans:		
Commercial	69,033	59,485
Personal consumer loans and credit lines	35,705	34,492
Leasing	21,283	10,257
Deferred loan fees, net	(353)	(423)
	125,668	103,811
Loans receivable	**1,161,638**	**1,149,319**
Allowance for loan and lease losses on non covered loans	(35,869)	(31,430)
Loans receivable, net	**1,125,769**	**1,117,889**
Mortgage loans held-for-sale	33,619	33,979
Total loans not-covered under shared-loss agreements with the FDIC, net	**1,159,388**	**1,151,868**
Loans covered under shared-loss agreements with the FDIC:		
Loans secured by 1-4 family residential properties	143,861	166,865
Construction and development secured by 1-4 family residential properties	16,044	17,232
Commercial and other construction	341,388	388,261
Leasing	45,598	79,093
Consumer	14,839	18,546
Total loans covered under shared-loss agreements with the FDIC	**561,730**	**669,997**
Allowance for loan and lease losses on covered loans	(37,240)	(49,286)
Total loans covered under shared-loss agreements with the FDIC, net	**524,490**	**620,711**
Total loans, net	**$ 1,683,878**	**$ 1,772,579**

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The following table presents the aging of the recorded investment in gross loans, excluding mortgage loans held for sale, as of September 30, 2011 and December 31, 2010 by class of loans:

	September 30, 2011						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due (in thousands)	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
Loans not covered under shared-loss agreements with the FDIC:							
Mortgage							
Residential							
Traditional	$ 21,302	$ 8,259	$ 72,334	$ 101,895	$ 601,336	$ 703,231	$
Non-traditional	2,607	91	11,100	13,798	59,533	73,331	
Loss mitigation program	5,608	1,621	10,752	17,981	42,621	60,602	
	29,517	9,971	94,186	133,674	703,490	837,164	
Home equity loans	391		333	724	812	1,536	
	29,908	**9,971**	**94,519**	**134,398**	**704,302**	**838,700**	
Commercial	**4,405**	**7,994**	**19,851**	**32,250**	**238,383**	**270,633**	
Consumer							
Personal consumer loans and credit lines - secured	81	49		130	7,323	7,453	
Personal consumer loans and credit lines - unsecured	452	121	164	737	20,119	20,856	
Credit cards	171	27	167	365	4,171	4,536	
Overdrafts	17	15	3	35	2,825	2,860	
	721	**212**	**334**	**1,267**	**34,438**	**35,705**	
Leasing	**202**		**119**	**321**	**20,962**	**21,283**	
Total loans not covered under shared-loss agreements with the FDIC	**$ 35,236**	**$ 18,177**	**$ 114,823**	**$ 168,236**	**$ 998,085**	**$ 1,166,321**	**$**

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	December 31, 2010						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
				(in thousands)			
Loans not covered under shared-loss agreements with the FDIC:							
Mortgage							
Residential							
Traditional	$ 22,093	$ 9,414	$ 76,604	$ 108,111	$ 638,158	$ 746,269	$ 37,850
Non-traditional	837	845	12,016	13,698	66,056	79,754	4,953
Loss mitigation program	2,528	1,043	9,336	12,907	33,497	46,404	6,060
	25,458	11,302	97,956	134,716	737,711	872,427	48,863
Home equity loans	149		340	489	961	1,450	
Other			55	55		55	
	25,607	**11,302**	**98,351**	**135,260**	**738,672**	**873,932**	**48,863**
Commercial	**1,123**	**9,367**	**13,390**	**23,880**	**210,396**	**234,992**	
Consumer							
Personal consumer loans and credit lines - secured	23			23	4,853	4,876	
Personal consumer loans and credit lines - unsecured	419	207	136	762	17,576	18,338	
Credit cards	262	173	285	720	3,650	4,370	
Overdrafts					7,624	6,908	
	704	**380**	**421**	**1,505**	**33,703**	**34,492**	
Leasing		**79**	**35**	**114**	**10,143**	**10,257**	
Total loans not covered under shared-loss agreements with the FDIC	**$ 27,434**	**$ 21,128**	**$ 112,197**	**$ 160,759**	**$ 992,914**	**$ 1,153,673**	**$ 48,863**

Non-covered Loans

The Group s credit activities are mainly with customers located in Puerto Rico. The Group s loan transactions are encompassed within four portfolio segments: mortgage, commercial, consumer and leases.

At September 30, 2011 and December 31, 2010, the Group had $132.4 million and $73.6 million, respectively, of non-accrual non-covered loans including credit cards accounted under ASC 310-20. At September 30, 2011 and December 31, 2010, loans of which terms have been extended and which are classified as troubled debt restructuring that are not included in non-performing assets amounted to $39.2 million and $35.0 million, respectively.

Up to March 31, 2011, residential mortgage loans, well collateralized and in process of collection, were placed on non-accrual status when reaching 365 days past due. On April 1, 2011, the Bank changed its policy on a prospective basis, 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 at the time the policy was changed were also placed on non-accrual status, and the interest receivable on such loans at the time the policy was changed is evaluated at least on a quarterly basis against the collateral underlying the loans, and written-down, if necessary. This change in policy was considered necessary based on an observed trend of increasing delinquencies and current economic conditions in Puerto Rico. Therefore, all loans 90 days or more past due at September 30, 2011

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are in non-accrual status. On April 1, 2011, mortgage loans between 90 and 365 days past due that were placed in non-accrual status amounted to $39.8 million.

The Group recorded a $1.8 million negative adjustment to interest income from non-covered residential mortgage loans in June 2011, as certain interest receivable accrued in prior years was deemed to be uncollectible.

The following table presents the recorded investment in non-covered loans on non-accrual status by class of loans as of September 30, 2011 and December 31, 2010:

	Non-accrual	
	September 30, 2011	December 31, 2010
	(In thousands)	
Mortgage		
Residential		
Traditional	$ 72,334	$ 38,754
Non-traditional	11,100	7,063
Loss mitigation program	10,752	3,276
	94,186	49,093
Home equity loans, secured personal loans	333	340
Other		55
	94,519	**49,488**
Commercial	**37,471**	**23,619**
Consumer		
Personal consumer loans and credit lines - unsecured	169	136
Credit cards	167	285
	336	**421**
Leasing	**119**	**35**
Total	**$ 132,445**	**$ 73,563**

Credit Quality Indicators

The Group categorizes non-covered loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: economic conditions, portfolio risk characteristics, prior loss experience, and results of periodic credit reviews of individual loans.

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

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

impairment all commercial loans over $250 thousand and over 90-days past-due. The portfolios of loans secured by residential properties, leases and consumer loans are considered homogeneous, and are evaluated collectively for impairment.

The Group uses the following definitions for risk ratings:

Special Mention: Loans classified as special mention have a potential weakness that deserves management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution s credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, questionable and improbable.

Loss: Loans classified loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this worthless loan even though partial recovery may be effected in the future.

ASC 310-10-35: Loans that are individually measured for impairment.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of September 30, 2011 and December 31, 2010, and based on the most recent analysis performed, the risk category of gross non-covered loans subject to risk rating, by class of loans, is as follows:

	Balance Outstanding at September 30, 2011	Risk Ratings					
		Pass	Special Mention	Substandard	Doubtful	Loss	ASC 310-10-35
	(In thousands)						
Commercial	**$ 270,633**	**$ 191,395**	**$ 30,677**	**$ 13,191**	**$ 15**	**$ 282**	**$ 35,073**

	Balance Outstanding at December 31, 2010	Risk Ratings					
		Pass	Special Mention	Substandard	Doubtful	Loss	ASC 310-10-35
	(In thousands)						
Commercial	**$ 234,992**	**$ 188,997**	**$ 5,908**	**$ 14,046**	**$ 143**	**$**	**$ 25,898**

The increase in the Special Mention risk rating reflects the addition of two commercial loan relationships that amounted to $25.4 million, mainly collateralized by existing commercial real estate properties, for which management identified potential weaknesses that deserve close attention.

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For residential and consumer loan classes, the Group also evaluates credit quality based on the delinquency status of the loan, which was previously presented. As of September 30, 2011 and December 31, 2010, and based on the most recent analysis performed, the risk category of gross non-covered loans not subject to risk rating, by class of loans, is as follows:

	Balance Outstanding at September 30, 2011	Delinquency						
		0-29 days	30-59 days	60-89 days (In thousands)	90-119 days	120-364 days	365+ days	ASC 310-10-35
Mortgage								
Traditional	$ 703,231	$ 601,336	$ 21,302	$ 8,259	$ 4,647	$ 25,490	$ 42,197	$
Non-traditional	73,331	59,533	2,607	91	582	2,237	8,281	
Loss mitigation program	60,602	9,996	605		279	1,410	1,798	46,514
	837,164	670,865	24,514	8,350	5,508	29,137	52,276	46,514
Home equity loans, secured personal loans	1,536	812	391				333	
	838,700	671,677	24,905	8,350	5,508	29,137	52,609	46,514
Consumer	35,705	34,438	721	212	189	145		
Leasing	21,283	20,962	202		23	96		
Total	**$ 895,688**	**$ 727,077**	**$ 25,828**	**$ 8,562**	**$ 5,720**	**$ 29,378**	**$ 52,609**	**$ 46,514**

	Balance Outstanding at December 31, 2010	Delinquency						
		0-29 days	30-59 days	60-89 days (In thousands)	90-119 days	120-364 days	365+ days	ASC 310-10-35
Mortgage								
Traditional	$ 746,269	$ 638,158	$ 22,093	$ 9,414	$ 5,560	$ 32,291	$ 38,753	$
Non-traditional	79,754	66,056	837	845	1,012	3,941	7,063	
Loss mitigation program	46,404	4,167	2,528	1,043		2,064	2,553	34,049
	872,427	708,381	25,458	11,302	6,572	38,296	48,369	34,049
Home equity loans, secured personal loans	1,450	961	149				340	
Other	55						55	
	873,932	709,342	25,607	11,302	6,572	38,296	48,764	34,049
Consumer	34,492	32,987	704	380	189	232		
Leasing	10,257	10,143		79	8	27		
Total	**$ 918,681**	**$ 752,472**	**$ 26,311**	**$ 11,761**	**$ 6,769**	**$ 38,555**	**$ 48,764**	**$ 34,049**

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The following table presents the troubled debt restructurings, which were modified by a reduction on interest rate and/or extension of the maturity date that occurred during the nine-month periods ended September 30, 2011 and September 30, 2010:

	Modifications Nine-Month Period Ended September 30, 2011 (Dollars in Thousands)						
	Number of contracts	Pre Modification Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months)	Post-Modification Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
Troubled Debt Restructurings							
Mortgage loans	101	$ 14,023	6.88%	329	$ 15,112	5.87%	379
Commercial loans	10	13,117	3.61%	77	13,046	3.36%	75

	Modifications Nine-Month Period Ended September 30, 2010 (Dollars in Thousands)						
	Number of contracts	Pre Modification Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months)	Post-Modification Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
Troubled Debt Restructurings							
Mortgage loans	114	$ 15,417	6.97%	300	$ 16,650	5.91%	369
Commercial loans	8	1,447	5.62%	61	1,465	4.80%	132

For the analysis of the allowance for loan and lease losses, impairment on mortgage loans assessed as troubled debt restructurings were measured using the present value of cash flows, whereas impaired commercial loans assessed as troubled debt restructurings were measured based on the fair value of collateral.

