ORIENTAL FINANCIAL GROUP INC
Form 10-K
March 09, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the Fiscal Year Ended December 31, 2011

or

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

For the Transition Period from to to .

Commission File No. 001-12647

ORIENTAL FINANCIAL GROUP INC.

Incorporated in the Commonwealth of Puerto Rico

IRS Employer Identification No. 66-0538893

Principal Executive Offices:

997 San Roberto Street

Oriental Center 10th Floor

Professional Office Park

San Juan, Puerto Rico 00926

Telephone Number: (787) 771-6800

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

Common Stock

($1.00 par value per share)

7.125% Noncumulative Monthly Income Preferred Stock, Series A

($1.00 par value per share, $25.00 liquidation preference per share)

7.0% Noncumulative Monthly Income Preferred Stock, Series B

($1.00 par value per share, $25.00 liquidation preference per share)

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

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

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

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

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

The aggregate market value of the common stock held by non-affiliates of Oriental Financial Group Inc. (the Group) was approximately $567.3 million as of June 30, 2011 based upon 44,011,107 shares outstanding and the reported closing price of $12.89 on the New York Stock Exchange on that date.

As of February 28, 2012, the Group had 40,980,081 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Group s definitive proxy statement relating to the 2012 annual meeting of shareholders are incorporated herein by reference in response to Items 10 through 14 of Part III.

ORIENTAL FINANCIAL GROUP INC.

FORM 10-K

For the Year Ended December 31, 2011

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FORWARD-LOOKING STATEMENTS

The information included in this annual report on Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to the financial condition, results of operations, plans, objectives, future performance and business of Oriental Financial Group Inc. (the Group), including, but not limited to, statements with respect to the adequacy of the allowance for loan losses, delinquency trends, market risk and the impact of interest rate changes, capital markets conditions, capital adequacy and liquidity, and the effect of legal proceedings and new accounting standards on the Group s financial condition and results of operations. All statements contained herein that are not clearly historical in nature are forward-looking, and the words anticipate, believe, continues, expect, estimate, intend, project and 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. or Puerto Rico governments or a downgrade in the credit ratings of the U.S. or Puerto Rico governments;
- changes in federal bank regulatory and supervisory policies, including required levels of capital;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) on the Group s businesses, business practices and cost of operations;
- the relative strength or weakness of the consumer and commercial credit sectors and of the real estate market in Puerto Rico;
- the performance of the stock and bond markets;
- competition in the financial services industry;
- additional Federal Deposit Insurance Corporation (FDIC) assessments; 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 annual report on Form 10-K are based upon information available to the Group as of the date of this report, and other than as required by law, including the requirements of applicable securities laws, the Group assumes no obligation to update or revise any such forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

PART I

ITEM 1. *BUSINESS*

General

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

The Group provides comprehensive banking and wealth management services to its clients through a complete range of banking and financial solutions, including mortgage, commercial and consumer lending; leasing; checking and savings accounts; financial planning, insurance, wealth management, and investment brokerage; and corporate and individual trust and retirement services. The Group operates through three major business segments: Banking, Wealth Management, and Treasury, and distinguishes itself based on quality service and marketing efforts focused on mid and high net worth individuals and families, including professionals and owners of small and mid-sized businesses, primarily in Puerto Rico. The Group has 30 financial centers in Puerto Rico and a subsidiary, Caribbean Pension Consultants Inc. (CPC), based in Boca Raton, Florida. The Group s long-term goal is to strengthen its banking and wealth management franchise by expanding its lending businesses, increasing the level of integration in the marketing and delivery of banking and wealth management services, maintaining effective asset-liability management, growing non-interest revenues from banking and wealth management services, and improving operating efficiencies.

The Group s strategy involves:

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

(2) Focusing on greater growth in mortgage, commercial and consumer lending; trust and wealth management services, insurance products; and increasing the level of integration in the marketing and delivery of banking and wealth management services;

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

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

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

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

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

Segment Disclosure

The Group has three 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 organizational structure, nature of products, distribution channels and economic characteristics of the products were also considered in the determination of the reportable segments. The Group measures the performance of these reportable segments based on pre-established goals involving different financial parameters such as net income, interest rate spread, loan production, and fees generated.

For detailed information regarding the performance of the Group s operating segments, please refer to Note 19 to the Group s accompanying consolidated financial statements.

Banking Activities

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

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

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

Loan Underwriting

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

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

Sale of Loans and Securitization Activities

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

Wealth Management Activities

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

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

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

OFSC also manages and participates in public offerings and private placements of debt and equity securities in Puerto Rico and engages in municipal securities business with the Commonwealth of Puerto Rico and its instrumentalities, municipalities, and public corporations. Investment banking revenue from such activities include gains, losses, and fees, net of syndicate expenses, arising from securities offerings in which OFSC acts as an underwriter or agent. Investment banking revenue also includes fees earned from providing merger-and-acquisition and financial restructuring advisory services.

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

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

Treasury Activities

Treasury activities encompass all of the Group s treasury-related functions. The Group s investment portfolio consists of mortgage-backed securities, obligations of U.S. Government sponsored agencies, Puerto Rico Government and agency obligations, structured credit investments, and money market instruments. Agency mortgage-backed securities, the largest component, consist principally of pools of residential mortgage loans that are made to consumers and then resold in the form of pass-through certificates in the secondary market, the payment of interest and principal of which is guaranteed by GNMA, FNMA or FHLMC.

Market Area and Competition

The main geographic business and service area of the Group is in Puerto Rico, where the banking market is highly competitive. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States of America. The Group also competes with brokerage firms with retail operations, credit unions, savings and loan cooperatives, small loan companies, insurance agencies, and mortgage banks in Puerto Rico. The Group encounters intense competition in attracting and retaining deposits and in its consumer and commercial lending activities. Management believes that the Group has been able to compete effectively for deposits and loans by offering a variety of transaction account products and loans with competitive terms, by emphasizing the quality of its service, by pricing its products at competitive interest rates, by offering convenient branch locations, and by offering financial planning and wealth management services at each of its branch locations. The FDIC-assisted acquisitions of three Puerto Rico banks in 2010 has created an environment for more rational loan and deposit pricing. The Group s ability to originate loans depends primarily on the service it provides to its borrowers, in making prompt credit decisions, and on the rates and fees that it charges.

Regulation and Supervision

General

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

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

Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity provided it does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Gramm-Leach-Bliley Act specifically provides that the following activities have been determined to be financial in nature : (a) lending, trust and other banking activities; (b) insurance activities; (c) financial, investment or economic advisory services; (d) securitization of assets; (e) securities underwriting and dealing; (f) existing bank holding company domestic activities; (g) existing bank holding company foreign activities; and (h) merchant banking activities. A financial holding company may generally commence any activity, or acquire any company, that is financial in nature without prior approval of the Federal Reserve Board. As provided by the Dodd-Frank Act, a financial holding company may not acquire a company, without prior Federal Reserve Board approval, in a transaction in which the total consolidated assets to be acquired by the financial holding company exceed $10 billion.

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

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

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

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

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

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

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act implements a variety of far-reaching changes and has been described as the most sweeping reform of the financial services industry since the 1930 s. It has a broad impact on the wealth management industry, including significant regulatory and compliance changes, such as: (1) enhanced resolution authority of troubled and failing banks and their holding companies; (2) enhanced lending limits strengthening the existing limits on a depository institution s credit exposure to one borrower; (3) increased capital and liquidity requirements; (4) increased regulatory examination fees; (5) changes to assessments to be paid to the FDIC for federal deposit insurance; (6) prohibiting bank holding companies, such as the Group, from including in regulatory Tier 1 capital future issuances of trust preferred securities or other hybrid debt and equity securities; and (7) numerous other provisions designed to improve supervision and oversight of, and strengthening safety and soundness for, the wealth management sector. Additionally, the Dodd-Frank Act establishes a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the Federal Reserve Board, the Office of the Comptroller of the Currency and the FDIC. Further, the Dodd-Frank Act addresses many corporate governance and executive compensation matters that will affect most U.S. publicly traded companies, including the Group. A few provisions of the Dodd-Frank Act are effective immediately, while various provisions are becoming effective in stages. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to implementing regulations.

The Dodd-Frank Act also creates a new consumer financial services regulator, the Bureau of Consumer Financial Protection (the Bureau), which will assume most of the consumer financial services regulatory responsibilities currently exercised by federal banking regulators and other agencies. The Bureau s primary functions include the supervision of covered persons (broadly defined to include any person offering or providing a consumer financial product or service and any affiliated service provider) for compliance with federal consumer financial laws. The Bureau will also have the broad power to prescribe rules applicable to a covered person or service provider identifying as unlawful, unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.

Holding Company Structure

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

Under the Dodd-Frank Act, a bank holding company, such as the Group, must serve as a source of financial strength for any subsidiary depository institution. The term source of financial strength is defined as the ability of a company to provide financial assistance to its insured depository institution subsidiaries in the event of financial distress at such subsidiaries. This support may be required at times when, absent such requirement, the bank holding company might not otherwise provide such support. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. The Bank is currently the only depository institution subsidiary of the Group.

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

Dividend Restrictions

The principal source of funds for the Group s holding company is the dividends from the Bank. The ability of the Bank to pay dividends on its common stock is restricted by the Puerto Rico Banking Act of 1933, as amended (the Banking Act), the Federal Deposit Insurance Act, as amended (the FDIA) and FDIC regulations. In general terms, the Banking Act provides that when the expenditures of a bank are greater than receipts, the excess of expenditures over receipts shall be charged against the undistributed profits of the bank and the balance, if any, shall be charged against the required reserve fund of the bank. If there is no sufficient reserve fund to cover such balance in whole or in part, the outstanding amount shall be charged against the bank s capital account. The Banking Act provides that until said capital has been restored to its original amount and the reserve fund to 20% of the original capital, the bank may not declare any dividends. In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding a bank.

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

Federal Home Loan Bank System

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

As a system member, the Bank is entitled to borrow from the FHLB of New York (the FHLB-NY) and is required to invest in FHLB-NY stock in an amount equal to the greater of 1% of the Bank s aggregate unpaid principal of its home mortgage loans, home purchase contracts, and similar obligations, or 5% of the Bank s aggregate amount of outstanding advances by the FHLB-NY. The Bank is in compliance with the stock ownership rules described above with respect to such advances, commitments, home mortgage loans and similar obligations. All loans, advances and other extensions of credit made by the FHLB-NY to the Bank are secured by a portion of the Bank s mortgage loan portfolio, certain other investments, and the capital stock of the FHLB-NY held by the Bank. The Bank is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances.

Federal Deposit Insurance Corporation Improvement Act

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

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

FDIC Insurance Assessments

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

The Dodd-Frank Act contains several important deposit insurance reforms, including the following: (i) the maximum deposit insurance amount was permanently increased to $250,000; (ii) the deposit insurance assessment is now based on the insured depository institution s average consolidated assets minus its average tangible equity, rather than on its deposit base; (iii) the minimum reserve ratio for the Deposit Insurance Fund was raised from 1.15% to 1.35% of estimated insured deposits by September 30, 2020; (iv) the FDIC is required to offset the effect of increased assessments on insured depository institutions with total consolidated assets of less than $10 billion; (v) the FDIC is no longer required to pay dividends if the Deposit Insurance Fund s reserve ratio is greater than the minimum ratio; and (vi) the FDIC will insure the full amount of qualifying noninterest-bearing transaction accounts for two years beginning December 31, 2010. As defined in the Dodd-Frank Act, a noninterest-bearing transaction account is a deposit or account maintained at a depository institution with respect to which interest is neither accrued nor paid, on which the depositor or account holder is permitted to make withdrawals by negotiable or transferrable instrument, payment orders of withdrawals, telephone or other electronic media transfers, or other similar items for the purpose of making payments or transfers to third parties or others, and on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal.

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

The Temporary Liquidity Guarantee Program (TLGP) of the FDIC provided two limited guarantee programs: the Debt Guarantee Program (DGP) and the Transaction Account Guarantee Program (TAGP). The DGP guarantees all newly issued senior unsecured debt (e.g., promissory notes, unsubordinated unsecured notes and commercial paper) up to prescribed limits issued by participating entities, including bank holding companies, in the period from October 14, 2008 through October 31, 2009. For eligible debt issued in that period, the FDIC provides the guarantee coverage until the earlier of the maturity date of the debt or December 31, 2012. The TAGP offered a full guarantee for non interest-bearing transaction deposit accounts held at FDIC-insured depository institutions. The unlimited deposit coverage was voluntary for eligible institutions and in addition to the $250,000 FDIC deposit insurance per depositor that was included as part of the Emergency Economic Stabilization Act of 2008. The TAGP coverage became effective on October 14, 2008 and continued for participating institutions until December 31, 2011. The Group opted to become a participating entity on both of these programs and pays applicable fees for participation. Participants in the DGP program have a fee structure based on a sliding scale, depending on length of maturity. Shorter-term debt has a lower fee structure and longer-term debt has a higher fee. The range is 50 basis points on debt of 180 days or less, and a maximum of 100 basis points for debt with maturities of one year or longer, on an annualized basis. Any eligible entity that has not chosen to opt out of the TAGP was assessed, on a quarterly basis, an annualized 10 cents per $100 fee on balances in non-interest bearing transaction accounts that exceed the existing deposit insurance limit of $250,000. The Group s banking subsidiary issued in March 2009 $105 million in notes guaranteed under the TLGP. These notes are due on March 16, 2012, bear interest at a 2.75% fixed rate, and are backed by the full faith and credit of the United States. Interest on the notes is payable on the 16th of each March and September. An annual fee of 100 basis points is paid to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes.

Brokered Deposits

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well capitalized institutions are not subject to limitations on brokered deposits, while adequately-capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the interest paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits. As of December 31, 2011, the Bank was a well capitalized institution and was therefore not subject to these limitations on brokered deposits.

