Executing on Our Strategy

2011 Annual Report

Oriental

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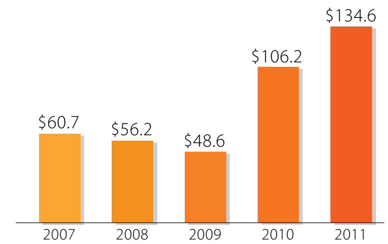
Oriental's Execution in Numbers

Recurring Net Revenues from Client Businesses

$ in millions

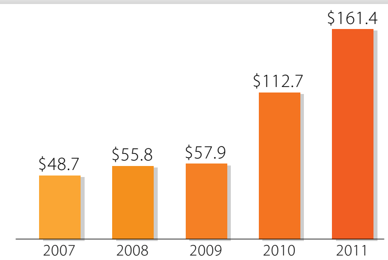
We've continued to make notable progress growing our banking businesses with clients and lessening our reliance on net interest income from investment securities. Net interest income from loans and non-interest income from banking and wealth management activities increased 27% year over year, to a record $134.6 million in 2011, and 122% since 2007.



Commercial Loan & Lease Production

$ in millions

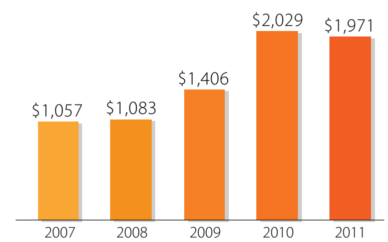
Because of our strong capital position, expanded platform and high levels of service, we have continued to build up our commercial lending and banking business. Commercial loan and lease production increased 43% year over year, to a record $161.4 million in 2011, and 231% since 2007.



Core Retail Deposits

$ in millions

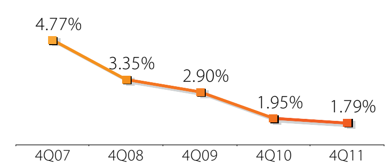
As an especially well capitalized bank, Oriental has been able to attract new customers and expand existing relationships. Core retail deposits totaled nearly $2 billion at December 31, 2011, off slightly year over year due to runoffs from maturing older, higher priced CDs. Excluding that, retail deposits increased 2.6%, and, since the end of 2007, are up 86%.



Cost of Deposits

$ in millions

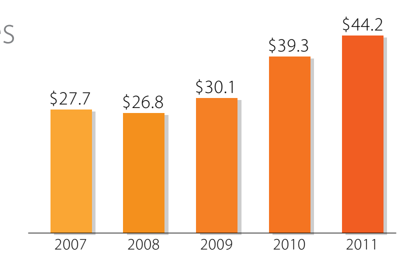
Oriental's reputation for stability has enabled us to continue to reduce the cost of funds. Our cost of deposits declined 8%, to 1.79% in the fourth quarter of 2011, from the year ago quarter. Since the fourth quarter of 2007, the cost of deposits has declined 62%.



Wealth Management, Mortgage, & Banking Revenues

$ in millions

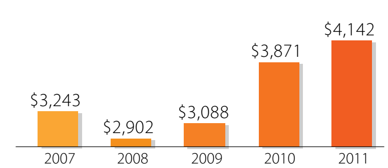
We have been steadily growing "core" non-interest income from banking and wealth management, as a result of the Eurobank acquisition, and through the expansion of commercial banking services. Altogether, these revenues increased 12% year over year, to a record $44.2 million in 2011, and 60% since 2007.



Wealth Management Assets

$ in millions

We have experienced rapid growth of assets under management (AUM) through our broker dealer and trust businesses. AUM grew 7%, to a record $4.1 billion at December 31, 2011 from a year ago, and has grown 28% from December 31, 2007.



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

Q&A with José Rafael Fernández

President, CEO and Vice Chairman of the Board
For Oriental Financial Group's
2011 Annual Report

Q: How would you summarize 2011?

JRF: 2011 was a good year for Oriental, one in which we built on top of what we accomplished in 2010, when we acquired Eurobank. We finished integrating all of the Eurobank business, and we built a new commercial banking team. We had low levels of loan losses, and we continued to increase reserves. In short, it was a very successful year.

Under José Ramón González, our Senior EVP - Banking & Corporate Development, we expanded our lending, credit and underwriting teams, and added a new head of corporate banking. We generated a record $140 million in commercial loans, up 38% from last year, enabling Oriental to achieve a strong position in the market. Our production was comprised of about $40 million in loans to small businesses and professionals and $100 million to corporate clients. It is important to point out that all of this happened in an economy that has been contracting for six years in Puerto Rico, and as we continued to maintain our conservative credit risk profile.

We also did well in our other banking areas. In our first full year in the business, auto leasing generated $22 million in loans, an 86% gain year over year. Consumer lending generated $22 million in loans, up 58% year over year. At the same time, we realized approximately $21 million of fee income in wealth management activities, including trust, brokerage and insurance. That grew 14.5% year over year and we posted a 17% increase in banking fees, to $14 million.

We successfully integrated the Eurobank branches into our network and their client accounts to Oriental's platform. The transition was essentially trouble free and we achieved high levels of client retention. We also successfully solidified good relationships with most former Eurobank clients. We sponsored several activities to make sure we got to know each other. Because of much closer client interactions and refinements in our loan servicing, the acquired portfolio is performing better than anticipated. This is creating significant opportunities to improve net interest margin.

Our results in 2011 present us with solid momentum going into 2012. We have an excellent team in place, with broad experience and terrific enthusiasm. We're very encouraged. The objectives we have for 2012 are for significantly greater results than what we accomplished in 2011.

Q: Now that Oriental is one of the top banks in Puerto Rico, how important is that in terms of how the Group is perceived?

JRF: It's very important. First, it is a huge responsibility, especially when Oriental is basically the only healthy local bank on the island. We truly believe that our mission is to do the best we can to help our clients grow and prosper, and to provide them added value. We're going to be working hard in 2012 to focus our value proposition at every point were our clients interact with us in order to further differentiate Oriental. The best way for us to do that is by defining how we provide added value to the client and how we execute on it, which is what we concentrate on every day.

Q: What metric do you look at when describing Oriental as the healthiest bank in Puerto Rico?

JRF: The number one metric is capital. We believe Oriental is among the best capitalized banks in the United States. We are in excellent shape in terms of asset quality and regulatory requirements. We also are very efficient and have tight control over costs. Our goal is to be regarded as the best performing bank on the island and to remain so for many years to come.

Q: What are your plans for moving ahead in lending and banking?

JRF: We will continue to expand the commercial lending and banking business, as well as auto leasing and consumer lending. We are working on integrating all of that into an offering that will enable us to increase the number of services and products each client uses. That's a challenge and an opportunity. The Eurobank acquisition helped us by expanding retail point of sale (POS) and cash management services for commercial clients. In 2011, we added to those by introducing a trade services business.

Q: How are you going to further develop the wealth management business?

JRF: Wealth management has always been a key part of our vision at Oriental. We have been able to evolve from our strong IRA business, which we still have, to a platform where we are leaders in retirement planning in Puerto Rico, and where we have a large share of the 401K, IRA and Keogh business. We have expanded to personal trusts, where we now also have a large market share on the island, and we are providing brokerage services for trusts. Altogether, our broker dealer and our trust business have more than $4 billion in assets under management. We also have an advisory platform with a group of certified financial planners, lawyers and CPAs that enables us to provide added value to our high net worth individual clients. Going forward, we plan to provide trust and investment advisory services to non-profit and for-profit companies in Puerto Rico. This will leverage our expertise in retirement and investments into an advisory service embracing asset protection, investments and fiduciary services, alongside our new commercial lending capabilities.

Q: What is your commercial lending strategy? It has demonstrated striking growth of late.

JRF: We have a great opportunity in commercial lending. We are focused on two different market segments. One is the middle market, which we call corporate, where we lend to businesses with annual sales of $5 million and above. The second is the small business and professional segment, where we lend to businesses with annual sales under $5 million. The market in Puerto Rico is not growing at present, so we need to win share. Because of our strong financial condition, and our emphasis on service, we are well positioned to attract clients who are disenfranchised with other institutions that are concerned more with solving their own issues as opposed to focusing on their clients' needs. Oriental is very well capitalized, very profitable and has minimal credit issues. Therefore, we can focus on the commercial market, identify good clients and attract them to Oriental.

Q: Oriental has had a great deal of success with the management of Eurobank loans it acquired, resulting in impressive performance of that portfolio. How did that come about?

JRF: Great hands on management. We acquired $1.5 billion in Eurobank loans, of which approximately $700 million were non-performing. In late 2011 and the first half of 2012, we created teams comprised of specialists in new business generation, underwriting and credit, and loan workout. Because of this group's effort, we began working very closely with the all Eurobank creditors, and by the end of 2011 the loans were performing much better than what we had anticipated.

Q: How would you rate your return on the Eurobank acquisition?

JRF: It has been excellent, far exceeding our expectations. Eurobank had around $57 million of expenses. We realized an expense savings of around 40% upon completion of integration, for a $23 million in profit right off the bat. At the same time, we projected the interest income that we would generate from the Eurobank loans would be $80 million in the first year, $60 million in the second year, and $35 million in the third year. Interest income goes down as the loans are paid down or retired, of course. The actual performance, however, has turned out to be $80 million the first year and $80 million in the second year, $20 million more than originally projected. The challenge with the acquisition is that we were asked by regulators to raise $300 million of capital, for an 8% leverage ratio. As a result, when you calculate the return on equity, the capital base is so large that the return does not look that impressive. However, from a strategic perspective, the acquisition also improved our market position and increased our number of branches.

Q: Has there been any change in loan and deposit pricing on the island?

JRF: The market is more competitive than last year in terms of loan pricing, but we are maintaining our discipline. On the deposit side, we have continued to lower the cost of funds on core funding, and we will continue to do so into 2012. We are also growing our non-interest bearing deposits from the commercial business. We hit a record in 2011 of $190 million of non-interest bearing deposits. We have close to $1 billion dollars in checking and savings accounts at Oriental. That's an all time record, too. There is an opportunity for us to continue to reduce cost of deposits, leveraging our reputation as a stable, healthy bank that doesn't have any issues.

Q: How are Oriental's retail banking, consumer lending and residential mortgage businesses faring in the current environment?

JRF: In retail banking, we now have 30 branches and they are increasingly focused on commercial lending. We have structured the leadership so that the regional directors bear the responsibility to grow small business loans while credit decision-making is centralized. Within the branches, we also are expanding our offering on credit cards and consumer loans. We did a good job this year, and we need to further expand that to other good clients. We also are cross selling with our commercial clients as well as our retail and deposit clients, and promoting credit and debit card usage. Regarding residential mortgage, our model is to originate and sell. While interest rates remain low, we will continue to originate conforming loans, sell them into the secondary market, and generate fees. We had about $213 million in production in 2011 and generated around $10 million in fees. We would hope to do about the same in 2012.

Q: What appears especially noteworthy about Oriental is the effort to build team spirit and instill a customer friendly attitude throughout the organization. How does Oriental do this?

JRF: For us to be successful, we need to function as a cohesive team and a team that is proud of where it works. One of the first things that we did when I became CEO eight years ago was to make sure that we provided the right training initiatives for our team. We also began to make sure we had appropriate compensation structures to ensure that we develop a performance oriented culture. We reworked the HR team three years ago, and started identifying talent within the organization having growth potential. We then instituted a development program, which we call the Managers' Academy. It's going into its third year now, and we're using it to prepare the future leaders of our organization. We also have a similar Executive Leadership Academy, through which every executive has gone.

These training programs aim to create a unified purpose and a collaborative work environment. Everything is a team effort. Teamwork is very positive and creates a reason to be here. I always say that people need a reason to work. On a basic level, that reason is typically money in your pocket and to provide for our families. But people also need a higher reason. At Oriental, that is helping the communities where we live. If we can help someone buy a car or a home, finance a business, or save for their children's education or their retirement, we help make stronger communities. If you have a larger goal like that, the rest comes naturally. It becomes a virtuous purpose for everyone.

Q: You obviously take great pride in Oriental's team spirit.

JRF: I'm very proud of it. That's the kind of culture we have begun to put in place at Oriental. It is something that is hard to measure, but something our clients and our investors should know about. When new employees join Oriental, their feedback is very positive. They tell us, "You have a great attitude here." We are certainly very much performance oriented; no ifs, ands, or buts about it. But people are happy working here, and that's important. You can't be at your best working all day in a situation where you are unhappy. From the feedback I get, we've managed to solve that.

We've also taken advantage of the market. Although many people are out of jobs in the banking sector, we have been growing our employee base. Oriental has grown from being 440 employees two and a half years ago to 740 employees today.

Q: How do you monitor and rate Oriental's capital adequacy?

JRF: We monitor capital every month. It's something that it's ingrained in our culture. Throughout our history, before I became CEO, Oriental's policy was to have enough capital to invest for the future, but also manage through a rainy day. That continues; our position today is excellent. We have close to $700 million of total capital. Our capital ratios are one of the best in the industry in Puerto Rico and in the United States. That's been recognized by investors, regulators -- everybody.

Unlike other banks that are capital constrained, we have a great opportunity to deploy our capital. We are using capital to be a strong local bank that helps improve the economy and the community in Puerto Rico. We have enough capital to explore acquisition opportunities, such as whole banks or selected portfolios, in order to accelerate our transformation and expand our strategic position in the market.

We also are returning capital to investors as our stock is selling under book value. In 2011, we completed a $30 million repurchase plan and established another one for an additional $70 million. For all of 2011, we bought back $59 million worth of shares at an average price of $11.28.

We are increasing our dividend. When you have a track record of increasing cash dividends, you are sending a clear message that the long term outlook of our organization is a very healthy one and that we are very confident of it. We increased our paid dividends by 6.25% in 2010 and by another 23.52% in 2011. That's part of the plan that we have in the years to come. We want to continue to increase our cash dividend as well as executing on our repurchase plan.

The markets, however, are volatile. We have to be cognizant of that. Our capital position enables us to manage this.

Q: How is the economy in Puerto Rico doing? How do you see the banking industry five years from now?

JRF: Puerto Rico needs additional consolidation in banking. Oriental is very well positioned to explore those opportunities within the local market. A bank needs to have a healthy economy to be able to lend more proactively. That's a big challenge for us and for the entire banking industry. We are hopeful we will begin seeing some improvement, and that the private sector and the government will unify and make the right decisions that are needed to take Puerto Rico to the next level. We can no longer afford a stagnant economy. We need a growing economy. That is going to require bringing capital from outside the island, and we need to put strategies in place to incentivize that capital to come to Puerto Rico.

Q: Why did Oriental title the 2011 annual report "Executing on Our Strategy"?

JRF: The 2010 annual report was titled "The Transition Has Begun." In 2011, we moved from transitioning to executing on our strategy. Transition means that you're moving from one place to a different place. We did that. We moved to this new place where we have a strong team, a strong base for commercial lending and fee income, and a generally expanding banking and wealth management businesses. That's also how I see all of 2012: Growing our commercial loans, auto leasing, and consumer lending, and generating higher levels of wealth management and banking fees.

Board of Directors & Executive Team

José J. Gil de Lamadrid, CPA
Chairman of the Board, Oriental Financial Group, Inc.

José Rafael Fernández
President, CEO and Vice Chairman of the Board
of Oriental Financial Group, Inc.

Juan Carlos Aguayo, P.E.
President and CEO of Structural Steel Works, Inc.

Pablo Iván Altieri, M.D.

Francisco Arriví
President and CEO of Pulte Homes International Caribbean Corp.

Julián S. Inclán
President, American Paper Corp.

Rafael Machargo, Esq.
Managing Partner, Machargo Chardón & Associates

Pedro Morazzani, CPA
Partner, CPA Firm Zayas, Morazzani & Co.

Josen Rossi
Chairman of the Board & CEO, Aireko Enterprises

Carlos O. Souffront, Esq.
Board Secretary

Seated from left: Carlos O. Souffront, Esq., Josen Rossi, Juan Carlos Aguayo, P.E., Pablo I. Altieri, M.D. Standing from left: Rafael Machargo, Esq., Pedro L. Morazzani, CPA, José Rafael Fernández, José J. Gil de Lamadrid, CPA, Francisco Arriví, Julian S. Inclán.

Leadership Team

Executive Team

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

José Ramón González, Senior Executive VP, Banking and Corporate Development

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

Ganesh Kumar, Executive VP & Chief Financial Officer

Officers

Gretell Báez, CPA, Senior VP, Banking Operations

Rafael Cruz, Eng., Senior VP, Compliance

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

Elena Manrara, Senior VP, Corporate Banking

Sean Miles, Senior VP, Managing Director - Oriental Financial Services, Inc.

César A. Ortiz, CPA, Esq., Senior VP & Controller

Ana T. Ramos, Senior VP, Information Technology

Mari Evelyn Rodríguez, Senior VP, Commercial Banking- Small Businesses

Ramón Rosado, Senior VP, Treasurer

Carlos O. Souffront, Esq., General Counsel

Tomás Torres, Senior VP, Chief Credit Officer

Carlos Viña, CPA, Senior VP & General Auditor

Jennifer Zapata, Senior VP, Human Resources

Form 10-K

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 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 ☑

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

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

Indicate by check mark 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 ☑ No ☐

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

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

Large accelerated filer ☐ Accelerated filer ☑ Non-accelerated filer ☐ (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 ☑

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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PART I

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," "should," "could," "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.

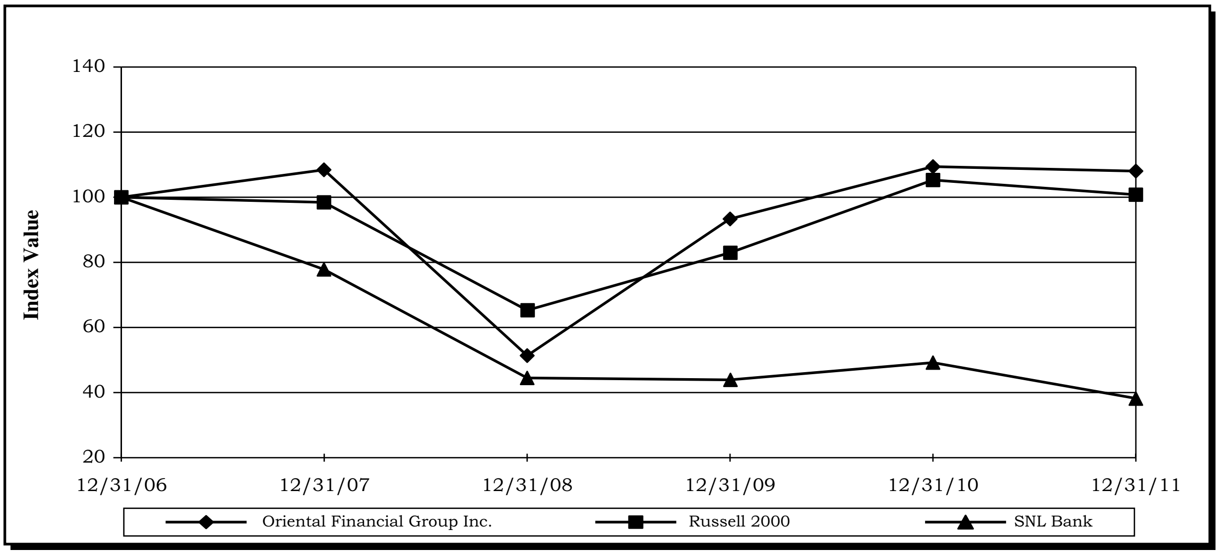
Stock Performance Graph

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

Total Return Performance



	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%**

	December 31,				
	2011	2010	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:

Consolidated Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends:	Year Ended December 31, 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:

	December 31, 2011	December 31, 2010	December 31, 2009
	(In thousands)		
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	2009
		(In thousands)	
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.

		Maturities				
			After One Year to Five Years		After Five Years	
	Balance Outstanding at December 31, 2011	One Year or Less	Fixed Interest Rates	Variable Interest Rates	Fixed Interest Rates	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%		1.2%
Securities sold under agreements to repurchase	86.9%	88.1%		88.3%
Advances from FHLB	8.0%	7.2%		7.0%
FDIC-guaranteed term notes	3.0%	2.7%		2.6%
Subordinated capital notes	1.0%	0.9%		0.9%
	100.0%	**100.0%**		**100.0%**
Securities sold under agreements to repurchase				
Amount outstanding at year-end	$3,056,238	$3,456,781		$3,557,308
Daily average outstanding balance	$3,417,892	$3,545,926		$3,659,442
Maximum outstanding balance at any month-end	$3,466,480	$3,566,588		$3,762,353

Liabilities and Funding Sources

As shown in Table 6, at December 31, 2011, the Group's total liabilities reached $6.0 billion, 8.8% lower than the $6.6 billion reported at December 31, 2010. This decrease is mostly due to the early extinguishment of a $100.0 million repurchase agreement during the third quarter of 2011, and the maturity of $300.0 million in repurchase agreements during the fourth quarter of 2011. Deposits and borrowings, the Group's funding sources, amounted to $5.9 billion at December 31, 2011 versus $6.5 billion at December 31, 2010, a 9.2% decrease. Borrowings represented 59.5% of interest-bearing liabilities and deposits represented 40.5%.

Borrowings consist mainly of funding sources through the use of repurchase agreements, FHLB advances, FDIC-guaranteed term notes (under the Temporary Liquidity Guarantee Program), subordinated capital notes, and other borrowings. At December 31, 2011, borrowings amounted to $3.5 billion, 10.3% lower than the $3.9 billion recorded at December 31, 2010. Repurchase agreements as of December 31, 2011 amounted to $3.1 billion, an 11.6% decrease when compared to $3.5 billion as of December 31, 2010. The decrease is mainly due to the early extinguishment of a $100.0 million repurchase agreement during the third quarter of 2011 and the cancellation of $300.0 million in repurchase agreements during the fourth quarter of 2011.

At December 31, 2011, short term borrowings amounted to $39.9 million, 6.0% lower than the $42.5 million reported at December 31, 2010. Short term borrowings mainly consist of deposits of the Puerto Rico Cash & Money Market Fund.

As a member of the Federal Home Loan Bank ("FHLB"), the Group can obtain advances from the FHLB, secured by the FHLB stock owned by the Group, as well as by certain of the Group's mortgage loans and investment securities. Advances from FHLB amounted to $281.8 million as of December 31, 2011, and December 31, 2010. These advances mature from May 2012 through May 2014.

The Group's banking subsidiary issued in March 2009 $105.0 million in notes guaranteed under the FDIC Temporary Liquidity Guarantee Program. These notes are due on March 16, 2012, bear interest at a 2.75% fixed rate, and are backed by the full faith and credit of the United States. Interest on the note is payable on the 16th of each March and September, beginning September 16, 2009. Shortly after issuance of the notes, the Group paid $3.2 million (equivalent to an annual fee of 100 basis points) to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes. This cost has been deferred and is being amortized over the term of the notes. The total cost of the notes for 2011 and 2010, including the amount of the debt issuance costs, was 3.87%.

At December 31, 2011, deposits, the second largest category of the Group's interest-bearing liabilities reached $2.395 billion, down 7.5% from $2.589 billion at December 31, 2010. This decrease was mainly attributable to a decrease in higher cost brokered deposits and other wholesale institutional deposits which decreased 8.2% and 40.0%, respectively, to $255.9 million and $168.3 million in December 31, 2011 from $278.9 million and $280.6 million in December 31, 2010.

At December 31, 2011, the scheduled maturities of time deposits and individual retirement accounts of $100 thousand or more were as follows:

	(In thousands)
Three (3) months or less	$115,134
Over 3 months through 6 months	78,360
Over 6 months through 12 months	133,056
Over 12 months	129,537
Total	**$456,087**

Stockholders' Equity

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

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

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 net proceeds of this offering were intended for general corporate purposes, which including funding organic acquisition and acquisition growth opportunities, including the participation in government assisted transactions in Puerto Rico. The Group contributed $93.0 million of the net proceeds in the form of capital to the Group's banking subsidiary, which used such amount for general corporate purposes and to bolster its regulatory capital needs.

On April 30, 2010, the Group issued 200,000 shares of the Series C Preferred Stock through a private placement. The Series C 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 deemed dividend on preferred stock.

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

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%).

Taking into consideration the Group's strong capital position, the quarterly cash dividend per common share was increased by 20%, to $0.06 per share, on November 30, 2011. On an annualized basis, this represents an increase to $0.24 per share, from $0.20, or an estimated annual increase of $1.6 million, based on 41.2 million shares outstanding at December 31, 2011.