The following table presents troubled debt restructurings that subsequently defaulted during the twelve-month periods ended September 30, 2011 and September 30, 2010:

	Twelve-Month Period Ended September 30, 2011		Twelve-Month Period Ended September 30, 2010	
	Number of contracts	Recorded Investment	Number of contracts	Recorded Investment
	(Dollars in Thousands)		(Dollars in Thousands)	
Troubled Debt Restructurings That Subsequently Defaulted				
Mortgage loans	28	$ 3,738	45	$ 5,833
Commercial loans	4	9,254	4	1,079

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Allowance for Loan and Lease Losses

Non-Covered Loans

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. The analysis includes a review of historical loan loss experience, value of underlying collateral, current economic conditions, financial condition of borrowers and other pertinent factors. While management uses available information in estimating probable loan losses, future additions to the allowance may be required based on factors beyond the Group s control.

The following table presents the changes and the balance in the allowance for loan and lease losses and the recorded investment in gross loans by portfolio segment and based on impairment method for the quarters and nine-month periods ended September 30, 2011 and 2010:

	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
			(in thousands)			
Quarter Ended September 30, 2011						
Allowance for loan and lease losses for non-covered loans:						
Balance at beginning of period	$ 17,770	$ 13,800	$ 1,520	$ 868	$ 271	$ 34,229
Charge-offs	(1,391)	(440)	(368)	(82)		(2,281)
Recoveries		56	63	2		121
Provision for (recapture of) non-covered loan and lease losses	4,851	(2,297)	486	659	101	3,800
Balance at end of period	**$ 21,230**	**$ 11,119**	**$ 1,701**	**$ 1,447**	**$ 372**	**$ 35,869**
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 2,973	$ 1,829	$	$	$	$ 4,802
Collectively evaluated for impairment	18,257	9,290	1,701	1,447	372	31,067
Total ending allowance balance	**$ 21,230**	**$ 11,119**	**$ 1,701**	**$ 1,447**	**$ 372**	**$ 35,869**
Loans:						
Individually evaluated for impairment	$ 46,513	$ 35,073	$	$	$	$ 81,586
Collectively evaluated for impairment	790,651	235,560	37,241	21,283		1,084,735
Total ending non-covered loans balance	**$ 837,164**	**$ 270,633**	**$ 37,241**	**$ 21,283**	**$**	**$ 1,166,321**

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	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
			(In thousands)			
Quarter Ended September 30, 2010						
Allowance for loan and lease losses for non-covered loans:						
Balance at beginning of period	$ 19,237	$ 6,312	$ 816	$ 99	$ 1,538	$ 28,002
Charge-offs	(432)	(1,720)	(365)			(2,517)
Recoveries		10	45			55
Provision for (recapture of) non-covered loan and lease losses	370	3,902	93	117	(382)	4,100
Balance at end of period	**$ 19,175**	**$ 8,504**	**$ 589**	**$ 216**	**$ 1,156**	**$ 29,640**
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 1,990	$ 523	$	$	$	$ 2,513
Collectively evaluated for impairment	17,185	7,981	589	216	1,156	27,127
Total ending allowance balance	**$ 19,175**	**$ 8,504**	**$ 589**	**$ 216**	**$ 1,156**	**$ 29,640**
Loans:						
Individually evaluated for impairment	$ 27,934	$ 24,766	$	$	$	$ 52,700
Collectively evaluated for impairment	859,317	192,514	30,796	5,926		1,088,553
Total ending non-covered loans balance	**$ 887,251**	**$ 217,280**	**$ 30,796**	**$ 5,926**	**$**	**$ 1,141,253**

	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
			(In thousands)			
Nine-Month Period Ended September 30, 2011						
Allowance for loan and lease losses for non-covered loans:						
Balance at beginning of period	$ 16,179	$ 11,153	$ 2,286	$ 860	$ 952	$ 31,430
Charge-offs	(4,480)	(1,478)	(1,160)	(174)		(7,292)
Recoveries	45	108	175	3		331
Provision for (recapture of) non-covered loan and lease losses	9,486	1,336	400	758	(580)	11,400
Balance at end of period	**$ 21,230**	**$ 11,119**	**$ 1,701**	**$ 1,447**	**$ 372**	**$ 35,869**
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 2,973	$ 1,829	$	$	$	$ 4,802
Collectively evaluated for impairment	18,257	9,290	1,701	1,447	372	31,067
Total ending allowance balance	**$ 21,230**	**$ 11,119**	**$ 1,701**	**$ 1,447**	**$ 372**	**$ 35,869**
Loans:						
Individually evaluated for impairment	$ 46,513	$ 35,073	$	$	$	$ 81,586
Collectively evaluated for impairment	790,651	235,560	37,241	21,283		1,084,735
Total ending non-covered loans balance	**$ 837,164**	**$ 270,633**	**$ 37,241**	**$ 21,283**	**$**	**$ 1,166,321**

	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
			(In thousands)			
Nine-Month Period Ended September 30, 2010						
Allowance for loan and lease losses for non-covered loans:						
Balance at beginning of period	$ 15,044	$ 7,112	$ 864	$	$ 252	$ 23,272
Charge-offs	(2,871)	(2,221)	(1,033)			(6,125)
Recoveries	76	32	171			279
Provision for non-covered loan and lease losses	6,926	3,581	587	216	904	12,214
Balance at end of period	**$ 19,175**	**$ 8,504**	**$ 589**	**$ 216**	**$ 1,156**	**$ 29,640**
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 1,990	$ 523	$	$	$	$ 2,513
Collectively evaluated for impairment	17,185	7,981	589	216	1,156	27,127
Total ending allowance balance	**$ 19,175**	**$ 8,504**	**$ 589**	**$ 216**	**$ 1,156**	**$ 29,640**
Loans:						
Individually evaluated for impairment	$ 27,934	$ 24,766	$	$	$	$ 52,700
Collectively evaluated for impairment	859,317	192,514	30,796	5,926		1,088,553
Total ending non-covered loans balance	**$ 887,251**	**$ 217,280**	**$ 30,796**	**$ 5,926**	**$**	**$ 1,141,253**

The Group evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. The total investment in impaired commercial loans was $35.1 million and $25.9 million at September 30, 2011 and December 31, 2010, respectively. The impaired commercial loans were measured based on the fair value of collateral, including those identified as troubled-debt restructurings. The valuation allowance for impaired commercial loans amounted to approximately $1.8 million and $823 thousand at September 30, 2011 and December 31, 2010, respectively. At September 30, 2011, the total investment in impaired mortgage loans was $46.5 million (December 31, 2010 - $34.0 million). Impairment on mortgage loans assessed as troubled debt restructurings was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately $3.0 million and $2.3 million at September 30, 2011 and December 31, 2010, respectively.

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The Group s recorded investment in commercial and mortgage loans that were individually evaluated for impairment, excluding FDIC covered loans, and the related allowance for loan and lease losses at September 30, 2011 and December 31, 2010 are as follows:

	September 30, 2011				
	Unpaid Principal	Recorded Investment	Specific Allowance (In thousands)	Coverage	Average Recorded Investment
Impaired loans with specific allowance					
Commercial	$ 18,814	$ 18,135	$ 1,829	10%	$ 16,257
Residential troubled debt restructuring	47,298	46,513	2,973	6%	39,912
Impaired loans with no specific allowance					
Commercial	19,189	16,938		0%	15,295
Total investment in impaired loans	**$ 85,301**	**$ 81,586**	**$ 4,802**	**6%**	**$ 71,464**

	December 31, 2010				
	Unpaid Principal	Recorded Investment	Specific Allowance (In thousands)	Coverage	Average Recorded Investment
Impaired loans with specific allowance					
Commercial	$ 11,948	$ 10,070	$ 823	8%	$ 10,622
Residential troubled debt restructuring	34,049	34,049	2,250	7%	16,977
Impaired loans with no specific allowance					
Commercial	15,828	15,828		0%	11,472
Total investment in impaired loans	**$ 61,825**	**$ 59,947**	**$ 3,073**	**5%**	**$ 39,071**

The following table presents the interest recognized in commercial and mortgage loans that were individually evaluated for impairment, excluding FDIC covered loans for the quarters and nine-month periods ended September 30, 2011 and 2010:

	Interest Income Recognized			
	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Impaired loans with specific allowance				
Commercial	$ 277	$ 141	$ 810	$ 351
Residential troubled debt restructuring	336	80	777	174
Impaired loans with no specific allowance				
Commercial	196	251	555	520
Total interest income from impaired loans	**$ 809**	**$ 472**	**$ 2,142**	**$ 1,045**

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Covered Loans under ASC 310-30

The Group s acquired loans under the FDIC-assisted acquisition of Eurobank were initially recorded at fair value, and no separate valuation allowance was recorded at the date of acquisition. The Group reviewed each loan at acquisition to determine if it should be accounted for under ASC 310-30 and, if so, determine whether each loan is to be accounted for individually or whether loans will be aggregated into pools of loans based on common risk characteristics. During the evaluation of whether a loan was considered impaired under ASC 310-30, the Group considered a number of factors, including the delinquency status of the loan, payment options and other loan features (i.e. reduced documentation, interest only, or negative amortization features), the geographic location of the borrower or collateral and the risk rating assigned to the loans. Based on the criteria, the Group considered the entire Eurobank portfolio, except for credit cards, to be impaired and accounted for under ASC 310-30. Credit cards were accounted under ASC 310-20.