Regulatory Capital Requirements

The Federal Reserve Board has risk-based capital guidelines for bank holding companies. Under the guidelines, the minimum ratio of qualifying total capital to risk-weighted assets is 8%. At least half of the total capital is to be comprised of qualifying common stockholders equity, qualifying noncumulative perpetual preferred stock (including related surplus), minority interests related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary, and restricted core capital elements (collectively Tier 1 Capital). Banking organizations are expected to maintain at least 50 percent of their Tier 1 Capital as common equity. Except as otherwise discussed below in light of the Dodd-Frank Act in connection with certain debt or equity instruments issued on or after May 19, 2010, not more than 25% of qualifying Tier 1 Capital may consist of qualifying cumulative perpetual preferred stock, trust preferred securities or other so- called restricted core capital elements. Tier 2 Capital may consist, subject to certain limitations, of allowance for loan and lease losses; perpetual preferred stock and related surplus; hybrid capital instruments, perpetual debt, and mandatory convertible debt securities; term subordinated debt and intermediate-term preferred stock, including related surplus; and unrealized holding gains on equity securities. Tier 3 Capital consists of qualifying unsecured subordinated debt. The sum of Tier 2 and Tier 3 Capital may not exceed the amount of Tier 1 Capital.

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

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

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

Failure to meet the capital guidelines could subject an institution to a variety of enforcement actions including the termination of deposit insurance by the FDIC and to certain restrictions on its business. At December 31, 2011, the Group was in compliance with all capital requirements. For more information, please refer to the accompanying consolidated financial statements.

Safety and Soundness Standards

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

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

Activities and Investments of Insured State-Chartered Banks

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

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

Transactions with Affiliates and Related Parties

Transactions between the Bank and any of its affiliates are governed by sections 23A and 23B of the Federal Reserve Act. These sections are important statutory provisions designed to protect a depository institution from transferring to its affiliates the subsidy arising from the institution s access to the Federal safety net. An affiliate of a bank is any company or entity that controls, is controlled by, or is under common control with the bank, including investment funds for which the bank or any of its affiliates is an investment advisor. Generally, sections 23A and 23B (1) limit the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate to an amount equal to 10% of the bank s capital stock and surplus, and limit such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus, and (2) require that all such transactions be on terms that are consistent with safe and sound banking practices. The term covered transactions includes the making of loans, purchase of or investment in securities issued by the affiliate, purchase of assets, acceptance of securities issued by the affiliate as collateral for a loan or extension of credit, issuance of guarantees and other similar types of transactions. The Dodd-Frank Act expanded the scope of transactions treated as covered transactions to include credit exposure to an affiliate on derivatives transactions, credit exposure resulting from a securities borrowing, or lending transaction or derivative transaction, and acceptances of affiliate-issued debt obligations or securities as collateral for a loan or extension of credit. Most loans by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100 to 130 percent of the loan amount, depending on the nature of the collateral. In addition, any covered transaction by a bank with an affiliate and any sale of assets or provision of services to an affiliate must be on terms that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with nonaffiliated companies. Regulation W of the Federal Reserve Board comprehensively implements sections 23A and 23B. The regulation unified and updated staff interpretations issued over the years prior to its adoption, incorporated several interpretative proposals (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate), and addressed issues arising as a result of the expanded scope of non-banking activities engaged in by banks and bank holding companies and authorized for financial holding companies under the Gramm-Leach-Bliley Act.

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

Community Reinvestment Act

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

USA Patriot Act

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

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

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

Privacy Policies

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

Sarbanes-Oxley Act

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

The Group has included in this annual report on Form 10-K the management assessment regarding the effectiveness of the Group s internal control over financial reporting. The internal control report includes a statement of management s responsibility for establishing and maintaining adequate internal control over financial reporting for the Group; management s assessment as to the effectiveness of the Group s internal control over financial reporting based on management s evaluation as of year-end; and the framework used by management as criteria for evaluating the effectiveness of the Group s internal control over financial reporting. As of December 31, 2011, the Group s management concluded that its internal control over financial reporting was effective.

Puerto Rico Banking Act

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

The Banking Act requires that a minimum of 10% of the Bank s net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid-in capital on common and preferred stock. At December 31, 2011, legal surplus amounted to $50.2 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.

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

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

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

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

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

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

Puerto Rico Internal Revenue Code

On January 31, 2011, the Governor of Puerto Rico signed into law the second and last phase of the Administration s tax reform bill. It creates the Internal Revenue Code for a New Puerto Rico, which has been subsequently amended several times (the 2011 Code). The 2011 Code provides for the gradual repeal of the Puerto Rico Internal Revenue Code of 1994 (the 1994 Code), as its provisions started to take effect, with some exceptions, as of January 1, 2011. For corporate taxpayers, the 2011 Code retains the 20% flat rate on normal-tax net income but establishes significantly lower rates applicable to surtax net income which is the normal-tax net income less the allowed surtax deduction. The 2011 Code provides a surtax rate from 5% to 10% for taxable years commencing after December 31, 2010 and before January 1, 2014. For taxable years commencing after December 31, 2013, the surtax rate may be reduced to 5% if certain economic and budgetary control tests are met by the Government of Puerto Rico. If such economic tests are not met, the reduction of the surtax rate will be postponed until the year when such economic tests are met. In the case of a controlled group of corporations, the determination of which surtax rate applies will be made by adding the normal-tax net income of each of the entities that are members of the controlled group reduced by the surtax deduction. The 2011 Code also increased the surtax deduction to $750,000. In the case of a controlled group of corporations, the surtax deduction should be distributed among the members of the controlled group. The 2011 Code reduces the alternative minimum tax (AMT) from 22% to 20%. It also eliminates the 5% additional surtax which was established by Act No. 7 of March 9, 2009, and the 5% recapture of the benefit of the income tax tables, except for the income earned by international banking entities, which was fully exempt and is subject to a 5% income tax for the taxable years beginning after December 31, 2008 and ending before January 1, 2012. Under the 2011 Code, a corporate taxpayer has a one-time option of determining its income tax liability and filing its income tax return pursuant to the 1994 Code. 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. The Group decided to implement the 2011 Code. Under the 2011 Code, all companies are treated as separate taxable entities and are not entitled to file consolidated returns. The Group and its subsidiaries are subject to Puerto Rico regular income tax or AMT on income earned from all sources. The AMT is payable if it exceeds regular income tax. The excess of AMT over regular income tax paid in any one year may be used to offset regular income tax in future years, subject to certain limitations.

International Banking Center Regulatory Act of Puerto Rico

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

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

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

Employees

At December 31, 2011, the Group had 725 employees. None of its employees is represented by a collective bargaining group. The Group considers its employee relations to be good.

Internet Access to Reports

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

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

ITEM 1A. ***RISK FACTORS***

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

Changes in interest rates may hurt the Group s business.

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

The Group is at risk because most of its business is conducted in Puerto Rico, which is experiencing a downturn in the economy and in the real estate market.

Because most of the Group s business activities are conducted in Puerto Rico and a significant portion of its credit exposure is concentrated in Puerto Rico, the Group s profitability and financial condition may be adversely affected by an extended economic slowdown, adverse political or economic developments in Puerto Rico or the effects of a natural disaster, all of which could result in a reduction in loan originations, an increase in non-performing assets, an increase in foreclosure losses on mortgage loans, and a reduction in the value of its loans and loan servicing portfolio.

The Commonwealth of Puerto Rico is in the sixth year of economic recession, and its government faces a significant fiscal deficit. The Commonwealth s access to municipal bond market and its credit ratings depend, in part, on achieving a balanced budget. Although the economic recession moderated in calendar year 2011 and the size of the Commonwealth s deficit has decreased, the Puerto Rico economy continues to struggle.

On August 8, 2011, Moody s lowered Puerto Rico s credit rating with a negative outlook. In taking such action, Moody s stated that the downgrade reflects the continued financial deterioration of the Commonwealth s severely underfunded government retirement systems, continued weak economic trend, and weak finances, with a historical trend of funding budget gaps with borrowing. Moody s negative outlook reflects the stress that the Commonwealth will face in the next few years as it continues to address the underfunding of the retirement systems from an already weak financial and economic position.

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

The decline in Puerto Rico s economy has had an adverse effect in the credit quality of the Group s loan portfolios as delinquency rates have increased in the short-term and may continue to increase until the economy stabilizes. Among other things, the Group has experienced an increase in the level of non-performing assets and loan loss provision, which adversely affects the Group s profitability. If the decline in economic activity continues, additional increases in the allowance for loan and lease losses could be necessary, and there could be further adverse effects on the Group s profitability. The reduction in consumer spending may also continue to impact growth in the Group s other interest and non-interest revenue sources.

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

Financial results are constantly exposed to market risk.

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

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

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

The Group is subject to interest rate risk because of the following factors:

- Assets and liabilities may mature or reprice at different times. For example, if assets reprice slower than liabilities and interest rates are generally rising, earnings may initially decline.

- Assets and liabilities may reprice at the same time but by different amounts. For example, when the general level of interest rates is rising, the Group may increase rates charged on loans by an amount that is less than the general increase in market interest rates because of intense pricing competition. Also, basis risk occurs when assets and liabilities have similar repricing frequencies but are tied to different market interest rate indices that may not move in tandem.

- Short-term and long-term market interest rates may change by different amounts, i.e., the shape of the yield curve may affect new loan yields and funding costs differently.

- The remaining maturity of various assets and liabilities may shorten or lengthen as interest rates change. For example, if long-term mortgage interest rates decline sharply, mortgage-backed securities portfolio may prepay significantly earlier than anticipated, which could reduce portfolio income. If prepayment rates increase, we would be required to amortize net premiums into income over a shorter period of time, thereby reducing the corresponding asset yield and net interest income. Prepayment risk also has a significant impact on mortgage-backed securities and collateralized mortgage obligations, since prepayments could shorten the weighted average life of these portfolios.

- Interest rates may have an indirect impact on loan demand, credit losses, loan origination volume, the value of financial assets and financial liabilities, gains and losses on sales of securities and loans, the value of mortgage servicing rights and other sources of earnings.

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

The hedging transactions that the Group enters into may not be effective in managing the exposure to market risk, including interest rate risk.

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

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

The Group may incur a significant impairment charge in connection with a decline in the market value of its investment securities portfolio.

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

When the fair value of a security declines, management must assess whether the decline is other-than-temporary. When the decline in fair value is deemed other-than-temporary, the amortized cost basis of the investment security is reduced to its then current fair value. The term other-than-temporary impairment is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, computed using original yield as the discount rate, to the amortized cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the credit loss. Such impairment charges reflect non-cash losses at the time of recognition. Subsequent disposition or sale of such assets could further affect the Group s future results of operations, as they are based on the difference between the sale prices received and adjusted amortized cost of such assets at the time of sale. The review of whether a decline in fair value is other-than-temporary considers numerous factors and many of these factors involve significant judgment.

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

The Group s success depends in part on its ability to analyze the relationship of changing interest rates on prepayments of the mortgage loans that underlie its mortgage-backed securities (MBS) portfolio. Changes in interest rates and prepayments affect the market price of MBS that the Group may purchase and any MBS that it may hold at a given time. As part of its overall portfolio risk management, the Group analyzes interest rate changes and prepayment trends separately and collectively to assess their effects on its investment portfolio. In conducting this analysis, the Group depends on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. The Homeowner Affordability and Stability Plan announced by the U.S. Treasury in February 2009, the Operation Twist program announced by the Federal Reserve Board on September 21, 2011 and the expansion of HARP announced by FHFA, Freddie Mac and Fannie Mae on October 24, 2011 could cause an increase in prepayment rates. On February 1, 2012, President Obama proposed legislation to expand HARP in order to allow a greater number of homeowners to refinance their mortgages at historically low interest rates. If the dislocations in the residential mortgage market, recent or future government actions, or other developments change the way that prepayment trends have historically responded to interest rate changes, the Group s ability to (i) assess the market value of its investment portfolio, (ii) implement its hedging strategies, and (iii) adopt techniques to reduce its prepayment rate volatility would be significantly affected. This could adversely affect the Group s financial position and results of operations.

The Group s risk management policies, procedures and systems may be inadequate to mitigate all risks inherent in the Group s various businesses.

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

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

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

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

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

The housing market in the U.S. is undergoing a correction of historic proportions. After a period of several years of booming housing markets, fueled by liberal credit conditions and rapidly rising property values, the sector has been in the midst of a substantial correction since early 2007. The general level of property values in the U.S., as measured by several indices widely followed by the market, has declined. These declines are the result of ongoing market adjustments that are aligning property values with income levels and home inventories. The supply of homes in the market has increased substantially, and additional property value decreases may be required to clear the overhang of excess inventory in the U.S. market.

The Group s business could be adversely affected if the Group cannot maintain access to stable funding sources.

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

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

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

The Group s decisions regarding credit risk and the allowance for loan and lease losses may materially and adversely affect the Group s business and results of operations.

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

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

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

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

The Group is subject to default and other risks in connection with mortgage loan originations.

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

Competition with other financial institutions could adversely affect the Group s profitability.

The Group faces substantial competition in originating loans and in attracting deposits and assets to manage. The competition in originating loans and attracting assets comes principally from other U.S., Puerto Rico and foreign banks, investment advisors, broker-dealers, mortgage banking companies, consumer finance companies, credit unions, insurance companies, and other institutional lenders and purchasers of loans. The Group will encounter greater competition as it expands its operations. Increased competition may require the Group to increase the rates paid on deposits or lower the rates charged on loans which could adversely affect the Group s profitability.

The Group may fail to realize the anticipated benefits of the FDIC-assisted acquisition.

The success of the FDIC-assisted acquisition will depend on, among other things, the Group s ability to realize anticipated cost benefits in a manner that permits growth opportunities and does not materially disrupt the Group s existing customer relationships or result in decreased revenues resulting from any loss of customers. If the Group is not able to successfully achieve these objectives, the anticipated benefits of the acquisition may not be realized fully or at all or may take longer to realize than expected. Additionally, the Group made fair value estimates of certain assets and liabilities in recording the acquisition. Actual values of these assets and liabilities could differ from the Group s estimates, which could result in not achieving the anticipated benefits of the acquisition.

The Group cannot assure that the FDIC-assisted acquisition will have positive results, including results relating to: correctly assessing the asset quality of the assets acquired; management attention and resources; the amount of longer-term cost savings; being able to profitably deploy funds acquired in the transaction; or the overall performance of the combined business. The Group s future growth and profitability depend, in part, on the ability to successfully manage the combined operations.

Given the continued economic recession in Puerto Rico, notwithstanding the shared-loss agreements with the FDIC with respect to certain Eurobank assets that the Group acquired, the Group may continue to experience increased credit costs or need to take additional markdowns and make additional provisions to the allowance for loan and lease losses on the assets and loans acquired that could adversely affect the Group s financial condition and results of operations in the future. There is no assurance that other unanticipated costs or losses will not be incurred.