The following are the consolidated capital ratios of the Group at December 31, 2011, 2010, and 2009:

TABLE 7 — CAPITAL, DIVIDENDS AND STOCK DATA

	December 31,			
	2011	2010	Variance %	2009
	(Dollars in thousands)			
Capital data:				
Stockholders' equity	$ 695,555	$ 732,331	–5.0%	$ 330,166
Regulatory Capital Ratios data:				
Leverage Capital Ratio	9.65%	9.50%	1.6%	6.52%
Minimum Leverage Capital Ratio Required	4.00%	4.00%		4.00%
Actual Tier 1 Capital	$ 661,614	$ 699,415	–5.4%	$ 414,702
Minimum Tier 1 Capital Required	$ 274,231	$ 294,472	–6.9%	$ 254,323
Excess over regulatory requirement	$ 387,383	$ 404,943	–4.3%	$ 160,379
Tier 1 Risk-Based Capital Ratio	31.56%	31.04%	1.7%	18.79%
Minimum Tier 1 Risk-Based Capital Ratio Required	4.00%	4.00%		4.00%
Actual Tier 1 Risk-Based Capital	$ 661,614	$ 699,415	–5.4%	$ 414,702
Actual Tier 1 Common Equity Capital	$ 593,614	$ 631,415	–6.0%	$ 346,702
Minimum Tier 1 Risk-Based Capital Required	$ 83,845	$ 90,139	–7.0%	$ 88,295
Excess over regulatory requirement	$ 577,769	$ 609,276	–5.2%	$ 326,407
Risk-Weighted Assets	$2,096,125	$2,253,487	–7.0%	$2,207,383
Total Risk-Based Capital Ratio	32.84%	32.32%	1.6%	19.84%
Minimum Total Risk-Based Capital Ratio Required	8.00%	8.00%		8.00%
Actual Total Risk-Based Capital	$ 688,415	$ 728,241	–5.5%	$ 437,975
Minimum Total Risk-Based Capital Required	$ 167,690	$ 180,279	–7.0%	$ 176,591
Excess over regulatory requirement	$ 520,725	$ 547,962	–5.0%	$ 261,384
Risk-Weighted Assets	$2,096,125	$2,253,487	–7.0%	$2,207,383
Tangible common equity (common equity less goodwill and core deposit intangible) to total assets	9.32%	9.03%	3.2%	3.97%
Tangible common equity to risk-weighted assets	29.75%	29.30%	1.5%	11.79%
Total equity to total assets	10.39%	10.02%	3.7%	5.04%
Total equity to risk-weighted assets	33.18%	32.50%	2.1%	14.96%
Tier 1 common equity to risk-weighted assets	28.32%	28.02%	1.1%	15.71%
Tier 1 common equity	$ 593,615	$ 631,415	–6.0%	$ 346,702
Stock data:				
Outstanding common shares	41,245	46,349	–11.0%	24,235
Book value per common share	$ 15.22	$ 14.33	6.2%	$ 10.82
Market price at end of period	$ 12.11	$ 12.49	–3.0%	$ 10.80
Market capitalization at end of period	$ 499,477	$ 578,899	–13.7%	$ 261,738

The following table provides a reconciliation of the Group's total stockholders' equity to tangible common equity and total assets to tangible assets at December 31, 2011 and 2010:

	December 31,	
	2011	2010
	(In thousands, except share or per share information)	
Total stockholders' equity	$ 695,555	$ 732,331
Preferred stock	(68,000)	(68,000)
Goodwill	(2,701)	(2,701)
Core deposit intangible	(1,185)	(1,328)
Total tangible common equity	$ 623,669	$ 660,302
Total assets	6,693,666	7,311,006
Goodwill	(2,701)	(2,701)
Core deposit intangible	(1,185)	(1,328)
Total tangible assets	$ 6,689,780	$ 7,306,977
Tangible common equity to tangible assets	9.32%	9.03%
Common shares outstanding at end of period	41,244,533	46,348,667
Tangible book value per common share	$ 15.12	$ 14.25

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

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

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

The table below reconciles the Group's total common equity (GAAP) at December 31, 2011 and 2010 to Tier 1 common equity as defined by the Federal Reserve Board, FDIC and other bank regulatory agencies (non-GAAP):

	December 31,	
	2011	2010
	(In thousands)	
Common stockholders' equity	$627,555	$664,331
Unrealized gains on available-for-sale securities, net of income tax	(79,245)	(36,988)
Unrealized losses on cash flow hedges, net of income tax	42,112	—
Disallowed deferred tax assets	(26,877)	(25,930)
Disallowed servicing assets	(1,045)	(969)
Intangible assets:		
Goodwill	(2,701)	(2,701)
Core deposit intangible	(1,185)	(1,328)
Subordinated capital notes	35,000	35,000
Total Tier 1 common equity	**$593,614**	**$631,415**
Tier 1 common equity to risk-weighted assets	**28.32%**	**28.02%**

The following table presents the Group's capital adequacy information for 2011, 2010, and 2009:

	December 31,		
	2011	2010	2009
		(In thousands)	
Risk-based capital:			
Tier 1 capital	$ 661,614	$ 699,415	$ 414,702
Supplementary (Tier II) capital	26,801	28,826	23,273
Total Capital	$ 688,415	$ 728,241	$ 437,975
Risk-weighted assets:			
Balance sheet items	$2,044,930	$2,216,120	$2,199,669
Off-balance sheet items	51,195	37,367	7,714
Total risk-weighted assets	$2,096,125	$2,253,487	$2,207,383
Ratios:			
Tier 1 capital (minimum required — 4%)	31.56%	31.04%	18.79%
Total capital (minimum required — 8%)	32.84%	32.32%	19.84%
Leverage ratio	9.65%	9.50%	6.52%
Equity to assets	10.39%	10.02%	5.04%
Tangible equity to assets	9.32%	9.03%	3.97%

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. At December 31, 2011 and 2010, the Group was a “well capitalized” institution for regulatory purposes.

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

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

Under the Dodd-Frank Act, federal banking regulators are required to establish minimum leverage and risk-based capital requirements, on a consolidated basis, for insured institutions, depository institution holding companies, and non-bank financial companies supervised by the Federal Reserve Board. The minimum leverage and risk-based capital requirements are to be determined based on the minimum ratios established for insured depository institutions under prompt corrective action regulations. In effect, such provision of the Dodd-Frank Act, 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.

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

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

	Price		Cash Dividend
	High	Low	Per share
2011			
December 31, 2011	$12.35	$ 9.19	$0.06
September 30, 2011	$13.20	$ 9.18	$0.05
June 30, 2011	$13.07	$11.26	$0.05
March 31, 2011	$12.84	$11.40	$0.05
2010			
December 31, 2010	$13.72	$11.50	$0.05
September 30, 2010	$14.45	$12.13	$0.04
June 30, 2010	$16.72	$12.49	$0.04
March 31, 2010	$14.09	$10.00	$0.04
2009			
December 31, 2009	$13.69	$ 9.43	$0.04
September 30, 2009	$15.41	$ 7.48	$0.04
June 30, 2009	$11.27	$ 4.88	$0.04
March 31, 2009	$ 7.38	$ 0.91	$0.04

The Bank is considered "well capitalized" under the regulatory framework for prompt corrective action. The table below shows the Bank's regulatory capital ratios at December 31, 2011, 2010, and 2009:

	December 31,			
	2011	2010	Variance %	2009
	(Dollars in thousands)			
Oriental Bank and Trust Regulatory Capital Ratios:				
Total Tier 1 Capital to Total Assets	9.06%	9.22%	–1.7%	5.78%
Actual Tier 1 Capital	$616,590	$666,531	–7.5%	$359,339
Minimum Capital Requirement (4%)	$272,178	$289,083	–5.8%	$248,671
Minimum to be well capitalized (5%)	$340,222	$361,354	–5.8%	$310,839
Total Tier 1 Capital to Risk-Weighted Assets	29.59%	29.95%	–1.2%	16.52%
Actual Tier 1 Capital	$616,590	$666,531	–7.5%	$359,339
Minimum Capital Requirement (4%)	$ 83,344	$ 89,025	–6.4%	$ 87,021
Minimum to be well capitalized (6%)	$125,015	$133,537	–6.4%	$130,532
Total Capital to Risk-Weighted Assets	30.87%	31.23%	–1.1%	17.59%
Actual Tier 1 Capital	$643,237	$695,013	–7.4%	$382,611
Minimum Capital Requirement (8%)	$166,687	$178,049	–6.4%	$174,042
Minimum to be well capitalized (10%)	$208,359	$222,562	–6.4%	$217,553

Group's Financial Assets Managed

The Group's financial assets managed include those managed by the Group's trust division, the retirement plan administration subsidiary, and the securities broker-dealer subsidiary. Assets managed by the trust division 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 the retirement plan administration subsidiary, CPC, manages 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. The Group's broker-dealer subsidiary offers a wide array of investment alternatives to its client base, such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money management wrap-fee programs. At December 31, 2011, total assets gathered by the broker-dealer subsidiary from its customer investment accounts increased to \$1.926 billion, compared to \$1.696 billion at December 31, 2010.

Allowance for Loan and Lease Losses and Non-Performing Assets

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

At December 31, 2011, the Group's allowance for non-covered loan losses amounted to \$37.0 million or 3.06% of total non-covered loans versus \$31.4 million or 2.66% of total non-covered loans at December 31, 2010. The allowance for residential mortgage loans increased by 33.5% or \$5.4 million, when compared with balances recorded at December 31, 2010. The allowance for commercial loans increased by 12.5% or \$1.4 million, when compared with balances recorded at December 31, 2010. The allowance for consumer loans decreased by 35.4% or \$810 thousand, when compared with balances recorded at December 31, 2010.

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

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

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

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

During the year ended December 31, 2011, net credit losses amounted to $9.6 million, a 24.0% increase when compared to $7.8 million reported for the same period of 2010. The increase was primarily due to a $2.0 million increase in net credit losses for mortgage loans. Net credit losses on consumer loans increased $124 thousand, while net credit losses on commercial loans deceased $408 thousand. Net credit losses on leases were $187 thousand for the year ended December 31, 2011. Total charge-offs increased from $8.2 million in 2010 to $10.1 million in 2011, and total recoveries increased from $479 thousand in 2010 to $506 thousand in 2011. As a result, the recoveries to charge-offs ratio decreased from 5.8% in 2010, to 5.0% in 2011.

The Group's non-performing assets include non-performing loans and foreclosed real estate (see Tables 11 and 12). At December 31, 2011 and 2010, the Group had $134.8 million and $122.4 million, respectively, of non-accrual non-covered loans including credit cards accounted under ASC 310-20. Covered loans are considered to be performing due to the application of the accretion method under ASC 310-30. At December 31, 2011 and 2010, loans of which terms have been extended and which are classified as troubled debt restructuring that are not included in non-performing assets amounted to $41.3 million and $35.0 million, respectively.

At December 31, 2011, the Group's non-performing assets totaled $149.8 million (2.42% of total assets) versus $134.8 million (2.03% of total assets) at December 31, 2010. The Group's non-performing loans generally reflect the recessionary economic environment in Puerto Rico. Nonetheless, the Group does not expect non-performing loans to result in significantly higher losses as most are well-collateralized with adequate loan-to-value ratios.

At December 31, 2011, the allowance for non-covered loan and lease losses to non-performing loans coverage ratio was 27.5% (25.6% at December 31, 2010).

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

The following items comprise non-performing assets:

- **Mortgage loans** — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan. At December 31, 2011, the Group's non-performing mortgage loans totaled $97.3 million (72.2% of the Group's non-performing loans), a 1.4% decrease from $98.7 million (80.4% of the Group's non-performing loans) at December 31, 2010. Non-performing loans in this category are primarily residential mortgage loans. On April 1, 2011, the Bank changed on a prospective basis its policy to place on non-accrual status residential mortgage loans well collateralized and in process of collection when reaching 90 days past due. All loans that were between 90 and 365 days past due when the policy was changed were also placed on non-accrual status, 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.

- **Commercial loans** — are placed on non-accrual status when they become 90 days or more past due and are written-down, if necessary, based on the specific evaluation of the underlying collateral, if any. At December 31, 2011, the Group's non-performing commercial loans amounted to $37.0 million (27.4% of the Group's non-performing loans), a 56.6% increase when compared to non-performing commercial loans of $23.6 million at December 31, 2010 (19.2% of the Group's non-performing loans). Approximately 72% of this portfolio is collateralized by commercial real estate properties.

- **Consumer loans** — are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 120 days in personal loans and 180 days in credit cards and personal lines of credit. At December 31, 2011, the Group's non-performing consumer loans amounted to $334 thousand (0.2% of the Group's total non-performing loans), a 20.7% decrease from $421 thousand at December 31, 2010 (0.3% of total non-performing loans).

- **Leases** — are placed on non-accrual status when they become 90 days past due and partially written-off to collateral value when payments are delinquent 120 days, and fully written-off when payments are delinquent 180 days. At December 31, 2011, the Group's non-performing leases amounted to $102 thousand (0.1% of the Group's total non-performing loans), an increase of 191.4% from $35 thousand at December 31, 2010 (0.0% of total non-performing loans).

- **Foreclosed real estate** — is initially recorded at the lower of the related loan balance or fair value less cost to sell as of the date of foreclosure. Any excess of the loan balance over the fair value of the property is charged against the allowance for loan and lease losses. Subsequently, any excess of the carrying value over the estimated fair value less disposition cost is charged to operations. Net losses on the sale of foreclosed real estate for the year ended December 31, 2011 amounted to $1.7 million compared to $524 thousand in the year ended December 31, 2010.

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

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

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

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

On October 24, 2011, the Federal Housing Finance Agency ("FHFA"), FHLMC and FNMA announced a series of FHFA-directed enhancements to the Home Affordable Refinance Program ("HARP") in an effort to attract more borrowers who can benefit from refinancing their home mortgages under this program. These enhancements entail the relaxation of underwriting guidelines, such as loan-to-value ratio, appraisals, and certain fees, among other things, subject to a variety of qualifications, and the extension of HARP until December 31, 2013. The enhancements do not change the time period for eligible loans, maintaining the requirement that the loans must have been guaranteed by Fannie Mae or Freddie Mac prior to June 2009. The Group does not expect these changes to have a significant impact on its results of operations.

The loans covered by the FDIC shared loss agreements were recognized at fair value as of April 30, 2010, which included the impact of expected credit losses. To the extent credit deterioration occurs in covered loans after the date of acquisition, the Group 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. These deviations are both positive and negative in nature. 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 for the year ended December 31, 2011, the Group recorded a recapture of covered loan and lease losses of $1.4 million. A provision for covered loan and lease losses of $6.2 million was recorded in the year ended December 31, 2010.

TABLE 8 — ALLOWANCE FOR LOAN AND LEASE LOSSES SUMMARY
YEARS ENDED DECEMBER 31, 2011, 2010, AND 2009

	December 31,		
	2011	2010	2009
	(in thousands)		
Non-covered loans			
Balance at beginning of year	$ 31,430	$23,272	$14,293
Provision for non-covered loan and lease losses	15,200	15,914	15,650
Charge-offs	(10,126)	(8,235)	(7,028)
Recoveries	506	479	357
Balance at end of year	**$ 37,010**	**$31,430**	**$23,272**
Covered loans			
Balance at beginning of year	$ 49,286	$ —	$ —
Provision for (recapture of) covered loan and lease losses	(1,387)	6,282	—
FDIC shared-loss portion on provision for (recapture of) covered loan and lease losses	(10,643)	43,004	—
Balance at end of year	**$ 37,256**	**$49,286**	**$ —**

TABLE 9 — ALLOWANCE FOR NON-COVERED LOAN AND LEASE LOSSES BREAKDOWN AS OF DECEMBER 31, 2011, 2010 AND 2009

	December 31,		
	2011	2010	2009
	(Dollars in thousands)		
Mortgage	$21,652	$ 16,179	$15,044
Commercial	12,548	11,153	7,112
Consumer	1,423	2,286	864
Leasing	845	860	—
Unallocated allowance	542	952	252
	$37,010	**$ 31,430**	**$23,272**
Allowance composition:			
Mortgage	58.52%	51.47%	64.60%
Commercial	33.90%	35.49%	30.60%
Consumer	3.84%	7.27%	3.70%
Leasing	2.28%	2.74%	0.00%
Unallocated allowance	1.46%	3.03%	1.10%
	100.00%	**100.00%**	**100.00%**
Allowance coverage ratio at end of period applicable to:			
Mortgage	2.64%	1.85%	1.60%
Commercial	4.16%	4.75%	3.60%
Consumer	3.57%	6.24%	3.76%
Leasing	3.28%	8.38%	0.00%
Unallocated allowance to total loans	0.05%	8.00%	0.02%
Total allowance to total loans	**3.11%**	**2.72%**	**2.00%**
Allowance coverage ratio to non-performing loans:			
Mortgage	22.32%	16.44%	17.05%
Commercial	33.92%	47.22%	45.33%
Consumer	216.59%	300.39%	194.16%
Leasing	828.43%	2457.14%	—
Total	**27.46%**	**25.59%**	**22.30%**

TABLE 10 — NET CREDIT LOSSES STATISTICS
YEARS ENDED DECEMBER 31, 2011, 2010, AND 2009

	December 31, 2011	2010	2009
	(Dollars in thousands)		
Mortgage			
Charge-offs	$ (5,836)	$ (3,867)	$ (3,493)
Recoveries	101	93	70
	(5,735)	**(3,774)**	**(3,423)**
Commercial			
Charge-offs	(2,506)	(2,913)	(2,223)
Recoveries	161	160	56
	(2,345)	**(2,753)**	**(2,167)**
Consumer			
Charge-offs	(1,587)	(1,455)	(1,312)
Recoveries	234	226	231
	(1,353)	**(1,229)**	**(1,081)**
Leasing			
Charge-offs	(197)	—	—
Recoveries	10	—	—
	$ (187)	**$ —**	**$ —**
Net credit losses			
Total charge-offs	(10,126)	(8,235)	(7,028)
Total recoveries	506	479	357
	$ (9,620)	**$ (7,756)**	**$ (6,671)**
Net credit losses to average loans outstanding:			
Mortgage	0.66%	0.41%	0.35%
Commercial	0.92%	1.34%	1.14%
Consumer	3.45%	4.43%	5.26%
Leasing	1.10%	—	—
Total	**0.81%**	**0.67%**	**0.57%**
Recoveries to charge-offs	**5.00%**	**5.82%**	**5.10%**
Average loans not covered under shared-loss agreements with the FDIC:			
Mortgage	$ 872,966	$ 923,345	$ 968,400
Commercial	254,617	206,090	189,951
Consumer	39,233	27,735	20,539
Leasing	16,996	5,129	—
Total	**$1,183,812**	**$1,162,299**	**$1,178,890**

TABLE 11 — NON-PERFORMING ASSETS
AS OF DECEMBER 31, 2011, 2010 AND 2009

	December 31,		
	2011	**2010**	**2009**
	(Dollars in thousands)		
Non-performing assets:			
Non-accruing loans			
Troubled Debt Restructuring loans	$ 27,533	$ 2,327	$ 214
Other loans	107,231	71,236	56,854
Accruing loans			
Troubled Debt Restructuring loans	—	3,371	443
Other loans	—	45,490	46,860
Total non-performing loans	$134,764	$122,424	$104,371
Foreclosed real estate not covered under the shared-loss agreement with the FDIC	13,812	11,969	9,347
Mortgage loans held for sale in non-accrual	1,223	—	—
	$149,799	**$134,393**	**$113,718**
Non-performing assets to total assets, excluding covered assets	**2.42%**	**2.03%**	**1.74%**
Non-performing assets to total capital	21.31%	18.35%	34.44%

	Year Ended December 31,		
	2011	**2010**	**2009**
Interest that would have been recorded in the period if the loans had not been classified as non-accruing loans	$ 5,415	$ 3,802	$ 3,571

The increase in non-accruing loans is mainly related to the policy change performed during the second quarter of 2011, to place on non-accrual status residential mortgage loans well collateralized and in process of collection when reaching 90 days past due. Furthermore, the increase in troubled debt restructuring loans in non-accrual status reflects an increase of $16.6 million in commercial loans classified as troubled debt restructurings and non-performing.

TABLE 12 — NON-PERFORMING LOANS
AS OF DECEMBER 31, 2011, 2010 AND 2009

	December 31,		
	2011	**2010**	**2009**
	(Dollars in thousands)		
Non-performing loans:			
Mortgage	$ 97,340	$ 98,348	$ 88,510
Commercial	36,988	23,619	15,688
Consumer	334	422	173
Leasing	102	35	—
Total	**$134,764**	**$122,424**	**$104,371**
Non-performing loans composition percentages:			
Mortgage	72.2%	80.4%	84.7%
Commercial	27.4%	19.3%	15.0%
Consumer	0.3%	0.3%	0.3%
Leasing	0.1%	0.0%	0.0%
Total	**100.0%**	**100.0%**	**100.0%**
Non-performing loans to:			
Total loan, excluding covered loans	**11.38%**	**10.65%**	**8.97%**
Total asset, excluding covered assets	**2.19%**	**1.85%**	**1.59%**
Total capital	**19.33%**	**16.72%**	**31.61%**

TABLE 13 — HIGHER RISK RESIDENTIAL MORTGAGE LOANS
AS OF DECEMBER 31, 2011

	Higher-Risk Residential Mortgage Loans*								
							High Loan-to-Value Ratio Mortgages		
	Junior Lien Mortgages			Interest Only Loans			LTV 90% and over		
	Carrying Value	Allowance	Coverage	Carrying Value	Allowance	Coverage	Carrying Value	Allowance	Coverage
	(Dollars in thousands)								
Delinquency:									
0 - 89 days	$18,270	$307	1.68%	$31,476	$ 604	1.92%	$ 85,111	$1,555	1.83%
90 - 119 days	627	44	7.02%	732	17	2.32%	1,143	74	6.47%
120 - 179 days	21	2	9.52%	374	47	12.57%	1,325	104	7.85%
180 - 364 days	1,249	105	8.41%	996	124	12.45%	3,748	326	8.70%
365 days and over	1,455	191	13.13%	2,880	597	20.73%	10,535	1,462	13.88%
Total	$21,622	$649	3.00%	$36,458	$1,389	3.81%	$101,862	$3,521	3.46%
Percentage of total loans not covered by FDIC shared-loss agreements	1.79%			3.01%			8.41%		
Refinanced or Modified Loans:									
Amount	$ 2,874	$208	7.24%	$ —	$ —	—	$ 14,950	$1,022	6.84%
Percentage of Higher-Risk Loan Category	13.29%			0.00%			14.68%		
Loan-to-Value Ratio:									
Under 70%	$16,153	$448	2.77%	$ 5,064	$ 97	1.92%	$ —	$ —	—
70% - 79%	3,222	79	2.45%	7,891	425	5.39%	—	—	—
80% - 89%	1,411	43	3.05%	9,077	275	3.03%	—	—	—
90% and over	836	79	9.45%	14,426	592	4.10%	101,862	3,521	3.46%
Total	$21,622	$649	3.00%	$36,458	$1,389	3.81%	$101,862	$3,521	3.46%

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

Contractual Obligations and Commercial Commitments

As disclosed in the notes to the Group's consolidated financial statements, the Group has certain obligations and commitments to make future payments under contracts. At December 31, 2011, the aggregate contractual obligations and commercial commitments are:

	Payments Due by Period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	After 5 years
	(in thousands)				
CONTRACTUAL OBLIGATIONS:					
Short term borrowings	$ 39,920	$ 39,920	$ —	$ —	$ —
Securities sold under agreements to repurchase	3,050,000	600,000	400,000	300,000	1,750,000
Advances from FHLB	280,000	225,000	55,000	—	—
FDIC-guaranteed term notes	105,000	105,000	—	—	—
Subordinated capital notes	36,083	—	—	—	36,083
Annual rental commitments under noncancelable operating leases	39,052	4,588	9,141	8,064	17,259
Total	**$3,550,055**	**$974,508**	**$464,141**	**$308,064**	**$1,803,342**

Loan commitments, which represent unused lines of credit and letters of credit provided to customers, increased from $104.3 million from the previous year to $106.1 million. Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates, bear variable interest and may require payment of a fee. Since the commitments may expire unexercised, the total commitment amounts do not necessarily represent future cash requirements. The Group evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the customer. Commitments for loans covered under the FDIC shared-loss agreements amounted to $31.1 million at December 31, 2011.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with GAAP which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

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

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

QUARTERLY FINANCIAL DATA (Unaudited)

The following is a summary of the unaudited quarterly results of operations:

TABLE 13A — SELECTED QUARTERLY FINANCIAL DATA:

	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011
	(In thousands, except per share data)			
EARNINGS DATA:				
Interest income	$78,034	$82,202	$71,536	$ 65,256
Interest expense	40,757	39,389	39,066	37,374
Net interest income	**37,277**	**42,813**	**32,470**	**27,882**
Provision for non-covered loan and lease losses	3,800	3,800	3,800	3,800
Provision for (recapture of) covered loan and lease losses, net	549	—	(1,936)	—
Total provision for loan and lease losses, net	4,349	3,800	1,864	3,800
Net interest income after provision for loan and lease losses	**32,928**	**39,013**	**30,606**	**24,082**
Non-interest income (loss)	7,406	16,760	17,177	(10,354)
Non-interest expenses	30,780	30,697	30,415	30,410
Income (loss) before taxes	**9,554**	**25,076**	**17,368**	**(16,682)**
Income tax expense (benefit)	6,472	(1,391)	580	(4,795)
Net income (loss)	**3,082**	**26,467**	**16,788**	**(11,887)**
Less: Dividends on preferred stock	(1,201)	(1,200)	(1,201)	(1,200)
Income available (loss) to common shareholders	**$ 1,881**	**$25,267**	**$15,587**	**$(13,087)**
PER SHARE DATA:				
Basic	**$ 0.04**	**$ 0.56**	**$ 0.35**	**$ (0.31)**
Diluted	**$ 0.04**	**$ 0.56**	**$ 0.35**	**$ (0.31)**

TABLE 13B — SELECTED QUARTERLY FINANCIAL DATA:

	March 31, 2010	June 30, 2010	September 30, 2010	December 31, 2010
	(In thousands, except per share data)			
EARNINGS DATA:				
Interest income	$70,336	$79,842	$ 81,221	$72,402
Interest expense	40,875	42,908	43,073	41,813
Net interest income	**29,461**	**36,934**	**38,148**	**30,589**
Provision for non-covered loan and lease losses	4,014	4,100	4,100	3,700
Provision for covered loan and lease losses, net	—	—	—	6,282
Total provision for loan and lease losses, net	4,014	4,100	4,100	9,982
Net interest income after provision for loan and lease losses	**25,447**	**32,834**	**34,048**	**20,607**
Non-interest income (loss)	8,055	(4,304)	(10,452)	11,899
Non-interest expenses	20,395	27,849	32,705	31,649
Income (loss) before taxes	**13,107**	**681**	**(9,109)**	**857**
Income tax expense (benefit)	1,171	34	(1,287)	(4,216)
Net income (loss)	**11,936**	**647**	**(7,822)**	**5,073**
Less: Dividends on preferred stock	(1,201)	(1,733)	(1,201)	(1,200)
Less: Deemed dividend on preferred stock beneficial conversion feature	—	—	(22,711)	—
Less: Allocation of undistributed earnings for participating preferred shares	—	(3,104)	—	—
Income available (loss) to common shareholders	**$10,735**	**$ (4,190)**	**$(31,734)**	**$ 3,873**
PER SHARE DATA:				
Basic	**$ 0.42**	**$ (0.13)**	**$ (0.70)**	**$ 0.08**
Diluted	**$ 0.41**	**$ (0.13)**	**$ (0.70)**	**$ 0.08**

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

Background

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

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

Market Risk

Market risk is the risk to earnings or capital arising from adverse movements in market rates or prices, such as interest rates or prices. The Group evaluates market risk together with interest rate risk.