To the extent credit deterioration occurs in covered loans after the date of acquisition, the Group will record an allowance for loan and lease losses and an increase in the FDIC loss-share indemnification asset for the expected reimbursement from the FDIC under the shared-loss agreements. There have been differences, both positive and negative, between actual and expected cash flows in several pools of loans acquired in the FDIC-assisted acquisition. At September 30, 2011, the Group concluded that certain pools reflect higher projected cash flows, resulting in reversals of previous impairments recorded as well as additions to accretable discount of $71 million. In the event that in future periods the positive trend continues, there may be further additions to the accretable discount which will increase the yield on the pools that have positive deviations between actual and expected cash flows.

The carrying amounts of these loans included in the balance sheet amounts of total loans at September 30, 2011 and December 31, 2010 are as follows:

	Total Loans Acquired	
	September 30, 2011	December 31, 2010
	(In thousands)	
Contractual balance	$ 1,206,276	$ 1,370,942
Carrying amount, net	$ 524,490	$ 620,711

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The following tables describe the accretable yield and non-accretable discount activity for the quarter and nine-month period ended September 30, 2011:

	Quarter Ended September 30, 2011	Nine-Month Period Ended September 30, 2011
	(In thousands)	
Accretable Yield Activity		
Balance at beginning of period	$ 115,722	$ 148,556
Accretion	(18,222)	(45,508)
Transfer from non-accretable discount	70,906	65,358
Balance at end of period	**$ 168,406**	**$ 168,406**

	Quarter Ended September 30, 2011	Nine-Month Period Ended September 30, 2011
	(In thousands)	
Non-Accretable Discount Activity		
Balance at beginning of period	$ 557,938	$ 603,296
Principal losses	(24,930)	(75,836)
Transfer to accretable yield	(70,906)	(65,358)
Balance at end of period	**$ 462,102**	**$ 462,102**

For covered loans, the Group evaluates credit quality based on the delinquency status of the loan, severity factors and risk ratings on commercial loans. Migration and credit quality trends are assessed by comparing information from acquisition date through September 30, 2011.

There have been more positive changes in the credit quality of various pools of covered loans than those originally estimated that caused improvements to the initial loss severity factors and credit default probabilities estimated for various pools of covered loans. These changes have resulted in the re-yielding of various pools as the cash flows are higher than the Group originally expected.

The Group s recorded investment in covered loan pools that were evaluated for impairment and the related allowance for covered loan and lease losses as of September 30, 2011 and the December 31, 2010 are as follows:

	September 30, 2011				
	Unpaid Principal	Recorded Investment	Specific Allowance	Coverage	Average Recorded Investment
			(In thousands)		
Covered Loans					
Impaired covered loans with specific allowance					
Loans secured by 1-4 family residential properties	$ 20,455	$ 13,889	$ 539	4%	$ 16,798
Commercial and other construction	341,726	187,747	34,966	19%	201,737
Consumer	21,199	14,933	1,735	12%	16,374
Total investment in impaired covered loans	**$ 383,380**	**$ 216,569**	**$ 37,240**	**17%**	**$ 234,909**

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	December 31, 2010				
	Unpaid Principal	Recorded Investment	Specific Allowance (In thousands)	Coverage	Average Recorded Investment
Covered Loans					
Impaired covered loans with specific allowance					
Loans secured by 1-4 family residential properties	$ 64,366	$ 38,885	$ 3,582	9%	$ 38,667
Construction and development secured by 1-4 family residential properties	55,524	11,828	1,939	16%	12,541
Commercial and other construction	637,044	318,404	43,765	14%	324,946
Total investment in impaired covered loans	**$ 756,934**	**$ 369,117**	**$ 49,286**	**13%**	**$ 376,154**

As a result of our quarterly assessment of actual versus expected cash flows for pools of covered loans, the changes in the allowance for loan and lease losses on covered loans for the nine-month period ended September 30, 2011 was as follows:

	Quarter Ended September 30, 2011	Nine-Month Period Ended September 30, 2011
	(In thousands)	
Balance at beginning of the period	$ 53,036	$ 49,286
Recapture of covered loan and lease losses, net	(1,936)	(1,387)
FDIC loss-share portion of recapture of covered loan and lease losses, net	(13,860)	(10,659)
Balance at end of the period	**$ 37,240**	**$ 37,240**

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.

No allowance for loan and lease losses on covered loans was recorded for the quarter and nine-month period ended September 30, 2010.

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NOTE 6 - SERVICING ASSETS

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

All separately recognized servicing assets are recognized at fair value using the fair value measurement method. Under the fair value measurement method, the Group measures servicing rights at fair value at each reporting date and reports changes in fair value of servicing assets in earnings in the period in which the changes occur, and includes these changes, if any, with mortgage banking activities in the unaudited consolidated statements of operations. The fair value of servicing rights is subject to fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

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

At September 30, 2011, servicing assets are composed of $9.7 million ($8.9 million - December 31, 2010) related to residential mortgage loans and $320 thousand ($770 thousand - December 31, 2010) of leasing servicing assets acquired in the FDIC-assisted acquisition on April 30, 2010.

The following table presents the changes in servicing rights measured using the fair value method for the quarters and nine-month periods ended September 30, 2011 and 2010:

	Quarter Ended September 30,		Nine-Month Period Ended September	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Fair value at beginning of period	$ 9,840	$ 9,285	$ 9,695	$ 7,120
Acquisition of leasing servicing asset from FDIC-assisted acquisition				1,190
Servicing from mortgage securitizations or assets transfers	615	819	1,828	2,229
Changes due to payments on loans	(225)	(398)	(705)	(614)
Changes in fair value due to changes in valuation model inputs or assumptions	(216)	(59)	(804)	(278)
Fair value at end of period	**$ 10,014**	**$ 9,647**	**$ 10,014**	**$ 9,647**

The following table presents key economic assumptions ranges used in measuring the mortgage related servicing asset fair value:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2011	2010	2011	2010
Constant prepayment rate	10.56% - 39.25%	9.24% - 38.76%	7.87% - 39.25%	8.40% - 38.76%
Discount rate	11.00% - 14.00%	11.00% - 14.00%	11.00% - 14.00%	11.00% - 14.00%

The following table presents key economic assumptions ranges used in measuring the leasing related servicing asset fair value:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2011	2010	2011	2010
Discount rate	14.33% - 15.07%	13.06% - 16.27%	13.22% - 17.38%	13.06% - 20.00%

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

		September 30, 2011 (in thousands)
Mortgage related servicing asset		
Carrying value of mortgage servicing asset	$	9,694
Constant prepayment rate		
Decrease in fair value due to 10% adverse change	$	(395)
Decrease in fair value due to 20% adverse change	$	(763)
Discount rate		
Decrease in fair value due to 10% adverse change	$	(420)
Decrease in fair value due to 20% adverse change	$	(807)
Leasing servicing asset		
Carrying value of leasing servicing asset	$	320
Discount rate		
Decrease in fair value due to 10% adverse change	$	(3)
Decrease in fair value due to 20% adverse change	$	(6)

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption.

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

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

Servicing fee income is based on a contractual percentage of the outstanding principal and is recorded as income when earned. Servicing fees on mortgage loans totaled $806 thousand and $627 thousand for the quarters ended September 30, 2011 and 2010, respectively. These fees totaled $2.3 million and $1.7 million for the nine-month periods ended September 30, 2011 and 2010, respectively. There were no late fees and ancillary fees recorded in such periods because these fees belong to the third party with which the Group is engaged in a subservicing agreement. Servicing fees on leases amounted to $150 thousand and $549 thousand for the quarter and nine-month period ended September 30, 2011, respectively. Servicing fees on leases amounted to $135 thousand and $373 thousand for the quarter and nine-month period ended September 30, 2010, respectively.

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NOTE 7 - PREMISES AND EQUIPMENT

Premises and equipment at September 30, 2011 and December 31, 2010 are stated at cost less accumulated depreciation and amortization as follows:

	Useful Life (Years)	September 30, 2011	December 31, 2010
		(In thousands)	
Land		$ 2,254	$ 2,328
Buildings and improvements	40	6,025	6,301
Leasehold improvements	5 10	20,615	20,564
Furniture and fixtures	3 7	10,014	10,099
Information technology and other	3 7	20,004	19,074
		58,912	58,366
Less: accumulated depreciation and amortization		(36,414)	(34,425)
		$ 22,498	**$ 23,941**

Depreciation and amortization of premises and equipment for the quarters ended September 30, 2011 and 2010, totaled $1.4 million and $1.6 million, respectively. For the nine-month periods ended September 30, 2011 and 2010, these expenses amounted to $4.1 million and $4.2 million, respectively. These are included in the unaudited consolidated statements of operations as part of occupancy and equipment expenses.

NOTE 8 - DERIVATIVE ACTIVITIES

During the nine-month period ended September 30, 2011, losses of $8.1 million were recognized and reflected as Derivative Activities in the unaudited 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. During the nine-month period ended September 30, 2010, losses of $59.8 million were recognized and reflected as Derivative Activities in the unaudited 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. The remaining losses mainly represent unrealized losses on new interest rate swaps.