To the extent credit deterioration occurs in covered loans after the date of acquisition, the Group would record an allowance for loan and lease losses. Also, the Group would record an increase in the FDIC loss-share indemnification asset for the expected reimbursement from the FDIC under the shared-loss agreements. For the year ended December 31, 2011, there have been deviations between actual and expected cash flows in several pools of loans acquired under the FDIC-assisted acquisition. The Group continues to evaluate these deviations to assess whether there has been additional deterioration since the acquisition on specific pools. For more information, please refer to the accompanying consolidated financial statements.

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

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

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

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

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

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

Although the loan portfolios acquired by the Group were initially accounted for at fair value, there is no assurance that such loans will not become impaired, which may result in additional provision for loan and lease losses related to these portfolios. The fluctuations in economic conditions, including those related to the Puerto Rico residential, commercial real estate, and construction markets, may increase the level of provision for credit losses that the Group makes to its loan portfolio and portfolios acquired in the FDIC-assisted acquisition, and consequently, reduce its net income. These fluctuations are not predictable, cannot be controlled, and may have a material adverse impact on the Group s operations and financial condition even if other favorable events occur.

The Group operates in a highly regulated environment and may be adversely affected by changes in federal and local laws and regulations.

The Group s operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of the Group s operations. Because the Group s business is highly regulated, the laws, rules and regulations applicable to the Group are subject to regular modification and change. For example, the Dodd-Frank Act has a broad impact on the wealth management industry, including significant regulatory and compliance changes, such as: (1) enhanced resolution authority of troubled and failing banks and their holding companies; (2) enhanced lending limits strengthening the existing limits on a depository institution s credit exposure to one borrower; (3) increased capital and liquidity requirements; (4) increased regulatory examination fees; (5) changes to assessments to be paid to the FDIC for federal deposit insurance; (6) prohibiting bank holding companies, such as the Group, from including in regulatory Tier 1 capital future issuances of trust preferred securities or other hybrid debt and equity securities; and (7) numerous other provisions designed to improve supervision and oversight of, the financial services industry. Additionally, the Dodd-Frank Act established a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the FDIC. It also creates a new consumer financial services regulator, the Bureau of Consumer Financial Protection, which assumed most of the consumer financial services regulatory responsibilities that were exercised by federal banking regulators and other agencies. Further, the Dodd-Frank Act addresses many corporate governance and executive compensation matters that affect most U.S. publicly traded companies, including the Group.

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

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

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

- the limitation on the Group s ability to raise capital through the use of trust preferred securities as these securities may no longer be included as Tier I capital going forward; and

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

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

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

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

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

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

Competition in attracting talented people could adversely affect the Group s operations.

The Group depends on its ability to attract and retain key personnel and the Group relies heavily on its management team. The inability to recruit and retain key personnel or the unexpected loss of key managers may adversely affect the operations. The Group s success to date has been influenced strongly by the ability to attract and retain senior management experienced in banking and wealth management. Retention of senior managers and appropriate succession planning will continue to be critical to the successful implementation of the Group s strategies.

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

None.

ITEM 2. ***PROPERTIES***

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

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

At December 31, 2011, the aggregate future rental commitments under the terms of the leases, exclusive of taxes, insurance and maintenance expenses payable by the Group was $39.1 million.

The Group s investment in premises and equipment, exclusive of leasehold improvements at December 31, 2011, was $37.9 million.

ITEM 3. ***LEGAL PROCEEDINGS***

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

PART II

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

The Group s common stock is traded on the New York Stock Exchange (NYSE) under the symbol OFG . Information concerning the range of high and low sales prices for the Group s common stock for each quarter in the years ended December 31, 2011 and 2010, as well as cash dividends declared for such periods are set forth under the Stockholders Equity caption in the Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A).

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

As of December 31, 2011, the Group had approximately 4,400 holders of record of its common stock, including all directors and officers of the Group, and beneficial owners whose shares are held in street name by securities broker-dealers or other nominees.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

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. As of December 31, 2011, the Group had purchased approximately 2,783,000 shares under the $70 million program for a total of $29.4 million, at an average price of $10.57 per share.

The following table presents the shares repurchased for each quarter in the year ended December 31, 2011:

Period	Total number of shares purchased as part of stock repurchase programs	Average price paid per share	Dollar amount of shares repurchased (excluding commissions paid)
	(In thousands, except shares and per share data)		
January 2011		$	$
February 2011	356,354	12.11	4,317
March 2011	671,225	12.14	8,149
Quarter ended March 31, 2011	**1,027,579**	**12.13**	**12,466**
April 2011	104,392	12.48	1,303
May 2011	134,100	11.56	1,550
June 2011	1,140,232	12.10	13,802
Quarter ended June 30, 2011	**1,378,724**	**12.08**	**16,655**
July 2011			
August 2011			
September 2011			
Quarter ended September 30, 2011			
October 2011	934,313	10.25	9,579
November 2011	1,087,650	10.41	11,318
December 2011	760,835	11.21	8,530
Quarter ended December 31, 2011	**2,782,798**	**10.57**	**29,427**
Year Ended December 31, 2011	**5,189,101**	**$ 11.28**	**$ 58,548**

The number of shares that may yet be purchased under the new $70 million program is estimated at 3,350,368, and was calculated by dividing the remaining balance of $40.6 million by $12.11 (closing price of the Group s common stock at December 31, 2011). The Group did not purchase any shares of its common stock other than through its publicly announced stock repurchase program during the year ended December 31, 2011.

Stock Performance Graph

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

The cumulative total stockholder return was obtained by dividing (i) the cumulative amount of dividends per share, assuming dividend reinvestment since the measurement point, December 31, 2006, plus (ii) the change in the per share price since the measurement date, by the share price at the measurement date.

Comparison of 5 Year Cumulative Total Return

Assumes Initial Investment of $100

	Period Ending					
Index	**12/31/06**	**12/31/07**	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**
Oriental Financial Group Inc.	100.00	108.47	51.24	93.26	109.27	107.93
Russell 2000	100.00	98.43	65.18	82.89	105.14	100.75
SNL Bank	100.00	77.71	44.34	43.88	49.17	38.08

ITEM 6. *SELECTED FINANCIAL DATA*

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

ORIENTAL FINANCIAL GROUP INC.

SELECTED FINANCIAL DATA

YEARS ENDED DECEMBER 31, 2011, 2010, 2009, 2008 AND 2007

			December 31,		
	2011	2010	2009	2008	2007
			(In thousands, except per share data)		
EARNINGS DATA:					
Interest income	$ 297,028	$ 303,801	$ 319,480	$ 339,039	$ 289,364
Interest expense	156,586	168,669	188,722	227,728	215,634
Net interest income	**140,442**	**135,132**	**130,758**	**111,311**	**73,730**
Provision for non-covered loan and lease losses	15,200	15,914	15,650	8,860	6,550
Provision for (recapture of) covered loan and lease losses, net	(1,387)	6,282			
Total provision for loan and lease losses, net	13,813	22,196	15,650	8,860	6,550
Net interest income after provision for loan and lease losses	**126,629**	**112,936**	**115,108**	**102,451**	**67,180**
Non-interest income (loss)	30,989	5,198	(1,813)	(12,242)	42,502
Non-interest expenses	122,302	112,598	83,378	72,742	66,859
Income before taxes	**35,316**	**5,536**	**29,917**	**17,467**	**42,823**
Income tax expense (benefit)	866	(4,298)	6,972	(9,323)	1,558
Net income	**34,450**	**9,834**	**22,945**	**26,790**	**41,265**
Dividends on preferred stock	(4,802)	(5,335)	(4,802)	(4,802)	(4,802)
Deemed dividend on preferred stock beneficial conversion feature		(22,711)			
Income available (loss) to common shareholders	**$ 29,648**	**$ (18,212)**	**$ 18,143**	**$ 21,988**	**$ 36,463**
PER SHARE DATA:					
Basic	**$ 0.67**	**$ (0.50)**	**$ 0.75**	**$ 0.91**	**$ 1.50**
Diluted	**$ 0.67**	**$ (0.50)**	**$ 0.75**	**$ 0.90**	**$ 1.50**
Average common shares outstanding and equivalents	**44,524**	**36,810**	**24,306**	**24,327**	**24,367**
Book value per common share	**$ 15.22**	**$ 14.33**	**$ 10.82**	**$ 7.96**	**$ 12.08**
Tangible book value per common share	**$ 15.12**	**$ 14.25**	**$ 10.73**	**$ 7.87**	**$ 12.00**
Market price at end of period	**$ 12.11**	**$ 12.49**	**$ 10.80**	**$ 6.05**	**$ 13.41**
Cash dividends declared per common share	**$ 0.21**	**$ 0.17**	**$ 0.16**	**$ 0.56**	**$ 0.56**
Cash dividends declared on common shares	**$ 9,153**	**$ 6,820**	**$ 3,888**	**$ 13,608**	**$ 13,611**

PERFORMANCE RATIOS:					
Return on average assets (ROA)	**0.48%**	**0.14%**	**0.35%**	**0.43%**	**0.76%**
Return on average common equity (ROE)	**4.50%**	**3.63%**	**7.16%**	**9.51%**	**13.52%**
Equity-to-assets ratio	**10.39%**	**10.02%**	**5.04%**	**4.21%**	**5.99%**
Efficiency ratio	**66.22%**	**64.54%**	**51.74%**	**52.65%**	**65.93%**
Expense ratio	**1.21%**	**1.14%**	**0.87%**	**0.77%**	**0.77%**
Interest rate spread	**2.12%**	**2.17%**	**2.00%**	**1.62%**	**1.27%**
Interest rate margin	**2.17%**	**2.11%**	**2.14%**	**1.86%**	**1.44%**

	2011	2010	December 31, 2009	2008	2007
			(In thousands, except per share data)		
PERIOD END BALANCES AND CAPITAL RATIOS:					
Investments and loans					
Investments securities	$ 3,867,970	$ 4,413,957	$ 4,974,269	$ 3,945,626	$ 4,585,610
Loans and leases not covered under shared loss agreements with the FDIC, net	1,173,677	1,151,868	1,140,069	1,219,112	1,179,566
Loans and leases covered under shared loss agreements with the FDIC, net	496,276	620,711			
Securities sold but not yet delivered				834,976	
	$ 5,537,923	**$ 6,186,536**	**$ 6,114,338**	**$ 5,999,714**	**$ 5,765,176**
Deposits and borrowings					
Deposits	$ 2,395,267	$ 2,588,888	$ 1,745,501	$ 1,785,300	$ 1,246,420
Securities sold under agreements to repurchase	3,056,238	3,456,781	3,557,308	3,761,121	3,861,411
Other borrowings	463,590	466,130	472,888	373,718	395,441
Securities purchased but not yet received			413,359	398	111,431
	$ 5,915,095	**$ 6,511,799**	**$ 6,189,056**	**$ 5,920,537**	**$ 5,614,703**
Stockholders equity					
Preferred equity	68,000	68,000	68,000	68,000	68,000
Common equity	47,809	47,808	25,739	25,739	25,557
Additional paid-in capital	499,096	498,435	213,445	212,625	210,073
Legal surplus	50,178	46,331	45,279	43,016	40,573
Retained earnings	68,149	51,502	77,584	51,233	45,296
Treasury stock, at cost	(74,808)	(16,732)	(17,142)	(17,109)	(17,023)
Accumulated other comprehensive income (loss)	37,131	36,987	(82,739)	(122,187)	(13,015)
	$ 695,555	**$ 732,331**	**$ 330,166**	**$ 261,317**	**$ 359,461**
Capital ratios					
Leverage capital	**9.65%**	**9.50%**	**6.52%**	**6.38%**	**6.69%**
Tier 1 risk-based capital	**31.56%**	**31.04%**	**18.79%**	**17.11%**	**18.59%**
Total risk-based capital	**32.84%**	**32.32%**	**19.84%**	**17.73%**	**19.06%**
Financial assets managed					
Trust assets managed	$ 2,216,088	$ 2,175,270	$ 1,818,498	$ 1,706,286	$ 1,962,226
Broker-dealer assets gathered	$ 1,926,148	$ 1,695,635	$ 1,269,284	$ 1,195,739	$ 1,281,168
Total assets managed	**$ 4,142,236**	**$ 3,870,905**	**$ 3,087,782**	**$ 2,902,025**	**$ 3,243,394**

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

	Year Ended December 31,				
Consolidated Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends:	**2011**	**2010**	**2009**	**2008**	**2007**
Excluding Interest on Deposits	1.26x	(A)	1.18x	1.07x	1.22x
Including Interest on Deposits	1.19x	(A)	1.13x	1.05x	1.17x

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

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

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

MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2011

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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 or values determined using pricing models. The fair values of certain derivative contracts are derived from pricing models that consider current market and contractual prices for the underlying financial instruments as well as time value and yield curve or volatility factors underlying the positions.

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

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

Level 2	Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on valuations obtained from third-party pricing services for identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments and (iii) derivative contracts and financial liabilities (e.g. callable brokered CDs and medium-term notes elected for fair value option under the fair value measurement framework), whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
Level 3	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, for which the determination of fair value requires significant management judgment or estimation.

Impairment of Investment Securities

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

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

- the identification and evaluation of investments that have indications of possible other-than-temporary impairment;
- the 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 s overall interest rate risk-management strategy 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 (i) receive cash or (ii) 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 has offered 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 that 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.

Loans and Allowance for Loan and Lease Losses

Because of the loss protection provided by the FDIC, the risks of the loans acquired in the FDIC-assisted acquisition of Eurobank that are covered by a shared loss agreement with the FDIC 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 also include credit cards balances acquired in the FDIC-assisted acquisition.

Non-Covered Loans

Non-covered loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for non-covered loan and lease losses, unamortized discount related to mortgage servicing 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.

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.

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 that are either over 90 days past due or adversely classified, or when deemed necessary by management. 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 home equity 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. Home equity loans are mainly equity lines of credit. The allowance factor on these loans is impacted by the historical loss factors on the sub-segments, the environmental risk factors described above and by delinquency buckets.

Commercial loans: In 2011, these loans were 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. 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.

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. 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 through the term of the shared-loss agreements.