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

Interest Rate Risk

Interest rate risk is the exposure of the Group's earnings or capital to adverse movements in interest rates. It is a predominant market risk in terms of its potential impact on earnings. The Group manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income.

ALCO oversees interest rate risk, liquidity management and other related matters.

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

On a monthly basis, the Group performs a net interest income simulation analysis on a consolidated basis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a one-year time horizon, assuming gradual upward and downward interest rate movements of 200 basis points, achieved during a twelve-month period. Simulations are carried out in two ways:

(1) using a static balance sheet as the Group had on the simulation date, and

(2) using a dynamic balance sheet based on recent growth patterns and business strategies.

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

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

These simulations are highly complex, and use many simplifying assumptions that are intended to reflect the general behavior of the Group over the period in question. There can be no assurance that actual events will match these assumptions in all cases. For this reason, the results of these simulations are only approximations of the true sensitivity of net interest income to changes in market interest rates. The following table presents the results of the simulations at December 31, 2011 for the most likely scenario, assuming a one-year time horizon:

	Net Interest Income Risk (one year projection)			
	Static Balance Sheet		Growing simulation	
Change in interest rate	**Amount Change**	**Percent Change**	**Amount Change**	**Percent Change**
(Dollars in thousands)				
+ 200 Basis points	$ 37,654	26.80%	$ 38,423	26.51%
+ 100 Basis points	$ 21,384	15.22%	$ 21,783	15.03%
– 50 Basis points	$(10,880)	–7.74%	$(11,335)	–7.82%

The impact of -100 and -200 basis point reductions in interest rates is not presented in view of current level of the federal funds rate and other short-term interest rates.

Future net interest income could be affected by the Group's investments in callable securities, prepayment risk related to mortgage loans and mortgage-backed securities, and its structured repurchase agreements and advances from the FHLB. As part of the strategy to limit the interest rate risk and reduce the re-pricing gaps of the Group's assets and liabilities, the maturity and the re-pricing frequency of the liabilities has been extended to longer terms.

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

Derivative instruments that are used as part of the Group's interest 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 exchanged-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 hose contract, it is bifurcated and carried at fair value. Please refer to Note 8 to the accompanying consolidated financial statements for further information on the Group's derivative activities.

Following is a summary of certain strategies, including derivative activities, used by the Group in 2011 to manage interest rate risk:

Interest rate swaps — In March 2011, the Group terminated all of its $1.250 billion open forward-settlement swaps with realized losses of $4.3 million. At the same time the Group entered into $950 million of new forward-settlement swaps, all of which were designated as cash flow hedges. 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. 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. The Group entered into the forward-settlement swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings, attributable to changes in the one-month LIBOR rate. Once the forecasted wholesale borrowings transactions occur, the interest rate swap will effectively fix the Group's interest payments on an amount of forecasted interest expense attributable to the one-month LIBOR rate corresponding to the swap notional stated rate. A derivative liability of $47.4 million was recognized at December 31, 2011, related to the valuation of these swaps. Refer to Note 8 of the consolidated financial statements for a description of these swaps.

The remaining $825 million in swaps will reduce the cost of $825 million of wholesale borrowings to 2.24% from 4.29%, starting in May 2012.

S&P options — The Group has offered its customers certificates of deposit with an option tied to the performance of the S&P index. At the end of five years, the depositor receives a minimum return or a specified percentage of the average increase of the month-end value of the stock index. The Group uses option agreements with major money center banks and major broker-dealer companies to manage its exposure to changes in that index. Under the terms of the option agreements, the Group receives the average increase in the month-end value of such index in exchange for a fixed premium. The changes in fair value of the options purchased and the options embedded in the certificates of deposit are recorded in earnings.

At December 31, 2011 and 2010, the fair value of the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of $9.5 million and $9.9 million, respectively; and the options sold to customers embedded in the certificates of deposit represented a liability of $9.4 million and $12.8 million, respectively, recorded in deposits.

Structured borrowings — The Group uses structured repurchase agreements and advances from FHLB, with embedded put options, to reduce the Group's exposure to interest rate risk by lengthening the contractual maturities of its liabilities.

Credit Risk

Credit risk is the possibility of loss arising from a borrower or counterparty in a credit-related contract failing to perform in accordance with its terms. The principal source of credit risk for the Group is its lending activities. In Puerto Rico, the Group's principal market, the economic recession moderated in calendar year 2011 according to government data. However, economic growth remains a challenge due to the lack of employment growth and a housing sector that remains under pressure in spite of progress made by the Puerto Rico government in reducing its fiscal deficit.

The Group manages its credit risk through a comprehensive credit policy which establishes sound underwriting standards by monitoring and evaluating loan portfolio quality, and by the constant assessment of reserves and loan concentrations. The Group also employs proactive collection and loss mitigation practices.

The Group may also encounter risk of default in relation to its securities portfolio. The securities held by the Group are principally agency mortgage-backed securities. Thus, a substantial portion of these instruments are guaranteed by mortgages, a U.S. government-sponsored entity, or the full faith and credit of the U.S. government. A credit default by the U.S. government or a downgrade in the credit ratings of the U.S. government may have a material adverse effect on the Group. The available-for-sale securities portfolio also includes approximately $81.5 million in structured credit investments that are considered of a higher credit risk than agency securities.

Management's Executive Credit Committee, composed of the Group's Chief Executive Officer, Chief Credit Risk Officer and other senior executives, has primary responsibility for setting strategies to achieve the Group's credit risk goals and objectives. Those goals and objectives are set forth in the Group's Credit Policy as approved by the Board.

Liquidity Risk

Liquidity risk is the risk of the Group not being able to generate sufficient cash from either assets or liabilities to meet obligations as they become due without incurring substantial losses. The Board has established a policy to manage this risk. The Group's cash requirements principally consist of deposit withdrawals, contractual loan funding, repayment of borrowings as these mature, and funding of new and existing investments as required.

The Group's business requires continuous access to various funding sources. While the Group is able to fund its operations through deposits as well as through advances from the FHLB 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. Most of the Group's repurchase agreements have been structured with initial terms that mature between three and ten years, and except for four repurchase agreements totaling $600 million, the counterparties have the right to exercise at par on a quarterly basis put options before their contractual maturities. The Group's $500 million repurchase agreement also provides for an optional early termination by either party upon no less than two business days' prior written notice to the other party. In the event of any such optional early termination, the amounts owed by or to the terminating party by the other party on the optional early termination date must take account of the termination value of the transaction, as determined by the calculation agent in the manner described in the repurchase agreement.

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

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

As of December 31, 2011, the Group had approximately $605.5 million in cash and cash equivalents, $258.8 million in investment securities, $586.5 million in commercial loans, and $435.7 million in mortgage loans available to cover liquidity needs.

Operational Risk

Operational risk is the risk of loss from inadequate or failed internal processes, personnel and systems or from external events. All functions, products and services of the Group are susceptible to operational risk.

The Group faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products. Coupled with external influences such as market conditions, security risks, and legal risk, the potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Group has developed, and continues to enhance, specific internal controls, policies and procedures that are designed to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these policies and procedures is to provide reasonable assurance that the Group's business operations are functioning within established limits.

The Group classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate wide risks, such as information security, business recovery, legal and compliance, the Group has specialized groups, such as Information Security, Corporate Compliance, Information Technology and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups. All these matters are reviewed and discussed in the Information Technology Steering Committee, and the Risk Management and Compliance Committee.

The Group is subject to extensive federal and Puerto Rico regulation, and this regulatory scrutiny has been significantly increasing over the last several years. The Group has established and continues to enhance procedures based on legal and regulatory requirements that are reasonably designed to ensure compliance with all applicable statutory and regulatory requirements. The Group has a corporate compliance function headed by a Compliance Director who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of a company-wide compliance program.

Concentration Risk

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

The Commonwealth of Puerto Rico is in the sixth year of an economic recession, and its government faces a significant fiscal deficit. The Commonwealth's access to the municipal bond market and its credit ratings depend, in part, on achieving a balanced budget. Since March 2009, the Puerto Rico government has enacted several laws to control expenditures, raise revenues, and stimulate the economy. Although the economic recession moderated in calendar year 2011, the Puerto Rico economy continues to struggle.

ITEM 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

ORIENTAL FINANCIAL GROUP INC.

FORM-10K

FINANCIAL DATA INDEX

FINANCIAL STATEMENTS

SUPPLEMENTARY INFORMATION (See Tables 13A and 13B under Item 7 of this report)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated statements of financial condition of Oriental Financial Group Inc. and subsidiaries (the "Group") as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in stockholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oriental Financial Group Inc. and its subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Oriental Financial Group Inc. and its subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 9, 2012 expressed an unqualified opinion on the effectiveness of the Group's internal control over financial reporting.

/s/ KPMG LLP

San Juan, Puerto Rico
March 9, 2012

Stamp No. 21770 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

ORIENTAL FINANCIAL GROUP INC.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

(1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Group;

(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Group are being made only in accordance with authorization of management and directors of the Group; and

(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Group's assets that could have a material effect on the financial statements.

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

As called for by Section 404 of the Sarbanes-Oxley Act of 2002, management has assessed the effectiveness of the Group's internal control over financial reporting as of December 31, 2011. Management made its assessment using the criteria set forth in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Criteria").

Based on its assessment, management has concluded that the Group maintained effective internal control over financial reporting as of December 31, 2011 based on the COSO Criteria.

The effectiveness of the Group's internal control over financial reporting as of December 31, 2011, has been audited by KPMG LLP, the Group's independent registered public accounting firm, as stated in their report dated March 9, 2012.

By: */s/ José Rafael Fernández*
José Rafael Fernández
President and Chief Executive Officer
Date: March 9, 2012

By: */s/ Ganesh Kumar*
Ganesh Kumar
Executive Vice President and Chief Financial Officer
Date: March 9, 2012

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited Oriental Financial Group Inc.'s (the "Group") internal control over financial reporting as of December 31, 2011, based on *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Group's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Group's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Oriental Financial Group Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of Oriental Financial Group Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2011, and our report dated March 9, 2012, expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

San Juan, Puerto Rico
March 9, 2012

Stamp No. 21769 of the Puerto Rico
Society of Certified Public Accountants was affixed to the record copy of this report.

ORIENTAL FINANCIAL GROUP INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31, 2011	December 31, 2010
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents		
Cash and due from banks	$ 601,614	$ 344,067
Money market investments	3,863	104,869
Total cash and cash equivalents	**605,477**	**448,936**
Investments:		
Trading securities, at fair value, with amortized cost of $176 (December 31, 2010 — $1,306)	180	1,330
Investment securities available-for-sale, at fair value, with amortized cost of $2,873,682 (December 31, 2010 — $3,661,146)	2,959,912	3,700,064
Investment securities held-to-maturity, at amortized cost, with fair value of $904,556 (December 31, 2010 — $675,721)	884,026	689,917
Federal Home Loan Bank (FHLB) stock, at cost	23,779	22,496
Other investments	73	150
Total investments	**3,867,970**	**4,413,957**
Loans:		
Mortgage loans held-for-sale, at lower of cost or fair value	26,939	33,979
Loans not covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of $37,010 (December 31, 2010 — $31,430)	1,146,738	1,117,889
Loans covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of $37,256 (December 31, 2010 — $49,286)	496,276	620,711
Total loans, net	**1,669,953**	**1,772,579**
FDIC shared-loss indemnification asset	392,367	473,629
Foreclosed real estate covered under shared-loss agreements with the FDIC	13,867	14,871
Foreclosed real estate not covered under shared-loss agreements with the FDIC	13,812	11,969
Accrued interest receivable	20,182	28,716
Deferred tax asset, net	32,023	30,732
Premises and equipment, net	21,520	23,941
Derivative assets	9,317	28,315
Other assets	47,178	63,361
Total assets	**$6,693,666**	**$7,311,006**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Demand deposits	$1,000,857	$ 954,554
Savings accounts	230,673	235,690
Certificates of deposit	1,163,737	1,398,644
Total deposits	**2,395,267**	**2,588,888**
Borrowings:		
Short-term borrowings	39,920	42,460
Securities sold under agreements to repurchase	3,056,238	3,456,781
Advances from FHLB	281,753	281,753
FDIC-guaranteed term notes	105,834	105,834
Subordinated capital notes	36,083	36,083
Total borrowings	**3,519,828**	**3,922,911**
FDIC net settlement payable	115	22,954
Derivative liabilities	47,425	64
Accrued expenses and other liabilities	35,476	43,858
Total liabilities	**5,998,111**	**6,578,675**
Stockholders' equity:		
Preferred stock, $1 par value; 10,000,000 shares authorized; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding, $25 liquidation value	68,000	68,000
Common stock, $1 par value; 100,000,000 shares authorized; 47,808,657 shares issued; 41,244,533 shares outstanding (December 31, 2010 — 47,807,734; 46,348,667)	47,809	47,808
Additional paid-in capital	499,096	498,435
Legal surplus	50,178	46,331
Retained earnings	68,149	51,502
Treasury stock, at cost, 6,564,124 shares (December 31, 2010 — 1,459,067 shares)	(74,808)	(16,732)
Accumulated other comprehensive income, net of tax of $1,848 (December 31, 2010 — $2,108)	37,131	36,987
Total stockholders' equity	**695,555**	**732,331**
Total liabilities and stockholders' equity	**$6,693,666**	**$7,311,006**

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

ORIENTAL FINANCIAL GROUP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2011	**2010**	**2009**
		(in thousands)	
Interest income:			
Loans not covered under shared-loss agreements with the FDIC	$ 68,333	$ 71,310	$ 73,155
Loans covered under shared-loss agreements with the FDIC	67,665	44,158	—
Total interest income from loans	**135,998**	**115,468**	**73,155**
Mortgage-backed securities	151,924	161,518	198,015
Investment securities and other	9,106	26,815	48,310
Total interest income	**297,028**	**303,801**	**319,480**
Interest expense:			
Deposits	45,645	48,603	54,947
Securities sold under agreements to repurchase	93,279	100,609	116,755
Advances from FHLB and other borrowings	12,347	12,248	12,380
FDIC-guaranteed term notes	4,084	4,084	3,175
Note payable to the FDIC	—	1,887	—
Subordinated capital notes	1,231	1,238	1,465
Total interest expense	**156,586**	**168,669**	**188,722**
Net interest income	**140,442**	**135,132**	**130,758**
Provision for non-covered loan and lease losses	15,200	15,914	15,650
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**
Net interest income after provision for loan and lease losses	**126,629**	**112,936**	**115,108**
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 banking and wealth management revenues	**44,235**	**39,318**	**30,139**
Total loss on other-than-temporarily impaired securities	(15,018)	(39,674)	(101,472)
Portion of loss on securities recognized in other comprehensive income	—	22,508	41,398
Other-than-temporary impairments on securities	(15,018)	(17,166)	(60,074)
Net (amortization) accretion of FDIC shared-loss indemnification asset	(3,379)	4,330	—
Fair value adjustment on FDIC equity appreciation instrument	—	909	—
Net gain (loss) on:			
Sale of securities	27,996	15,032	4,385
Derivatives	(13,220)	(36,823)	29,181
Early extinguishment of repurchase agreements	(4,790)	—	(17,551)
Trading securities	(15)	23	12,564
Foreclosed real estate	(1,717)	(524)	(570)
Other	(3,103)	99	113
Total non-interest income (loss), net	**30,989**	**5,198**	**(1,813)**

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

ORIENTAL FINANCIAL GROUP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (Continued)

	Year Ended December 31,		
	2011	2010	2009
		(in thousands)	
Non-interest expenses:			
Compensation and employee benefits	45,552	41,723	32,020
Occupancy and equipment	17,407	18,556	14,763
Professional and service fees	21,742	16,491	10,379
Insurance	6,642	7,006	7,233
Advertising, business promotion, and strategic initiatives	5,975	4,978	4,208
Electronic banking charges	5,709	4,504	2,194
Taxes, other than payroll and income taxes	4,721	5,106	3,004
Loan servicing and clearing expenses	3,979	3,051	2,390
Foreclosure and repossession expenses	2,936	2,830	929
Communication	1,623	2,561	1,567
Director and investor relations	1,305	1,463	1,374
Printing, postage, stationery and supplies	1,264	1,188	902
Other	3,447	3,141	2,415
Total non-interest expenses	**122,302**	**112,598**	**83,378**
Income before income taxes	**35,316**	**5,536**	**29,917**
Income tax expense (benefit)	866	(4,298)	6,972
Net income	**34,450**	**9,834**	**22,945**
Less: Dividends on preferred stock	(4,802)	(5,335)	(4,802)
Less: Deemed dividend on preferred stock beneficial conversion feature	—	(22,711)	—
Income available (loss) to common shareholders	**$ 29,648**	**$ (18,212)**	**$18,143**
Income (loss) per common share:			
Basic	**$ 0.67**	**$ (0.50)**	**$ 0.75**
Diluted	**$ 0.67**	**$ (0.50)**	**$ 0.75**
Average common shares outstanding and equivalents	**44,524**	**36,810**	**24,306**
Cash dividends per share of common stock	**$ 0.21**	**$ 0.17**	**$ 0.16**

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

ORIENTAL FINANCIAL GROUP INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Year Ended December 31,		
	2011	2010	2009
	(In thousands)		
Preferred stock:			
Balance at beginning of year	$ 68,000	$ 68,000	$ 68,000
Issuance of preferred stock	—	177,289	—
Conversion of preferred stock to common stock	—	(177,289)	—
Balance at end of year	**68,000**	**68,000**	**68,000**
Additional paid-in capital from beneficial conversion feature			
Balance at beginning of year	—	—	—
Issuance of preferred stock — beneficial conversion feature	—	22,711	—
Conversion of preferred stock — beneficial conversion feature	—	(22,711)	—
Balance at end of year	**—**	**—**	**—**
Common stock:			
Balance at beginning of year	47,808	25,739	25,739
Issuance of common stock	—	8,740	—
Conversion of preferred stock to common stock	—	13,320	—
Exercised stock options	1	9	—
Balance at end of year	**47,809**	**47,808**	**25,739**
Additional paid-in capital:			
Balance at beginning of year	498,435	213,445	212,625
Issuance of common stock	—	90,896	—
Conversion of preferred stock to common stock	—	186,680	—
Deemed dividend on preferred stock beneficial conversion feature	—	22,711	—
Stock-based compensation expense	1,310	1,194	742
Exercised stock options	7	63	—
Lapsed restricted stock units	(656)	(380)	—
Capital contribution	—	—	78
Common stock issuance costs	—	(5,250)	—
Preferred stock issuance costs	—	(10,924)	—
Balance at end of year	**499,096**	**498,435**	**213,445**
Legal surplus:			
Balance at beginning of year	46,331	45,279	43,016
Transfer from retained earnings	3,847	1,052	2,263
Balance at end of year	**50,178**	**46,331**	**45,279**
Retained earnings:			
Balance at beginning of year	51,502	77,584	51,233
Cumulative effect on initial adoption of accounting principle	—	—	14,359
Net income	34,450	9,834	22,945
Cash dividends declared on common stock	(9,154)	(6,818)	(3,888)
Cash dividends declared on preferred stock	(4,802)	(5,335)	(4,802)
Deemed dividend on preferred stock beneficial conversion feature	—	(22,711)	—
Transfer to legal surplus	(3,847)	(1,052)	(2,263)
Balance at end of year	**68,149**	**51,502**	**77,584**
Treasury stock:			
Balance at beginning of year	(16,732)	(17,142)	(17,109)
Stock purchased	(58,775)	—	(182)
Lapsed restricted stock units	656	380	—
Stock used to match defined contribution plan	43	30	149
Balance at end of year	**(74,808)**	**(16,732)**	**(17,142)**
Accumulated other comprehensive income, net of tax:			
Balance at beginning of year	36,987	(82,739)	(122,187)
Cumulative effect on initial adoption of accounting principle	—	—	(14,359)
Other comprehensive income, net of tax	144	119,726	53,807
Balance at end of year	**37,131**	**36,987**	**(82,739)**
Total stockholders' equity	**$695,555**	**$ 732,331**	**$ 330,166**

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

ORIENTAL FINANCIAL GROUP INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2011	2010	2009
		(In thousands)	
Net income	**$ 34,450**	**$ 9,834**	**$ 22,945**
Other comprehensive income:			
Unrealized gain (loss) on securities available-for-sale	60,287	127,144	(3,323)
Realized gain on investment securities included in net income	(27,996)	(15,032)	(4,385)
Total loss on other- than-temporarily impaired securities	15,018	39,674	101,472
Portion of loss on securities recognized in other comprehensive income	—	(22,508)	(41,398)
Unrealized losses on cash flow hedges	(47,425)	—	—
Income tax effect	260	(9,552)	1,441
Other comprehensive income for the year	**144**	**119,726**	**53,807**
Comprehensive income	**$ 34,594**	**$129,560**	**$ 76,752**