The following table details Derivative Assets and Derivative Liabilities as reflected in the unaudited consolidated statements of financial condition at September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
	(In thousands)	
Derivative assets:		
Forward settlement swaps	$	$ 11,023
Options tied to Standard & Poor s 500 Stock Market Index	6,707	9,870
Swap options		7,422
	$ 6,707	**$ 28,315**

Derivative liabilities:		
Forward settlement swaps	$ 48,122	$
Other	24	64
	$ 48,146	**$ 64**

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Forward-settlement Swaps

The Group enters into the forward-settlement swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings, attributable to changes in the one-month LIBOR rate. Once the forecasted wholesale borrowings transactions occur, the interest rate swap will effectively fix the Group s interest payments on an amount of forecasted interest expense attributable to the one-month LIBOR rate corresponding to the swap notional stated rate. These forward-settlement swaps are designated as cash flow hedges for the forecasted wholesale borrowings transactions and properly documented as such, therefore, qualifying for cash flow hedge accounting. Changes in the fair value of these derivatives are recorded in accumulated other comprehensive income to the extent there is no significant ineffectiveness in the cash flow hedging relationships. Currently, the Group does not expect to reclassify any amount included in other comprehensive income related to these forward-settlement swaps to earnings in the next twelve months. There were no derivatives designated for hedge accounting at December 31, 2010.

The following table shows a summary of these swaps and their terms, at September 30, 2011:

Notional Amount (In thousands)	Fixed Rate	Trade Date	Settlement Date	Maturity Date
$ 100,000	1.1275%	03/18/11	12/28/11	06/28/13
100,000	1.2725%	03/18/11	12/28/11	09/28/13
125,000	1.6550%	03/18/11	05/09/12	02/09/14
100,000	1.5300%	03/18/11	12/28/11	03/28/14
125,000	1.7700%	03/18/11	05/09/12	05/09/14
100,000	1.8975%	03/18/11	05/09/12	08/09/14
100,000	1.9275%	03/18/11	12/28/11	01/28/15
100,000	2.0000%	03/18/11	12/28/11	03/28/15
100,000	2.2225%	05/05/11	08/14/12	05/14/15
100,000	2.1100%	03/18/11	12/28/11	06/28/15
25,000	2.4365%	05/05/11	05/04/12	05/04/16
150,000	2.7795%	05/05/11	12/06/12	06/06/16
25,000	2.6200%	05/05/11	07/24/12	07/24/16
25,000	2.6350%	05/05/11	07/30/12	07/30/16
50,000	2.6590%	05/05/11	08/10/12	08/10/16
100,000	2.6750%	05/05/11	08/16/12	08/16/16
$ 1,425,000				

An unrealized loss of $48.1 million was recognized in accumulated other comprehensive income related to the valuation of these swaps at September 30, 2011, and the related derivative liability is being reflected in the accompanying unaudited consolidated statements of financial condition.

Swap Options

In May 2011, the Group sold all options to enter into interest rate swaps, not designated as cash flow hedges, with an aggregate notional amount of $250 million, recording a loss of $2.2 million.

Options tied to Standard & Poor s 500 Stock Market Index

The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor s 500 stock market index (S&P Index). The Group uses option agreements with major broker-dealer companies to manage its exposure to changes in this index. Under the terms of the option agreements, the Group receives the average increase in the month-end value of the index in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings. At September 30, 2011 and December 31, 2010, the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of $6.7 million (notional amount of $135.1 million) and $9.9 million (notional amount of $149.0 million), respectively; the options sold to customers embedded in the certificates of deposit and recorded as deposits in the unaudited consolidated

statements of financial condition, represented a liability of $7.2 million (notional amount of $130 million) and $12.8 million (notional amount of $143.4 million), respectively.

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NOTE 9 - ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

Accrued interest receivable at September 30, 2011 and December 31, 2010 consists of the following:

	September 30, 2011	December 31, 2010
	(In thousands)	
Loans	$ 8,620	$ 11,068
Investments	15,626	17,648
	$ 24,246	**$ 28,716**

Other assets at September 30, 2011 and December 31, 2010 consist of the following:

	September 30, 2011	December 31, 2010
	(In thousands)	
Prepaid FDIC insurance	$ 12,882	$ 16,796
Servicing assets	10,014	9,695
Other prepaid expenses	10,477	7,858
Goodwill	2,701	2,701
Mortgage tax credits	2,605	3,432
Other repossessed assets (covered by FDIC shared-loss agreements)	1,824	2,350
Debt issuance costs	1,375	2,299
Core deposit intangible	1,221	1,328
Investment in Statutory Trust	1,086	1,086
Accounts receivable and other assets	14,154	15,816
	$ 58,339	**$ 63,361**

On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 31, 2009, along with each institution s risk-based deposit insurance assessment for the third quarter of 2009. The prepayment balance of the assessment covering fiscal years 2010, 2011 and 2012 amounted to $12.9 million and $16.8 million at September 30, 2011 and December 31, 2010, respectively.

Other prepaid expenses amounting to $10.5 million and $7.9 million at September 30, 2011 and December 31, 2010, respectively, include prepaid municipal, property and income taxes aggregating to $6.6 million and $4.5 million, respectively.

In December 2007, the Commonwealth of Puerto Rico established mortgage loan tax credits for financial institutions that provided financing for the acquisition of new homes. Under an agreement reached during the second quarter of 2011 with the Puerto Rico Treasury Department, the Group may use half of these credits to reduce taxable income in taxable year 2011, and the remaining half of the credits in taxable year 2012. At September 30, 2011 and December 31, 2010, tax credits for the Group amounted to $2.6 million and $3.4 million, respectively.

In March 2009, the Group s banking subsidiary issued $105 million in notes guaranteed under the FDIC Temporary Liquidity Guarantee Program. Shortly after issuance of the notes, the Group paid $3.2 million (equivalent to an annual fee of 100 basis points) to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes. These costs have been deferred and are being amortized over the term of the notes. At September 30, 2011 and December 31, 2010, this deferred issue cost was $1.4 million and $2.3 million, respectively.

Other repossessed assets amounting to $1.8 million and $2.4 million at September 30, 2011 and December 31, 2010, respectively, represent covered assets under the FDIC shared-loss agreements and are related to the Eurobank leasing portfolio acquired under the FDIC-assisted acquisition.

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NOTE 10 - DEPOSITS AND RELATED INTEREST

Total deposits as of September 30, 2011 and December 31, 2010 consist of the following:

	September 30, 2011	December 31, 2010
	(In thousands)	
Non-interest bearing demand deposits	$ 181,711	$ 170,705
Interest-bearing savings and demand deposits	1,054,226	1,019,539
Individual retirement accounts	356,952	361,972
Retail certificates of deposit	395,902	477,180
Total retail deposits	1,988,791	2,029,396
Institutional deposits	184,022	280,617
Brokered deposits	205,552	278,875
	$ 2,378,365	**$ 2,588,888**

At September 30, 2011 and December 31, 2010, the weighted average interest rate of the Group s deposits was 1.91% and 2.12%, respectively, inclusive of non-interest bearing deposits of $181.7 million and $170.7 million, respectively. Interest expense for the quarters and nine-month periods ended September 30, 2011 and 2010 is set forth below:

	Quarter Ended September 30		Nine-Month Period Ended September 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Demand and savings deposits	$ 3,979	$ 4,586	$ 12,488	$ 13,047
Certificates of deposit	7,579	8,094	22,872	22,827
	$ 11,558	**$ 12,680**	**$ 35,360**	**$ 35,874**

At September 30, 2011 and December 31, 2010, time deposits in denominations of $100 thousand or higher, excluding unamortized discounts, amounted to $456.4 million and $590.0 million, including public fund deposits from various Puerto Rico government agencies of $65.2 million and $65.3 million at a weighted average rate of 0.05% in both periods, which were collateralized with investment securities with fair value of $74.7 million and $73.4 million, respectively.

Excluding equity indexed options in the amount of $7.2 million, which are used by the Group to manage its exposure to the Standard & Poor s 500 stock market index, and also excluding accrued interest of $5.1 million and unamortized deposit discounts in the amount of $6.6 million, the scheduled maturities of certificates of deposit at September 30, 2011 are as follows:

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	(In thousands)
Within one year:	
Three (3) months or less	$ 223,478
Over 3 months through 1 year	398,375
	621,853
Over 1 through 2 years	293,339
Over 2 through 3 years	117,083
Over 3 through 4 years	23,261
Over 4 through 5 years	81,026
	$ 1,136,562

The aggregate amount of overdraft in demand deposit accounts that were reclassified to loans amounted to $2.9 million as of September 30, 2011 ($7.6 million December 31, 2010).

NOTE 11 - BORROWINGS

Short Term Borrowings

At September 30, 2011, short term borrowings amounted to $46.6 million (December 31, 2010 $42.5 million) which mainly consist of deposits of the Puerto Rico Cash & Money Market Fund with a weighted average rate of 0.78% (December 31, 2010 0.60%), which were collateralized with investment securities with fair value of $52.1 million (December 31, 2010 $47.5 million).

Securities Sold under Agreements to Repurchase

At September 30, 2011, securities underlying agreements to repurchase were delivered to, and are being held by, the counterparties with whom the repurchase agreements were transacted. The counterparties have agreed to resell to the Group the same or similar securities at the maturity of the agreements.