Income Taxes

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

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

Management evaluates 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 the applicable statute of limitations.

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

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

On January 31, 2011, the Governor of Puerto Rico signed into law the 2011 Code, which provides for the gradual repeal of the 1994 Code, as its provisions started to take effect, with some exceptions, as of January 1, 2011. For corporate taxpayers, the 2011 Code retains the 20% flat rate on normal-tax net income but establishes significantly lower rates applicable to surtax net income which is the normal-tax net income less the allowed surtax deduction. The 2011 Code provides a surtax rate from 5% to 10% for taxable years commencing after December 31, 2010 and before January 1, 2014. For taxable years commencing after December 31, 2013, the surtax rate may be reduced to 5% if certain economic and budgetary control tests are met by the Government of Puerto Rico. If such economic tests are not met, the reduction of the surtax rate will be postponed until the year when such economic tests are met. In the case of a controlled group of corporations, the determination of which surtax rate applies will be made by adding the normal-tax net income of each of the entities that are members of the controlled group reduced by the surtax deduction. The 2011 Code also increased the surtax deduction to $750,000. In the case of a controlled group of corporations, the surtax deduction should be distributed among the members of the controlled group. The 2011 Code reduces the AMT from 22% to 20%. It also eliminates the 5% additional surtax which was established by Act No. 7 of March 9, 2009, and the 5% recapture of the benefit of the income tax tables, except for the income earned by international banking entities, which was fully exempt and is subject to a 5% income tax for the taxable years beginning after December 31, 2008 and ending before January 1, 2012. Under the 2011 Code, a corporate taxpayer has a one-time option of determining its income tax liability and filing its income tax return pursuant to the 1994 Code. 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. The Group decided to implement the 2011 Code. Under the 2011 Code, all companies are treated as separate taxable entities and are not entitled to file consolidated returns. The Group and its subsidiaries are subject to Puerto Rico regular income tax or AMT on income earned from all sources. The AMT is payable if it exceeds regular income tax. The excess of AMT over regular income tax paid in any one year may be used to offset regular income tax in future years, subject to certain limitations.

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

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

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

A transfer of financial assets (all or a portion of the financial asset) in which the Group surrenders control over these financial assets will be accounted for as a sale to the extent that consideration, other than beneficial interests in the transferred assets, is received in exchange. The Group has surrendered control over transferred assets if all of the following conditions are met:

a. The transferred assets have been isolated from the Group put presumptively beyond the reach of the Group and its creditors even in bankruptcy or other receivership.

b. Each transferee has the right to pledge or exchange the assets it received and no condition both constrains the transferee from taking advantage of its rights to pledge or exchange and provided more than a deminimis benefit to the Group.

c. The Group does not maintain effective control over the transferred assets through either (1) an agreement that both entitles and obligates the Group to repurchase or redeem them before their maturity or (2) the ability to unilaterally cause the holder to return specific assets other than through a cleanup call.

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

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

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 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 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, FASB 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 FASB 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 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 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.

OVERVIEW OF FINANCIAL PERFORMANCE

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

The Group is a publicly-owned financial holding company that provides a full range of banking and wealth management services through its subsidiaries. It provides comprehensive banking and wealth management services through a complete range of banking and financial solutions, including mortgage, commercial and consumer lending; leasing; checking and savings accounts; financial planning, insurance, wealth management, and investment brokerage; and corporate and individual trust and retirement services. The Group operates through three major business segments: Banking, Wealth Management, and Treasury, and distinguishes itself based on quality service and marketing efforts focused on mid and high net worth individuals and families, including professionals and owners of small and mid-sized businesses, primarily in Puerto Rico. The Group has 30 financial centers in Puerto Rico and a subsidiary in Boca Raton, Florida. The Group s long-term goal is to strengthen its banking and wealth management franchise by expanding its lending businesses, increasing the level of integration in the marketing and delivery of banking and wealth management services, maintaining effective asset-liability management, growing non-interest revenues from banking and wealth management services, and improving operating efficiencies.

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

During the year ended December 31, 2011, the Group continued to perform well despite the turbulent credit market and the economic recession in Puerto Rico. The Group selectively reduced its use of wholesale funding, while increasing interest income from loans and core banking and wealth management revenues. In addition, the FDIC-assisted Eurobank acquisition, which was fully integrated in 2011, is becoming more accretive than originally expected by the Group.

Operating revenues for the year ended December 31, 2011, increased 22.2% or $31.1 million to $171.4 million from the year ended December 31, 2010. Following is a tabular presentation of the Group s operating revenues for each of the three years in the period ended December 31, 2011.

		December 31,	
	2011	**2010**	**2009**
		(In thousands)	
OPERATING REVENUES			
Net interest income	$ 140,442	$ 135,132	$ 130,758
Non-interest income (loss), net	30,989	5,198	(1,813)
Total operating revenues	**$ 171,431**	**$ 140,330**	**$ 128,945**

Interest Income

Total interest income for the year ended December 31, 2011 decreased 2.2%, as compared to the same period in 2010, to $297.0 million. Such decrease from 2010 primarily reflects a 14.5% decrease on interest income from investments, related to an increase in premium amortization due to the decline in interest rates that caused an increase in prepayment speeds, and lower balance in the investment securities portfolio. Excluding a $1.8 million negative adjustment to interest income from non-covered residential mortgage loans as certain interest receivable accrued in prior years was deemed to be uncollectible during the second quarter of 2011, interest income from non-covered loans remained level.

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

Interest Expense

Total interest expense for the year ended December 31, 2011 fell 7.2%, to $156.6 million as compared to the same period in 2010. This reflects both lower cost of deposits (1.87% vs. 2.12%) and of securities sold under agreements to repurchase (2.73% vs. 2.84%).

Net Interest Income

Net interest income for the year ended December 31, 2011 was $140.4 million, up 3.9% from the same period in 2010. Such increase from 2010 primarily reflects a 17.8% increase in interest income from loans, mainly as a result of the continued improved performance of covered loans and growth of the Group s non-covered commercial, auto leasing and consumer loan portfolio.

Net interest margin of 2.17% for the year ended December 31, 2011 increased 6 basis points from the same period in 2010.

Provision for Loan and Lease Losses

Provision for non-covered loans for the year ended December 31, 2011 decreased 4.5% as compared to the same period in 2010. Recapture for covered loans for the year ended December 31, 2011 was $1.4 million. This recapture is mainly due to an improvement in expected cash flows on the loan portfolio acquired in the FDIC-assisted acquisition of Eurobank.

Non-Interest Income

The Group s niche market approach to the integrated delivery of services to mid and high net worth clients performed well as the Group expanded market share in light of the FDIC-assisted acquisition and the Group s service proposition and capital strength, as opposed to using rates to attract loans or deposits. During the year ended December 31, 2011, core banking and wealth management revenues increased 12.5% to $44.2 million as compared to the same period in 2010, primarily reflecting a $2.9 million increase in wealth management revenues to $20.6 million and a $2.0 million increase in banking service revenues to $13.8 million.

The Group recorded an other than temporary impairment of $15.0 million on a $26.0 million collateralized debt obligation. This security was later sold in January 2012 and no additional gain or loss was realized on the sale, since this asset was sold at the same value reflected at December 31, 2011.

The net amortization of the FDIC loss-share indemnification asset of $3.4 million for the year ended December 31, 2011, compared to net accretion of $4.3 million for the same period in 2010, resulted from the ongoing evaluation of expected cash flows of the loan portfolio acquired in the FDIC-assisted acquisition of Eurobank, which resulted in reduced losses expected to be collected from the FDIC and the improved re-yielding of the accretable yield on the covered loans. This reduction in claimable losses amortizes the loss-share indemnification asset at a rate that mirrors the aforementioned re-yielding on the covered loans. This amortization is net of the accretion of the discount recorded to reflect the expected claimable loss at its net present value.

Results for the year also include a $27.9 million gain on the sale of investment securities with a book value of $592.3 million as the Group took advantage of market opportunities. This was partially offset by losses of $13.2 million in derivative activities and a $4.8 million loss on the early extinguishment of a $100 million repurchase agreement.

During the year ended December 31, 2011, losses of $13.2 million were recognized and reflected as Derivative Activities in the consolidated statements of operations. These losses were mainly due to realized losses of $4.3 million from terminations of forward-settlement swaps with a notional amount of $1.25 billion, and to realized losses of $2.2 million from terminations of options to enter into interest rate swaps that were purchased in November 2010 with a notional amount of $250 million. These terminations allowed the Group to enter into new forward-settlement swap contracts with a notional amount of $1.2 billion, all of which were designated as hedging instruments. In May 2011, the Group entered into forward-settlement swap contracts with a notional amount of $475 million, all of which were also designated as hedging instruments. Prior to the acquisition of the new forward-settlement swap contracts, these derivatives were not being designated for hedge accounting. In December 2011, $600 million in repurchase agreement funding with an average cost of 4.23% matured. Utilizing cash on hand and proceeds from the sale of approximately $77 million of mortgage backed securities, the Group paid off $300 million of these repurchase agreements. The remaining balance of $300 million was renewed for an average period of approximately three and a half years at an effective fixed rate of 2.36%. These transactions enabled the Group to eliminate $300 million in wholesale funding, reduce cost of funds on an additional $300 million of borrowings, and deploy cash at a significantly higher return, all of which is expected to generate approximately $13 million more in net interest income on an annualized basis. During the year ended December 31, 2010, losses of $36.8 million were recognized and reflected as Derivative Activities in the consolidated statements of operations. These losses included realized losses of $42.0 million due to the terminations of forward settlement swaps with a notional amount of $900.0 million. These terminations allowed the Group to enter into new forward-settlement swap contracts with the same notional amount and maturity, and effectively reduce the interest rate of the pay-fixed side of such deals.

Non-Interest Expenses

Non-interest expenses increased 8.6% to $122.3 million for the year ended December 31, 2011, compared to $112.6 million in the previous year, largely due to the integration of Eurobank operations which contained a full year of operations in 2011 as opposed to eight months in 2010, resulting in an efficiency ratio of 66.22% for the year ended December 31, 2011 (compared to 64.54% for the year ended December 31, 2010).

Income Tax Expense (Benefit)

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

Income Available (Loss) to Common Shareholders

For the year ended December 31, 2011, the Group s income available to common shareholders totaled $29.6 million, compared to a loss to common shareholders of $18.2 million a year-ago. Earnings per basic and fully diluted common share were $0.67, for the year ended December 31, 2011, compared to loss per basic and fully diluted common share of $0.50 for the year ended December 31, 2010.

Interest Earning Assets

The investment portfolio amounted to $3.868 billion at December 31, 2011, a 12.4% decrease compared to $4.414 billion at December 31, 2010, while the loan portfolio decreased 5.8% to $1.670 billion at December 31, 2011, compared to $1.773 billion at December 31, 2010. The decrease in the investment portfolio reflects a reduction of 20.0%, or $740.2 million, in the available-for-sale portfolio, due to the sale of approximately $592.3 million in investment securities and the maturity of FNMA and FHLMC certificates, which was partially offset by an increase of 28.1%, or $194.1 million, in the held-to-maturity portfolio. The decrease in the loan portfolio is due to a decrease in covered loans of 20.0% as they continue to pay down, which was partially offset by an increase of 1.9% in non-covered loans.

In early January 2012, the Group made the strategic decision to sell a $26.0 million collateralized debt obligation at a loss of $15.0 million. This loss was accounted for as other-than-temporary impairment in the fourth quarter of 2011 and no additional gain or loss was realized on the sale in January 2012, since this asset was sold at the same value reflected at December 31, 2011.

Interest Bearing Liabilities

Total deposits amounted to $2.395 billion at December 31, 2011, a decrease of 7.5% compared to $2.589 billion at December 31, 2010. Core retail deposits, which exclude institutional and brokered deposits, remained approximately level compared to December 31, 2010, while wholesale deposits decreased 24.2% as higher cost deposits matured during the year. Interest-bearing savings and demand deposits increased 2.2%, while retail deposits decreased 20.8%.

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

Stockholders Equity

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

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

Book value per share was $15.22 at December 31, 2011 compared to $14.33 at December 31, 2010.

The Group maintains capital ratios in excess of regulatory requirements. At December 31, 2011, Tier 1 Leverage Capital Ratio was 9.65% (2.41 times the requirement of 4.00%), Tier 1 Risk-Based Capital Ratio was 31.56% (7.89 times the requirement of 4.00%), and Total Risk-Based Capital Ratio was 32.84% (4.11 times the requirement of 8.00%).

Return on Average Assets and Common Equity

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

Assets Under Management

Assets managed by the trust division, the pension plan administration subsidiary, and the broker-dealer subsidiary increased from $3.871 billion as of December 31, 2010 to $4.142 billion as of December 31, 2011. The Group s trust division offers various types of individual retirement accounts (IRA) and manages 401(k) and Keogh retirement plans and custodian and corporate trust accounts, while CPC manages the administration of private retirement plans. At December 31, 2011, total assets managed by the Group s trust division and CPC amounted to $2.216 billion, compared to $2.175 billion at December 31, 2010. At December 31, 2011, total assets managed by the broker-dealer from its customer investment accounts increased to $1.926 billion, compared to $1.696 billion at December 31, 2010.

Lending

Total loan production and purchases of $396.0 million for the year remained strong compared to $371.6 million in the previous year, as the Group s capital levels and low credit losses enabled it to continue prudent lending. The Group sells most of its conforming mortgages in the secondary market, and retains servicing rights. As a result, mortgage banking activities now reflect originations as well as a growing servicing portfolio, a source of recurring revenue.

Mortgage loan production (including purchases) for the year ended December 31, 2011 of $212.8 million decreased 13.2% from the same period in 2010. Commercial loan production for the year ended December 31, 2011 of $139.8 million increased 38.3% from the same period in 2010. Leasing and consumer loans production for the year ended December 31, 2011 totaled $43.4 million, up 70.9% from the same period in 2010.