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

ORIENTAL FINANCIAL GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2011	2010	2009
		(In thousands)	
Cash flows from operating activities:			
Net income	$ 34,450	$ 9,834	$ 22,945
Adjustments to reconcile net income to net cash used in operating activities:			
Amortization of deferred loan origination fees, net of costs	(86)	211	218
Amortization of investment securities premiums, net of accretion of discounts	37,989	40,667	13,075
Amortization of core deposit intangible	143	95	—
Net amortization (accretion) of FDIC shared-loss indemnification asset	3,379	(4,330)	—
Other-than-temporary impairments on securities	15,018	17,166	60,074
Other impairments on securities	77	—	—
Depreciation and amortization of premises and equipment	5,479	5,764	5,987
Deferred income tax, net	(1,363)	(10,092)	(1,782)
Provision for covered and non-covered loan and lease losses, net	13,813	22,196	15,650
Stock-based compensation	1,310	1,194	742
Fair value adjustment of servicing asset	(759)	(1,805)	(4,301)
(Gain) loss on:			
Sale of securities	(27,996)	(15,032)	(4,385)
Sale of mortgage loans held for sale	(5,845)	(5,383)	(3,827)
Derivatives	13,220	36,823	(29,181)
Early extinguishment of repurchase agreements	4,790	—	17,551
Foreclosed real estate	1,717	524	570
Sale of other repossessed properties	34	—	—
Sale of premises and equipment	23	49	(71)
Originations and purchases of loans held-for-sale	(194,781)	(227,401)	(230,240)
Proceeds from sale of loans held-for-sale	80,399	77,705	106,071
Net (increase) decrease in:			
Trading securities	1,150	(807)	(267)
Accrued interest receivable	8,534	4,940	10,258
Other assets	15,156	(332)	(26,008)
Net increase (decrease) in:			
Accrued interest on deposits and borrowings	(1,058)	650	(5,368)
Accrued expenses and other liabilities	(39,084)	23,461	8,295
Net cash used in operating activities	**(34,291)**	**(23,903)**	**(43,994)**

	Year Ended December 31,		
	2011	2010	2009
		(In thousands)	
Cash flows from investing activities:			
Purchases of:			
Investment securities available-for-sale	(495,018)	(5,630,637)	(12,577,326)
Investment securities held-to-maturity	(311,922)	(703,390)	—
FHLB stock	(1,283)	(2,560)	(26,981)
Equity options	(424)	(5,899)	(4,067)
Maturities and redemptions of:			
Investment securities available-for-sale	780,430	3,011,108	3,825,193
Investment securities held-to-maturity	109,584	12,754	—
FHLB stock	—	10,077	28,057
Proceeds from sales of:			
Investment securities available-for-sale	620,304	3,689,869	9,101,639
Foreclosed real estate	11,946	7,886	9,312
Other repossessed assets	6,237	711	—
Premises and equipment	304	631	128
Origination and purchase of loans, excluding loans held-for-sale	(201,172)	(144,210)	(93,093)
Principal repayment of loans, including covered loans	266,777	231,976	131,079
Reimbursements from the FDIC on shared-loss agreements	75,474	120,675	—
Additions to premises and equipment	(3,385)	(9,974)	(4,636)
Cash and cash equivalents received in FDIC-assisted acquisition	—	89,777	—
Net cash provided by investing activities	**857,852**	**678,794**	**389,305**
Cash flows from financing activities:			
Net increase (decrease) in:			
Deposits	(192,368)	115,377	(26,764)
Short term borrowings	(2,540)	(6,719)	19,986
Securities sold under agreements to repurchase	(404,790)	(100,000)	(217,551)
Issuance of FDIC-guaranteed term notes	—	—	105,000
Advances from FHLB	—	—	1,397,880
Exercise of stock options	8	72	—
Issuance of common stock, net	—	94,386	—
Issuance of preferred stock, net	—	189,076	—
Capital contribution	—	—	78
Repayments of advances from FHLB	—	—	(1,424,580)
Repayments of purchase money note issued to the FDIC	—	(715,970)	—
Purchase of treasury stock	(58,775)	—	(182)
Termination of derivative instruments	5,401	(47,147)	20,263
Dividends paid on preferred stock	(4,802)	(5,335)	(4,802)
Dividends paid on common stock	(9,154)	(6,818)	(3,888)
Net cash used in financing activities	**(667,020)**	**(483,078)**	**(134,560)**
Net change in cash and cash equivalents	**156,541**	**171,813**	**210,751**
Cash and cash equivalents at beginning of year	448,936	277,123	66,372
Cash and cash equivalents at end of year	**$ 605,477**	**$ 448,936**	**$ 277,123**

	Year Ended December 31,		
	2011	2010	2009
	(In thousands)		
Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:			
Interest paid	$ 157,645	$ 167,992	$ 191,992
Income taxes paid	$ 4,109	$ 6,281	$ 54
Mortgage loans securitized into mortgage-backed securities	$ 135,034	$ 142,907	$ 147,419
Securities purchased but not yet received	$ —	$ —	$ 413,359
Transfer from loans to foreclosed real estate	$ 18,875	$ 12,408	$ 10,067
Conversion of preferred stock to common stock	$ —	$ 200,000	$ —

For the year ended December 31, 2010, the changes in operating assets and liabilities included in the reconciliation of net income to net cash provided by operating activities, as well as the changes in assets and liabilities presented in the investing and financing sections are net of the effect of the assets acquired and liabilities assumed from the FDIC-assisted acquisition. Refer to Note 2 to the consolidated financial statements for the composition and balances of the assets and liabilities recorded at fair value by the Group on April 30, 2010. The cash received in the transaction, which amounted to $89.8 million, is presented in the investing activities section of the Consolidated Statements of Cash Flows as “Cash and cash equivalents received in FDIC-assisted acquisition.”

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2011, 2010, AND 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Nature of Operations

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

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

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

Oriental Financial Services operates as a securities broker-dealer and is subject to the supervision, examination and regulation of the Financial Industry Regulatory Authority ("FINRA"), the Securities and Exchange Commission (the "SEC"), and the OCFI. Oriental Insurance operates as an insurance agency and is subject to the supervision, examination and regulation of the Office of the Commissioner of Insurance of Puerto Rico.

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

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

Use of Estimates in the Preparation of Financial Statements

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

Principles of Consolidation

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

Cash Equivalents

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

Earnings per Common Share

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

Securities Purchased/Sold Under Agreements to Resell/Repurchase

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

Investment Securities

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

The Group classified certain agency-issued mortgage-backed securities as held-to-maturity. The Group has both the intent and ability to hold such securities until their maturities. Furthermore, the Group believes it will be able to recover substantially all of its recorded investment mainly because these are agency-issued mortgage-backed securities, and also because the securities cannot be contractually prepaid or otherwise settled before their stated maturity by the issuing agency, except for the principal prepayments that may occur throughout their terms based on the payment behavior of the collateral loans.

The Group purchased the securities classified as held-to-maturity during the fourth quarter of 2010, and made the classification in response to management's asset-liability management strategy. The Group believes that it can accomplish its asset-liability management goals and still maximize net interest income without having all its securities classified as available-for-sale. This designation is consistent with held-to-maturity classification requirements, specifically those stated in section 25-18 of ASC 320-10-25.

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

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

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

Financial Instruments

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

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

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

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

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

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

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

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

As part of this new hedging strategy started in the first quarter of 2011, the Group formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash flow hedges to (i) specific assets and liabilities on the balance sheet or (ii) 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 (i) 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); (ii) the derivative expires or is sold, terminated, or exercised; (iii) it is no longer probable that the forecasted transaction will occur; (iv) a hedged firm commitment no longer meets the definition of a firm commitment; or (v) management determines that designating the derivative as a hedging instrument is no longer appropriate or desired.

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.

Off-Balance Sheet Instruments

In the ordinary course of business, the Group enters into off-balance sheet instruments consisting of commitments to extend credit, further discussed in Note 16 hereto. Such financial instruments are recorded in the financial statements when these are funded or related fees are incurred or received. The Group periodically evaluates the credit risks inherent in these commitments, and establishes accruals for such risks if and when these are deemed necessary.

Mortgage Banking Activities and Loans Held-For-Sale

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

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

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

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

The transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the Group surrenders control over the assets is accounted for as a sale if all of the following conditions set forth in ASC Topic 860 are met: (i) the assets must be isolated from creditors of the transferor, (ii) the transferee must obtain the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (iii) the transferor cannot maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. When the Group transfers financial assets and the transfer fails any one of these criteria, the Group is prevented from derecognizing the transferred financial assets and the transaction is accounted for as a secured borrowing. For federal and Puerto Rico income tax purposes, the Group treats the transfers of loans which do not qualify as “true sales” under the applicable accounting guidance, as sales, recognizing a deferred tax asset or liability on the transaction. For transfers of financial assets that satisfy the conditions to be accounted for as sales, the Group derecognizes all assets sold; recognizes all assets obtained and liabilities incurred in consideration as proceeds of the sale, including servicing assets and servicing liabilities, if applicable; initially measures at fair value assets obtained and liabilities incurred in a sale; and recognizes in earnings any gain or loss on the sale. The guidance on transfer of financial assets requires a true sale analysis of the treatment of the transfer under state law as if the Group was a debtor under the bankruptcy code. A true sale legal analysis includes several legally relevant factors, such as the nature and level of recourse to the transferor, and the nature of retained interests in the loans sold. The analytical conclusion as to a true sale is never absolute and unconditional, but contains qualifications based on the inherent equitable powers of a bankruptcy court, as well as the unsettled state of the common law. Once the legal isolation test has been met, other factors concerning the nature and extent of the transferor’s control over the transferred assets are taken into account in order to determine whether derecognition of assets is warranted.

When the Group sells or securitizes mortgage loans, it generally makes customary representations and warranties regarding the characteristics of the loans sold. Conforming conventional mortgage loans are combined 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 the 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 these must be brought back onto the Group's books as assets at fair value, regardless of whether the Group intends to exercise the buy-back option. Quality review procedures are performed by the Group as required under the government agency programs to ensure that assets guideline qualifications are met. The Group has not recorded any specific contingent liability in the consolidated financial statements for these customary representation and warranties related to loans sold by the Group, and management believes that, based on historical data, the probability of payments and expected losses under these representation and warranty arrangements is not significant.

Servicing Assets

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

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

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

On April 30, 2010, the Group acquired a leasing servicing asset as part of the FDIC-assisted acquisition. The Group follows the same accounting methodology for the leasing servicing asset used for mortgage loans servicing asset, as described above.

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 transaction that are covered under the FDIC shared-loss agreements are significantly different from those loans not covered under the FDIC shared-loss agreements. Accordingly, the Group presents loans subject to the shared-loss agreements as "covered loans" and loans that are not subject to the FDIC shared-loss agreements as "non-covered loans." Non-covered loans include credit card balances acquired in the FDIC-assisted acquisition.

Non-Covered Loans

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

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

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.

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

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

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 covered 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.

The Group adopted the ASU No. 2011-02 issued by FASB 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.

Reserve for Unfunded Commitments

The reserve for unfunded commitments is maintained at a level believed by management to be sufficient to absorb estimated probable losses related to unfunded credit facilities and is included in other liabilities in the consolidated statements of condition. The determination of the adequacy of the reserve is based upon an evaluation of the unfunded credit facilities. Net adjustments to the reserve for unfunded commitments are included in other operating expenses in the consolidated statements of operations.

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.

Core Deposit Intangible

Core deposit intangible (“CDI”) is a measure of the value of checking and savings deposits acquired in a business combination. The fair value of the CDI stemming from any given business combination is based on the present value of the expected cost savings attributable to the core deposit funding, relative to an alternative source of funding. CDI is amortized straight-line over a 10-year period. The Group evaluates such identifiable intangible for impairment when an indication of impairment exists. No impairment charges were required to be recorded in the periods ended December 31, 2011 and 2010. If an impairment loss is determined to exist in the future, the loss would be reflected in the consolidated statement of operations for the period in which such impairment is identified.

Foreclosed Real Estate and Other Repossessed Property

Non-covered Foreclosed Real Estate

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

Covered Foreclosed Real Estate and Other Repossessed Property

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

Premises and Equipment

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

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 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.

Equity-Based Compensation Plan

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

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

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

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

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

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

Comprehensive Income

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

Commitments and Contingencies

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

Subsequent Events

The Group has evaluated events subsequent to the balance sheet date and prior to filing this annual report on Form 10-K for the year ended December 31, 2011, and has adjusted and disclosed those events that have occurred that would require adjustment or disclosure in the consolidated financial statements.

Reclassifications

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

Recent Accounting Developments

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.

2. FDIC-ASSISTED ACQUISITION AND FDIC SHARED-LOSS INDEMNIFICATION ASSET

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

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

The assets acquired and liabilities assumed as of April 30, 2010 were presented at their fair value. In many cases, the determination of these fair values required management to make estimates about discount rates, expected cash flows, market conditions and other future events that are highly subjective in nature and were subject to change. The fair values initially assigned to the assets acquired and liabilities assumed are preliminary and subject to refinement for up to one year after the closing date of the acquisition as new information relative to closing date fair values became available. The process was completed on April 29, 2011.

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

The Bank has agreed to make a true-up payment, also known as clawback liability, to the FDIC on the date that is 45 days following the last day (such day, the “True-Up Measurement Date”) of the final shared-loss month, or upon the final disposition of all covered assets under the shared-loss agreements in the event losses thereunder fail to reach expected levels. Under the shared-loss agreements, the Bank will pay to the FDIC 50% of the excess, if any, of: (i) 20% of the Intrinsic Loss Estimate of $906.0 million (or $181.2 million) (as determined by the FDIC) less (ii) the sum of: (A) 25% of the asset discount (per bid) (or $227.5 million); plus (B) 25% of the cumulative shared-loss payments (defined as the aggregate of all of the payments made or payable to the Bank minus the aggregate of all of the payments made or payable to the FDIC); plus (C) the sum of the period servicing amounts for every consecutive twelve-month period prior to and ending on the True-Up Measurement Date in respect of each of the shared-loss agreements during which the shared-loss provisions of the applicable shared-loss agreement is in effect (defined as the product of the simple average of the principal amount of shared-loss loans and shared-loss assets at the beginning and end of such period times 1%). The true-up payment represents an estimated liability of $13.3 million and $10.7 million, net of discount, as of December 31, 2011 and 2010, respectively. This estimated liability is accounted for as a reduction of the indemnification asset. The indemnification asset represents the portion of estimated losses covered by the shared-loss agreements between the Bank and the FDIC.

The operating results of the Group for the years ended December 31, 2011 and 2010 include the operating results produced by the acquired assets and liabilities assumed since May 1, 2010. The Group believes that given the nature of assets and liabilities assumed, the significant amount of fair value adjustments, the nature of additional consideration provided to the FDIC (note payable and equity appreciation instrument) and the FDIC shared-loss agreements now in place, historical results of Eurobank are not meaningful to the Group’s results, and thus no pro forma information is presented.

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

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

The FDIC shared-loss indemnification asset activity for the years ended December 31, 2011 and 2010 is as follows:

	December 31, 2011	December 31, 2010
	(In thousands)	
Balance at beginning of year	$473,629	$ —
Additions	—	545,213
Shared-loss agreements reimbursements from the FDIC	(75,819)	(120,675)
Recoveries on (reduction of) expected credit impairment losses to be covered under shared-loss agreements, net	(10,643)	43,004
Accretion (amortization) of FDIC shared-loss indemnification asset, net	(3,379)	4,330
Incurred expenses to be reimbursed under shared-loss agreements	8,579	1,757
Balance at end of year	**$392,367**	**$ 473,629**

3. INVESTMENTS

Money Market Investments

The Group considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months or less at the date of acquisition. At December 31, 2011 and 2010, money market instruments included as part of cash and cash equivalents amounted to $3.9 million and $104.9 million, respectively.

Investment Securities

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

	December 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
	(In thousands)				
Available-for-sale					
FNMA and FHLMC certificates	$2,583,881	$ 92,899	$ —	$2,676,780	3.61%
GNMA certificates	26,186	2,151	—	28,337	5.94%
CMOs issued by US Government sponsored agencies	128,505	1,739	199	130,045	2.33%
Total mortgage-backed securities	**2,738,572**	**96,789**	**199**	**2,835,162**	**3.57**
Obligations of Puerto Rico Government and political subdivisions	82,437	249	1,204	81,482	5.14%
Structured credit investments	46,904	—	9,616	37,288	2.92%
Other debt securities	5,769	211	—	5,980	3.28%
Total investment securities	**135,110**	**460**	**10,820**	**124,750**	**4.29%**
Total securities available-for-sale	**2,873,682**	**97,249**	**11,019**	**2,959,912**	**3.60%**
Held-to-maturity					
Mortgage-backed securities					
FNMA and FHLMC certificates	884,026	20,530	—	904,556	3.34%
Total	**$3,757,708**	**$117,778**	**$11,019**	**$3,864,468**	**3.54%**

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

	December 31, 2011			
	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)		(In thousands)	
Mortgage-backed securities				
Due after 5 to 10 years				
FNMA and FHLMC certificates	$ 59,118	$ 59,986	$ —	$ —
Total due after 5 to 10 years	**59,118**	**59,986**	**—**	**—**
Due after 10 years				
FNMA and FHLMC certificates	2,524,763	2,616,794	884,026	904,556
GNMA certificates	26,186	28,337	—	—
CMOs issued by US Government sponsored agencies	128,505	130,045	—	—
Total due after 10 years	**2,679,454**	**2,775,176**	**884,026**	**904,556**
Total mortgage-backed securities	**2,738,572**	**2,835,162**	**884,026**	**904,556**
Investment securities				
Due from 1 to 5 years				
Obligations of Puerto Rico Government and political subdivisions	10,254	10,279	—	—
Total due from 1 to 5 years	**10,254**	**10,279**	**—**	**—**
Due after 5 to 10 years				
Obligations of Puerto Rico Government and political subdivisions	23,735	22,952	—	—
Structured credit investments	46,904	37,288	—	—
Total due after 5 to 10 years	**70,639**	**60,240**	**—**	**—**
Due after 10 years				
Obligations of Puerto Rico Government and political subdivisions	48,448	48,251	—	—
Other debt securities	5,769	5,980		
Total due after 10 years	**54,217**	**54,231**	**—**	**—**
Total investment securities	**135,110**	**124,750**	**—**	**—**
Total	**$2,873,682**	**$2,959,912**	**$884,026**	**$904,556**

Keeping with the Group's investment strategy, during the years ended December 31, 2011 and 2010, there were certain sales of available-for sale securities because the Group felt at the time of such sales that gains could be realized while at the same time having good opportunities to invest the proceeds in other investment securities with attractive yields and terms that would allow the Group to continue to protect its net interest margin. Also, the Group, as part of its asset/liability management, purchases US government sponsored agencies discount notes close to their maturities as a short term vehicle to reinvest the proceeds of sale transactions until investment securities with attractive yields can be purchased. During the years ended December 31, 2011 and 2010, the Group sold approximately $5.1 million and $282.5 million, respectively, of discount notes with minimal aggregate gross gains which amounted to less than $1 thousand; and sold approximately $9.0 million and $387.9 million, respectively, of discount notes with minimal aggregate gross losses which amounted to less than $1 thousand.

The tables below present the gross realized gains and losses by category for the years ended December 31, 2011, 2010 and 2009:

Description	December 31, 2011			
	Sale Price	Book Value at Sale	Gross Gains	Gross Losses
	(In thousands)			
Sale of Securities Available-for-Sale				
Mortgage-backed securities				
FNMA and FHLMC certificates	$ 309,112	$ 293,580	$15,532	$ —
GNMA certificates	214,948	207,378	7,572	2
CMOs issued by US Government sponsored agencies	82,144	77,250	4,894	
Total mortgage-backed securities	606,204	578,208	27,998	2
Investment securities				
Obligations of US Government sponsored agencies	14,100	14,100	—	—
Total investment securities	14,100	14,100	—	—
Total	**$ 620,304**	**$ 592,308**	**$27,998**	**$ 2**

Description	December 31, 2010			
	Sale Price	Book Value at Sale	Gross Gains	Gross Losses
	(In thousands)			
Sale of Securities Available-for-Sale				
Mortgage-backed securities and CMOs				
FNMA and FHLMC certificates	$1,783,631	$1,755,808	$27,823	$ —
GNMA certificates	293,997	288,726	5,271	—
Non-agency collateralized mortgage obligations	430,926	453,702	—	22,776
Total mortgage-backed securities and CMOs	2,508,554	2,498,236	33,094	22,776
Investment securities				
Obligations of US Government sponsored agencies	1,196,123	1,191,408	4,716	1
Obligations of Puerto Rico Government and political subdivisions	2,394	2,395	—	1
Total investment securities	1,198,517	1,193,803	4,716	2
Total	**$3,707,071**	**$3,692,039**	**$37,810**	**$22,778**

	December 31, 2009			
Description	Sale Price	Book Value at Sale	Gross Gains	Gross Losses
	(In thousands)			
Sale of Securities Available-for-Sale				
Mortgage-backed securities and CMOs				
FNMA and FHLMC certificates	$5,088,807	$5,018,408	$71,549	$ 1,150
GNMA certificates	353,801	353,176	625	—
CMOs issued by US Government sponsored agencies	336,994	330,585	6,409	—
Total mortgage-backed securities and CMOs	5,779,602	5,702,169	78,583	1,150
Investment securities				
Obligations of US Government sponsored agencies	3,189,827	3,188,991	856	20
Obligations of Puerto Rico Government and political subdivisions	90,000	90,000	—	—
Structured credit investments	42,210	116,094	—	73,884
Total investment securities	3,322,037	3,395,085	856	73,904
Total	**$9,101,639**	**$9,097,254**	**$79,439**	**$75,054**

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

	December 31, 2011		
	12 months or more		
	Amortized Cost	(In thousands) Unrealized Loss	Fair Value
		(In thousands)	
Securities Available-for-Sale			
Structured credit investments	$36,374	$ 9,616	$26,758
Obligations of Puerto Rico Government and political subdivisions	24,697	1,204	23,493
CMOs issued by US Government sponsored agencies	2,384	199	2,185
	63,455	**11,019**	**52,436**

At December 31, 2011, there were no available for sale securities in a continuous unrealized loss position for less than 12 months. In addition, at December 31, 2011, there were no individual held-to-maturity securities in an unrealized loss position.

	December 31, 2010		
	Less than 12 months		
	Amortized Cost	Unrealized Loss	Fair Value
		(In thousands)	
Securities Available-for-Sale			
FNMA and FHLMC certificates	$245,533	$ 2,058	$243,475
CMOs issued by US Government sponsored agencies	2,591	21	2,570
Obligations of US Government sponsored agencies	1,000	—	1,000
	249,124	**2,079**	**247,045**

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

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

	December 31, 2010		
	Less than 12 months		
		(In thousands)	
	Amortized Cost	Unrealized Loss	Fair Value
Held-to-maturity			
FNMA and FHLMC certificates	**$689,917**	**$14,196**	**$675,721**

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

- 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.

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

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

At December 31, 2011, the Group's portfolio of structured credit investments amounted to $46.9 million (amortized cost) in the available-for-sale portfolio, with net unrealized losses of approximately $9.6 million. The Group's structured credit investments portfolio consist of two types of instruments: synthetic collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs).

On January 12, 2012, the Group made the strategic decision to sell its $25.5 million investment in a corporate bond that was partially invested in a synthetic CDO at a loss of $15.0 million. This loss was accounted for as an 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. The main considerations underlying the Group's decision to sell the security included the continued deteriorating credit conditions surrounding the underlying reference portfolio of the CDO, including an event of default that occurred during the fourth quarter of 2011, and the projected analysis prepared by a third-party specialist that showed defaults in excess of the deal's subordination level in more than 50% of the scenarios modeled. The corporate bond sold was a unique and completely distinguishable investment from the rest of the Group's portfolio, including the remaining structured credit investments. As a result of this transaction, the Group continued to reduce its exposure to non-agency securities, as well as to credit risk in the U.S. economy, and also was able to improve its risk-based capital position.

The CLOs are collateralized mostly by senior secured (via first liens) “middle market” commercial and industrial loans, which are securitized in the form of obligations. The Group invested in three of such instruments in 2007, and as of December 31, 2011, such instruments have an aggregate amortized cost of $36.4 million and unrealized losses of $9.6 million. These investments are all floating rate notes, which reset quarterly based on the three-month LIBOR rate.