At September 30, 2011 and December 31, 2010, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of $6.3 million and $6.8 million, respectively, were as follows:

	September 30, 2011		December 31, 2010	
	Borrowing Balance	Fair Value of Underlying Collateral	Borrowing Balance	Fair Value of Underlying Collateral
	(In thousands)		(In thousands)	
Citigroup Global Markets Inc.	$ 1,500,000	$ 1,614,475	$ 1,600,000	$ 1,752,619
Credit Suisse Securities (USA) LLC	1,250,000	1,337,681	1,250,000	1,325,392
UBS Financial Services Inc.	500,000	624,990	500,000	605,706
JP Morgan Chase Bank NA	100,000	120,791	100,000	119,997
Total	**$ 3,350,000**	**$ 3,697,937**	**$ 3,450,000**	**$ 3,803,714**

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The original terms of the Group s structured repurchase agreements range between three and ten years, and except for the $300 million repurchase agreement that settled on March 28, 2011 with a weighted average coupon of 2.86% and maturity of September 28, 2014 (as described below), the counterparties have the right to exercise put options at par on a quarterly basis before their contractual maturity from one to three years after the agreements settlement dates. The following table shows a summary of these agreements and their terms, excluding accrued interest in the amount of $6.3 million, at September 30, 2011:

Year of Maturity	Borrowing Balance (In thousands)	Weighted-Average Coupon	Settlement Date	Maturity Date	Next Put Date
2011					
	100,000	4.17%	12/28/2006	12/28/2011	12/28/2011
	50,000	4.13%	12/28/2006	12/28/2011	12/28/2011
	100,000	4.29%	12/28/2006	12/28/2011	12/28/2011
	350,000	4.25%	12/28/2006	12/28/2011	12/28/2011
	600,000				
2012					
	350,000	4.26%	5/9/2007	5/9/2012	11/9/2011
	100,000	4.50%	8/14/2007	8/14/2012	11/16/2011
	150,000	4.31%	3/6/2007	12/6/2012	12/6/2011
	600,000				
2014					
	100,000	4.72%	7/27/2007	7/27/2014	10/27/2011
	300,000	2.86%	3/28/2011	9/28/2014	N/A
	400,000				
2017					
	500,000	4.67%	3/2/2007	3/2/2017	12/2/2011
	250,000	0.25%	3/2/2007	3/2/2017	12/2/2011
	100,000	0.00%	6/6/2007	3/6/2017	12/6/2011
	900,000	0.00%	3/6/2007	6/6/2017	12/6/2011
	1,750,000				
	$ 3,350,000	**2.64%**			

None of the structured repurchase agreements referred to above with put dates up to the date of this filing were put by the counterparties at their corresponding put dates. Such repurchase agreements include $1.25 billion, which reset at each put date at a formula which is based on the three-month LIBOR rate less fifteen times the difference between the ten-year SWAP rate and the two-year SWAP rate, with a minimum of 0.00% on $1.0 billion and 0.25% on $250 million, and a maximum of 10.6%. These repurchase agreements bear the respective minimum rates of 0.0% and 0.25% to at least their next put dates scheduled for December 2011.

Advances from the Federal Home Loan Bank

Advances are received from the FHLB under an agreement whereby the Group is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances. At September 30, 2011, these advances were secured by mortgage and commercial loans amounting to $565.8 million and $34.2 million, respectively. Also, at September 30, 2011, the Group had an additional

borrowing capacity with the FHLB of $153.4 million. At September 30, 2011, the weighted average remaining maturity of FHLB s advances was 14.2 months (December 31, 2010 23.15 months).

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In 2007, the Group restructured most of its FHLB advances portfolio into longer-term, structured advances. The original terms of these advances range between five and seven years, and the FHLB has the right to exercise put options at par on a quarterly basis before the contractual maturity of the advances from nine months to one year after the advances settlement dates. The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of $1.8 million, at September 30, 2011:

Year of Maturity	Borrowing Balance (In thousands)	Weighted-Average Coupon	Settlement Date	Maturity Date	Next Put Date
2012					
	$ 25,000	4.37%	5/4/2007	5/4/2012	11/4/2011
	25,000	4.57%	7/24/2007	7/24/2012	10/24/2011
	25,000	4.26%	7/30/2007	7/30/2012	10/30/2011
	50,000	4.33%	8/10/2007	8/10/2012	11/11/2011
	100,000	4.09%	8/16/2007	8/16/2012	11/16/2011
	225,000				
2014					
	25,000	4.20%	5/8/2007	5/8/2014	11/8/2011
	30,000	4.22%	5/11/2007	5/11/2014	11/10/2011
	55,000				
	$ 280,000	**4.24%**			

None of the structured advances from the FHLB referred to above with put dates up to the date of this filing were put by the FHLB at their corresponding put dates.

Subordinated Capital Notes

Subordinated capital notes amounted to $36.1 million at September 30, 2011 and December 31, 2010.

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

The proceeds from this issuance were used by the Statutory Trust II to purchase a like amount of floating rate junior subordinated deferrable interest debentures (subordinated capital note) issued by the Group. The subordinated capital note has a par value of $36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (3.30% at September 30, 2011; 3.25% at December 31, 2010), payable quarterly, and matures on September 17, 2033. The subordinated capital note purchased by the Statutory Trust II may be called at par after five years and quarterly thereafter (next call date December 2011). The trust redeemable preferred securities have the same maturity and call provisions as the subordinated capital notes. The subordinated deferrable interest debentures issued by the Group are accounted for as a liability denominated as subordinated capital notes on the unaudited consolidated statements of financial condition.

The subordinated capital notes are treated as Tier 1 capital for regulatory purposes. Under Federal Reserve Board rules, restricted core capital elements, which are qualifying trust preferred securities, qualifying cumulative perpetual preferred stock (and related surplus) and certain minority interests in consolidated subsidiaries, are limited in the aggregate to no more than 25% of a bank holding company s core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability. However, under the Dodd-Frank Act, bank holding companies are prohibited from including in their Tier 1 capital hybrid debt and equity securities, including trust preferred securities, issued on or after May 19, 2010. Any 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, may continue to be included as Tier 1 capital. Therefore, the Group is permitted to continue to include its existing trust preferred securities as Tier 1 capital.

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FDIC-Guaranteed Term Notes Temporary Liquidity Guarantee Program

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

NOTE 12 - INCOME TAXES

On January 31, 2011, the Governor of Puerto Rico signed into law the 2011 Code. As such, the 1994 Code would be gradually repealed by the 2011 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% regular income tax rate but establishes significantly lower surtax rates. The 2011 Code provides a surtax rate from 5% to 10% for years starting after December 31, 2010, but before January 1, 2014. That surtax rate may be reduced to 5% after December 31, 2013, 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 net taxable income of each of the entities members of the controlled group reduced by the surtax deduction. The 2011 Code also provides a surtax deduction of $750,000. In the case of controlled group of corporations, the surtax deduction may be distributed among the members of the controlled group. The alternative minimum tax (AMT) is 20%. The 2011 Code 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 income earned by international banking entities, which was fully exempt and is subject to a 5% income tax for the years beginning after December 31, 2008 and ending before January 1, 2012. Under the 2011 Code, a corporate taxpayer has an irrevocable one-time election to defer the application of the 2011 Code for five years. This election must be made with the filing of the 2011 income tax return and, once made, is irrevocable for the taxable year when the election is made and for each of the next four taxable years. 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. In the first quarter of 2011, Oriental reduced by approximately $5.4 million its deferred tax asset, and accordingly increased its income tax expense, as a result of the 2011 Code.

The Group classifies unrecognized tax benefits in income taxes payable. These gross unrecognized tax benefits would affect the effective tax rate if realized. The balance of unrecognized tax benefits at September 30, 2011 was $1.4 million (December 31, 2010 - $6.3 million). The variance is attributed to various contingencies settled with the Puerto Rico Treasury Department on June 30, 2011 in which the Group paid $2.0 million, approximately $3.0 million less than what the Group had accrued for this purpose. Following such settlements, only the 2010 tax period remains subject to examination by the Puerto Rico Treasury Department. It is the Group s policy to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the unaudited consolidated statements of operations. The Group had accrued $653 thousand at September 30, 2011 (December 31, 2010 - $1.5 million) for the payment of interest and penalties relating to unrecognized tax benefits.

NOTE 13 - STOCKHOLDERS EQUITY

Preferred Stock

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

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

At the annual meeting of shareholders held on April 30, 2010, the shareholders approved an increase of the number of authorized shares of preferred stock, par value $1.00 per share, from 5,000,000 to 10,000,000.

On April 30, 2010, the Group issued 200,000 shares of Mandatorily Convertible Non-Cumulative Non-Voting Perpetual Preferred Stock, Series C (the Series C Preferred Stock), through a private placement. The Series C Preferred Stock had a liquidation preference of $1,000 per share and was converted to common stock on July 8, 2010 at a conversion price of $15.015 per share. The offering resulted in net proceeds of $189.4 million after deducting offering costs. On May 13, 2010, the Group made a capital contribution of $179.0 million to its banking subsidiary.

The difference between the conversion price of $15.015 per share and the market price of the common stock on April 30, 2010 ($16.72) was considered a contingent beneficial conversion feature on June 30, 2010, when the conversion was approved by the majority of the shareholders. Such feature amounted to $22.7 million at June 30, 2010 and was recorded as a deemed dividend on preferred stock upon conversion to common stock.

Common Stock

On March 19, 2010, the Group completed the public offering of 8,740,000 shares of its common stock. The offering resulted in net proceeds of $94.6 million after deducting offering costs. On March 25, 2010, the Group made a capital contribution of $93.0 million to its banking subsidiary.

At the annual meeting of shareholders held on April 30, 2010, the shareholders approved an increase of the number of authorized shares of common stock, par value $1.00 per share, from 40,000,000 to 100,000,000.

At a special meeting of shareholders of the Group held on June 30, 2010, the majority of the shareholders approved the issuance of 13,320,000 shares of the Group s common stock upon the conversion of the Series C Preferred Stock, which was converted on July 8, 2010 at a conversion price of $15.015 per share.

Treasury Stock

On February 3, 2011, the Group announced that its Board of Directors had approved a stock repurchase program pursuant to which the Group was authorized to purchase in the open market up to $30 million of its outstanding shares of common stock. On June 29, 2011, the Group announced the completion of this $30 million stock repurchase program and the approval by the Board of Directors of a new program to purchase an additional $70 million of common stock in the open market.

Any shares of common stock repurchased are held by the Group as treasury shares. The Group records treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. 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. Up to September 30, 2011 there were no purchases under the new $70 million stock repurchase program. After September 30, 2011, the Group purchased approximately 1,199,000 shares under this program for a total of $12.3 million at the date of this report, at an average price of $10.29 per share. These subsequent purchases will reduce the fourth quarter share count.