On April 1, 2011, the Bank changed on a prospective basis its policy to place on non-accrual status residential mortgage loans well collateralized and in process of collection when reaching 90 days past due. All loans that were between 90 and 365 days past due when the policy was changed were also placed on non-accrual status, and the interest receivable on such loans was evaluated on a periodic basis against the collateral underlying the loans, and written-down, if necessary. On December 31, 2011, the Bank further revised its policy to reverse against income all interest recorded on residential mortgage loans reaching 90 days past due including the remaining interest on loans that were between 90 and 365 days past due as of April 1, 2011. On December 31, 2011 the Bank also charged-off this remaining accrued interest on residential mortgage loans over 90 days past due. This change in estimate was considered necessary to comply with guidance received from the Group s regulators. 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. Additionally, in December 2011 the Group recorded a $2.4 million loss on the write-down of interest receivable on delinquent non-covered residential mortgage loans.

Credit Quality on Non-Covered Loans

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

NPLs increased 9.7% or $12.0 million in the year. The Group s NPLs generally reflect the recessionary economic environment in Puerto Rico. Nonetheless, the Group does not expect NPLs to result in significantly higher losses as most are well-collateralized with adequate loan-to-value ratios. In residential mortgage lending, more than 90% of the Group s portfolio consists of fixed-rate, fully amortizing, fully documented loans that do not have the level of risk generally associated with subprime loans. In commercial lending, more than 90% of all loans are collateralized by real estate. Covered loans are considered to be performing due to the application of the accretion method under ASC 310-30, as discussed in Note 2 to the consolidated financial statements.

Non-GAAP Measures

From time to time, the Group uses certain non-GAAP measures of financial performance to supplement the financial statements presented in accordance with GAAP. The Group presents non-GAAP measures when its management believes that the additional information is useful and meaningful to investors. Non-GAAP measures do not have any standardized meaning and are therefore unlikely to be comparable to similar measures presented by other companies. The presentation of non-GAAP measures is not intended to be a substitute for, and should not be considered in isolation from, the financial measures reported in accordance with GAAP.

The Group s management has reported and discussed the results of operations herein both on a GAAP basis and on a pre-tax operating income basis (defined as net interest income, less provision for loan and lease losses, plus banking and wealth management revenues, less non-interest expenses, and calculated on the accompanying table). The Group s management believes that, given the nature of the items excluded from the definition of pre-tax operating income, it is useful to state what the results of operations would have been without them so that investors can see the financial trends from the Group s continuing business.

Tangible common equity consists of common equity less goodwill and core deposit intangibles. Management believes that the ratios of tangible common equity to total assets and to risk-weighted assets assist investors in analyzing the Group s capital position.

Pre-tax operating income of approximately $48.6 million increased 22.5% compared to $39.7 million in the previous year. Pre-tax operating income is calculated as follows:

	2011	December 31, 2010 (In thousands)	2009
PRE-TAX OPERATING INCOME			
Net interest income	$ 140,442	$ 135,132	$ 130,758
Less: Provision for non-covered loan and lease losses	(15,200)	(15,914)	(15,650)
Plus/(Less): Recapture of (provision for) covered loan and lease losses, net	1,387	(6,282)	
	126,629	**112,936**	**115,108**
Core non-interest income:			
Wealth management revenues	20,571	17,967	14,469
Banking service revenues	13,788	11,797	5,942
Mortgage banking activities	9,876	9,554	9,728
Total core non-interest income	**44,235**	**39,318**	**30,139**
Less: Non-interest expenses	(122,302)	(112,598)	(83,378)
Total pre-tax operating income	**$ 48,562**	**$ 39,656**	**$ 61,869**

At December 31, 2011, tangible common equity to total assets was 9.32% compared to 9.03% at December 31, 2010. Tangible common equity to risk-weighted assets and total equity to risk-weighted assets at December 31, 2011 increased to 29.75% and 33.18%, respectively, from 29.30% and 32.50% at December 31, 2010.

Comparison of the years ended December 31, 2010 and 2009

Highlights of the year ended December 31, 2010 compared to December 31, 2009 included:

Pre-tax operating income of approximately $39.7 million decreased $35.9 million from $61.9 million in the previous year.

With the FDIC-assisted acquisition on April 30, 2010, the Group added total loans with a fair value of $785.9 million. In addition to these loans, the Group acquired $10.1 million in Federal Home Loan Bank stock, foreclosed real estate and other repossessed properties of $16.6 million and recorded an FDIC loss-share indemnification asset of $545.2 million.

Net credit impairment of $6.3 million, attributable to various pools of loans covered under the shared-loss agreements with the FDIC, was recorded during the quarter ended December 31, 2010.

Net interest income increased 3.3%, to $135.1 million, due to an improvement in the net interest spread to 2.17% from 2.00%, primarily reflecting the addition of covered loans from the FDIC-assisted acquisition. In addition, the Group paid off a 4.39%, $100.0 million repurchase agreement that matured on August 16, 2010 and redeemed the $595.0 million remaining balance of its 0.88% note to the FDIC, which originated as part of the FDIC-assisted acquisition.

Core banking and wealth management revenues increased 30.5%, to $39.3 million, primarily reflecting a $5.8 million increase in banking service revenues, to $11.8 million and a $3.5 million increase in wealth management revenues, to $18.0 million.

Retail deposits, reflecting growth in both Group customers and core deposits assumed on the FDIC-assisted acquisition, grew 44.2% or $621.6 million, to $2.0 billion, enabling the Group to reduce higher cost deposits.

Non-interest expenses increased 8.6%, to $112.6 million, largely the result of expenses associated with the former Eurobank operations.

Results for the year also include gains on sales of agency securities of $15.0 million, and losses in derivative activities of $36.9 million.

Strategic decision in December 2010 to sell the remaining balance of the BALTA private label collateralized mortgage obligation (CMO). The proceeds from such sale amounted to approximately $63.5 million, which were slightly higher than the $63.2 million fair value at which this instrument was carried in the Group s books. This $300,000 difference represents a positive effect on stockholders equity of this transaction for the Group. A loss of $22.8 million was recorded in the fourth quarter of 2010 for the difference between the amortized cost and the sales price.

In early January 2010, the Group sold $374.3 million of non-agency CMOs at a loss of $45.8 million. This loss was accounted for as other-than-temporary impairment in the fourth quarter of 2009 and no additional gain or loss was realized on the sale in January 2010, since these assets were sold at the same value reflected at December 31, 2009.

After giving effect to these transactions approximately 98% of the Group s investment securities portfolio consist of fixed-rate mortgage-backed securities or notes, guaranteed or issued by FNMA, FHLMC or GNMA, and U.S. agency senior debt obligations, backed by a U.S. government sponsored entity or the full faith and credit of the U.S. government. This compares to 89% at December 31, 2009.

Stockholders equity increased $402.2 million, or 121.8%, to $732.3 million, at December 31, 2010, compared to a year ago. This increase reflects capital raises of $94.5 million in March 2010 and $189.4 million in April 2010, the net income for the year, and an improvement of approximately $119.7 million in the fair value of the investment securities portfolio.

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 $94.5 million after deducting offering costs. The Group made a capital contribution of $93.0 million to its banking subsidiary.

On April 30, 2010, the Group issued 200,000 shares of Series C Preferred Stock, through a private placement. The preferred stock had a liquidation preference of $1,000 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. At a special meeting of shareholders of the Group held on June 30, 2010, 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. The difference between the $15.015 per share conversion price 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 shareholders. Such feature amounted to $22.7 million at June 30, 2010 and was recorded as a dividend of preferred stock.

ANALYSIS OF RESULTS OF OPERATIONS

TABLE 1 YEAR-TO-DATE ANALYSIS OF NET INTEREST

INCOME AND CHANGES DUE TO VOLUME/RATE

For the Years Ended December 31, 2011 and 2010

	Interest		Average rate		Average balance	
	December 2011	December 2010	December 2011	December 2010	December 2011	December 2010
			(Dollars in thousands)			
A TAX EQUIVALENT SPREAD						
Interest-earning assets	$ 297,028	$ 303,801	4.60%	4.74%	$ 6,463,294	$ 6,412,468
Tax equivalent adjustment	79,002	99,071	1.22%	1.54%		
Interest-earning assets tax equivalent	**376,030**	**402,872**	**5.82%**	**6.28%**	**6,463,294**	**6,412,468**
Interest-bearing liabilities	156,586	168,669	2.48%	2.57%	6,317,970	6,561,223
Tax equivalent net interest income/spread	**219,444**	**234,203**	**3.34%**	**3.71%**	**145,324**	**(148,755)**
Tax equivalent interest rate margin			**3.40%**	**3.65%**		
B NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	159,924	187,930	3.73%	4.03%	4,283,404	4,661,483
Trading securities		6	0.00%	2.11%	740	284
Money market investments	1,106	397	0.25%	0.42%	437,013	93,943
	161,030	**188,333**	**3.41%**	**3.96%**	**4,721,157**	**4,755,710**
Loans not covered under shared-loss agreements with the FDIC:						
Mortgage	49,065	56,406	5.62%	6.11%	872,966	923,345
Commercial	14,564	12,022	5.72%	5.83%	254,617	206,090
Leasing	1,498	319	8.81%	6.22%	16,996	5,129
Consumer	3,206	2,563	8.17%	9.24%	39,233	27,735
	68,333	**71,310**	**5.77%**	**6.14%**	**1,183,812**	**1,162,299**
Loans covered under shared-loss agreements with the FDIC:						
Loans secured by residential properties	15,880	10,029	9.58%	7.66%	165,681	130,848
Commercial and construction	41,829	23,331	13.05%	8.36%	320,490	278,808
Leasing	8,419	9,280	14.49%	13.11%	58,088	70,770
Consumer	1,537	1,518	10.93%	10.82%	14,066	14,033
	67,665	**44,158**	**12.12%**	**8.93%**	**558,325**	**494,459**
Total Loans	**135,998**	**115,468**	**7.81%**	**6.97%**	**1,742,137**	**1,656,758**
Total interest earning assets	**297,028**	**303,801**	**4.60%**	**4.74%**	**6,463,294**	**6,412,468**
Interest-bearing liabilities:						
Deposits:						
Non-interest bearing deposits			0.00%	0.00%	171,304	136,738
Now accounts	12,533	14,826	1.61%	2.14%	780,430	692,906
Savings and money market	3,476	3,055	1.43%	1.67%	243,896	182,973
Individual retirement accounts	9,921	10,604	2.76%	3.16%	358,809	335,323
Retail certificates of deposits	10,196	10,610	2.33%	2.64%	437,519	402,318

Total retail deposits	**36,126**	**39,095**	**1.81%**	**2.23%**	**1,991,958**	**1,750,258**
Institutional deposits	3,706	4,737	1.76%	1.35%	210,574	350,807
Brokered deposits	5,813	4,771	2.49%	2.54%	233,337	188,102
Total wholesale deposits	**9,519**	**9,508**	**2.14%**	**1.76%**	**443,911**	**538,909**
	45,645	**48,603**	**1.87%**	**2.12%**	**2,435,869**	**2,289,167**
Borrowings:						
Securities sold under agreements to repurchase	93,279	100,609	2.73%	2.84%	3,417,892	3,545,926
Advances from FHLB and other borrowings	12,347	12,248	3.83%	3.77%	322,480	324,847
FDIC-guaranteed term notes	4,084	4,084	3.87%	3.87%	105,646	105,597
Purchase money note issued to the FDIC		1,887		0.73%		259,603
Subordinated capital notes	1,231	1,238	3.41%	3.43%	36,083	36,083
	110,941	**120,066**	**2.86%**	**2.81%**	**3,882,101**	**4,272,056**
Total interest bearing liabilities	**156,586**	**168,669**	**2.48%**	**2.57%**	**6,317,970**	**6,561,223**
Net interest income/spread	**$ 140,442**	**$ 135,132**	**2.12%**	**2.17%**		
Interest rate margin			**2.17%**	**2.11%**		
Excess of average interest-earning assets over average interest-bearing liabilities (excess of average interest-bearing liabilities over average interest-earning assets)					**$ 145,325**	**$ (148,755)**
Average interest-earning assets to average interest-bearing liabilities ratio					**102.30%**	**97.73%**

C CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
Interest Income:			
Investments	$ (1,368)	$ (25,935)	$ (27,303)
Loans	7,024	13,506	20,530
	5,656	**(12,429)**	**(6,773)**
Interest Expense:			
Deposits	3,115	(6,073)	(2,958)
Repurchase agreements	(3,633)	(3,697)	(7,330)
Other borrowings	(1,974)	179	(1,795)
	(2,492)	**(9,591)**	**(12,083)**
Net Interest Income	**$ 8,148**	**$ (2,838)**	**$ 5,310**

TABLE 1A ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE:

For the Years Ended December 31, 2010 and 2009

	Interest		Average rate		Average balance	
	December 2010	December 2009	December 2010	December 2009	December 2010	December 2009
			(Dollars in thousands)			
A TAX EQUIVALENT SPREAD						
Interest-earning assets	$ 303,801	$ 319,480	4.74%	5.22%	$ 6,412,468	$ 6,117,104
Tax equivalent adjustment	99,071	105,407	1.54%	1.72%		
Interest-earning assets tax equivalent	**402,872**	**424,887**	**6.28%**	**6.94%**	**6,412,468**	**6,117,104**
Interest-bearing liabilities	168,669	188,722	2.57%	3.22%	6,561,223	5,859,249
Tax equivalent net interest income/spread	**234,203**	**236,165**	**3.71%**	**3.72%**	**(148,755)**	**257,855**
Tax equivalent interest rate margin			**3.65%**	**3.65%**		
B NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	187,930	244,815	4.03%	5.11%	4,661,483	4,792,378
Trading securities	6	940	2.11%	3.69%	284	25,441
Money market investments	397	570	0.42%	0.47%	93,943	120,395
	188,333	**246,325**	**3.96%**	**4.99%**	**4,755,710**	**4,938,214**
Loans not covered under shared-loss agreements with the FDIC:						
Mortgage	56,406	60,743	6.11%	6.27%	923,345	968,400
Commercial	12,022	10,437	5.83%	5.49%	206,090	189,951
Leasing	319		6.22%		5,129	
Consumer	2,563	1,975	9.24%	9.62%	27,735	20,539
	71,310	**73,155**	**6.14%**	**6.21%**	**1,162,299**	**1,178,890**
Loans covered under shared-loss agreements with the FDIC:						
Loans secured by residential properties	10,029		7.66%		130,848	
Commercial and construction	23,331		8.37%		278,808	
Leasing	9,280		13.11%		70,770	
Consumer	1,518		10.82%		14,033	
	44,158		**8.93%**		**494,459**	
Total Loans	**115,468**	**73,155**	**6.97%**	**6.21%**	**1,656,758**	**1,178,890**
Total interest earning assets	**303,801**	**319,480**	**4.74%**	**5.22%**	**6,412,468**	**6,117,104**
Interest-bearing liabilities:						
Deposits:						
Non-interest bearing deposits			0.00%	0.00%	136,738	46,750
Now accounts	14,826	17,205	2.14%	2.92%	692,906	588,219
Savings and money market	3,055	910	1.67%	1.43%	182,973	63,439
Individual retirement accounts	10,604	10,452	3.16%	3.44%	335,323	303,811
Retail certificates of deposits	10,610	9,916	2.64%	3.75%	402,318	264,088
Total retail deposits	**39,095**	**38,483**	**2.23%**	**3.04%**	**1,750,258**	**1,266,307**
Institutional deposits	4,737	5,297	1.35%	3.51%	350,807	150,925