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

- Identification of the estimated fair value of the contractual coupon of the loans underlying the CLO. Such fair values are calculated based on information that is obtained directly from the trustee’s reports for each CLO security.
- Calculation of the yield-to-maturity for each loan in the CLO, and determination of the interest rate spread (yield less the risk-free rate).
- Estimated default probabilities for each loan in the CLO. These are based on the credit ratings for each company in the structure, and this information also is obtained directly from the trustee’s reports for each CLO security. The default probabilities are adjusted based on the credit rating assuming the highest default probabilities for the loans of those entities with the lowest credit ratings. In addition to determining the current default probabilities, estimates are developed to calculate the cumulative default probabilities in successive years. To establish the reasonability of the default estimates, market-implied default rates are compared to historical credit ratings-based default rates.
- Once the default probabilities are estimated, the average numbers of defaults is calculated for the loans underlying each CLO security. In those cases where defaults are deemed to occur, a recovery rate is applied to the cash flow determination at the time in which the default is expected to occur. The recovery rate is based on average historical information for similar securities, as well as the actual recovery rates for defaults that have occurred within the pool of loans underlying the securities owned by the Group.
- One hundred simulations are carried out and run through a cash flow engine for the underlying pool of loans in each CLO security. Each one of the simulations uses different default estimates and forward yield curve assumptions.

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

The cash flow analysis performed by the Group for the $12 million CLO did not reflect any scenario where there was a principal impairment. Moreover, on November 23, 2011 S&P increased its rating to “AA” from “A”, and on November 6. 2011 Moody’s increased its rating to “A2” from “Baa1”. In addition, the CLO’s subordination level is 26.18%.

With respect to the $10 million CLO, the cash flow analysis performed by the Group also did not reflect any scenario where there was a principal impairment. On November 2, 2011, Moody’s increased its rating to “A2” from “A3”, and S&P has maintained its “A” rating. Also, the CLO’s subordination level is 20.64%.

The cash flow analysis performed by the Group for the $15 million CLO detected that there was a principal impairment in 30 out of 100 scenarios, with average losses of 14.18% and three scenarios where the impairment amount is 100% of the Group’s investment. The level of projected losses can be explained by the deterioration of macro-economic factors during the year ended December 31, 2011, as evidenced by the Euro-zone sovereign debt crisis and relatively high unemployment in the United States. There has also been a widening in the credit spreads used in the valuations of securities similar to CLOs held by the Group mainly as a result of the type of loans that constitute the collateral of the CLOs. On August 3, 2011, Moody's upgraded its rating to "Baa2" from "Baa3". There have been no other credit actions by S&P since March 4, 2010, when they lowered its rating from "A-" to "BBB+," which is still investment grade. Also, the CLO's subordination level is 7.54%.

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

Other securities in an unrealized loss position at December 31, 2011 are mainly composed of highly liquid securities that in most cases have a large and efficient secondary market. Valuations are performed on a monthly basis. The Group's management believes that the unrealized losses of such other securities at December 31, 2011, are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuer or guarantor. At December 31, 2011, the Group does not have the intent to sell these investments in an unrealized loss position.

In December 2010, the Group made the strategic decision to sell the BALTA private label non-agency CMO at a loss of $22.8 million.

The following table summarizes other-than-temporary impairment losses on securities for the years ended December 31, 2011, 2010 and 2009:

	December 31,		
	2011	**2010**	**2009**
		(In thousands)	
Total loss other-than-temporarily impaired securities	$(15,018)	$(39,674)	$(101,472)
Portion of loss on securities recognized in other comprehensive income	—	22,508	41,398
Net impairment losses recognized in earnings	**$(15,018)**	**$(17,166)**	**$ (60,074)**

4. PLEDGED ASSETS

At December 31, 2011, residential mortgage loans, commercial loans and leases amounting to $548.8 million, $40.9 million and $7.8 million, respectively, were pledged to secure advances and borrowings from the Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB"). Investment securities with fair values totaling $3.4 billion, $71.9 million and $62.7 million at December 31, 2011, were pledged to secure securities sold under agreements to repurchase, Puerto Rico public fund deposits and deposits of the Puerto Rico Cash & Money Market Fund, respectively. Also, at December 31, 2011, investment securities with fair values totaling $56.2 million were pledged against interest rate swaps contracts, while others with fair values of $126 thousand were pledged as a bond for the Bank's trust operations to the OCFI. At December 31, 2010, residential mortgage loans amounting to $512.0 million were pledged to secure advances and borrowings from the FHLB. Investment securities with fair values totaling $3.8 billion, $73.4 million, $19.1 million, and $47.5 million at December 31, 2010, were pledged to secure securities sold under agreements to repurchase, Puerto Rico public fund deposits, Federal Reserve Bank of New York advances, and deposits of the Puerto Rico Cash & Money Market Fund, respectively. Also, at December 31, 2010, investment securities with fair values totaling $9.9 million were pledged against interest rate swaps contracts, while others with fair values of $124 thousand were pledged as a bond for the Bank's trust operations to the OCFI.

As of December 31, 2011, and December 31, 2010, investment securities available-for-sale not pledged amounted to $258.8 million and $422.1 million, respectively. As of December 31, 2011, and December 31, 2010, mortgage loans not pledged amounted to $435.7 million and $394.4 million, respectively. As of December 31, 2011, commercial loans not pledged amounted to $586.5 million; there were no commercial loans pledged as of December 31, 2010. As of December 31, 2011, leases not pledged amounted to $54.1 million. There were no leases pledged as of December 31, 2010.

5. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN AND LEASE LOSSES

Loans Receivable Composition

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

	December 31, 2011	December 31, 2010
	(In thousands)	
Loans not covered under shared-loss agreements with FDIC:		
Loans secured by real estate:		
Residential	$ 819,651	$ 872,427
Home equity loans and others	1,411	1,505
Commercial	218,261	178,232
Deferred loan fees, net	(4,300)	(3,931)
	1,035,023	1,048,233
Other loans:		
Commercial	83,312	56,760
Personal consumer loans and credit lines	39,890	34,492
Leasing	25,768	10,257
Deferred loan fees, net	(245)	(423)
	148,725	101,086
Loans receivable	**1,183,748**	**1,149,319**
Allowance for loan and lease losses on non covered loans	(37,010)	(31,430)
Loans receivable, net	**1,146,738**	**1,117,889**
Mortgage loans held-for-sale	26,939	33,979
Total loans not-covered under shared-loss agreements with FDIC, net	**1,173,677**	**1,151,868**
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**

Non-covered Loans

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

The following table presents the aging of the recorded investment in gross loans not covered under shared-loss agreements with the FDIC, excluding mortgage loans held for sale, as of December 31, 2011 and 2010 by class of loans:

	December 31, 2011						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
	(In thousands)						
Mortgage							
Residential							
Traditional	$18,931	$ 9,434	$ 72,837	$101,202	$ 584,600	$ 685,802	$—
Non-traditional	1,109	819	10,857	12,785	57,240	70,025	—
Loss mitigation program	4,887	2,113	13,323	20,323	43,501	63,824	—
	24,927	12,366	97,017	134,310	685,341	819,651	—
Home equity loans, secured personal loans	142	—	323	465	946	1,411	—
	25,069	**12,366**	**97,340**	**134,775**	**686,287**	**821,062**	**—**
Commercial							
Commercial secured by real estate	1,205	1,697	27,741	30,643	187,618	218,261	—
Other commercial and industrial	1,536	99	616	2,251	81,061	83,312	—
	2,741	**1,796**	**28,357**	**32,894**	**268,679**	**301,573**	**—**
Consumer							
Personal consumer loans and credit lines — secured	36	61	19	116	8,974	9,090	—
Personal consumer loans and credit lines — unsecured	383	113	122	618	21,558	22,176	—
Credit cards	119	43	191	353	4,202	4,555	—
Overdrafts	19	9	2	30	4,039	4,069	—
	557	**226**	**334**	**1,117**	**38,773**	**39,890**	**—**
Leasing	**339**	**—**	**102**	**441**	**25,327**	**25,768**	**—**
Total loans not covered under shared-loss agreements with the FDIC	**$28,706**	**$14,388**	**$126,133**	**$169,227**	**$1,019,066**	**$1,188,293**	**$—**

	December 31, 2010						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Loans 90+ Days Past Due and Still Accruing
	(In thousands)						
Mortgage							
Residential							
Traditional	$22,093	$ 9,414	$ 76,604	$108,111	$638,158	$ 746,269	$37,850
Non-traditional	837	845	12,016	13,698	66,056	79,754	4,953
Loss mitigation program	2,528	1,043	9,336	12,907	33,497	46,404	6,060
	25,458	11,302	97,956	134,716	737,711	872,427	48,863
Home equity loans	149	—	340	489	961	1,450	—
Other	—	—	55	55	—	55	—
	25,607	**11,302**	**98,351**	**135,260**	**738,672**	**873,932**	**48,863**
Commercial							
Commercial secured by real estate	1,090	9,326	13,132	23,548	154,684	178,232	—
Other commercial and industrial	33	41	258	332	56,428	56,760	—
	1,123	**9,367**	**13,390**	**23,880**	**211,112**	**234,992**	**—**
Consumer							
Personal consumer loans and credit lines — secured	23	—	—	23	4,853	4,876	—
Personal consumer loans and credit lines — unsecured	419	207	136	762	17,576	18,338	—
Credit cards	262	173	285	720	3,650	4,370	—
Overdrafts	—	—	—	—	6,908	6,908	—
	704	**380**	**421**	**1,505**	**32,987**	**34,492**	**—**
Leasing	**—**	**79**	**35**	**114**	**10,143**	**10,257**	**—**
Total loans not covered under shared-loss agreements with the FDIC	**$27,434**	**$21,128**	**$112,197**	**$160,759**	**$992,914**	**$1,153,673**	**$48,863**

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

	December 31, 2011	December 31, 2010
	(In thousands)	
Non-accrual loans		
Mortgage		
Residential		
Traditional	$ 72,837	$38,754
Non-traditional	10,857	7,063
Loss mitigation program	13,323	3,276
	97,017	49,093
Home equity loans, secured personal loans	323	340
Other	—	55
	97,340	**49,488**
Commercial		
Commercial secured by real estate	34,789	23,338
Other commercial and industrial	2,199	281
	36,988	**23,619**
Consumer		
Personal consumer loans and credit lines — unsecured	143	136
Credit cards	191	285
	334	**421**
Leasing	**102**	**35**
Total non-accrual loans	**$134,764**	**$73,563**

At December 31, 2011 and 2010, the Group had $134.8 million and $73.6 million, respectively, of non-accrual non-covered loans including credit cards accounted under ASC 310-20. At December 31, 2011 and 2010, loans of which terms have been extended and which are classified as troubled debt restructuring that are not included in non-accrual loans amounted to $41.3 million and $35.0 million, respectively.

Up to March 31, 2011, residential mortgage loans, well collateralized and in process of collection, were placed on non-accrual status when reaching 365 days past due. On April 1, 2011, the Bank changed 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 Indicators

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

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

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

The Group uses the following definitions for risk ratings:

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

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

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

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

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

As of December 31, 2011 and 2010, and based on the most recent analysis performed, the risk category of gross non-covered loans subject to risk rating, by class of loans, is as follows:

	December 31, 2011					
	Risk Ratings					
	Balance Outstanding	Pass	Special Mention	Substandard	Doubtful	Individually Measured for Impairment
	(In thousands)					
Commercial						
Commercial secured by real estate	$218,261	$148,894	$25,185	$ 1,957	$ 13	$42,212
Other commercial and industrial	83,312	74,714	3,517	929	—	4,152
Total	**$301,573**	**$223,608**	**$28,702**	**$ 2,886**	**$ 13**	**$46,364**

	December 31, 2010					
	Risk Ratings					
	Balance Outstanding	Pass	Special Mention	Substandard	Doubtful	Individually Measured for Impairment
	(In thousands)					
Commercial						
Commercial secured by real estate	$178,232	$136,201	$ 4,536	$13,603	$143	$23,749
Other commercial and industrial	56,760	52,796	1,372	443	—	2,149
Total	**$234,992**	**$188,997**	**$ 5,908**	**$14,046**	**$143**	**$25,898**

The increase in the "Special Mention" risk rating reflects the addition of two commercial loan relationships that amounted to $23.2 million, mainly collateralized by existing commercial real estate properties, for which management identified potential weaknesses that deserve close attention.

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

	December 31, 2011							
	Delinquency							
	Balance Outstanding	0-29 days	30-59 days	60-89 days	90-119 days	120-364 days	365+ days	Individually Measured for Impairment
	(In thousands)							
Mortgage								
Traditional	$685,802	$584,600	$18,931	$ 9,434	$3,775	$26,457	$42,605	$ —
Non-traditional	70,025	57,240	1,109	819	849	2,725	7,283	—
Loss mitigation program	63,824	7,928	601	757	—	1,002	2,054	51,482
	819,651	649,768	20,641	11,010	4,624	30,184	51,942	51,482
Home equity loans	1,411	946	142	—	—	—	323	—
	821,062	650,714	20,783	11,010	4,624	30,184	52,265	51,482
Consumer	39,890	38,773	557	226	202	132	—	—
Leasing	25,768	25,327	339	—	21	81	—	—
Total	**$886,720**	**$714,814**	**$21,679**	**$11,236**	**$4,847**	**$30,397**	**$52,265**	**$51,482**

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

The following tables present the troubled debt restructurings modified during the years ended December 31, 2011, 2010 and 2009:

	December 31, 2011						
	Number of Contracts	Pre Modification Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months)	Post-Modification Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
	(Dollars in Thousands)						
Mortgage loans	187	$24,722	6.74%	319	$26,620	5.52%	385
Commercial loans	17	15,642	4.03%	68	12,413	3.59%	75

	December 31, 2010						
	Number of Contracts	Pre Modification Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months)	Post-Modification Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
	(Dollars in Thousands)						
Mortgage loans	238	$32,649	6.70%	294	$34,842	5.55%	370
Commercial loans	20	5,906	5.77%	70	6,361	5.80%	82

	December 31, 2009						
	Number of Contracts	Pre Modification Outstanding Recorded Investment	Pre-Modification Weighted Average Rate	Pre-Modification Weighted Average Term (in Months)	Post-Modification Outstanding Recorded Investment	Post-Modification Weighted Average Rate	Post-Modification Weighted Average Term (in Months)
	(Dollars in Thousands)						
Mortgage loans	101	$16,511	6.65%	262	$17,095	6.13%	353
Commercial loans	2	45	5.25%	59	37	6.80%	53

The following table presents troubled debt restructurings that defaulted subsequent to their modification during the years ended December 31, 2011, 2010 and 2009:

	December 31,					
	2011		2010		2009	
	Number of Contracts	Recorded Investment	Number of contracts	Recorded Investment	Number of contracts	Recorded Investment
			(Dollars in Thousands)			
Mortgage loans	34	$3,993	20	$3,444	8	$1,203
Commercial loans	6	$9,224	14	3,611	—	—

Allowance for Loan and Lease Losses

Non-Covered Loans

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

The following table presents the changes and the balance in the allowance for loan and lease losses and the recorded investment in gross loans by portfolio segment and based on impairment method for the years ended December 31, 2011, 2010 and 2009:

	December 31, 2011					
	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
			(In thousands)			
Allowance for loan and lease losses for non-covered loans:						
Balance at beginning of year	$ 16,179	$ 11,153	$ 2,286	$ 860	$ 952	$ 31,430
Charge-offs	(5,836)	(2,506)	(1,587)	(197)	—	(10,126)
Recoveries	101	161	234	10	—	506
Provision for (recapture of) non-covered loan and lease losses	11,208	3,740	490	172	(410)	15,200
Balance at end of year	**$ 21,652**	**$ 12,548**	**$ 1,423**	**$ 845**	**$ 542**	**$ 37,010**
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 3,355	$ 3,518	$ —	$ —	$ —	$ 6,873
Collectively evaluated for impairment	18,244	9,030	1,476	845	542	30,137
Total ending allowance balance	**$ 21,599**	**$ 12,548**	**$ 1,476**	**$ 845**	**$ 542**	**$ 37,010**
Loans:						
Individually evaluated for impairment	$ 51,482	$ 46,364	$ —	$ —	$ —	$ 97,846
Collectively evaluated for impairment	769,580	255,209	39,890	25,768	—	1,090,447
Total ending non-covered loans balance	**$821,062**	**$301,573**	**$39,890**	**$25,768**	**$ —**	**$1,188,293**

	December 31, 2010					
	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
	(In thousands)					
Allowance for loan and lease losses for non-covered loans:						
Balance at beginning of year	$ 15,044	$ 7,112	$ 864	$ —	$252	$ 23,272
Charge-offs	(3,867)	(2,913)	(1,455)	—	—	(8,235)
Recoveries	93	160	226	—	—	479
Provision for non-covered loan and lease losses	4,909	6,794	2,651	860	700	15,914
Balance at end of year	**$ 16,179**	**$ 11,153**	**$ 2,286**	**$ 860**	**$952**	**$ 31,430**
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 2,387	$ 823	$ —	$ —	$ —	$ 3,210
Collectively evaluated for impairment	13,792	10,330	2,286	860	952	28,220
Total ending allowance balance	**$ 16,179**	**$ 11,153**	**$ 2,286**	**$ 860**	**$952**	**$ 31,430**
Loans:						
Individually evaluated for impairment	$ 36,067	$ 25,898	$ —	$ —	$ —	$ 61,965
Collectively evaluated for impairment	837,865	209,094	34,492	10,257	—	1,091,708
Total ending non-covered loans balance	**$873,932**	**$234,992**	**$34,492**	**$10,257**	**$ —**	**$1,153,673**

	December 31, 2009					
	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
	(In thousands)					
Allowance for loan and lease losses for non-covered loans:						
Balance at beginning of year	$ 8,567	$ 4,013	$ 1,660	$—	$ 53	$ 14,293
Charge-offs	(3,493)	(2,223)	(1,312)	—	—	(7,028)
Recoveries	70	56	231	—	—	357
Provision for non-covered loan and lease losses	9,900	5,266	285	—	199	15,650
Balance at end of year	**$ 15,044**	**$ 7,112**	**$ 864**	**$—**	**$252**	**$ 23,272**
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 683	$ 709	$ —	$—	$ —	$ 1,392
Collectively evaluated for impairment	14,361	6,403	864	—	252	21,880
Total ending allowance balance	**$ 15,044**	**$ 7,112**	**$ 864**	**$—**	**$252**	**$ 23,272**
Loans:						
Individually evaluated for impairment	$ 10,717	$ 15,582	$ —	$—	$ —	$ 26,299
Collectively evaluated for impairment	909,591	182,147	21,539	—	—	1,113,277
Total ending non-covered loans balance	**$920,308**	**$197,729**	**$21,539**	**$—**	**$ —**	**$1,139,576**

The Group evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. The total investment in impaired commercial loans was $46.4 million and $25.9 million at December 31, 2011 and 2010, respectively. The impaired commercial loans were measured based on the fair value of collateral or the present value of cash flows method, including those identified as troubled-debt restructurings. 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 restructurings was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately $3.4 million and $2.3 million at December 31, 2011 and 2010, respectively.

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

	December 31, 2011				
	Unpaid Principal	Recorded Investment	Specific Allowance	Coverage	Average Recorded Investment
			(In thousands)		
Impaired loans with specific allowance					
Commercial	$ 25,974	$23,368	$3,518	15%	$17,949
Residential troubled debt restructuring	52,480	51,482	3,355	7%	42,699
Impaired loans with no specific allowance					
Commercial	23,780	22,996	—	0%	16,480
Total investment in impaired loans	**$102,234**	**$97,846**	**$6,873**	**7%**	**$77,128**

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

The following table presents the interest recognized in commercial and mortgage loans that were individually evaluated for impairment, excluding FDIC covered loans for the years ended December 31, 2011, 2010 and 2009:

	December 31,		
	2011	2010	2009
		(In thousands)	
Impaired loans with specific allowance			
Commercial	$ 418	$ 158	$ 86
Residential troubled debt restructuring	1,146	743	226
Impaired loans with no specific allowance			
Commercial	611	651	241
Total interest income from impaired loans	**$2,175**	**$1,552**	**$553**

Covered Loans

The Group's acquired loans under the FDIC-assisted acquisition of Eurobank were initially recorded at fair value, and no separate valuation allowance was recorded at the date of acquisition. The Group reviewed each loan at acquisition to determine if it should be accounted for under ASC 310-30 and, if so, determine whether each loan is to be accounted for individually or whether loans will be aggregated into pools of loans based on common risk characteristics. During the evaluation of whether a loan was considered impaired under ASC 310-30, the Group considered a number of factors, including the delinquency status of the loan, payment options and other loan features (i.e. reduced documentation, interest only, or negative amortization features), the geographic location of the borrower or collateral and the risk rating assigned to the loans. In instances where it was determined that for some of the loans in the acquired loan pool that it is probable that all the contractual payments would be received (therefore the loans meet the first criteria of ASC 310-30-15-2 but not the second), the Group applied the discount accretion guidance as ASC 310-30, instead of the standard loan discount accretion guidance of ASC 310-20 to those loans (the loans under SOP 03-3). As documented in a letter from the AICPA Depository Institution Expert Panel to the Office of Chief Accountant of the SEC, on December 5, 2009, the SEC addressed the recognition of discount accretion for loans acquired under these circumstances. As referred to in the AICPA's letter, when loans are acquired with a significant discount for credit (e.g., at a fair value lower than the contractual amounts due) and such loans are not within the scope of ASC 310-30, the AICPA believed that the SEC—would not object to an accounting policy based on contractual cash flows or an accounting policy based on expected cash flows, meaning that an entity could either apply the accretion guidance of ASC 310-20 or that of the ASC 310-30 to such loans. Consistent with the AICPA's views, the Group applied the guidance of ASC 310-30 to all loans acquired in the transaction including loans that do not meet the scope of ASC 310-30. Based on the criteria, the Group considered the entire Eurobank portfolio, except for credit cards, to be impaired and accounted for under ASC 310-30. Credit cards were accounted under ASC 310-20.

To the extent credit deterioration occurs in covered loans after the date of acquisition, the Group will record an allowance for loan and lease losses and an increase in the FDIC loss-share indemnification asset for the expected reimbursement from the FDIC under the shared-loss agreements. There have been differences, both positive and negative, between actual and expected cash flows in several pools of loans acquired in the FDIC-assisted acquisition. At December 31, 2011, the Group concluded that certain pools reflect higher projected cash flows, resulting in reversals of previous impairments recorded as well as additions to accretable discount of $110.7 million.

The covered loans carrying amounts included in the balance sheet at December 31, 2011 and 2010 are as follows:

	December 31, 2011	December 31, 2010
	(In thousands)	
Contractual required payments receivable	$1,134,524	$1,421,849
Non-accretable discount	(412,170)	(603,296)
Cash expected to be collected	722,354	818,553
Accretable yield	(188,822)	(148,556)
Carrying amount, gross	533,532	669,997
Allowance for loan and lease losses	(37,256)	(49,286)
Carrying amount, net	**$ 496,276**	**$ 620,711**

The following tables describe the accretable yield and non-accretable discount activity for the years ended December 31, 2011 and 2010:

	December 31, 2011	December 31, 2010
	(In thousands)	
Accretable Yield Activity		
Balance at beginning of Year	$148,556	$ —
Additions	—	200,523
Accretion	(67,666)	(44,158)
Transfer from (to) non-accretable discount	107,932	(7,809)
Balance at end of year	**$188,822**	**$148,556**

	December 31, 2011	December 31, 2010
	(In thousands)	
Non-Accretable Discount Activity		
Balance at beginning of Year	$ 603,296	$ —
Additions	—	782,887
Principal losses	(83,194)	(187,400)
Transfer (to) from accretable yield	(107,932)	7,809
Balance at end of year	**$ 412,170**	**$ 603,296**

For covered loans, the Group evaluates credit quality based on the delinquency status of the loan, severity factors and risk ratings on certain commercial loans. Migration and credit quality trends are assessed by comparing information from acquisition date through December 31, 2011.

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

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

	December 31, 2011				
	Unpaid Principal	Recorded Investment	Specific Allowance	Coverage	Average Recorded Investment
	(In thousands)				
Impaired covered loans with specific allowance					
Loans secured by 1-4 family residential properties	$ 55,901	$ 32,130	$ 1,657	5%	$ 36,197
Construction and development secured by 1-4 residential properties	80,821	16,976	2,042	12%	16,903
Commercial and other construction	357,596	146,924	31,665	22%	161,562
Consumer	19,619	13,778	1,892	14%	15,981
Total investment in impaired covered loans	**$513,937**	**$209,808**	**$37,256**	**18%**	**$230,643**

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

As a result of the Group's quarterly assessment of actual versus expected cash flows for pools of covered loans, the changes in the allowance for loan and lease losses on covered loans for the years ended December 31, 2011 and 2010 was as follows:

	December 31,	
	2011	2010
	(In thousands)	
Balance at beginning of year	$ 49,286	$ —
Provision for (recapture of) covered loan and lease losses, net	(1,387)	6,282
FDIC shared-loss portion of provision for (recapture of) covered loan and lease losses, net	(10,643)	43,004
Balance at end of year	**$ 37,256**	**$49,286**

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.