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The activity in connection with common shares held in treasury by the Group for the nine-month periods ended September 30, 2011 and 2010 is set forth below:

	Nine-Month Period Ended September 30			
	2011		2010	
	Shares	Dollar Amount	Shares	Dollar Amount
	(In thousands)			
Beginning of period	1,459	$ 16,732	1,504	$ 17,142
Common shares used for exercise of restricted stock units	(51)	(561)		
Common shares repurchased as part of the stock repurchase program	2,406	29,242		
Common shares used to match defined contribution plan, net	(21)	(37)	(14)	(26)
End of period	**3,793**	**$ 45,376**	**1,490**	**$ 17,116**

Regulatory Capital Requirements

The Group (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Group s and the Bank s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Group and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. This has changed under the Dodd-Frank Act, which requires federal banking regulators to establish minimum leverage and risk-based capital requirements, on a consolidated basis, for insured institutions, depository 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.

Quantitative measures established by regulation to ensure capital adequacy require the Group and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations) and of Tier 1 capital to average assets (as defined in the regulations). As of September 30, 2011 and December 31, 2010, the Group and the Bank met all capital adequacy requirements to which they are subject.

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As of September 30, 2011 and December 31, 2010, the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. The Group s and the Bank s actual capital amounts and ratios as of September 30, 2011 and December 31, 2010 are as follows:

	Actual		Minimum Capital Requirement	
	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)			
Group Ratios				
As of September 30, 2011				
Total Capital to Risk-Weighted Assets	$ 734,547	**32.74%**	$ 179,485	**8.00%**
Tier 1 Capital to Risk-Weighted Assets	$ 705,939	**31.47%**	$ 89,742	**4.00%**
Tier 1 Capital to Total Assets	$ 705,939	**10.12%**	$ 279,070	**4.00%**
As of December 31, 2010				
Total Capital to Risk-Weighted Assets	$ 728,241	**32.32%**	$ 180,279	**8.00%**
Tier 1 Capital to Risk-Weighted Assets	$ 699,415	**31.04%**	$ 90,139	**4.00%**
Tier 1 Capital to Total Assets	$ 699,415	**9.50%**	$ 294,472	**4.00%**

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
Bank Ratios						
As of September 30, 2011						
Total Capital to Risk-Weighted Assets	$ 657,492	**29.70%**	$ 177,102	**8.00%**	$ 221,377	**10.00%**
Tier 1 Capital to Risk-Weighted Assets	$ 629,251	**28.42%**	$ 88,551	**4.00%**	$ 132,826	**6.00%**
Tier 1 Capital to Total Assets	$ 629,251	**9.13%**	$ 275,666	**4.00%**	$ 344,582	**5.00%**
As of December 31, 2010						
Total Capital to Risk-Weighted Assets	$ 695,013	**31.23%**	$ 178,049	**8.00%**	$ 222,562	**10.00%**
Tier 1 Capital to Risk-Weighted Assets	$ 666,531	**29.95%**	$ 89,025	**4.00%**	$ 133,537	**6.00%**
Tier 1 Capital to Total Assets	$ 666,531	**9.22%**	$ 289,083	**4.00%**	$ 361,354	**5.00%**

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

Equity-Based Compensation Plan

The Omnibus Plan provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, and dividend equivalents, as well as equity-based performance awards. The Omnibus Plan replaced and superseded the Stock Option Plans. All outstanding stock options under the Stock Option Plans continue in full force and effect, subject to their original terms.

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The activity in outstanding options for the nine-month periods ended September 30, 2011 and 2010 is set forth below:

	Nine-Month Period Ended September 30,			
	2011		2010	
	Number Of Options	Weighted Average Exercise Price	Number Of Options	Weighted Average Exercise Price
Beginning of period	765,989	$ 15.25	514,376	$ 16.86
Options granted	85,000	11.90	162,700	11.98
Options exercised	(550)	9.19	(8,337)	8.60
Options forfeited	(33,142)	14.82	(3,000)	22.21
End of period	**817,297**	**$ 14.92**	**665,739**	**$ 15.75**

The following table summarizes the range of exercise prices and the weighted average remaining contractual life of the options outstanding at September 30, 2011:

	Outstanding			Exercisable	
Range of Exercise Prices	**Number of Options**	**Weighted Average Exercise Price**	**Weighted Average Contract Life Remaining (Years)**	**Number of Options**	**Weighted Average Exercise Price**
$ 5.63 to $ 8.45	14,285	$ 8.28	7.6	3,343	$ 8.28
8.46 to 11.27	2,000	10.29	5.9	1,000	10.29
11.28 to 14.09	571,527	12.16	6.9	189,002	12.40
14.10 to 16.90	62,035	15.60	2.9	62,035	15.60
19.72 to 22.54	25,050	20.68	3.4	20,800	20.44
22.55 to 25.35	83,350	23.99	2.5	83,350	23.99
25.36 to 28.17	59,050	27.46	3.1	59,050	27.46
	817,297	**$ 14.92**	**5.8**	**418,580**	**$ 17.67**
Aggregate Intrinsic Value	**$ 19,857**			**$ 4,647**	

The average fair value of each option granted during the nine-month period ended September 30, 2011 was $6.48. The average fair value of each option granted was estimated at the date of the grant using the Black-Scholes option pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no restrictions and are fully transferable and negotiable in a free trading market. Black-Scholes does not consider the employment, transfer or vesting restrictions that are inherent in the Group s stock options. Use of an option valuation model, as required by GAAP, includes highly subjective assumptions based on long-term predictions, including the expected stock price volatility and average life of each option grant.

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The following assumptions were used in estimating the fair value of the options granted during the nine-month periods ended September 30, 2011 and 2010:

	Nine-Month Period Ended September 30,	
	2011	2010
Weighted Average Assumptions:		
Dividend yield	1.62%	1.39%
Expected volatility	58.99%	60.30%
Risk-free interest rate	3.11%	3.44%
Expected life (in years)	8.0	8.0

The following table summarizes the restricted units activity under the Omnibus Plan for the nine-month periods ended September 30, 2011 and 2010:

	Nine-Month Period Ended September 30, 2011		Nine-Month Period Ended September 30, 2010	
	Restricted Units	Weighted Average Grant Date Fair Value	Restricted Units	Weighted Average Grant Date Fair Value
Beginning of period	243,525	$ 13.43	147,625	$ 14.64
Restricted units granted	39,500	11.88	53,500	10.40
Restricted units lapsed	(51,116)	20.44		
Restricted units forfeited	(14,620)	12.21	(400)	21.86
End of period	**217,289**	**$ 11.67**	**200,725**	**$ 13.76**

Legal Surplus

The Banking Act requires that a minimum of 10% of the Bank s net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid in capital on common and preferred stock. At September 30, 2011, legal surplus amounted to $51.3 million (December 31, 2010 $46.3 million). The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders. It is the Federal Reserve Board s policy that a bank holding company should not maintain a level of cash dividends to its shareholders that places undue pressure on the capital of the bank subsidiaries or that can be funded only through additional borrowings or other arrangements that may undermine the bank holding company s ability to serve as a source of strength.

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Earnings per Common Share

The calculation of earnings per common share for the quarters and nine-month periods ended September 30, 2011 and 2010 is as follows:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except per share data)			
Net income (loss)	$ 16,788	$ (7,821)	$ 46,336	$ 4,760
Less: Dividends on preferred stock	(1,201)	(1,200)	(3,602)	(4,134)
Less: Deemed dividend on preferred stock beneficial conversion feature		(22,711)		(22,711)
Income available (loss) to common shareholders	**$ 15,587**	**$ (31,732)**	**$ 42,734**	**$ (22,085)**
Average common shares outstanding and equivalents	**44,105**	**42,288**	**45,141**	**33,645**
Earnings per common share - basic	**0.35**	**(0.75)**	**0.95**	**(0.66)**
Earnings per common share - diluted	**$ 0.35**	**$ (0.75)**	**$ 0.95**	**$ (0.66)**

For the quarter and nine-month period ended September 30, 2011, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 572,284 and 558,193, respectively, compared to 312,700 and 420,200 for the same periods in 2010. The conversion of the Group s mandatorily convertible non-cumulative non-voting perpetual preferred stock, Series C, into shares of the Group s common stock during the nine-month period ended September 30, 2010, resulted in a non-cash beneficial conversion feature of $22.7 million, representing the intrinsic value between the conversion rate of $15.015 and the common stock closing price of $16.72 on April 30, 2010, the date the preferred shares were offered. Upon conversion, the beneficial conversion feature was recorded as a deemed dividend to the preferred stockholders reducing retained earnings, with a corresponding offset to surplus (paid in capital), and thus did not affect total stockholders equity or the book value of the common stock. However, the deemed dividend increased the net loss applicable to common stock and affected the calculation of basic and diluted EPS for the quarter and nine-month period ended September 30, 2010. Moreover, in computing diluted EPS, dilutive convertible securities that remained outstanding for the period prior to actual conversion were not included as average potential common shares because the effect would have been antidilutive. In computing both basic and diluted EPS, the common shares issued upon actual conversion were included in the weighted average calculation of common shares after the date of conversion.

Accumulated Other Comprehensive Income

Accumulated other comprehensive income, net of income tax, as of September 30, 2011 and December 31, 2010, consisted of:

	September 30, 2011	December 31, 2010
	(In thousands)	
Unrealized gain on securities available-for-sale which are not other-than-temporarily impaired	$ 73,090	$ 39,094
Unrealized loss on cash flow hedges	(48,122)	
Income tax effect	(249)	(2,107)
	$ 24,719	**$ 36,987**

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NOTE 14 - FAIR VALUE

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

Fair Value Measurement

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

Money market investments

The fair value of money market investments is based on the carrying amounts reflected in the unaudited consolidated statements of financial condition as these are reasonable estimates of fair value given the short-term nature of the instruments.