Brokered deposits	4,771	11,167	2.54%	3.40%	188,102	328,810
Total wholesale deposits	**9,508**	**16,464**	**1.76%**	**3.43%**	**538,909**	**479,735**
	48,603	**54,947**	**2.12%**	**3.15%**	**2,289,167**	**1,746,042**
Borrowings:						
Securities sold under agreements to repurchase	100,609	116,755	2.84%	3.19%	3,545,926	3,659,442
Advances from FHLB and other borrowings	12,248	12,380	3.77%	3.76%	324,847	328,969
FDIC-guaranteed term notes	4,084	3,175	3.87%	3.58%	105,597	88,713
Purchase money note issued to the FDIC	1,887		0.73%		259,603	
Subordinated capital notes	1,238	1,465	3.43%	4.06%	36,083	36,083
	120,066	**133,775**	**2.81%**	**3.25%**	**4,272,056**	**4,113,207**
Total interest bearing liabilities	**168,669**	**188,722**	**2.57%**	**3.22%**	**6,561,223**	**5,859,249**
Net interest income/spread	**$ 135,132**	**$ 130,758**	**2.17%**	**2.00%**		
Interest rate margin			**2.11%**	**2.14%**		
Excess of average interest-earning assets over average interest-bearing liabilities (excess of average interest-bearing liabilities over average interest-earning assets)					**$ (148,755)**	**$ 257,855**
Average interest-earning assets to average interest-bearing liabilities ratio					**97.73%**	**104.40%**

C CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
Interest Income:			
Investments	$ (9,104)	$ (48,888)	$ (57,992)
Loans	43,128	(815)	42,313
	34,024	**(49,703)**	**(15,679)**
Interest Expense:			
Deposits	17,092	(23,436)	(6,344)
Repurchase agreements	(3,622)	(12,524)	(16,146)
Other borrowings	2,366	71	2,437
	15,836	**(35,889)**	**(20,053)**
Net Interest Income	**$ 18,188**	**$ (13,814)**	**$ 4,374**

Net Interest Income

Comparison of the years ended December 31, 2011 and 2010

Net interest income is a function of the difference between rates earned on the Group s interest-earning assets and rates paid on its interest-bearing liabilities (interest rate spread) and the relative amounts of its interest-earning assets and interest-bearing liabilities (interest rate margin). As further discussed in the Risk Management section of this MD&A, the Group constantly monitors the composition and re-pricing of its assets and liabilities to maintain its net interest income at adequate levels. Table 1 shows the major categories of interest-earning assets and interest-bearing liabilities, their respective interest income, expenses, yields and costs, and their impact on net interest income due to changes in volume and rates for the years ended December 31, 2011 and 2010.

Net interest income amounted to $140.4 million for the year ended December 31, 2011, an increase of 3.9% from $135.1 million for the same period in 2010. These changes reflect an increase of 17.8% in interest income from loans for the year ended December 31, 2011, as compared to the same period in 2010.

Interest rate spread decreased 5 basis points to 2.12% for the year ended December 31, 2011 from 2.17% in the year ended December 31, 2010. This decrease reflects a 14 basis point decrease in the average yield of interest earning assets to 4.60% in the year ended December 31, 2011 from 4.74% for the same period in 2010, partially offset by a 9 basis point decrease in the average cost of funds to 2.48% in the year ended December 31, 2011 from 2.57% for the same period in 2010, as further explained below.

The decrease in interest income for the year was primarily the result of a decrease of $12.4 million in interest rate variance, and was partially offset by a $5.7 million increase in interest-earning assets volume variance. Interest income from loans increased 17.8% to $136.0 million for the year ended December 31, 2011, mainly due to the continued improved performance of covered loans. Interest income on investments decreased 14.5% to $161.0 million for the year ended December 31, 2011, compared to $188.3 million for the same period in 2010, reflecting an increase in premium amortization due to the decline in interest rates that caused an increase in prepayment speeds, and lower balance in the investment securities portfolio.

Interest expense decreased 7.2% reaching $156.6 million for the year ended December 31, 2011. This decrease was primarily the result of a $9.6 million decrease in interest rate variance, and a $2.5 million decrease in interest-earning liabilities volume variance. These decreases are due to a reduction in the cost of funds, which decreased 9 basis points to 2.48% from the previous year. The cost of deposits decreased by 25 basis points to 1.87% compared to 2.12% for the same period in 2010.

For the year ended December 31, 2011, the average balance of total interest-earning assets was $6.463 billion, a 0.8% increase from the same period in 2010. This increase in average balance of interest-earning assets was mainly attributable to a 5.2% increase in average loans, partially offset by a 0.7% decrease in average investments. As of December 31, 2011, the Group had $605.5 million in cash and cash equivalents versus $448.9 million as of December 31, 2010.

For the year ended December 31, 2011, the average yield on interest-earning assets was 4.60% compared to 4.74% for the same period in 2010. This was mainly due to a decrease in the investment portfolio yield to 3.41% versus 3.96% for the same period in 2010. However, this was offset by the higher average yields in the loan portfolio, mainly due to the covered loans acquired in the FDIC-assisted acquisition with an average yield of 12.12% for the year ended December 31, 2011 compared to 8.93% for the same period in 2010.

Comparison of the years ended December 31, 2010 and 2009

Table 1A shows the major categories of interest-earning assets and interest-bearing liabilities, their respective interest income, expenses, yields and costs, and their impact on net interest income due to changes in volume and rates for the years ended December 31, 2010 and 2009.

Net interest income amounted to $135.2 million for the year ended December 31, 2010, an increase of 3.1% from $131.0 million in the same period of 2009. The increase for the year 2010 reflects a 10.5% decrease in interest expense, due to a negative rate variance of interest-bearing liabilities of $27.5 million, partially offset by a positive volume variance of interest-bearing liabilities of $7.6 million. The decrease of 4.9% in interest income for the year ended December 31, 2010 was primarily the result of a decrease of $49.7 million in rate variance, partially offset by an increase of $34.0 million in volume variance. Interest rate spread increased 17 basis points to 2.17% for the year ended December 31, 2010 from 2.0% for the same period of 2009. This increase reflects a 65 basis point decrease in the average cost of funds to 2.57% for the year ended December 31, 2010 from 3.22% for the same period of 2009, partially offset by a 48 basis point decrease in the average yield of interest earning assets to 4.74% for the year ended December 31, 2010 from 5.22% for the same period of 2009.

Interest income decreased 4.9% to $303.8 million for the year ended December 31, 2010, as compared to $319.5 million for the period of 2009, reflecting the decrease in yields. Interest income is generated by investment securities, which accounted for 62.0% of total interest income, and from loans, which accounted for 38.0% of total interest income. Interest income from investments decreased 23.5% to $188.3 million, due to a decrease in yield of 103 basis points from 4.99% to 3.96%. Decline of $36.5 million during the current year in interest income from mortgage-backed securities was primarily due to higher premium amortization, reflecting increases in pre-payment as well as lower average yield on recently purchased securities. Interest income from loans increased 57.8% to $115.5 million, mainly due to the contribution of loans acquired.

On April 30, 2010, the Bank acquired certain assets with a book value of $1.690 billion and a fair value of $909.9 million and assumed certain deposits and other liabilities with a book value of $731.9 million and a fair value of $739.0 million in the FDIC-assisted acquisition of Eurobank. Considering covered loans, the loan portfolio yield increased from 6.21% in 2009 to 6.97% in 2010.

Interest expense decreased 10.5%, to $168.6 million for the year ended December 31, 2010, from $188.5 million for the same period of 2009. The decrease is due to a significant reduction in cost of funds, which decreased 65 basis points from 3.22% to 2.57%. Reduction in the cost of funds is mostly due to a reduction in the rate paid on deposits, mainly due to the certificates of deposit assumed in the FDIC-assisted acquisition, which were recorded at fair value at the acquisition date. In addition, the reduction in cost of funds was also affected by the maturity of $100.0 million in securities sold under agreements to repurchase that occurred in August 2010. For the year 2010 the cost of deposits decreased 101 basis points to 2.12%, as compared to the period of 2009. For the year 2010 the cost of borrowings decreased 44 basis points to 2.81% from 3.25% in the same period of 2009. The net interest income also benefitted from a reduction in the interest expense with reductions of $13.7 million in securities sold under agreements to repurchase, and $6.2 million on deposits.

TABLE 2 NON-INTEREST INCOME (LOSS) SUMMARY

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010, AND 2009

	December 31,			
	2011	2010	Variance %	2009
	(Dollars in thousands)			
Wealth management revenues	$ 20,571	$ 17,967	14.5%	$ 14,469
Banking service revenues	13,788	11,797	16.9%	5,942
Mortgage banking activities	9,876	9,554	3.4%	9,728
Total banking and wealth management revenues	44,235	39,318	12.5%	30,139
Total other-than-temporarily impaired securities	(15,018)	(39,674)	62.1%	(101,472)
Portion of loss on securities recognized in other comprehensive income		22,508	100.0%	41,398
Other-than-temporary impairments on securities	(15,018)	(17,166)	12.5%	(60,074)
Net (amortization) accretion of FDIC shared-loss indemnification asset	(3,379)	4,330	178.0%	
Fair value adjustment on FDIC equity appreciation instrument		909	100.0%	
Net gain (loss) on:				
Sale of securities	27,996	15,032	86.2%	4,385
Derivatives	(13,220)	(36,823)	64.1%	29,181
Early extinguishment of repurchase agreements	(4,790)		100.0%	(17,551)
Trading securities	(15)	23	165.2%	12,564
Foreclosed real estate	(1,717)	(524)	227.7%	(570)
Other	(3,103)	99	3234.3%	113
	(13,246)	(34,120)	61.2%	(31,952)
Total non-interest income (loss), net	**$ 30,989**	**$ 5,198**	**496.2%**	**$ (1,813)**

Non-Interest Income

Comparison of the years ended December 31, 2011 and 2010

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

As shown in Table 2, the Group recorded non-interest income in the amount of $31.0 million for the year ended December 31, 2011, compared to $5.2 million during 2010, an increase of $25.8 million. This increase is mainly related to the effect of a decrease of $23.6 million in losses on derivatives activities, and an increase of $13.0 million in gain on sale of securities. During the year ended December 31, 2011, the Group recorded $13.2 million in derivative losses, primarily as a result of the strategic decision to sell its remaining swap options. Following the sale, the Group entered into new swaps to manage interest rate risk with an aggregate notional amount of $1.425 billion designated as cash flow hedges. In December 2011, the Group cancelled $300 million of these cash flow hedges as the forecasted transaction was not deemed probable of occurring. This transaction resulted in a loss which is included in the previously mentioned loss on derivatives activities. An unrealized loss of $47.4 million was recognized in accumulated other comprehensive income related to the valuation of the remaining swaps which are deemed to be in effect at December 31, 2011.

Wealth management revenues, which consist of commissions and fees from fiduciary activities, and commissions and fees from securities brokerage and insurance activities, increased 14.5% to $20.6 million in the year ended December 31, 2011, from $18.0 million for the same period in 2010. Banking service revenues, which consist primarily of fees generated by deposit accounts, electronic banking services, and customer services, increased 16.9% to $13.8 million in the year ended December 31, 2011, from $11.8 million for the same period in 2010. These increases are attributable to an increase in electronic banking service fees.

Income generated from mortgage banking activities increased 3.4% to $9.9 million in the year ended December 31, 2011, from $9.6 million for the same period in 2010, mainly as a result of favorable pricing of mortgages sold into the secondary market.

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

Comparison of the years ended December 31, 2010 and 2009

As shown in Table 2, the Group recorded non-interest income in the amount of $5.2 million for the year ended December 31, 2010, compared to a loss of $1.8 million in 2009.

Wealth management revenues, which consist of commissions and fees from fiduciary activities, and commissions and fees from securities brokerage and insurance activities, increased 24.2%, to $18.0 million in the year ended December 31, 2010, from $14.5 million in the same period of 2009. Banking service revenues, which consist primarily of fees generated by deposit accounts, electronic banking services, and customer services, increased 98.5% to $11.8 million in the year ended December 31, 2010, from $5.9 million in the same period of 2009. These increases are attributable to increases in electronic banking service fees and fees generated from the customers of former Eurobank banking business.

Income generated from mortgage banking activities decreased 1.8% in the year ended December 31, 2010, from $9.7 million in the year ended December 31, 2009, to $9.6 million for the same period in 2010 mainly as the result of a decrease in residential mortgage loan production.

For the year ended December 31, 2010, a loss from securities, derivatives, trading activities and other investment activities was $38.9 million, compared to a loss of $13.9 million in the same period of 2009. The decrease was mostly due to net loss of $36.8 million in derivatives during the year ended December 31, 2010, compared with gains of $29.2 million for the same period in 2009.

Net loss on derivative activities of $36.8 million in 2010 mainly reflected realized losses of $42.0 million due to the terminations of forward-settle swaps. These terminations allowed the Group to enter into new swap contracts, while effectively reducing the interest rate of the pay-fixed side of such swaps, from an average cost of 3.53% to an average cost of 1.83%. These swaps will enable the Group to fix, at 1.83%, the cost of $1.25 billion in repurchase agreements funding ($900 million maturing in December 2011 and $350 million maturing in May

2012) that currently have a blended cost of approximately 4.40%. These losses were partially offset, mainly by a gain of approximately $6.0 million in the valuation of interest rate swaps and options outstanding as of December 31, 2010.