6. SERVICING ASSETS

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

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

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

At December 31, 2011, servicing assets are composed of $10.2 million ($8.9 million — December 31, 2010) related to residential mortgage loans and $221 thousand ($770 thousand — December 31, 2010) of leasing servicing assets acquired in the FDIC-assisted acquisition on April 30, 2010.

The following table presents the changes in servicing rights measured using the fair value method for the years ended December 31, 2011 and 2010:

	December 31, 2011	December 31, 2010
	(In thousands)	
Fair value at beginning of year	$ 9,695	$7,120
Acquisition of leasing servicing assets from FDIC-assisted acquisition	—	1,190
Servicing from mortgage securitizations or assets transfers	2,458	2,933
Changes due to payments on loans	(976)	(869)
Changes in fair value due to changes in valuation model inputs or assumptions	(723)	(679)
Fair value at end of year	**$10,454**	**$9,695**

The following table presents key economic assumptions ranges used in measuring the mortgage related servicing asset fair value for the years ended December 31, 2011 and 2010:

	December 31, 2011	December 31, 2010
Constant prepayment rate	7.87% - 40.38%	9.50% - 37.57%
Discount rate	10.50% - 14.00%	11.00% - 14.00%

The following table presents key economic assumptions ranges used in measuring the leasing related servicing asset fair value for the years ended December 31, 2011 and 2010:

	December 31, 2011	December 31, 2010
Discount rate	13.22% - 17.38%	13.13% - 17.89%

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

	December 31, 2011
	(In thousands)
Mortgage related servicing asset	
Carrying value of mortgage servicing asset	$10,233
Constant prepayment rate	
Decrease in fair value due to 10% adverse change	$ (408)
Decrease in fair value due to 20% adverse change	$ (790)
Discount rate	
Decrease in fair value due to 10% adverse change	$ (434)
Decrease in fair value due to 20% adverse change	$ (835)
Leasing servicing asset	
Carrying value of leasing servicing asset	$ 221
Discount rate	
Decrease in fair value due to 10% adverse change	$ (2)
Decrease in fair value due to 20% adverse change	$ (4)

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

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

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

Servicing fee income is based on a contractual percentage of the outstanding principal and is recorded as income when earned. Servicing fees on mortgage loans totaled $3.1 million, $2.4 million and $1.6 million for the years ended December 31, 2011, 2010 and 2009, respectively. There were no late fees and ancillary fees recorded in such periods because these fees belong to the third party with which the Group is engaged in a subservicing agreement. Servicing fees on leases amounted to $625 thousand and $404 thousand for the years ended December 31, 2011 and 2010, respectively. There were no fees during 2009.

7. PREMISES AND EQUIPMENT

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

	Useful Life (Years)	December 31, 2011	December 31, 2010
		(In thousands)	
Land	—	$ 2,254	$ 2,328
Buildings and improvements	40	5,890	6,301
Leasehold improvements	5 — 10	18,182	20,564
Furniture and fixtures	3 — 7	9,718	10,099
Information technology and other	3 — 7	20,008	19,074
		56,052	58,366
Less: accumulated depreciation and amortization		(34,532)	(34,425)
		$ 21,520	**$ 23,941**

Depreciation and amortization of premises and equipment for the years ended December 31, 2011, 2010 and 2009, totaled $5.5 million, $5.8 million and $6.0 million, respectively. These are included in the consolidated statements of operations as part of occupancy and equipment expenses.

8. DERIVATIVE ACTIVITIES

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%. 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.

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

	December 31,	
	2011	2010
	(In thousands)	
Derivative assets:		
Forward settlement swaps	$ —	$11,023
Options tied to Standard & Poor’s 500 Stock Market Index	9,317	9,870
Swap options	—	7,422
	$ 9,317	**$28,315**
Derivative liabilities:		
Forward settlement swaps	$47,425	$ —
Other	—	64
	$47,425	**$ 64**

Forward-Settlement Swaps

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

The following table shows a summary of these swaps and their terms, at December 31, 2011:

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

An unrealized loss of $47.4 million was recognized in accumulated other comprehensive income related to the valuation of these swaps at December 31, 2011, and the related derivative liability is being reflected in the accompanying consolidated statements of financial condition.

Swap Options

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

Options Tied to Standard & Poor's 500 Stock Market Index

The Group has offered its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index ("S&P Index"). The Group uses option agreements with major broker-dealer companies to manage its exposure to changes in this index. Under the terms of the option agreements, the Group receives the average increase in the month-end value of the index in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings. At December 31, 2011 and 2010, the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of $9.3 million (notional amount of $130.9 million) and $9.9 million (notional amount of $149.0 million), respectively; the options sold to customers embedded in the certificates of deposit and recorded as deposits in the consolidated statements of financial condition represented a liability of $9.4 million (notional amount of $125.8 million) and $12.8 million (notional amount of $143.4 million), respectively.

At December 31, 2011, the yearly contractual maturities of options tied to the S&P Index were as follows:

Year Ending December 31,	Derivative asset (S&P purchased options)	Derivative liability (S&P embedded options)
	(In thousands)	
2012	$ 64,285	$ 63,060
2013	38,590	35,487
2014	17,340	16,674
2015	7,330	7,425
2016	3,375	3,195
	$130,920	**$125,841**

9. ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

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

	December 31,	
	2011	2010
	(In thousands)	
Non-covered loans	$ 5,519	$11,068
Investments	14,663	17,648
	$20,182	**$28,716**

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

	December 31,	
	2011	2010
	(In thousands)	
Prepaid FDIC insurance	$11,599	$16,796
Servicing assets	10,454	9,695
Other prepaid expenses	6,498	7,858
Goodwill	2,701	2,701
Mortgage tax credits	1,303	3,432
Core deposit intangible	1,185	1,328
Investment in Statutory Trust	1,086	1,086
Debt issuance costs	1,067	2,299
Other repossessed assets (covered by FDIC shared-loss agreements)	708	2,350
Accounts receivable and other assets	10,577	15,816
	$47,178	**$63,361**

On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 31, 2009, along with each institution's risk-based deposit insurance assessment for the third quarter of 2009. The prepayment balance of the assessment covering fiscal years 2010, 2011 and 2012 amounted to $11.6 million and $16.8 million at December 31, 2011 and 2010, respectively.

Other prepaid expenses amounting to $10.5 million and $9.7 million at December 31, 2011 and 2010, respectively, include prepaid municipal, property and income taxes aggregating to $3.2 million and $4.5 million, respectively.

In December 2007, the Commonwealth of Puerto Rico established mortgage loan tax credits for financial institutions that provided financing for the acquisition of new homes. Under an agreement reached during the second quarter of 2011 with the Puerto Rico Treasury Department, the Group may use half of these credits to reduce taxable income in taxable year 2011, and the remaining half of the credits in taxable year 2012. At December 31, 2011 and 2010, tax credits for the Group amounted to $1.3 million and $3.4 million, respectively.

In March 2009, the Group's banking subsidiary issued $105 million in notes guaranteed under the FDIC Temporary Liquidity Guarantee Program. Shortly after issuance of the notes, the Group paid $3.2 million (equivalent to an annual fee of 100 basis points) to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes. These costs have been deferred and are being amortized over the term of the notes. At December 31, 2011 and 2010, this deferred issue cost was $1.1 million and $2.3 million, respectively.

Other repossessed assets amounting to $708 thousand and $2.4 million at December 31, 2011 and 2010, respectively, represent covered assets under the FDIC shared-loss agreements and are related to the Eurobank leasing portfolio acquired in the FDIC-assisted acquisition.

10. DEPOSITS AND RELATED INTEREST

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

	December 31,	
	2011	2010
	(In thousands)	
Non-interest bearing demand deposits	$ 190,001	$ 170,705
Interest-bearing savings and demand deposits	1,041,529	1,019,539
Individual retirement accounts	361,411	361,972
Retail certificates of deposit	378,146	477,180
Total retail deposits	1,971,087	2,029,396
Institutional deposits	168,301	280,617
Brokered deposits	255,879	278,875
	$2,395,267	**$2,588,888**

At December 31, 2011 and 2010, the weighted average interest rate of the Group's deposits was 1.87% and 2.12%, respectively, including non-interest bearing deposits of $190.0 million and $170.7 million, respectively. Interest expense for the years ended December 31, 2011, 2010 and 2009 is set forth below:

	December 31,		
	2011	2010	2009
	(In thousands)		
Demand and savings deposits	$16,009	$17,881	$18,115
Certificates of deposit	29,636	30,722	36,832
	$45,645	**$48,603**	**$54,947**

At December 31, 2011 and 2010, time deposits in denominations of $100 thousand or higher, excluding unamortized discounts, amounted to $456.1 million and $590.0 million, including public fund deposits from various Puerto Rico government agencies of $65.2 million and $65.3 million at a weighted average rate of 0.05% in both periods, which were collateralized with investment securities with fair value of $71.9 million and $73.4 million, respectively.

Excluding equity indexed options in the amount of $9.4 million, which are used by the Group to manage its exposure to the Standard & Poor's 500 stock market index, and also excluding accrued interest of $4.5 million and unamortized deposit discounts in the amount of $5.2 million, the scheduled maturities of certificates of deposit at December 31, 2011 are as follows:

	December 31, 2011
	(In thousands)
Within one year:	
Three (3) months or less	$ 252,297
Over 3 months through 1 year	420,727
	673,024
Over 1 through 2 years	271,066
Over 2 through 3 years	108,369
Over 3 through 4 years	24,832
Over 4 through 5 years	77,843
	$1,155,134

The aggregate amount of overdraft in demand deposit accounts that were reclassified to loans amounted to $4.2 million as of December 31, 2011 ($7.6 million — December 31, 2010).

11. BORROWINGS

Short Term Borrowings

At December 31, 2011, short term borrowings amounted to $39.9 million (December 31, 2010 — $42.5 million) which mainly consist of deposits of the Puerto Rico Cash & Money Market Fund with a weighted average rate of 0.80% (December 31, 2010 — 0.60%), which were collateralized with investment securities with fair value of $62.7 million (December 31, 2010 — $47.5 million).

Securities Sold under Agreements to Repurchase

At December 31, 2011, securities underlying agreements to repurchase were delivered to, and are being held by, the counterparties with whom the repurchase agreements were transacted. The counterparties have agreed to resell to the Group the same or similar securities at the maturity of the agreements.

At December 31, 2011 and 2010, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of $6.2 million and $6.3 million, respectively, were as follows:

	December 31,			
	2011		2010	
	Borrowing Balance	Fair Value of Underlying Collateral	Borrowing Balance	Fair Value of Underlying Collateral
	(In thousands)			
Credit Suisse Securities (USA) LLC	$1,250,000	$1,337,394	$1,250,000	$1,325,392
Citigroup Global Markets Inc.	900,000	974,286	1,600,000	1,752,619
UBS Financial Services Inc.	500,000	620,888	500,000	605,706
JP Morgan Chase Bank NA	300,000	357,400	100,000	119,997
Deutsche Bank	100,000	109,177	—	—
Total	**$3,050,000**	**$3,399,145**	**$3,450,000**	**$3,803,714**

The original terms of the Group's structured repurchase agreements range between three and ten years, and except for four repurchase agreements totaling $600 million (as described below), the counterparties have the right to exercise put options at par on a quarterly basis before their contractual maturities from one to three years after the agreements' settlement dates. The Group's $500 million repurchase agreement also provides for an optional early termination by either party upon no less than two business days' prior written notice to the other party. In the event of any such optional early termination, the amounts owed by or to the terminating party by the other party on the optional early termination date must take account of the termination value of the transaction, as determined by the calculation agent in the manner described in the repurchase agreement. The following table shows a summary of these agreements and their terms, excluding accrued interest in the amount of $6.2 million, at December 31, 2011:

Year of Maturity	Borrowing Balance	Weighted-Average Coupon	Settlement Date	Maturity Date	Next Put Date
	(In thousands)				
2012					
	350,000	4.26%	5/9/2007	5/9/2012	2/9/2012
	100,000	4.50%	8/14/2007	8/14/2012	2/16/2012
	150,000	4.31%	3/6/2007	12/6/2012	3/6/2012
	600,000				
2014					
	100,000	4.72%	7/27/2007	7/27/2014	1/27/2012
	300,000	2.86%	3/28/2011	9/28/2014	N/A
	400,000				
2015					
	100,000	0.60%	12/28/2011	3/30/2015	N/A
	100,000	0.68%	12/29/2011	1/28/2015	N/A
	100,000	0.65%	12/28/2011	6/28/2015	N/A
	300,000				
2017					
	500,000	4.67%	3/2/2007	3/2/2017	3/2/2012
	250,000	0.25%	3/2/2007	3/2/2017	3/2/2012
	100,000	0.00%	6/6/2007	3/6/2017	3/6/2012
	900,000	0.00%	3/6/2007	6/6/2017	3/6/2012
	1,750,000				
	$3,050,000	**2.13%**			

None of the structured repurchase agreements referred to above with put dates up to the date of this filing were put by the counterparties. Such repurchase agreements include $1.25 billion, which reset at each put date at a formula which is based on the three-month LIBOR rate less fifteen times the difference between the ten-year SWAP rate and the two-year SWAP rate, with a minimum of 0.00% on $1.0 billion and 0.25% on $250 million, and a maximum of 10.6%. These repurchase agreements bear the respective minimum rates of 0.0% and 0.25% until at least their next put dates scheduled for March 2012.

The following table presents the borrowings organized by type acting as collateral under repurchase agreements, excluding accrued interest in the amount of $6.2 million and $6.3 million at December 31, 2011 and 2010, respectively:

	December 31,			
	2011		2010	
	Borrowing Balance	Fair Value of Underlying Collateral	Borrowing Balance	Fair Value of Underlying Collateral
	(In thousands)			
GNMA certificates				
Within 30 days	$ —	$ 7,588	$ —	$ 38,877
Less than 1 year	3,901	4,048	5,275	5,221
1 — 3 years	—	—	16,090	16,537
3 — 5 years	500	552	—	—
over 5 years	6,492	2,248	45,783	21,303
	10,893	14,436	67,148	81,938
FNMA certificates				
Within 30 days	—	654,436	—	509,914
Less than 1 year	650,825	664,774	572,590	547,108
1 — 3 years	254,141	231,450	769,645	787,326
3 to 5 years	269,500	291,051	100,000	78,689
over 5 years	1,515,940	1,127,921	1,421,948	1,230,407
	2,690,406	2,969,632	2,864,183	3,153,444
FHLMC certificates				
Within 30 days	—	51,364	—	87,823
Less than 1 year	63,846	66,213	38,160	39,269
1 — 3 years	1,270	1,313	26,060	21,327
3 to 5 years	—	—	—	—
over 5 years	227,568	230,375	282,269	240,570
	292,684	349,265	346,489	388,989
CMOs				
Within 30 days	—	7,528	—	2,739
Less than 1 year	6,335	6,319	169,305	171,021
1 — 3 years	19,682	19,657	2,875	2,983
3 to 5 years	30,000	32,308	—	—
	56,017	65,812	172,180	176,743
US Agency securities				
1 — 3 years	—	—	—	2,600
	—	—	—	2,600
Total	**$3,050,000**	**$3,399,145**	**$3,450,000**	**$3,803,714**

The collateral of the repurchase agreements is not limited to the maturity buckets outlined above, and is generally available for any borrowing as governed by existing master repurchase agreements in place with each counter party.

At December 31, 2011 and 2010, the weighted average interest rate of the Group's repurchase agreements was 2.13% and 2.81%, respectively, and included agreements with interest ranging from 0.00% to 4.72%. The following summarizes significant data on securities sold under agreements to repurchase as of December 31, 2011 and 2010, excluding accrued interest:

	December 31,	
	2011	2010
	(In thousands)	
Average daily aggregate balance outstanding	$3,417,892	$3,545,926
Maximum outstanding balance at any month-end	$3,466,450	$3,566,588
Weighted average interest rate during the year	2.73%	2.84%
Weighted average interest rate at year end	2.13%	2.81%

Advances from the Federal Home Loan Bank

Advances are received from the FHLB under an agreement whereby the Group is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances. At December 31, 2011, these advances were secured by mortgage and commercial loans amounting to $548.8 million and $40.9 million, respectively. Also, at December 31, 2011, the Group had an additional borrowing capacity with the FHLB of $149.6 million. At December 31, 2011, the weighted average remaining maturity of FHLB's advances was 11.2 months (December 31, 2010 — 23.15 months).

In 2007, the Group restructured most of its FHLB advances portfolio into longer-term, structured advances. The original terms of these advances range between five and seven years, and the FHLB has the right to exercise put options at par on a quarterly basis before the contractual maturity of the advances from nine months to one year after the advances' settlement dates. The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of $1.8 million, at December 31, 2011:

Year of Maturity	Borrowing Balance	Weighted-Average Coupon	Settlement Date	Maturity Date	Next Put Date
	(In thousands)				
2012					
	$ 25,000	4.37%	5/4/2007	5/4/2012	2/4/2012
	25,000	4.57%	7/24/2007	7/24/2012	1/24/2012
	25,000	4.26%	7/30/2007	7/30/2012	1/31/2012
	50,000	4.33%	8/10/2007	8/10/2012	2/11/2012
	100,000	4.09%	8/16/2007	8/16/2012	2/16/2012
	225,000				
2014					
	25,000	4.20%	5/8/2007	5/8/2014	2/8/2012
	30,000	4.22%	5/11/2007	5/11/2014	2/10/2012
	55,000				
	$280,000	**4.24%**			

None of the advances referred to in the previous table with put dates up to the date of this filing were put by the FHLB at their corresponding put dates.

FDIC-Guaranteed Term Notes — Temporary Liquidity Guarantee Program

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

Subordinated Capital Notes

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

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

The proceeds from this issuance were used by the Statutory Trust II to purchase a like amount of floating rate junior subordinated deferrable interest debentures ("subordinated capital note") issued by the Group. The subordinated capital note has a par value of $36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (3.30% at December 31, 2011; 3.25% at December 31, 2010), is payable quarterly, and matures on September 17, 2033. The subordinated capital note purchased by the Statutory Trust II may be called at par after five years and quarterly thereafter (next call date March 2012). The trust redeemable preferred securities have the same maturity and call provisions as the subordinated capital notes. The subordinated deferrable interest debentures issued by the Group are accounted for as a liability denominated as subordinated capital note on the unaudited consolidated statements of financial condition.

The subordinated capital note is treated as Tier 1 capital for regulatory purposes. Under Federal Reserve Board rules, restricted core capital elements, which are qualifying trust preferred securities, qualifying cumulative perpetual preferred stock (and related surplus) and certain minority interests in consolidated subsidiaries, are limited in the aggregate to no more than 25% of a bank holding company's core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability. However, under the Dodd-Frank Act, bank holding companies are prohibited from including in their Tier 1 capital hybrid debt and equity securities, including trust preferred securities, issued on or after May 19, 2010. Any such instruments issued before May 19, 2010 by a bank holding company, such as the Group, with total consolidated assets of less than $15 billion as of December 31, 2009, may continue to be included as Tier 1 capital. Therefore, the Group is permitted to continue to include its existing trust preferred securities as Tier 1 capital.

12. EMPLOYEE BENEFIT PLAN

The Group has a profit sharing plan containing a cash or deferred arrangement qualified under Sections 1081.01(a) and 1081.01(d) of the 2011 Code, and Sections 401(a) and 401(k) of the United States Revenue Code of 1986, as amended (the "U.S. Code"). This plan is subject to the provisions of Title I of the

Employee Retirement Security Act of 1976, as amended ("ERISA"). This plan covers all full-time employees of the Group who are age twenty-one or older. Under this plan, participants may contribute each year from 2% to 10% of their compensation, as defined in the plan, up to a specified amount. The Group currently contributes 80 cents for each dollar contributed by an employee, up to $832 per employee. The Group's matching contribution is invested in shares of its common stock. This plan is entitled to acquire and hold qualified employer securities as part of its investment of the trust assets pursuant to ERISA Section 407. For the years ended December 31, 2011, 2010 and 2009, the Group contributed 24,128 shares, 15,242 shares, and 37,956 shares, respectively, of its common stock at a cost of approximately $42,789, $29,267, and $148,700 at the time of contribution. The Group's contribution becomes 100% vested once the employee completes three years of service.

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

13. RELATED PARTY TRANSACTIONS

The Bank grants loans to its directors, executive officers and to certain related individuals or organizations in the ordinary course of business. These loans are offered at the same terms as loans to unrelated third parties. The activity and balance of these loans for the years ended December 31, 2011 and 2010 were as follows:

	December 31,	
	2011	2010
	(In thousands)	
Balance at the beginning of year	$3,452	$3,889
New loans	615	187
Repayments	(108)	(617)
Credits of persons no longer considered related parties	(187)	(7)
Balance at the end of year	**$3,772**	**$3,452**

14. INCOME TAX

Under Puerto Rico law, 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.

The components of income tax expense (benefit) for the years ended December 31, 2011, 2010, and 2009 are as follows:

	December 31,		
	2011	2010	2009
		(In thousands)	
Current income tax expense	$ 2,229	$ 5,794	$ 8,754
Deferred income tax benefit	(1,363)	(10,092)	(1,782)
Income tax expense (benefit)	**$ 866**	**$ (4,298)**	**$ 6,972**

The Group maintained an effective tax rate lower than the maximum marginal statutory rate of 30.00%, 40.95%, and 40.95% as of December 31, 2011, 2010 and 2009, respectively, mainly due to income generated by the IBE taxed at 5% and to the interest income arising from investments exempt from Puerto Rico income taxes, net of expenses attributable to the exempt income. For 2011, 2010 and 2009 the Bank's investment securities portfolio and loans portfolio generated tax-exempt interest income of $9.8 million, $28.6 million, and $39.8 million, respectively. For 2011, 2010, and 2009 the IBE generated $36.9 million, $15.5 million, and $49.1 million in income taxable at a 5% income tax rate.

Pursuant to the Declaration of Fiscal Emergency and Plan for Economic Stabilization and Restoration of the Puerto Rico Credit Act of March 9, 2009, for the 2009 and 2010 taxable years every taxable corporation engaged in trade or business in Puerto Rico, including banks and insurance companies, was subject to an additional 5% surcharge on corporate income tax, increasing the maximum tax rate from 39% to 40.95%. Also, income earned by international banking entities, which was previously fully exempt, is subject to a 5% income tax for tax years beginning after December 31, 2008, and ending before January 1, 2012. These taxes were imposed on a temporary basis as a measure to generate additional revenues to address the fiscal crisis that the government of Puerto Rico is currently facing.

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

	December 31,					
	2011		2010		2009	
	Amount	Rate	Amount	Rate	Amount	Rate
	(Dollars in thousands)					
Tax at statutory rates	$ 10,595	30.00%	$ 2,267	40.95%	$ 12,251	40.95%
Tax effect of exempt income, net	(10,512)	–29.77%	(5,569)	–100.60%	(22,081)	–73.81%
Effect of tax rate on capital loss carryforwards	(1,535)	–4.34%	(6,012)	–108.60%	16,481	55.09%
Change in valuation allowance	(1,292)	–3.66%	2,929	52.91%	81	0.27%
Income tax contingencies provision (credit)	(2,807)	–7.95%	53	0.96%	671	2.24%
Effect in deferred taxes due to reduction in tax rates from 40.95% to 30%	5,179	14.66%	—	—	—	—
Effect of change in tax status of IBE	499	1.41%	—	—	—	—
Other items, net	739	2.10%	2,034	36.74%	(431)	-1.44%
Income tax expense (benefit)	**$ 866**	**2.45%**	**$(4,298)**	**-77.64%**	**$ 6,972**	**23.30%**

The tax effect of the income earned by the IBE is included in the "tax effect of exempt income, net" caption on the table above, and amounted to $9.2 million, $5.6 million and $17.7 million for the years ended December 31, 2011, 2010 and 2009, respectively.