Securities purchased under agreements to resell

The fair value of securities purchased under agreements to resell is based on the carrying amounts reflected in the unaudited consolidated statements of financial condition as these are reasonable estimates of fair value given the short-term nature of the instruments.

Investment securities

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

Derivative instruments

The fair value of the forward-starting interest rate swaps is largely a function of the financial market s expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future. The fair value of most of these derivative instruments is based on observable market parameters, which include discounting the instruments cash flows using the U.S. dollar LIBOR-based discount rates, and also applying yield curves that account for the industry sector and the credit rating of the counterparty and/or the Group.

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

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Servicing assets

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

Loans receivable considered impaired that are collateral dependent

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

Foreclosed real estate

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

Assets and liabilities measured at fair value on a recurring basis, including financial liabilities for which the Group has elected the fair value option, are summarized below:

	September 30, 2011 Fair Value Measurements			
	Level 1	**Level 2**	**Level 3**	**Total**
		(In thousands)		
Investment securities available-for-sale	$	$ 3,175,919	$ 51,053	$ 3,226,972
Securities purchased under agreements to resell	165,000			165,000
Money market investments	3,431			3,431
Derivative assets			6,707	6,707
Derivative liabilities		(48,146)	(7,235)	(55,381)
Servicing assets			10,014	10,014
	$ 168,431	**$ 3,127,773**	**$ 60,539**	**$ 3,356,743**

	December 31, 2010 Fair Value Measurements			
	Level 1	**Level 2**	**Level 3**	**Total**
		(In thousands)		
Investment securities available-for-sale	$	$ 3,658,371	$ 41,693	$ 3,700,064
Money market investments	111,728			111,728
Derivative assets		18,445	9,870	28,315
Derivative liabilities		(64)	(12,830)	(12,894)
Servicing assets			9,695	9,695
	$ 111,728	**$ 3,676,752**	**$ 48,428**	**$ 3,836,908**

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The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarters ended September 30, 2011 and 2010:

	Total Fair Value Measurements (Quarter Ended September 30, 2011)					
	Investment securities available-for-sale					
Level 3 Instruments Only	CDO s	CLO s	Obligations of Puerto Rico Government and political subdivisions	Derivative asset (S&P Purchased Options)	Derivative liability (S&P Embedded Options)	Servicing assets
	(In thousands)					
Balance at beginning of period	$ 17,484	$ 28,229	$ 10,068	$ 11,925	$ (12,877)	$ 9,840
Gains (losses) included in earnings				(5,272)	4,459	
Changes in fair value of investment securities available for sale included in other comprehensive income	(1,951)	(2,965)	10			
New instruments acquired or recorded from securitizations				54	1,183	615
Principal repayments, sales, and amortization		179	(1)			(225)
Changes in fair value of servicing assets						(216)
Balance at end of period	**$ 15,533**	**$ 25,443**	**$ 10,077**	**$ 6,707**	**$ (7,235)**	**$ 10,014**

	Total Fair Value Measurements (Quarter Ended September 30, 2010)					
	Investment securities available-for-sale					
Level 3 Instruments Only	CDO s	CLO s	Non-Agency CMOs	Derivative asset (S&P Purchased Options)	Derivative liability (S&P Embedded Options)	Servicing assets
	(In thousands)					
Balance at beginning of period	$ 16,438	$ 25,168	$ 71,805	$ 4,433	$ (7,473)	$ 9,285
Gains (losses) included in earnings			(14,738)	2,392	(360)	
Changes in fair value of investment securities available for sale included in other comprehensive income	691	145	9,582			
New instruments acquired				281	(2,357)	819
Principal repayments, sales, and amortization			(3,403)	328	(637)	(398)
Changes in fair value of servicing assets				(328)	720	(59)
Balance at end of period	**$ 17,129**	**$ 25,313**	**$ 63,246**	**$ 7,106**	**$ (10,107)**	**$ 9,647**

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The table below presents reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine-month periods ended September 30, 2011 and 2010:

	Total Fair Value Measurements (Nine-Month Period Ended September 30, 2011)					
	Investment securities available-for-sale					
Level 3 Instruments Only	**CDO s**	**CLO s**	**Obligations of Puerto Rico Government and political subdivisions**	**Derivative asset (S&P Purchased Options)**	**Derivative liability (S&P Embedded Options)**	**Servicing assets**
	(In thousands)					
Balance at beginning of period	$ 16,143	$ 25,550	$	$ 9,870	$ (12,830)	$ 9,695
Gains (losses) included in earnings				(3,587)	3,175	
Changes in fair value of investment securities available for sale included in other comprehensive income	(610)	(287)	75			
New instruments acquired			10,005	424	482	1,828
Principal repayments, sales, and amortization		180	(3)		1,938	(705)
Changes in fair value of servicing assets						(804)
Balance at end of period	**$ 15,533**	**$ 25,443**	**$ 10,077**	**$ 6,707**	**$ (7,235)**	**$ 10,014**

	Total Fair Value Measurements (Nine-Month Period Ended September 30, 2010)					
	Investment securities available-for-sale					
Level 3 Instruments Only	**CDO s**	**CLO s**	**Non-Agency CMOs**	**Derivative asset (S&P Purchased Options)**	**Derivative liability (S&P Embedded Options)**	**Servicing assets**
	(In thousands)					
Balance at beginning of period	$ 15,148	$ 23,235	$ 71,723	$ 6,464	$ (9,543)	$ 7,120
Gains (losses) included in earnings			(17,166)	(177)	1,952	
Changes in fair value of investment securities available for sale included in other comprehensive income	1,981	2,078	18,890			
New instruments acquired				1,147	(3,236)	3,419
Principal repayments, sales, and amortization			(10,201)	(328)	720	(614)
Changes in fair value of servicing assets						(278)
Balance at end of period	**$ 17,129**	**$ 25,313**	**$ 63,246**	**$ 7,106**	**$ (10,107)**	**$ 9,647**

There were no transfers into and out of Level 1 and Level 2 fair value measurements during the nine-month periods ended September 30, 2011 and 2010.

The table below presents a detail of investment securities available-for-sale classified as level 3 at September 30, 2011:

	September 30, 2011				
Type	Amortized Cost	Unrealized Gains (Losses)	Fair Value	Weighted Average Yield	Principal Protection
			(In thousands)		
Obligations of Puerto Rico Government and political subdivisions	$ 10,002	$ 75	$ 10,077	3.50%	N/A
Structured credit investments					
CDO	$ 25,548	$ (10,014)	$ 15,534	5.80%	6.22%
CLO	15,000	(5,286)	9,714	2.44%	7.60%
CLO	11,978	(3,297)	8,681	1.86%	26.18%
CLO	9,379	(2,331)	7,048	1.25%	20.64%
	$ 61,905	$ (20,928)	$ 40,977	3.68%	
Total	**$ 71,907**	**$ (20,853)**	**$ 51,054**	**3.53%**	

Additionally, the Group may be required to measure certain assets at fair value in periods subsequent to initial recognition on a nonrecurring basis in accordance with GAAP. The adjustments to fair value usually result from the application of lower of cost or fair value accounting, identification of impaired loans requiring specific reserves under ASC 310-10-35 or write-downs of individual assets.

The following table presents financial and non-financial assets that were subject to a fair value measurement on a nonrecurring basis at September 30, 2011 and December 31, 2010, and which were still included in the unaudited consolidated statements of financial condition as of such dates. The amounts disclosed represent the aggregate of the fair value measurements of those assets as of the end of the reporting periods.

	Carrying value at	
	September 30, 2011 Level 3	December 31, 2010 Level 3
	(In thousands)	(In thousands)
Impaired commercial loans	$ 35,073	$ 25,898
Foreclosed real estate	30,994	26,840
	$ 66,067	**$ 52,738**

Impaired commercial loans relate mostly to certain impaired collateral dependent loans. The impairment of commercial loans was measured based on the fair value of collateral, which is derived from appraisals that take into consideration prices on observed transactions involving similar assets in similar locations, in accordance with provisions of ASC 310-10-35. Foreclosed real estate represents the fair value of foreclosed real estate (including those covered under FDIC shared-loss agreements) that was measured at fair value less estimated cost to sell.

Impaired commercial loans, which are measured using the fair value of the collateral for collateral dependent loans, had a carrying amount of $30.1 million and $25.9 million at September 30, 2011 and December 31, 2010, respectively, with a valuation allowance of $1.8 million and $823 thousand, respectively.

The assets acquired and liabilities assumed in the FDIC-assisted acquisition as of April 30, 2010 were presented at their fair value, as discussed in Note 2.

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Fair Value of Financial Instruments

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

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

The estimated fair value and carrying value of the Group s financial instruments at September 30, 2011 and December 31, 2010 is as follows:

	September 30, 2011		December 31, 2010	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	(In thousands)			
Financial Assets:				
Cash and cash equivalents	$ 517,336	$ 517,336	$ 448,936	$ 448,936
Securities purchased under agreements to resell	165,000	165,000		
Trading securities	346	346	1,330	1,330
Investment securities available-for-sale	3,226,972	3,226,972	3,700,064	3,700,064
Investment securities held-to-maturity	854,633	837,920	675,721	689,917
Federal Home Loan Bank (FHLB) stock	23,779	23,779	22,496	22,496
Total loans (including loans held-for-sale)				
Non-covered loans, net	1,193,123	1,159,388	1,150,945	1,151,868
Covered loans, net	604,159	524,490	600,421	620,711
Derivative assets	6,707	6,707	28,315	28,315
FDIC shared-loss indemnification asset	343,453	392,096	430,383	473,629
Accrued interest receivable	24,246	24,246	28,716	28,716
Servicing assets	10,014	10,014	9,695	9,695
Financial Liabilities:				
Deposits	2,504,564	2,378,365	2,585,922	2,588,888
Securities sold under agreements to repurchase	3,406,605	3,356,322	3,701,669	3,456,781
Advances from FHLB	287,199	281,753	303,868	281,753
FDIC-guaranteed term notes	106,026	105,112	106,428	105,834
Subordinated capital notes	36,083	36,083	36,083	36,083
Short term borrowings	46,619	46,619	42,460	42,460
Derivative liabilities	48,146	48,146	64	64
Accrued expenses and other liabilities	42,932	42,932	43,858	43,858

The following methods and assumptions were used to estimate the fair values of significant financial instruments at September 30, 2011 and December 31, 2010:

Cash and cash equivalents, money market investments, time deposits with other banks, securities purchased under agreements to resell, securities sold but not yet delivered, accrued interest receivable and payable, securities and loans purchased but not yet received, federal funds purchased, accrued expenses and other liabilities have been valued at the carrying amounts reflected in the unaudited consolidated statements of financial condition as these are reasonable estimates of fair value given the short-term nature of the instruments.