Keeping with the Group s investment strategy, during the years ended December 31, 2010 and 2009, there were certain sales of available-for-sale securities because the Group felt at the time of such sales that gains could be realized while at the same time having good opportunities to invest the proceeds in other investment securities with attractive yields and terms that would allow the Group to continue to protect its net interest margin. Sale of securities available-for-sale, which generated net gains of $15.0 million for the year ended December 31, 2010, increased 242.8% when compared to $4.4 million for the same period a year ago. Net gains for the year ended December 31, 2010 included gains of $4.7 million in sales of Obligations of U.S. government sponsored agencies and gains of $33.1 million in sales of FNMA, FHLMC, and GNMA mortgage-backed securities. The gains realized during the year in the sales of securities available-for-sale allowed the Group to make the strategic decision to sell the remaining balance of the BALTA private label collateralized mortgage obligation (CMO) in December 2010. The proceeds from such sale amounted to approximately $63.2 million. A loss of $22.8 million was recorded in the fourth quarter for the difference between the security s amortized cost and the sales price.

During 2010, a gain of $23 thousand was recognized in trading securities, compared to a gain of $12.6 million in the previous year.

During 2010 and 2009, the Group recorded other-than-temporary impairment losses of $17.2 million and $60.1 million, respectively.

TABLE 3 NON-INTEREST EXPENSES SUMMARY

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009

		December 31,		
	2011	**2010**	**Variance %**	**2009**
		(Dollars in thousands)		
Compensation and employee benefits	$ 45,552	$ 41,723	9.2%	$ 32,020
Occupancy and equipment	17,407	18,556	-6.2%	10,379
Professional and service fees	21,742	16,491	31.8%	14,763
Insurance	6,642	7,006	-5.2%	7,233
Advertising, business promotion, and strategic initiatives	5,975	4,978	20.0%	4,208
Electronic banking charges	5,709	4,504	26.8%	2,194
Taxes, other than payroll and income taxes	4,721	5,106	-7.5%	3,004
Loan servicing and clearing expenses	3,979	3,051	30.4%	2,390
Foreclosure and repossession expenses	2,936	2,830	3.7%	929
Communication	1,623	2,561	-36.6%	1,567
Director and investor relations	1,305	1,463	-10.8%	1,374
Other	4,711	4,329	8.8%	3,317
Total non-interest expenses	**$ 122,302**	**$ 112,598**	**8.6%**	**$ 83,378**
Relevant ratios and data:				
Efficiency ratio	**66.22%**	**64.54%**		**51.74%**
Expense ratio	**1.21%**	**1.10%**		**87.00%**
Compensation and benefits to non-interest expense	**37.25%**	**37.05%**		**38.40%**
Compensation to total assets owned	**0.68%**	**0.57%**		**0.49%**
Average number of employees	**725**	**725**		**541**
Average compensation per employee	**$ 62.8**	**$ 57.5**		**$ 59.2**
Assets owned per average employee	**$ 9,233**	**$ 10,084**		**$ 12,109**

Non-Interest Expenses

Comparison of the years ended December 31, 2011 and 2010

Non-interest expenses for the year ended December 31, 2011 increased 8.6% to $122.3 million, compared to $112.6 million for the same period in 2010. The increase in non-interest expenses for the year ended December 31, 2011 is primarily driven by the integration of former Eurobank employees after the FDIC-assisted acquisition on April 30, 2010 and therefore had only a partial impact on the year ended December 31, 2010.

Compensation and employee benefits increased 9.2% to $45.6 million from $41.7 million for the same period in 2010. Average employees remained at 725 for the years ended December 31, 2011 and 2010.

Professional and service fees for the year ended December 31, 2011 increased 31.8% to $21.7 million, compared to $16.5 million for the same period in 2010. The increase for the year ended December 31, 2011 is mainly due to expenses for servicing the loans acquired in the FDIC-assisted acquisition, which commenced in late June 2010.

Occupancy and equipment expense decreased 6.2% to $17.4 million for the year ended December 31, 2011 compared to the same period in 2010. This decrease is mainly attributed to fewer branches when compared to the same period in 2010.

Decrease in insurance expenses for the year ended December 31, 2011, as compared to the same period in 2010, is principally due to the change in FDIC assessment rates and the change in the methodology applied to the Bank. This current methodology is based on average consolidated total assets less average tangible equity, instead of total deposits.

Increase in electronic banking charges for the year ended December 31, 2011, compared to the same period in 2010, is mainly due to increases in the volume of transactions, as the result of new customers from the FDIC-assisted acquisition.

Decrease in taxes, other than payroll and income taxes, for the year ended December 31, 2011, as compared to same period in 2010, is principally due to the effect of the Eurobank integration, which for 2010 contemplated property taxes for all of Eurobank s former facilities.

Advertising, business promotion, and strategic initiatives for the year ended December 31, 2011 increased 20.0%, as compared to the same period in 2010, primarily to support the expansion of commercial banking and the Group s rebranding.

Loan servicing and clearing expenses increased 30.4%, foreclosure and repossession expenses increased 3.7%, printing, postage, stationery and supplies expenses increased 6.4%, and other operating expenses increased 9.7%, and communication expenses and director and investor relations decreased 36.6% and 10.8%, respectively, for the year ended December 31, 2011 when compared to the same period ended December 31, 2010.

The non-interest expense results reflect an efficiency ratio of 66.2% for the year ended December 31, 2011, compared to 64.5% for the year ended December 31, 2010. The efficiency ratio measures how much of a company s revenue is used to pay operating expenses. The Group computes its efficiency ratio by dividing non-interest expenses by the sum of its net interest income and non-interest income, but excluding gains on sale of investments securities, derivatives gains or losses, credit-related other-than-temporary impairment losses, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permits greater comparability. Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to a loss of $13.2 million for the year ended December 31, 2011, compared to a loss of $34.1 million for the year ended December 31, 2010.

Comparison of the years ended December 31, 2010 and 2009

Non-interest expenses for the year ended December 31, 2010 increased 35.0% to $112.6 million, compared to $83.4 million for the same period of 2009. The increase in non-interest expense is primarily driven by higher compensation and employees benefits, professional services fees, and occupancy and equipment expenses.

Compensation and employee benefits increased 30.3% to $41.7 million from $32.0 million in the year ended December 31, 2009. The increase is mainly driven by the integration of employees of Eurobank since April 30, 2010. This factor represented an increase of approximately $7.2 million in payroll for the year ended December 31, 2010.

Occupancy and equipment expense increased 25.7% to $18.6 million in the year ended December 31, 2010. The increase is mainly driven by the integration of branches of Eurobank since April 30, 2010. This factor represented an increase of approximately $3.4 million in occupancy and equipment for the year ended December 31, 2010.

Professional and service fees increased 58.9% for the year ended December 31, 2010, mainly due to servicing expenses during the year for certain commercial and construction loans acquired from the FDIC-assisted acquisition amounting to $5.2 million. This fluctuation is also affected by a one-time professional expense amounting to approximately $1.2 million, as part of the FDIC-assisted acquisition.

Increases in taxes, other than payroll and income taxes of 70.0% for the year ended December 31, 2010 as compared to same period of 2009, are principally due to increase in municipal license tax, based on business volume and assets, which increased compared to previous year. The increase in overall business volume and asset is also related to the addition of new branches and the assets acquired in the FDIC-assisted acquisition.

Increase in electronic banking charges of 105.3% for the year ended December 31, 2010 against the same period of 2009, are mainly due to increase in point-of-sale (POS) transactions, in addition to Eurobank s increased transactions as the result of the Group s commercial POS cash management business.

In the year ended December 31, 2010, advertising and business promotion expenses, loan servicing and clearing expenses, communication expenses, director and investor relations expenses, foreclosure and repossession expenses, and other operating expenses increased 18.3%, 27.7%, 63.4%, 6.5%, 204.6% and 68.6%, respectively, compared to the year ended December 31, 2009.

The non-interest expense results reflect an efficiency ratio of 64.53% for the year ended December 31, 2010, compared to 51.74% in 2009. The efficiency ratio measures how much of a Group s revenue is used to pay operating expenses. The Group computes its efficiency ratio by dividing non-interest expenses by the sum of its net interest income and non-interest income, but excluding gains on sale of investments securities, derivatives gains or losses, credit-related other-than-temporary impairment losses, and other income that may be considered volatile in nature. Management believes that the exclusion of those items permit greater comparability. Amounts presented as part of non-interest income that are excluded from the efficiency ratio computation amounted to net losses of $34.2 million and $32.2 million for the years ended December 31, 2010 and 2009, respectively.

Provision for Loan and Lease Losses

Comparison of the years ended December 31, 2011 and 2010

The provision for non-covered loan and lease losses for the year ended December 31, 2011 totaled $15.2 million, a 4.5% decrease from the $15.9 million reported for 2010. Based on an analysis of the credit quality and the composition of the Group s loan portfolio, management determined that the provision for 2011 was adequate in order to maintain the allowance for loan and lease losses at an adequate level.

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

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

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

Included in the review of individual loans are those that are impaired. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan s effective interest rate, or as a practical expedient, at the observable market price of the loan or the fair value of the collateral, if the loan is collateral dependent. Loans are individually evaluated for impairment, except large groups of small balance homogeneous loans that are collectively evaluated for impairment, and loans that are recorded at fair value or at the lower of cost or market. The portfolios of mortgage, leases and consumer loans are considered homogeneous, and are evaluated collectively for impairment. For the commercial loans portfolio, all loans over $250 thousand that are either over 90 days past due or adversely classified are evaluated for impairment, or when deemed necessary by management. At December 31, 2011, the total investment in impaired commercial loans was $46.4 million, compared to $25.9 million at December 31, 2010. Impaired commercial loans increased principally as a result of an increase of $10.9 million in commercial loans classified as troubled debt restructurings and $5.4 million in current loans adversely classified by management during its impairment analysis. Most of the impaired commercial loans are measured based on the fair value of collateral method, since most impaired loans during the period were collateral dependant, all other loans are measured using the present value of cash flows method. The valuation allowance for impaired commercial loans amounted to approximately $3.5 million and $823 thousand at December 31, 2011 and 2010, respectively. At December 31, 2011, the total investment in impaired mortgage loans was $51.5 million (December 31, 2010 $36.1 million). Impairment on mortgage loans assessed as troubled debt restructuring was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately $3.4 million and $2.4 million at December 31, 2011 and 2010, respectively.

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

Loan loss ratios and credit risk categories are updated quarterly and are applied in the context of GAAP and the 2006 Interagency Policy Statement on the Allowance For Loan and Lease Losses, which requires that depository institutions have prudent, conservative, but not excessive loan loss allowances that fall within an acceptable range of estimated losses. While management uses available information in estimating probable loan losses, future changes to the allowance may be necessary, based on factors beyond the Group s control, such as factors affecting general economic conditions.

There have been no material changes in criteria or estimation techniques as compared to prior periods that impacted the determination of the current period allowance for loan and lease losses. However, during the quarter ended September 30, 2011, the Group divided the commercial loan portfolio into two classes, commercial loans secured by existing commercial real estate properties and other commercial loans, for purposes of evaluating the allowance for loan and lease losses.

The loans covered by the FDIC shared-loss agreement were recognized at fair value as of April 30, 2010, which included the impact of expected credit losses. As part of the Group s assessment of actual versus expected cash flows on covered loans, higher cash flows are expected for various pools of loans for which impairment has been previously recorded as an allowance for covered loan and lease losses. The resulting higher expected cash flows are recorded as a reduction in such previously recorded allowance and a recapture of covered loan and lease losses of $1.4 million for the year ended December 31, 2011, net of the effect from the FDIC shared-loss indemnification asset. A provision for covered loan and lease losses of $6.2 million was recorded in the year ended December 31, 2010, net of the effect from the FDIC shared-loss indemnification asset.

Each quarter, actual cash flows on covered loans are reviewed against the cash flows expected to be collected. If it is deemed probable that the Group will be unable to collect all of the cash flows previously expected (e.g., the cash flows expected to be collected at acquisition adjusted for any probable changes in estimate thereafter), the covered loans shall be deemed impaired and an allowance for covered loan and lease losses will be recorded. When there is a probable significant increase in cash flows expected to be collected or if the actual cash flows collected are significantly greater than those previously expected, the Group will reduce any allowance for loan and lease losses established after acquisition for the increase in the present value of cash flows expected to be collected, and recalculate the amount of accretable yield for the loan based on the revised cash flow expectations.

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

Comparison of the years ended December 31, 2010 and 2009

The provision for non-covered loan and lease losses for the year ended December 31, 2010 totaled $15.9 million, a 1.7% increase from the $15.7 million reported for 2009. Based on an analysis of the credit quality and the composition of the Group s loan portfolio, management determined that the provision for 2010 was adequate in order to maintain the allowance for loan and lease losses at an adequate level.

Net credit losses increased $1.1 million, to $7.8 million, representing 0.67% of average non-covered loans outstanding, versus 0.57% in 2009. The allowance for non-covered loan and lease losses increased to $31.4 million (2.65% of total loans) at December 31, 2010, compared to $23.3 million (2.00% of total loans) a year ago.

For the commercial loans portfolio, all loans over $250 thousand and over 90 days past due are evaluated for impairment. At December 31, 2010, the total investment in impaired commercial loans was $25.9 million, compared to $15.6 million at December 31, 2009. Impaired commercial loans are measured based on the fair value of collateral method, since all impaired loans during the period were collateral dependent. The valuation allowance for impaired commercial loans amounted to approximately $823 thousand and $709 thousand at December 31, 2010 and December 31, 2009, respectively. Net credit losses on impaired commercial loans for the years ended December 31, 2010 and 2009 were $1.9 million and $776 thousand, respectively. At December 31, 2010, the total investment in impaired mortgage loans was $36.1 million (December 31, 2009 $10.7 million). Impairment on mortgage loans assessed as troubled debt restructuring was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately $2.4 million and $683 thousand at December 31, 2010 and 2009, respectively.