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

The components of the Group's deferred tax asset, net, at December 31, 2011 and 2010 are as follows:

	December 31, 2011	December 31, 2010
	(In thousands)	
Deferred tax asset:		
Allowance for loan losses and other reserves	$ 22,281	$ 31,479
FDIC-assisted acquisition	11,967	10,782
Deferred loan origination fees, net	1,417	2,139
Derivative unrealized net loss	5,312	142
S&P option contracts	4,670	6,731
Net capital and operating loss carryforwards	7,368	13,547
Other deferred tax assets	2,605	2,582
Total gross deferred tax asset	55,620	67,402
Deferred tax liability:		
FDIC shared-loss indemnification asset	(12,072)	(20,696)
Derivative unrealized net gain	—	(5,267)
Unrealized net gain on available-for-sale securities	(4,273)	(1,910)
Servicing Asset	(3,070)	(3,480)
Other deferred tax liabilities	(1,211)	(1,054)
Total deferred tax liabilities	(20,626)	(32,407)
Less: Valuation allowance	(2,971)	(4,263)
Net deferred tax asset	**$ 32,023**	**$ 30,732**

In assessing the realizability of the deferred tax asset, management considers whether it is more likely than not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of the deferred tax asset is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax asset are deductible, management believes it is more likely than not that the Group will realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2011. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry-forward period are reduced.

The holding company and its subsidiaries have operating and capital loss carry-forwards for income tax purposes which are available to offset future taxable income and capital gains. Operating loss carry-forwards are available until December 2019 and capital loss carry-forwards are available until December 2016. The majority of these operating and capital loss carry-forwards are at the Bank amounting to approximately $36.0 million and $48.4 million as of December 31, 2011 and 2010, respectively.

For purposes of income taxes associated with the FDIC-assisted acquisition, the Group assumed some tax positions, which are being evaluated by the Puerto Rico Treasury Department and are supported by the corresponding technical merits.

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 classifies unrecognized tax benefits in income taxes payable. These gross unrecognized tax benefits would affect the effective tax rate if realized. The balance of unrecognized tax benefits at December 31, 2011 and 2010 was $1.4 million and $6.3 million, respectively. The variance is attributed to various contingencies settled with the Puerto Rico Treasury Department on June 30, 2011 in which the Group paid $2.0 million, approximately $3.0 million less than what the Group had accrued for this purpose. Following such settlements, only the 2010 tax period remains subject to examination by the Puerto Rico Treasury Department. It is the Group's policy to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the consolidated statements of operations. The Group had accrued $342 thousand at December 31, 2011 (December 31, 2010 — $1.5 million) for the payment of interest and penalties relating to unrecognized tax benefits.

15. STOCKHOLDERS' EQUITY

Preferred Stock

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

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

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

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

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

Common Stock

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

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

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

Regulatory Capital Requirements

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

Quantitative measures established by regulation to ensure capital adequacy require the Group and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations) and of Tier 1 capital to average assets (as defined in the regulations). As of December 31, 2011 and 2010, the Group and the Bank met all capital adequacy requirements to which they are subject. As of December 31, 2011 and 2010, the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables.

The Group's and the Bank's actual capital amounts and ratios as of December 31, 2011 and 2010 are as follows:

	Actual		Minimum Capital Requirement	
	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)			
Group Ratios				
As of December 31, 2011				
Total Capital to Risk-Weighted Assets	$688,415	**32.84%**	$167,690	**8.00%**
Tier 1 Capital to Risk-Weighted Assets	$661,614	**31.56%**	$ 83,845	**4.00%**
Tier 1 Capital to Total Assets	$661,614	**9.65%**	$274,231	**4.00%**
As of December 31, 2010				
Total Capital to Risk-Weighted Assets	$728,241	**32.32%**	$180,279	**8.00%**
Tier 1 Capital to Risk-Weighted Assets	$699,415	**31.04%**	$ 90,139	**4.00%**
Tier 1 Capital to Total Assets	$699,415	**9.50%**	$294,472	**4.00%**

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
Bank Ratios						
As of December 31, 2011						
Total Capital to Risk-Weighted Assets	$643,237	**30.87%**	$166,687	**8.00%**	$208,359	**10.00%**
Tier 1 Capital to Risk-Weighted Assets	$616,590	**29.59%**	$ 83,344	**4.00%**	$125,015	**6.00%**
Tier 1 Capital to Total Assets	$616,590	**9.06%**	$272,178	**4.00%**	$340,222	**5.00%**
As of December 31, 2010						
Total Capital to Risk-Weighted Assets	$695,013	**31.23%**	$178,049	**8.00%**	$222,562	**10.00%**
Tier 1 Capital to Risk-Weighted Assets	$666,531	**29.95%**	$ 89,025	**4.00%**	$133,537	**6.00%**
Tier 1 Capital to Total Assets	$666,531	**9.22%**	$289,083	**4.00%**	$361,354	**5.00%**

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

Equity-Based Compensation Plan

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

The activity in outstanding options for the years ended December 31, 2011, 2010 and 2009 is set forth below:

	December 31,					
	2011		2010		2009	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Beginning of year	765,989	$15.25	514,376	$16.86	500,200	$17.14
Options granted	85,000	11.90	262,700	11.97	15,676	8.28
Options exercised	(923)	8.82	(8,337)	8.60	—	—
Options forfeited	(63,362)	13.69	(2,750)	23.29	(1,500)	21.86
End of year	**786,704**	**$15.02**	**765,989**	**$15.25**	**514,376**	**$16.86**

The following table summarizes the range of exercise prices and the weighted average remaining contractual life of the options outstanding at December 31, 2011:

	Outstanding			Exercisable	
Range of Exercise Prices	Number of Options	Weighted Average Exercise Price	Weighted Average Contract Life Remaining (Years)	Number of Options	Weighted Average Exercise Price
$ 5.63 to $ 8.45	12,792	$ 8.28	7.32	2,970	$ 8.28
8.46 to 11.27	2,000	10.29	5.64	1,000	10.29
11.28 to 14.09	542,427	12.14	6.41	193,452	12.35
14.10 to 16.90	62,035	15.60	2.60	62,035	15.60
19.72 to 22.54	25,050	20.68	3.18	20,800	20.44
22.55 to 25.35	83,350	23.99	2.28	83,350	23.99
25.36 to 28.17	59,050	27.46	2.82	59,050	27.46
	786,704	**$15.02**	**5.32**	**422,657**	**$17.60**
Aggregate Intrinsic Value	**$167,219**			**$ 23,909**	

The average fair value of each option granted during 2011, 2010, and 2009 was $6.48, $6.66, and $4.49, respectively. The average fair value of each option granted was estimated at the date of the grant using the Black-Scholes option pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no restrictions and are fully transferable and negotiable in a free trading market. Black-Scholes does not consider the employment, transfer or vesting restrictions that are inherent in the Group's stock options. Use of an option valuation model, as required by GAAP, includes highly subjective assumptions based on long-term predictions, including the expected stock price volatility and average life of each option grant.

The following assumptions were used in estimating the fair value of the options granted during the years ended December 31, 2011, 2010 and 2009:

	December 31, 2011	December 31, 2010	December 31, 2009
Weighted Average Assumptions:			
Dividend yield	1.62%	1.47%	4.55%
Expected volatility	58.99%	60.00%	36.00%
Risk-free interest rate	3.11%	3.07%	4.40%
Expected life (in years)	8.0	8.0	8.5

The following table summarizes the restricted units' activity under the Omnibus Plan for the years ended December 31, 2011, 2010 and 2009:

	December 31,					
	2011		2010		2009	
	Restricted Units	Weighted Average Grant Date Fair Value	Restricted Units	Weighted Average Grant Date Fair Value	Restricted Units	Weighted Average Grant Date Fair Value
Beginning of year	243,525	$13.43	147,625	$14.64	99,916	$18.54
Restricted units granted	39,500	11.88	131,000	11.88	53,609	8.18
Restricted units lapsed	(59,916)	20.65	(30,000)	12.49	—	—
Restricted units forfeited	(17,960)	11.67	(5,100)	14.12	(5,900)	21.86
End of year	**205,149**	**$11.27**	**243,525**	**$13.43**	**147,625**	**$14.64**

Legal Surplus

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

Earnings per Common Share

The calculation of earnings per common share for the years ended December 31, 2011, 2010 and 2009 is as follows:

	December 31,		
	2011	2010	2009
	(In thousands, except per share data)		
Net income	$34,450	$ 9,834	$22,945
Less: Dividends on preferred stock	(4,802)	(5,335)	(4,802)
Less: Deemed dividend on preferred stock beneficial conversion feature	—	(22,711)	—
Income available (loss) to common shareholders	**$29,648**	**$(18,212)**	**$18,143**
Average common shares outstanding and equivalents	**44,524**	**36,810**	**24,306**
Earnings (loss) per common share — basic	**0.67**	**(0.50)**	**(0.75)**
Earnings (loss) per common share — diluted	**$ 0.67**	**$ (0.50)**	**$ (0.75)**

For the years ended December 31, 2011, 2010, and 2009, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 529,093, 214,256, and 355,720, respectively. The conversion of the Group's mandatorily convertible non-cumulative non-voting perpetual preferred stock, Series C, into shares of the Group's common stock during the year ended December 31, 2010, resulted in a non-cash beneficial conversion feature of $22.7 million, representing the intrinsic value between the conversion rate of $15.015 and the common stock closing price of $16.72 on April 30, 2010, the date the preferred shares were offered. Upon conversion, the beneficial conversion feature was recorded as a deemed dividend to the preferred stockholders reducing retained earnings, with a corresponding offset to surplus (paid in capital), and thus did not affect total stockholders' equity or the book value of the common stock. However, the deemed dividend increased the net loss applicable to common stock and affected the calculation of basic and diluted EPS for the year ended December 31, 2010. Moreover, in computing diluted EPS, dilutive convertible securities that remained outstanding for the period prior to actual conversion were not included as average potential common shares because the effect would have been antidilutive. In computing both basic and diluted EPS, the common shares issued upon actual conversion were included in the weighted average calculation of common shares after the date of conversion.

Treasury Stock

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

Any shares of common stock repurchased are held by the Group as treasury shares. The Group records treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. Under the $30 million program, initiated in February 2011, the Group purchased a total of 2,406,303 shares at an average price of $12.10 per share. 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. After December 31, 2011, the Group purchased approximately 469,000 additional shares under this program for a total of $5.4 million as of March 9, 2012, at an average price of $11.61 per share. These subsequent purchases will reduce the 2012 share count.

The following table presents the shares repurchased for each month 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.

The activity in connection with common shares held in treasury by the Group for the years ended December 31, 2011, 2010 and 2009 is set forth below:

	December 31,					
	2011		2010		2009	
	Shares	Dollar Amount	Shares	Dollar Amount	Shares	Dollar Amount
	(In thousands, except shares data)					
Beginning of year	1,459,067	$16,732	1,504,309	$17,142	1,442,265	$17,109
Common shares used upon lapsing of restricted stock units	(59,916)	(656)	(30,000)	(380)	—	—
Common shares repurchased as part of the stock repurchase program	5,189,101	58,775	—	—	100,000	182
Common shares repurchased (used) to match defined contribution plan, net	(24,128)	(43)	(15,242)	(30)	(37,956)	(149)
End of year	**6,564,124**	**$74,808**	**1,459,067**	**$16,732**	**1,504,309**	**$17,142**

Accumulated Other Comprehensive Income

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

	December 31, 2011	December 31, 2010
	(In thousands)	
Unrealized gain on securities available-for-sale which are not other-than-temporarily impaired	$ 86,404	$39,095
Unrealized loss on cash flow hedges	(47,425)	—
Income tax effect	(1,848)	(2,108)
	$ 37,131	**$36,987**

16. COMMITMENTS

Loan Commitments

At December 31, 2011 and 2010, there were $106.1 million and $104.3 million in loan commitments, respectively, which represents unused lines of credit and letters of credit provided to customers. These lines of credit had a reserve of $518 thousand and $662 thousand at December 31, 2011 and 2010, respectively. Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates, bear variable interest and may require payment of a fee. Since the commitments may expire unexercised, the total commitment amounts do not necessarily represent future cash requirements. The Group evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Group upon the extension of credit, is based on management's credit evaluation of the customer. Commitments for loans covered under the FDIC shared-loss agreements amounted to $31.1 million and $42.6 million at December 31, 2011 and 2010, respectively.

At December 31, 2011, commitments to sell or securitize mortgage loans, expiring on or before December 31, 2012, amounted to approximately $66.1 million. At December 31, 2010, commitments to sell or securitize mortgage loans amounted to approximately $49.8 million.

Lease Commitments

The Group has entered into various operating lease agreements for branch facilities and administrative offices. Rent expense for the years ended December 31, 2011, 2010 and 2009 amounted to $6.1 million, $7.6 million, and $5.6 million, respectively, and is included in the "occupancy and equipment" caption in the consolidated statements of operations. Future rental commitments under terms of leases in effect at December 31, 2011, exclusive of taxes, insurance, and maintenance expenses payable by the Group, are summarized as follows:

Year Ending December 31,	Minimum Rent
	(In thousands)
2012	$ 4,588
2013	4,572
2014	4,569
2015	4,323
2016	3,741
Thereafter	17,259
	$39,052

17. CONTINGENCIES

The Group and its subsidiaries are defendants in a number of legal proceedings incidental to their business. In the ordinary course of business, the Group and its subsidiaries are also subject to governmental and regulatory examinations. Certain subsidiaries of the Group, including a bank, a registered broker-dealer, and an insurance agency, are subject to regulation by various U.S., Puerto Rico and other regulators.

The Group seeks to resolve all litigation and regulatory matters in the manner management believes is in the best interests of the Group and its shareholders, and contests liability, allegations of wrongdoing and, where applicable, the amount of damages or scope of any penalties or other relief sought as appropriate in each pending matter.

Accounting and Disclosure Framework

ASC 450 governs the disclosure and recognition of loss contingencies, including potential losses from litigation and regulatory matters. ASC 450 defines a "loss contingency" as "an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur." It imposes different requirements for the recognition and disclosure of loss contingencies based on the likelihood of occurrence of the contingent future event or events. It distinguishes among degrees of likelihood using the following three terms: "probable," meaning that "the future event or events are likely to occur"; "remote," meaning that "the chance of the future event or events occurring is slight"; and "reasonably possible," meaning that "the chance of the future event or events occurring is more than remote but less than likely." These three terms are used below as defined in ASC 450.

Accruals. ASC 450 requires accrual for a loss contingency when it is "probable that one or more future events will occur confirming the fact of loss" *and* "the amount of the loss can be reasonably estimated." In accordance with ASC 450, the Group establishes accruals for all litigation and regulatory matters when the Group believes it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. When the reasonable estimate of the loss is within a range of amounts, the minimum amount of the range is accrued, unless some higher amount within the range is a better estimate than any other amount within the range. Once established, accruals are adjusted from time to time, as appropriate, in light of additional information. The amount of loss ultimately incurred in relation to those matters may be substantially higher or lower than the amounts accrued for those matters.

Disclosure. ASC 450 requires disclosure of a loss contingency if "there is at least a reasonable possibility that a loss or an additional loss may have been incurred" *and* there is no accrual for the loss because the conditions described above are not met *or* an exposure to loss exists in excess of the amount accrued. In accordance with ASC 450, if the Group has not accrued for a matter because the Group believes that a loss is reasonably possible but not probable, or that a loss is probable but not reasonably estimable, and the matter therefore does not meet the criteria for accrual, it discloses the loss contingency. In addition, the Group discloses matters for which it has accrued if it believes an exposure to loss exists in excess of the amount accrued. In accordance with ASC 450, the Group's disclosure includes an estimate of the reasonably possible loss or range of loss for those matters as to which an estimate can be made. ASC 450 does not require disclosure of an estimate of the reasonably possible loss or range of loss where an estimate cannot be made. Neither accrual nor disclosure is required for losses that are deemed remote.

Opinion of Management as to Eventual Outcome. Subject to the foregoing, it is the opinion of the Group's management, based on current knowledge and after taking into account its current legal accruals that the eventual outcome of all matters would not be likely to have a material adverse effect on the consolidated financial condition of the Group. Nonetheless, given the substantial or indeterminate amounts sought in certain of these matters, and the inherent unpredictability of such matters, an adverse outcome in certain of these matters could, from time to time, have a material adverse effect on the Group's consolidated results of operations or cash flows in particular quarterly or annual periods. The Group has evaluated all litigation and regulatory matters where the likelihood of a potential loss is deemed reasonably possible. The Group has determined that the estimate of the reasonably possible loss is not significant.

18. FAIR VALUE

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

Fair Value Measurement

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

Money market investments

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

Securities purchased under agreements to resell

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

Investment securities

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

Derivative instruments

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

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

Servicing assets

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

Loans receivable considered impaired that are collateral dependent

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

Foreclosed real estate

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

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

	December 31, 2011			
	Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Investment securities available-for-sale	$ —	$2,912,600	$ 47,312	$2,959,912
Money market investments	3,863	—	—	3,863
Derivative assets	—	—	9,317	9,317
Derivative liabilities	—	(47,425)	(9,362)	(56,787)
Servicing assets	—	—	10,454	10,454
	$ 3,863	**$2,865,175**	**$ 57,721**	**$2,926,759**

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

The table below presents reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2011 and 2010:

	Total Fair Value Measurements December 31, 2011					
	Investment securities available-for-sale					
Level 3 Instruments Only	CDOs	CLOs	Obligations of Puerto Rico Government and political subdivisions	Derivative asset (S&P Purchased Options)	Derivative liability (S&P Embedded Options)	Servicing assets
	(In thousands)					
Balance at beginning of year	$ 16,143	$25,550	$ —	$9,870	$(12,830)	$ 9,695
Gains (losses) included in earnings	(15,018)	—	—	(977)	1,935	—
Changes in fair value of investment securities available for sale included in other comprehensive income	9,405	1,011	23	—	—	—
New instruments acquired	—	—	10,005	424	(405)	2,458
Principal repayments	—	—	—	—	—	(976)
Amortization	—	197	(4)	—	1,938	—
Changes in fair value of servicing assets	—	—	—	—	—	(723)
Balance at end of year	**$ 10,530**	**$26,758**	**$ 10,024**	**$9,317**	**$ (9,362)**	**$10,454**

	Total Fair Value Measurements December 31, 2010					
	Investment securities available-for-sale					
Level 3 Instruments Only	CDOs	CLOs	Non-Agency CMOs	Derivative asset (S&P Purchased Options)	Derivative liability (S&P Embedded Options)	Servicing assets
	(In thousands)					
Balance at beginning of year	$ 15,148	$23,235	$ 71,723	$6,464	$ (9,543)	$ 7,120
Gains (losses) included in earnings	—	—	(39,942)	2,587	1,869	—
Changes in fair value of investment securities available for sale included in other comprehensive income	995	2,314	41,398	—	—	—
New instruments acquired	—	—	—	1,147	(5,959)	4,123
Principal repayments	—	1	(73,179)	(328)	803	(869)
Changes in fair value of servicing assets	—	—	—	—	—	(679)
Balance at end of year	**$ 16,143**	**$25,550**	**$ —**	**$9,870**	**$(12,830)**	**$ 9,695**

There were no transfers into and out of Level 1 and Level 2 fair value measurements during the years ended December 31, 2011 and 2010.

The table below presents a detail of investment securities available-for-sale classified as level 3 at December 31, 2011:

Type	December 31, 2011 Amortized Cost	Unrealized Gains (Losses)	Fair Value	Weighted Average Yield	Principal Protection
	(In thousands)				
Obligations of Puerto Rico Government and political subdivisions	$10,001	$ 23	$10,024	3.50%	N/A
Structured credit investments					
CDO	$10,530	$ —	$10,530	5.80%	5.74%
CLO	15,000	(4,581)	10,419	2.61%	7.54%
CLO	11,979	(2,942)	9,037	1.97%	26.18%
CLO	9,395	(2,093)	7,302	1.40%	20.64%
	$46,904	$(9,616)	$37,288	2.92%	
Total	**$56,905**	**$(9,593)**	**$47,312**	**3.02%**	

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

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

	Carrying value at December 31, 2011 Level 3	Carrying value at December 31, 2010 Level 3
	(In thousands)	
Impaired commercial loans	$46,364	$25,898
Foreclosed real estate	27,679	26,840
	$74,043	**$52,738**

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

Impaired commercial loans, which are measured using the fair value of the collateral for collateral dependent loans, had a carrying amount of $46.4 million and $25.9 million at December 31, 2011 and 2010, respectively, with a valuation allowance of $3.5 million and $823 thousand. 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.

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

Fair Value of Financial Instruments

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

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

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

	December 31,			
	2011		2010	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	(In thousands)			
Financial Assets:				
Cash and cash equivalents	$ 605,477	$ 605,477	$ 448,936	$ 448,936
Trading securities	180	180	1,330	1,330
Investment securities available-for-sale	2,959,912	2,959,912	3,700,064	3,700,064
Investment securities held-to-maturity	904,556	884,026	675,721	689,917
Federal Home Loan Bank (FHLB) stock	23,779	23,779	22,496	22,496
Total loans (including loans held-for-sale)				
Non-covered loans, net	1,211,539	1,173,677	1,150,945	1,151,868
Covered loans, net	584,110	496,276	600,421	620,711
Derivative assets	9,317	9,317	28,315	28,315
FDIC shared-loss indemnification asset	312,957	392,367	430,383	473,629
Accrued interest receivable	20,182	20,182	28,716	28,716
Servicing assets	10,454	10,454	9,695	9,695
Financial Liabilities:				
Deposits	2,527,432	2,395,267	2,585,922	2,588,888
Securities sold under agreements to repurchase	3,092,122	3,056,238	3,701,669	3,456,781
Advances from FHLB	285,663	281,753	303,868	281,753
FDIC-guaranteed term notes	105,752	105,834	106,428	105,834
Subordinated capital notes	36,083	36,083	36,083	36,083
Short term borrowings	39,920	39,920	42,460	42,460
Derivative liabilities	47,425	47,425	64	64
Accrued expenses and other liabilities	35,476	35,476	43,858	43,858

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

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

- Investments in FHLB stock are valued at their redemption value.
- The fair value of investment securities is based on quoted market prices, when available, or market prices provided by recognized broker-dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument. The estimated fair value of the structured credit investments and the non-agency collateralized mortgage obligations are determined by using a third party cash flow valuation model to calculate the present value of projected future cash flows. The assumptions used, which are highly uncertain and require a high degree of judgment, include primarily market discount rates, current spreads, duration, leverage, default, home price depreciation, and loss rates. The assumptions used are drawn from a wide array of data sources, including the performance of the collateral underlying each deal. The external-based valuation, which is obtained at least on a quarterly basis, is analyzed and its assumptions are evaluated and incorporated in either an internal-based valuation model when deemed necessary or compared to counterparties' prices, and agreed by management.
- The FDIC shared-loss indemnification asset is measured separately from each of the covered asset categories as it is not contractually embedded in any of the covered asset categories. The fair value of the FDIC shared-loss indemnification asset represents the present value of the estimated cash payments (net of amount owed to the FDIC) expected to be received from the FDIC for future losses on covered assets based on the credit assumptions on estimated cash flows for each covered asset pool and the shared-loss percentages. The ultimate collectability of the FDIC shared-loss indemnification asset is dependent upon the performance of the underlying covered loans, the passage of time and claims paid by the FDIC which are impacted by the Bank's adherence to certain guidelines established by the FDIC.
- The fair values of the derivative instruments are provided by valuation experts and counterparties. Certain derivatives with limited market activity are valued using externally developed models that consider unobservable market parameters. The Group has offered its customers certificates of deposit with an option tied to the performance of the S&P Index, and uses equity indexed option agreements with major broker-dealer companies to manage its exposure to changes in this index. Their fair value is obtained through the use of an external based valuation that was thoroughly evaluated and adopted by management as its measurement tool for these options. The payoff of these options is linked to the average value of the S&P Index on a specific set of dates during the life of the option. The methodology uses an average rate option or a cash-settled option whose payoff is based on the difference between the expected average value of the S&P Index during the remaining life of the option and the strike price at inception. The assumptions, which are uncertain and require a degree of judgment, include primarily S&P Index volatility, forward interest rate projections, estimated index dividend payout, and leverage.
- Fair value of interest rate swaps and options on interest rate swaps is based on the net discounted value of the contractual projected cash flows of both the pay-fixed receive-variable legs of the contracts. The projected cash flows are based on the forward yield curve, and discounted using current estimated market rates.
- The fair value of the covered and non-covered loan portfolio (including loans held-for-sale) is estimated by segregating by type, such as mortgage, commercial, consumer, and leasing. Each loan segment is further segmented into fixed and adjustable interest rates and by performing and non-performing categories. The fair value of performing loans is calculated by discounting contractual cash flows, adjusted for prepayment estimates (voluntary and involuntary), if any, using estimated current market discount rates that reflect the credit and interest rate risk inherent in the loan. This fair value is not currently an indication of an exit price as that type of assumption could result in a different fair value estimate.