Investments in FHLB stock are valued at their redemption value.

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

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

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

Fair value of interest rate swaps and options on interest rate swaps is based on the net discounted value of the contractual projected cash flows of both the pay-fixed receive-variable legs of the contracts. The projected cash flows are based on the forward yield curve, and discounted using current estimated market rates.

The fair value of the covered and non-covered loan portfolio (including loans held-for-sale) is estimated by segregating by type, such as mortgage, commercial, consumer, and leasing. Each loan segment is further segmented into fixed and adjustable interest rates and by performing and non-performing categories. The fair value of performing loans is calculated by discounting contractual cash flows, adjusted for prepayment estimates (voluntary and involuntary), if any, using estimated current market discount rates that reflect the credit and interest rate risk inherent in the loan. This fair value is not currently an indication of an exit price as that type of assumption could result in a different fair value estimate.

The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is based on the discounted value of the contractual cash flows, using estimated current market discount rates for deposits of similar remaining maturities.

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For short-term borrowings, the carrying amount is considered a reasonable estimate of fair value. The subordinated capital notes have a par value of $36.1 million, and bear interest based on 3-month LIBOR plus 295 basis points (3.30% at September 30, 2011; 3.25% at December 31, 2010), payable quarterly. The fair value of long-term borrowings is based on the discounted value of the contractual cash flows, using current estimated market discount rates for borrowings with similar terms and remaining maturities and put dates.

The fair value of commitments to extend credit and unused lines of credit is based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standings.

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

NOTE 15 - SEGMENT REPORTING

The Group segregates its businesses into the following major reportable segments: Banking, Wealth Management, and Treasury. Management established the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Group s organization, nature of its products, distribution channels and economic characteristics of the products were also considered in the determination of the reportable segments. The Group measures the performance of these reportable segments based on pre-established goals of different financial parameters such as net income, net interest income, loan production, and fees generated. Non-interest expenses allocations among segments were reviewed during the fourth quarter of 2010 to reallocate expenses from the Banking to the Wealth Management and Treasury segments for a suitable presentation. The Group s methodology for allocating non-interest expenses among segments is based on several factors such as revenues, employee headcount, occupied space, dedicated services or time, among others. These factors are reviewed on a periodical basis and may change if the conditions so warrant.

Banking includes the Bank s branches and mortgage banking, with traditional banking products such as deposits and mortgage, commercial and consumer loans. Mortgage banking activities are carried out by the Bank s mortgage banking division, whose activities include the origination of mortgage loans for the Group s own portfolio, and the sale of loans directly into the secondary market or the securitization of conforming loans into mortgage-backed securities.

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

The Treasury segment encompasses all of the Group s asset/liability management activities such as: purchases and sales of investment securities, interest rate risk management, derivatives, and borrowings. Intersegment sales and transfers, if any, are accounted for as if the sales or transfers were to third parties, that is, at current market prices. The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies included in the Group s annual report on Form 10-K.

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Following are the results of operations and the selected financial information by operating segment as of and for the quarters ended September 30, 2011 and 2010:

	Banking	Wealth Management	Treasury	Total Major Segments (In thousands)	Eliminations	Consolidated Total
Quarter Ended September 30, 2011						
Interest income	$ 35,509	$	$ 36,153	$ 71,662	$	**$ 71,662**
Interest expense	(8,247)		(30,964)	(39,211)		**(39,211)**
Net interest income	**27,262**		**5,189**	**32,451**		**32,451**
Provision for non-covered loan and lease losses	(3,800)			(3,800)		**(3,800)**
Recapture of covered loan and lease losses, net	1,936			1,936		**1,936**
Non-interest income	3,143	5,503	8,542	17,188		**17,188**
Non-interest expenses	(23,103)	(4,167)	(3,137)	(30,407)		**(30,407)**
Intersegment revenues	319			319	(319)	
Intersegment expenses		(202)	(117)	(319)	319	
Income before income taxes	**$ 5,757**	**$ 1,134**	**$ 10,477**	**$ 17,368**	**$**	**$ 17,368**
Total assets as of September 30, 2011	**$ 3,236,344**	**$ 14,361**	**$ 4,464,861**	**$ 7,715,566**	**$ (692,278)**	**$ 7,023,288**

	Banking	Wealth Management	Treasury	Total Major Segments (In thousands)	Eliminations	Consolidated Total
Quarter Ended September 30, 2010						
Interest income	$ 34,342	$	$ 46,879	$ 81,221	$	**$ 81,221**
Interest expense	(10,727)		(32,334)	(43,061)		**(43,061)**
Net interest income	23,615		14,545	38,160		**38,160**
Provision for non-covered loan losses	(4,100)			(4,100)		**(4,100)**
Non-interest income (loss)	8,385	4,456	(23,304)	(10,463)		**(10,463)**
Non-interest expenses	(24,670)	(4,690)	(3,345)	(32,705)		**(32,705)**
Intersegment revenues	449			449	(449)	
Intersegment expenses		(384)	(65)	(449)	449	
Income (loss) before income taxes	**$ 3,679**	**$ (618)**	**$ (12,169)**	**$ (9,108)**	**$**	**$ (9,108)**
Total assets as of September 30, 2010	**$ 3,290,112**	**$ 11,249**	**$ 4,801,326**	**$ 8,102,687**	**$ (712,919)**	**$ 7,389,768**

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Following are the results of operations and the selected financial information by operating segment as of and for the nine-month periods ended September 30, 2011 and 2010:

	Banking	Wealth Management	Treasury	Total Major Segments (In thousands)	Eliminations	Consolidated Total
Nine-month period ended September 30, 2011						
Interest income	$ 96,602	$	$ 135,170	$ 231,772	$	**$ 231,772**
Interest expense	(26,132)		(93,316)	(119,448)		**(119,448)**
Net interest income	70,470		41,854	112,324		**112,324**
Provision for non-covered loan losses	(11,400)			(11,400)		**(11,400)**
Recapture of covered loan and lease losses, net	1,387			1,387		**1,387**
Non-interest income	16,597	14,879	10,102	41,578		**41,578**
Non-interest expenses	(71,517)	(12,362)	(8,013)	(91,892)		**(91,892)**
Intersegment revenues	1,042			1,042	(1,042)	
Intersegment expenses		(708)	(334)	(1,042)	1,042	
Income before income taxes	**$ 6,579**	**$ 1,809**	**$ 43,609**	**$ 51,997**	**$**	**$ 51,997**

	Banking	Wealth Management	Treasury	Total Major Segments (In thousands)	Eliminations	Consolidated Total
Nine-month period ended September 30, 2010						
Interest income	$ 81,385	$	$ 150,015	$ 231,400	$	**$ 231,400**
Interest expense	(29,239)		(97,562)	(126,801)		**(126,801)**
Net interest income	52,146		52,453	104,599		**104,599**
Provision for non-covered loan losses	(12,214)			(12,214)		**(12,214)**
Non-interest income (loss)	19,419	12,910	(39,086)	(6,757)		**(6,757)**
Non-interest expenses	(58,576)	(12,714)	(9,660)	(80,950)		**(80,950)**
Intersegment revenues	1,169	763		1,932	(1,932)	
Intersegment expenses		(1,784)	(148)	(1,932)	1,932	
Income (loss) before income taxes	**$ 1,944**	**$ (825)**	**$ 3,559**	**$ 4,678**	**$**	**$ 4,678**

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Item 2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SELECTED FINANCIAL DATA

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	Quarter Ended September 30,			Nine-Month Period Ended September 30,		
	2011	**2010**	**Variance %**	**2011**	**2010**	**Variance %**
EARNINGS DATA:						
Interest income	$ 71,662	$ 81,221	-11.8%	$ 231,772	$ 231,400	0.2%
Interest expense	39,211	43,061	-8.9%	119,448	126,801	-5.8%
Net interest income	**32,451**	**38,160**	-15.0%	**112,324**	**104,599**	7.4%
Provision for non-covered loan and lease losses	3,800	4,100	-7.3%	11,400	12,214	-6.7%
Recapture of covered loan and lease losses, net	(1,936)		-100.0%	(1,387)		-100.0%
Net interest income after provision for loan and lease losses	**30,587**	**34,060**	-10.2%	**102,311**	**92,385**	10.7%
Non-interest income (loss)	17,188	(10,463)	264.3%	41,578	(6,757)	715.3%
Non-interest expenses	30,407	32,705	-7.0%	91,892	80,950	13.5%
Income (loss) before taxes	**17,368**	**(9,108)**	290.7%	**51,997**	**4,678**	1011.5%
Income tax expense (benefit)	580	(1,287)	145.1%	5,661	(82)	7003.7%
Net income (loss)	**16,788**	**(7,821)**	314.7%	**46,336**	**4,760**	873.4%
Less: Dividends on preferred stock	(1,201)	(1,200)	-0.1%	(3,602)	(4,134)	12.9%
Less: Deemed dividend on preferred stock beneficial conversion feature		(22,711)	100.0%		(22,711)	100.0%
Income available (loss) to common shareholders	**$ 15,587**	**$ (31,732)**	149.1%	**$ 42,734**	**$ (22,085)**	293.5%
PER SHARE DATA:						
Basic	**$ 0.35**	**$ (0.75)**	147.1%	**$ 0.95**	**$ (0.66)**	244.1%
Diluted	**$ 0.35**					