The loans covered by the FDIC shared-loss agreement were recognized at fair value as of April 30, 2010, which included the impact of expected credit losses. As a result of a net credit impairment attributable to various pools of loans covered under the shared-loss agreements with the FDIC, the Group recorded a provision for covered loan and lease losses of $6.3 million during the year ended December 31, 2010. This impairment consists of $49.3 million in gross estimated losses, less a $43.0 million increase in the FDIC shared-loss indemnification asset. During the year ended December 31, 2011, the Group s assessment of actual versus expected cash flows on covered loans reflected that higher cash flows are expected for various pools of loans for which impairment has been previously recorded as an allowance for covered loan and lease losses. The resulting higher expected cash flows are recorded as a reduction in such previously recorded allowance and a recapture of covered loan and lease losses of $1.4 million for the year ended December 31, 2011. This recapture consists of $12.0 million decrease in gross estimated losses, less a $10.6 million decrease in the FDIC shared-loss indemnification asset.

Income Taxes

Comparison of the years ended December 31, 2011 and 2010

For the year ended December 31, 2011, the Group recorded an income tax expense of $866 thousand, as compared to income tax benefit of $4.3 million for the same period in 2010. This increase reflects a $5.2 million expense related to the re-measurement of the net deferred tax assets due to a reduction in the marginal corporate income tax rate from 40.95% to 30% as a result of the 2011 Code, partially reduced by the various contingencies settled with the Puerto Rico Treasury Department during the quarter ended June 30, 2011 in which the Group paid $2.0 million, approximately $3.0 million less than what the Group had reserved for this purpose. As part of the settlement reached, all taxable years prior to 2010 are closed for purposes of any assessments of additional income taxes by the Puerto Rico Treasury Department. Also, mortgage tax credits amounting to $2.6 million became available for the years 2011 and 2012, $1.3 million of which were used during 2011 to offset any taxable income. The Group expects to obtain benefits from this reduction in tax rates on future corporate tax filings. For the year ended December 31, 2011, the effective tax rate of the Group reached 2.45% compared to an effective tax benefit of 77.64% for the same period in 2010. Included in the aforementioned effective tax rate is the net effect of the change in the enacted tax rate of 14.66%; the decrease in the tax liability rate of the Group s international banking entity of 1.41%, which reduced its statutory tax rate from 5.00% to 0.00%; and a decrease in the income tax contingencies credit of 7.95%, which includes the benefits recorded from the settlement of contingencies with the Puerto Rico Treasury Department.

Comparison of the years ended December 31, 2010 and 2009

The income tax benefit was $4.3 million for the year ended December 31, 2010, as compared to an expense of $7.0 million for 2009, as a result of decreased operating income and investment gains. The effective income tax rate in 2010 was lower than the 40.95% statutory tax rate for the Group, due to the high level of tax-advantaged interest income earned on certain investments and loans, net of the disallowance of related expenses attributable to exempt income. Exempt interest relates principally to interest earned on obligations of the United States and Puerto Rico governments and certain mortgage-backed securities, including securities held by the Group s international banking entity.

TABLE 4 ASSETS SUMMARY AND COMPOSITION

AS OF DECEMBER 31, 2011, 2010 AND 2009

	December 31,			
	2011	**2010**	**Variance %**	**2009**
	(Dollars in thousands)			
Investments:				
FNMA and FHLMC certificates	$ 3,560,807	$ 3,972,107	10.4%	$ 2,764,172
Obligations of US Government sponsored agencies		3,000	100.0%	1,007,091
Non-agency collateralized mortgage obligations			0.0%	446,037
CMO s issued by US Government sponsored agencies	130,045	177,804	26.9%	286,509
GNMA certificates	28,336	127,714	77.8%	346,103
Structured credit investments	37,288	41,693	10.6%	38,383
Puerto Rico Government and agency obligations	81,482	67,663	20.4%	65,364
FHLB stock	23,779	22,496	5.7%	19,937
Other debt securities	5,980		100.0%	
Other investments	253	1,480	82.9%	673
	3,867,970	**4,413,957**	**12.4%**	**4,974,269**
Loans:				
Loans not covered under shared-loss agreements with the FDIC	1,183,748	1,149,319	3.0%	1,136,080
Allowance for loan and lease losses on non covered loans	(37,010)	(31,430)	17.8%	(23,272)
Non covered loans receivable, net	**1,146,738**	**1,117,889**	**2.6%**	**1,112,808**
Mortgage loans held for sale	26,939	33,979	20.7%	27,261
Total loans not covered under shared-loss agreements with the FDIC, net	**1,173,677**	**1,151,868**	**1.9%**	**1,140,069**
Loans covered under shared-loss agreements with the FDIC	533,532	669,997	20.4%	
Allowance for loan and lease losses on covered loans	(37,256)	(49,286)	24.4%	
Total loans covered under shared loss agreements with the FDIC, net	**496,276**	**620,711**	**20.0%**	
Total loans, net	**1,669,953**	**1,772,579**	**5.8%**	**1,140,069**
Total securities and loans	**5,537,923**	**6,186,536**	**10.5%**	**6,114,338**
Other assets:				
Cash and due from banks	601,614	344,067	74.9%	247,691
Money market investments	3,863	104,869	96.3%	29,432
FDIC shared-loss indemnification asset	392,367	473,629	17.2%	
Foreclosed real estate	27,679	26,840	3.1%	9,347
Accrued interest receivable	20,182	28,716	29.7%	33,656
Deferred tax asset, net	32,023	30,732	4.2%	31,685
Premises and equipment, net	21,520	23,941	10.1%	19,775
Derivative assets	9,317	28,315	67.1%	
Other assets	47,178	63,361	25.5%	64,909
Total other assets	**1,155,743**	**1,124,470**	**2.8%**	**436,495**
Total assets	**$ 6,693,666**	**$ 7,311,006**	**8.4%**	**$ 6,550,833**
Investment portfolio composition:				
FNMA and FHLMC certificates	92.0%	90.1%		55.5%
Obligations of US Government sponsored agencies	0.0%	0.1%		20.2%
Non-agency collateralized mortgage obligations	0.0%	0.0%		9.0%
CMO s issued by US Government sponsored agencies	3.4%	4.0%		5.8%
GNMA certificates	0.7%	2.9%		7.0%

Structured credit investments	1.0%	0.9%	0.8%
Puerto Rico Government and agency obligations	2.1%	1.5%	1.3%
FHLB stock	0.6%	0.5%	0.4%
Other debt securities and other investments	0.2%	0.0%	0.0%
	100.0%	**100.0%**	**100.0%**

ANALYSIS OF FINANCIAL CONDITION

Assets Owned

At December 31, 2011, the Group s total assets amounted to $6.7 billion, a decrease of 8.4% when compared to $7.3 billion at December 31, 2010, and interest-earning assets reached $5.5 billion, down 10.5%, versus $6.2 billion at December 31, 2010.

As detailed in Table 4, investments are the Group s largest interest-earning assets component. Investments principally consist of money market instruments, U.S. government and agency bonds, mortgage-backed securities and Puerto Rico government and agency bonds. At December 31, 2011, the investment portfolio decreased 12.4% from $4.4 billion to $3.9 billion. This decrease is mostly due to a decrease of $411.3 million or 10.4% in FNMA and FHLMC certificates, and a decrease of $99.4 million or 77.8% in GNMA certificates.

At December 31, 2011, approximately 96% of the Group s investment securities portfolio consists of fixed-rate mortgage-backed securities or notes, guaranteed or issued by FNMA, FHLMC or GNMA, and U.S. agency senior debt obligations, backed by a U.S. government-sponsored entity or the full faith and credit of the U.S. government, compared to 98% at December 31, 2010.

The Group s loan portfolio is mainly comprised of residential loans, home equity loans, commercial loans collateralized by mortgages on real estate located in Puerto Rico, and leases. At December 31, 2011, the Group s loan portfolio, the second largest category of the Group s interest-earning assets, amounted to $1.7 billion, a decrease of 5.8% from $1.8 billion at December 31, 2010. The loan portfolio decrease was mainly attributable to a decrease of $124.4 million or 20.0% in covered loans as they continue to pay down, which was partially offset by an increase of 1.9% in non-covered loans.

At December 31, 2011, the mortgage loan portfolio amounted to $821.1 million (69.1% of the gross non-covered loan portfolio), compared to $873.9 million (75.8% of the gross non-covered loan portfolio) at December 31, 2010. Mortgage loan production and purchases of $212.8 million for the year ended December 31, 2011 decreased 13.2%, from $245.2 million, when compared to the year ended December 31, 2010.

At December 31, 2011, the commercial loan portfolio amounted to $301.6 million (25.3% of the gross non-covered loan portfolio), compared to $234.3 million (20.3% of the gross non-covered loan portfolio) at December 31, 2010. Commercial loan production increased 38.3% for the year ended December 31, 2011 from $101.0 million in 2010 to $139.8 million in 2011.

At December 31, 2011, the consumer loan portfolio amounted to $39.9 million (3.4% of the gross non-covered loan portfolio), compared to $34.5 million (3.0% of the gross non-covered loan portfolio) at December 31, 2010. Consumer loan production increased 58.0% for the year ended December 31, 2011 from $13.8 million in 2010 to $21.7 million in 2011.

At December 31, 2011, the leasing portfolio amounted to $25.8 million (2.2% of the gross non-covered loan portfolio), compared to $10.3 million (0.9% of the gross non-covered loan portfolio) at December 31, 2010. Leasing production increased 86.1% for the year ended December 31, 2011 from $11.6 million in 2010 to $21.6 million in 2011.

The FDIC shared-loss indemnification asset amounted to $392.4 million and $473.6 million as of December 31, 2011 and 2010, respectively. This decrease is mainly related to reimbursements received from the FDIC during 2011 of $75.5 million.

TABLE 5 LOANS RECEIVABLE COMPOSITION:

AS OF DECEMBER 31, 2011, 2010 AND 2009

	December 31,		
	2011	2010 (In thousands)	2009
Loans not covered under shared-loss agreements with FDIC:			
Loans secured by real estate:			
Residential	$ 819,651	$ 872,427	$ 918,688
Home equity loans and others	1,411	1,505	1,565
Commercial	218,261	178,232	157,631
Deferred loan fees, net	(4,300)	(3,931)	(3,318)
	1,035,023	1,048,233	1,074,566
Other loans:			
Commercial	83,312	56,760	40,357
Personal consumer loans and credit lines	39,890	34,492	21,335
Leasing	25,768	10,257	
Deferred loan fees, net	(245)	(423)	(178)
	148,725	101,086	61,514
Loans receivable	**1,183,748**	**1,149,319**	**1,136,080**
Allowance for loan and lease losses on non covered loans	(37,010)	(31,430)	(23,272)
Loans receivable, net	**1,146,738**	**1,117,889**	**1,112,808**
Mortgage loans held-for-sale	26,939	33,979	27,261
Total loans not-covered under shared-loss agreements with FDIC, net	**1,173,677**	**1,151,868**	**1,140,069**
Loans covered under shared-loss agreements with FDIC:			
Loans secured by 1-4 family residential properties	140,824	166,865	
Construction and development secured by 1-4 family residential properties	16,976	17,232	
Commercial and other construction	325,832	388,261	
Leasing	36,122	79,093	
Consumer	13,778	18,546	
Total loans covered under shared-loss agreements with FDIC	**533,532**	**669,997**	
Allowance for loan and lease losses on covered loans	(37,256)	(49,286)	
Total loans covered under shared-loss agreements with FDIC, net	**496,276**	**620,711**	
Total loans, net	**$ 1,669,953**	**$ 1,772,579**	**$ 1,140,069**

The following table summarizes the remaining contractual maturities of the Group s total non-covered loans (gross of deferred loan fees) segmented to reflect cash flows as of December 31, 2011. Contractual maturities do not necessarily reflect the actual term of a loan, considering prepayments.

	Balance Outstanding at December 31, 2011	One Year or Less	Maturities After One Year to Five Years Fixed Interest Rates	Maturities After One Year to Five Years Variable Interest Rates	After Five Years Fixed Interest Rates	After Five Years Variable Interest Rates
	(In thousands)					
Non-covered loans						
Mortgage, mainly residential	$ 819,651	$ 14,858	$ 43,558	$	$ 761,235	$
Commercial, mainly real estate	301,573	74,620	120,534	69,162	29,046	8,211
Consumer	41,301	8,789	28,090	24	3,103	1,295
Leasing	25,768	116	20,581		5,071	
Total	**$ 1,188,293**	**$ 98,383**	**$ 212,763**	**$ 69,186**	**$ 798,455**	**$ 9,506**

TABLE 6 LIABILITIES SUMMARY AND COMPOSITION

AS OF DECEMBER 31, 2011, 2010 AND 2009

	December 31,			
	2011	2010	Variance %	2009
	(Dollars in thousands)			
Deposits:				
Non-interest bearing deposits	$ 190,001	$ 170,705	11.3%	$ 73,548
Now accounts	810,844	783,744	3.5%	619,947
Savings and money market accounts	230,673	235,690	2.1%	86,791
Certificates of deposit	1,159,258	1,393,743	16.8%	961,344
	2,390,776	**2,583,882**	**7.5%**	**1,741,630**
Accrued interest payable	4,491	5,006	10.3%	3,871
	2,395,267	**2,588,888**	**7.5%**	**1,745,501**
Borrowings:				
Short term borrowings	39,920	42,460	6.0%	49,218
Securities sold under agreements to repurchase	3,056,238	3,456,781	11.6%	3,557,308
Advances from FHLB	281,753	281,753	0.0%	281,753
FDIC-guaranteed term notes	105,834	105,834	0.0%	105,834
Subordinated capital notes	36,083	36,083	0.0%	36,083
	3,519,828	**3,922,911**	**10.3%**	**4,030,196**
Total deposits and borrowings	**5,915,095**	**6,511,799**	**9.2%**	**5,775,697**
FDIC net settlement payable	115	22,954	99.5%	
Derivative liabilities	47,425	64	74001.6%	
Securities and loans purchased but not yet received			0.0%	413,359
Other liabilities	35,476	43,858	19.1%	31,611
Total liabilities	**$ 5,998,111**	**$ 6,578,675**	**8.8%**	**$ 6,220,667**
Deposits portfolio composition percentages:				
Non-interest bearing deposits	8.0%	6.7%		4.2%
Now accounts	33.9%	30.3%		35.6%
Savings accounts	9.6%	9.1%		5.0%
Certificates of deposit	48.5%	53.9%		55.2%
	100.0%	**100.0%**		**100.0%**
Borrowings portfolio composition percentages:				
Federal funds purchases and other short term borrowings	1.1%	1.1%		