- The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is based on the discounted value of the contractual cash flows, using estimated current market discount rates for deposits of similar remaining maturities.
- For short-term borrowings, the carrying amount is considered a reasonable estimate of fair value. The subordinated capital notes have a par value of $36.1 million, and bear interest based on 3-month LIBOR plus 295 basis points (3.30% at December 31, 2011; 3.25% at December 31, 2010), payable quarterly. The fair value of long-term borrowings is based on the discounted value of the contractual cash flows, using current estimated market discount rates for borrowings with similar terms and remaining maturities and put dates.
- The fair value of commitments to extend credit and unused lines of credit is based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.
- The fair value of servicing assets is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration actual and expected loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions.

19. SEGMENT REPORTING

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

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

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

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

Following are the results of operations and the selected financial information by operating segment as of and for the years ended December 31, 2011, 2010, and 2009:

	December 31, 2011					
	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations	Consolidated Total
	(In thousands)					
Interest income	$ 135,998	$ 29	$ 161,001	$ 297,028	$ —	**$ 297,028**
Interest expense	(33,334)	—	(123,252)	(156,586)	—	**(156,586)**
Net interest income	102,664	29	37,749	140,442	—	**140,442**
Provision for non-covered loan and lease losses	(15,200)	—	—	(15,200)	—	**(15,200)**
Recapture of covered loan and lease losses	1,387	—	—	1,387	—	**1,387**
Non-interest income (loss)	15,210	20,888	(5,109)	30,989	—	**30,989**
Non-interest expenses	(93,625)	(18,113)	(10,564)	(122,302)	—	**(122,302)**
Intersegment revenues	1,431	—	—	1,431	(1,431)	**—**
Intersegment expenses	—	(937)	(494)	(1,431)	1,431	**—**
Income before income taxes	**$ 11,867**	**$ 1,867**	**$ 21,582**	**$ 35,316**	**$ —**	**$ 35,316**
Total assets	**$3,379,937**	**$ 14,557**	**$3,995,279**	**$7,389,773**	**$(696,107)**	**$6,693,666**

	December 31, 2010					
	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations	Consolidated Total
	(In thousands)					
Interest income	$ 115,468	$ 15	$ 188,318	$ 303,801	$ —	**$ 303,801**
Interest expense	(39,169)	—	(129,500)	(168,669)	—	**(168,669)**
Net interest income	76,299	15	58,818	135,132	—	**135,132**
Provision for non-covered loan and lease losses	(15,914)	—	—	(15,914)	—	**(15,914)**
Provision for covered loan and lease losses	(6,282)	—	—	(6,282)	—	**(6,282)**
Non-interest income (loss)	26,150	17,883	(38,835)	5,198	—	**5,198**
Non-interest expenses	(85,603)	(15,569)	(11,426)	(112,598)	—	**(112,598)**
Intersegment revenues	1,622	763	—	2,385	(2,385)	**—**
Intersegment expenses	—	(2,156)	(229)	(2,385)	2,385	**—**
Income (loss) before income taxes	**$ (3,728)**	**$ 936**	**$ 8,328**	**$ 5,536**	**$ —**	**$ 5,536**
Total assets	**$3,367,628**	**$ 15,484**	**$4,670,547**	**$8,053,659**	**$(742,653)**	**$7,311,006**

	December 31, 2009					
	Banking	Wealth Management	Treasury	Total Major Segments	Eliminations	Consolidated Total
	(In thousands)					
Interest income	$ 73,155	$ 47	$ 246,278	$ 319,480	$ —	**$ 319,480**
Interest expense	(35,099)	—	(153,623)	(188,722)	—	**(188,722)**
Net interest income	38,056	47	92,655	130,758	—	130,758
Provision for non-covered loan losses	(15,650)	—	—	(15,650)	—	**(15,650)**
Non-interest income (loss)	15,190	14,496	(31,499)	(1,813)	—	**(1,813)**
Non-interest expenses	(57,204)	(14,783)	(11,391)	(83,378)	—	**(83,378)**
Intersegment revenues	1,297	—	—	1,297	(1,297)	**—**
Intersegment expenses	—	(1,172)	(125)	(1,297)	1,297	**—**
Income (loss) before income taxes	**$ (18,311)**	**$ (1,412)**	**$ 49,640**	**$ 29,917**	**$ —**	**$ 29,917**
Total assets	**$1,655,515**	**$ 9,879**	**$5,223,969**	**$6,889,363**	**$(338,530)**	**$6,550,833**

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

As a bank holding company subject to the regulations of the Federal Reserve Board, the Group must obtain approval from the Federal Reserve Board for any dividend if the total of all dividends declared by it in any calendar year would exceed the total of its consolidated net profits for the year, as defined by the Federal Reserve Board, combined with its retained net profits for the two preceding years. The payment of dividends by the Bank to the Group may also be affected by other regulatory requirements and policies, such as the maintenance of certain regulatory capital levels. For the year ended December 31, 2011, the Bank and Oriental Insurance paid $85 million and $2 million in dividends to the Group, respectively. No dividends were paid during the years ended December 31, 2010 and 2009.

The following condensed financial information presents the financial position of the holding company only as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years ended December 31, 2011, 2010 and 2009:

ORIENTAL FINANCIAL GROUP INC.

CONDENSED STATEMENTS OF FINANCIAL POSITION INFORMATION
(Holding Company Only)

	December 31,	
	2011	2010
	(In thousands)	
ASSETS		
Cash and cash equivalents	$ 20,406	$ 16,402
Investment securities held-to-maturity, at amortized cost	18,876	8,175
Investment securities available-for-sale, at fair value	—	106,611
Other investment securities	73	150
Investment in bank subsidiary, equity method	683,064	727,878
Investment in nonbank subsidiaries, equity method	10,668	10,489
Due from bank subsidiary, net	192	319
Deferred tax asset, net	—	1,830
Other assets	2,217	1,939
Total assets	**$735,496**	**$873,793**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Securities sold under agreements to repurchase	$ —	$100,236
Subordinated capital notes	36,083	36,083
Dividend payable	2,476	2,320
Accrued expenses and other liabilities	1,382	2,823
Total liabilities	**39,941**	**141,462**
Stockholders' equity	695,555	732,331
Total liabilities and stockholders' equity	**$735,496**	**$873,793**

CONDENSED STATEMENTS OF OPERATIONS INFORMATION
(Holding Company Only)

	Year ended December 31,		
	2011	2010	2009
		(In thousands)	
Income (loss):			
Interest income	$ 3,584	$ 3,563	$ 10,501
Loss on early extinguishment of repurchase agreements	(4,790)	—	(17,551)
Gain on sale of securities	4,005	—	6,620
Investment and trading activities, net and other	5,372	4,083	18,023
Total income	**8,171**	**7,646**	**17,593**
Expenses:			
Interest expense	4,050	5,770	10,810
Operating expenses	7,766	5,884	4,817
Total expenses	**11,816**	**11,654**	**15,627**
Income (loss) before income taxes	**(3,645)**	**(4,008)**	**1,966**
Income tax (expense) benefit	(2,107)	1,652	(1,400)
Income (loss) before changes in undistributed earnings (losses) of subsidiaries	**(5,752)**	**(2,356)**	**566**
Equity in undistributed earnings (losses) from:			
Bank subsidiary	38,474	10,518	22,626
Nonbank subsidiaries	1,728	1,672	(247)
Net income	**$34,450**	**$ 9,834**	**$ 22,945**

CONDENSED STATEMENTS OF COMPREHENSIVE INCOME INFORMATION
(Holding Company Only)

	Year ended December 31,		
	2011	2010	2009
		(In thousands)	
Net income	$34,450	$ 9,834	$22,945
Other comprehensive income:			
Unrealized gain (loss) on securities available-for-sale arising during the year	(1,844)	2,779	4,521
Realized gain on securities available-for-sale included in net income	(4,005)	—	(6,620)
Other comprehensive income from bank subsidiary	5,716	117,364	55,929
Income tax effect	277	(417)	(23)
Total other comprehensive income for the year	**144**	**119,726**	**53,807**
Total comprehensive income	**$34,594**	**$129,560**	**$76,752**

ORIENTAL FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

CONDENSED STATEMENTS OF CASH FLOWS INFORMATION
(Holding Company Only)

	Year ended December 31,		
	2011	2010	2009
		(In thousands)	
Cash flows from operating activities:			
Net income	$ 34,450	$ 9,834	$ 22,945
Adjustments to reconcile net income to net cash provided (used in) by operating activities:			
Equity in undistributed earnings from banking subsidiary	(38,474)	(10,518)	(22,626)
Equity in undistributed (earnings) losses from nonbanking subsidiaries	(1,728)	(1,672)	247
Amortization of investment securities premiums, net of accretion discounts	115	1,526	79
Loss on early extinguishment of repurchase agreements	4,790	—	17,551
Realized gain on sale of securities	(4,005)	—	(6,620)
Other impairments on securities	77	—	—
Stock-based compensation	1,310	1,194	742
Deferred income tax, net	2,107	(1,652)	(190)
(Increase) decrease in other assets	(275)	(161)	2,294
Increase (decrease) in accrued expenses, other liabilities, and dividend payable	(1,244)	3,607	(2,746)
Net cash provided by (used in) operating activities	**(2,877)**	**2,158**	**11,676**
Cash flow from investing activities:			
Purchase of investment securities available-for-sale	(19,429)	(264,696)	(1,562,012)
Purchase of investment securities held-to-maturity	(12,702)	(8,188)	—
Redemptions and maturities of investment securities available-for-sale	31,493	152,408	337,600
Redemptions of investment securities held-to-maturity	1,920	12	—
Proceeds from sale of investment securities available-for-sale	96,221	119,497	1,463,149
Net (increase) decrease in due from bank subsidiary, net	127	(225)	(49)
Capital contribution to banking subsidiary	—	(292,000)	(15,000)
Net cash provided by (used in) investing activities	**97,630**	**(293,192)**	**223,688**
Cash flow from financing activities:			
Net decrease in securities sold under agreements to repurchase	(105,026)	—	(217,551)
Proceeds from exercise of stock options, net	8	72	—
Proceeds from issuance of common stock, net	—	94,386	—
Proceeds from issuance of preferred stock, net	—	189,075	—
Purchase of treasury stock	(58,775)	—	(182)
Dividends from subsidiaries	87,000	—	—
Capital contribution	—	—	78
Dividends paid	(13,956)	(12,153)	(8,690)
Net cash provided by (used in) financing activities	**(90,749)**	**271,380**	**(226,345)**
Net change in cash and cash equivalents	**4,004**	**(19,654)**	**9,019**
Cash and cash equivalents at beginning of year	16,402	36,056	27,037
Cash and cash equivalents at end of year	**$ 20,406**	**$ 16,402**	**$ 36,056**

21. SUBSEQUENT EVENTS

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.

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

Not applicable.

ITEM 9A. *CONTROLS AND PROCEDURES*

Disclosure Controls and Procedures

The Group's management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of December 31, 2011, an evaluation was carried out under the supervision and with the participation of the Group's management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of the Group's disclosure controls and procedures. Based upon such evaluation, the CEO and CFO have concluded that, as of the end of the period covered by this annual report on Form 10-K, the Group's disclosure controls and procedures provided reasonable assurance of effectiveness in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Group in the reports that it files or submits under the Securities Exchange Act of 1934. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute assurance that it will detect or uncover failures within the Group to disclose material information otherwise required to be set forth in the Group's periodic reports.

Management's Annual Report on Internal Control over Financial Reporting

The Management's Annual Report on Internal Control over Financial Reporting is included in Item 8 of this report.

Attestation Report of the Registered Public Accounting Firm

The registered public accounting firm's attestation report on the Group's internal control over financial reporting is included in Item 8 of this report.

Changes in Internal Control over Financial Reporting

There have not been any changes in the Group's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d -15 (f) under the Exchange Act) during the last quarter of the year ended December 31, 2011, that has materially affected, or is reasonably likely to materially affect, the Group's internal control over financial reporting.

ITEM 9B. *OTHER INFORMATION*

Julio Micheo resigned as Senior Executive Vice President and Chief Investment Strategist of the Group effective October 17, 2011.

PART III

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

ITEM 12. *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

The Group's Amended and Restated 2007 Omnibus Performance Incentive Plan (the "Omnibus Plan") provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted units and dividend equivalents, as well as equity-based performance awards. The Omnibus Plan was adopted in 2007, amended and restated in 2008, and further amended in 2010. It replaced and superseded the Group's 1996, 1998 and 2000 Incentive Stock Option Plans (the "Stock Option Plans"). All outstanding stock options under the Stock Option Plans continue in full force and effect, subject to their original terms and conditions. The following table shows certain information pertaining to the awards under the Omnibus Plan and the Stock Option Plans as of December 31, 2011:

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, warrants and rights	(b) Weighted-Average Exercise Price of Outstanding Options, warrants and rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding those reflected in column (a))
Equity compensation plans approved by shareholders:			
Omnibus Plan	574,040(1)	$12.12(2)	275,968
Other non-active stock option plans	417,813	$17.58(2)	—
	991,853	$15.02	275,968

(1) Includes 368,891 stock options and 205,149 restricted stock units.

(2) Exercise price related to stock options.

Other information required by this Item is incorporated herein by reference to the Group's definitive proxy statement to be filed with the SEC no later than 120 days after the end of the fiscal year covered by this report.

PART IV

ITEM 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

The following financial statements are filed as part of this report under Item 8 — Financial Statements and Supplementary Data.

Financial Statements:

Reports of Independent Registered Public Accounting Firm
Management's Report on Internal Control Over Financial Reporting
Attestation Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting
Consolidated Statements of Financial Condition as of December 31, 2011 and 2010
Consolidated Statements of Operations for the years ended December 31, 2011, 2010, and 2009
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2011, 2010, and 2009
Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2011, 2010, and 2009
Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010, and 2009
Notes to the Consolidated Financial Statements

Financial Statement Schedules

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

Exhibits

Exhibit No.:	Description Of Document:
2.1	Purchase and Assumption Agreement — Whole Bank, All Deposits, dated as of April 30, 2010, among the Federal Deposit Insurance Corporation, Receiver of Eurobank, San Juan, Puerto Rico, the Federal Deposit Insurance Corporation, and Oriental Bank and Trust.(1)
3.1	Certificate of Incorporation, as amended.(2)
3.2	By-Laws.(3)
4.1	Certificate of Designation of the 7.125% Noncumulative Monthly Income Preferred Stock, Series A.(4)
4.2	Certificate of Designation of the 7.0% Noncumulative Monthly Income Preferred Stock, Series B.(5)
4.3	Certificate of Designation of the Mandatory Convertible Noncumulative Non-Voting Perpetual Preferred Stock, Series C.(6)
4.4	Registration Rights Agreement, dated April 23, 2010, between the Group and each of the purchasers of the Series C Preferred Stock.(7)
10.1	Securities Purchase Agreement, dated April 23, 2010, between the Group and each of the purchasers of the Series C Preferred Stock.(8)
10.2	Omnibus Asset Servicing Agreement, dated as of June 9, 2010, between Oriental Bank and Trust and Bayview Loan Servicing, LLC.(9)
10.3	Lease Agreement between Oriental Financial Group Inc. and Professional Office Park V, Inc.(10)
10.4	First Amendment to Lease Agreement Dated May 18, 2004, between Oriental Financial Group Inc. and Professional Office Park V, Inc.(11)
10.5	Change in Control Compensation Agreement between Oriental Financial Group Inc. and José R. Fernández(12)
10.6	Change in Control Compensation Agreement between Oriental Financial Group Inc. and Norberto González(13)
10.7	Change in Control Compensation Agreement between Oriental Financial Group Inc. and Ganesh Kumar(14)
10.8	Change in Control Compensation Agreement between Oriental Financial Group Inc. and Mari Evelyn Rodríguez(15)
10.9	Change in Control Compensation Agreement between Oriental Financial Group Inc. and José R. González(16)
10.10	Technology Outsourcing Agreement between Oriental Financial Group Inc. and Metavante Corporation(17)
10.11	Amended and Restated 2007 Omnibus Performance Incentive Plan(18)
10.12	Form of qualified stock option award and agreement(19)

Exhibit No.:	Description Of Document:
10.13	Form of restricted stock award and agreement(20)
10.14	Form of restricted unit award and agreement(21)
10.15	Agreement between Oriental Financial Group Inc. and José J. Gil de Lamadrid(22)
10.16	Employment Agreement between Oriental Financial Group Inc. and José R. Fernández(23)
12.1	Computation of Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends (included in Item 6 hereof).
21.1	List of subsidiaries
23.1	Consent of KPMG LLP
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.1	The following materials from the Group's annual report on Form 10-K for the year ended December 31, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Financial Condition, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Changes in Stockholders' Equity, (iv) Consolidated Statements of Comprehensive Income, and (v) Consolidated Statements of Cash Flow.

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(1) Incorporated herein by reference to Exhibit 2.1 of the Group's current report on Form 8-K filed with the SEC on May 6, 2010.

(2) Incorporated herein by reference to Exhibit 3.1 of the Group's quarterly report on form 10-Q filed with the SEC on August 10, 2010.

(3) Incorporated herein by reference to Exhibit 3(ii) of the Group's current report on Form 8-K filed with the SEC on June 23, 2008.

(4) Incorporated herein by reference to Exhibit 4.1 of the Group's registration statement on Form 8-A filed with the SEC on April 30, 1999.

(5) Incorporated herein by reference to Exhibit 4.1 of the Group's registration statement on Form 8-A filed with the SEC on September 26, 2003.

(6) Incorporated herein by reference to Exhibit 3.1 of the Group's current report on Form 8-K filed with the SEC on May 3, 2010.

(7) Incorporated herein by reference to Exhibit 4.1 of the Group's quarterly report on Form 10-Q filed with the SEC on August 10, 2010.

(8) Incorporated herein by reference to Exhibit 10.1 of the Group's quarterly report on Form 10-Q filed with the SEC on November 4, 2010.

(9) Incorporated herein by reference to Exhibit 10.1 of the Group's current report on Form 8-K filed with the SEC on June 14, 2010.

(10) Incorporated herein by reference to Exhibit 10.5 of the Group's annual report on Form 10-K filed with the SEC on September 13, 2005.

(11) Incorporated herein by reference to Exhibit 10.6 of the Group's annual report on Form 10-K filed with the SEC on September 13, 2005.

(12) Incorporated herein by reference to Exhibit 10.12 of the Group's annual report on Form 10-K filed with the SEC on September 13, 2005.

(13) Incorporated herein by reference to Exhibit 10.13 of the Group's annual report on Form 10-K filed with the SEC on September 13, 2005.

(14) Incorporated herein by reference to Exhibit 10.14 of the Group's annual report on Form 10-K filed with the SEC on September 13, 2005.

(15) Incorporated herein by reference to Exhibit 10.1 of the Group's quarterly report on Form 10-Q filed with the SEC on October 17, 2006.

(16) Incorporated herein by reference to Exhibit 10.17 of the Group's annual report on Form 10-K filed with the SEC on March 10, 2011.

(17) Incorporated herein by reference to Exhibit 10.23 of the Group's annual report on Form 10-K filed with the SEC on March 28, 2007.

(18) Incorporated herein by reference to Exhibit 4.1 of the Group's registration statement on Form S-8 filed with the SEC on October 21, 2010 (No. 333-170064).

(19) Incorporated herein by reference to Exhibit 10.1 of the Group's registration statement on Form S-8 filed with the SEC on November 30, 2007.

(20) Incorporated herein by reference to Exhibit 10.2 of the Group's registration statement on Form S-8 filed with the SEC on November 30, 2007.

(21) Incorporated herein by reference to Exhibit 10.27 of the Group's annual report on Form 10-K filed with the SEC on March 16, 2009.

(22) Incorporated herein by reference to Exhibit 10.28 of the Group's quarterly report on Form 10-Q filed with the SEC on November 6, 2009.

(23) Incorporated herein by reference to Exhibit 10.16 of the Group's annual report on Form 10-K filed with the SEC on March 1, 2011.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ORIENTAL FINANCIAL GROUP INC.

By: /s/ José Rafael Fernández — Dated: March 9, 2012
José Rafael Fernández
President and Chief Executive Officer

By: /s/ Ganesh Kumar — Dated: March 9, 2012
Ganesh Kumar
Executive Vice President and Chief Financial Officer

By: /s/ César A. Ortiz — Dated: March 9, 2012
César A. Ortiz
Senior Vice President and Controller

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

By: /s/ José J. Gil de Lamadrid — Dated: March 9, 2012
José J. Gil de Lamadrid
Chairman of the Board

By: /s/ José Rafael Fernández — Dated: March 9, 2012
José Rafael Fernández
Vice Chairman of the Board

By: /s/ Juan Carlos Aguayo — Dated: March 9, 2012
Juan Carlos Aguayo
Director

By: /s/ Pablo I. Altieri — Dated: March 9, 2012
Dr. Pablo I. Altieri
Director

By: /s/ Francisco Arriví — Dated: March 9, 2012
Francisco Arriví
Director

By: /s/ Julian Inclán — Dated: March 9, 2012
Julian Inclán
Director

By: /s/ Rafael Machargo — Dated: March 9, 2012
Rafael Machargo
Director

By: /s/ Pedro Morazzani Dated: March 9, 2012

Pedro Morazzani
Director

By: /s/ Josen Rossi Dated: March 9, 2012

Josen Rossi
Director

EXHIBIT 21.1

LIST OF SUBSIDIARIES

A) **ORIENTAL BANK AND TRUST** - an insured non-member commercial bank organized and existing under the laws of the Commonwealth of Puerto Rico.

SUBSIDIARIES OF ORIENTAL BANK AND TRUST:

1. **Oriental International Bank Inc.** – an international banking entity organized and existing under the laws of the Commonwealth of Puerto Rico.
2. **Oriental Mortgage Corporation** - a mortgage bank organized and existing under the laws of the Commonwealth of Puerto Rico.
3. **EB Operating Number One, Inc.** - a corporation organized and existing under the laws of the Commonwealth of Puerto Rico, which was created to manage certain foreclosed real property that has rental operations.

B) **ORIENTAL FINANCIAL SERVICES CORP.** - a registered securities broker-dealer organized and existing under the laws of the Commonwealth of Puerto Rico.

C) **ORIENTAL INSURANCE, INC.** – a registered insurance agency organized and existing under the laws of the Commonwealth of Puerto Rico.

D) **CARIBBEAN PENSION CONSULTANTS, INC –** a corporation organized and existing under the laws of the State of Florida that offers third party pension plan administration in the continental U.S., Puerto Rico and the Caribbean.

E) **ORIENTAL FINANCIAL (PR) STATUTORY TRUST II –** a special purpose statutory trust organized under the laws of the State of Connecticut.

EXHIBIT 23.1

I. CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Oriental Financial Group Inc.:

We consent to the incorporation by reference in the registration statements No. 333-170064, No. 333-147727, No. 333-102696, No. 333-57052, and No. 333-84473 on Form S-8, and registration statement No. 333-155452 on Form S-3 of Oriental Financial Group Inc. (the "Group") of our reports dated March 9, 2012, with respect to the consolidated statements of financial condition of the Group as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in stockholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2011 and the effectiveness of internal control over financial reporting as of December 31, 2011, which reports appear in the annual report on Form 10-K of the Group for the year ended December 31, 2011 and to the reference to our firm under the heading "Experts" in the registration statements.

/s/ KPMG LLP

San Juan, Puerto Rico
March 9, 2012

EXHIBIT 31.1

MANAGEMENT CERTIFICATION PURSUANT TO

SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, **José Rafael Fernández**, certify that:

1. I have reviewed this annual report on Form 10-K of Oriental Financial Group Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date March 9, 2012

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

EXHIBIT 31.2

MANAGEMENT CERTIFICATION PURSUANT TO

SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, **Ganesh Kumar**, certify that:

1. I have reviewed this annual report on Form 10-K of Oriental Financial Group Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 9, 2012

By: /s/ Ganesh Kumar
Ganesh Kumar
Executive Vice President and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. §1350)

In connection with Oriental Financial Group Inc.'s ("Oriental") annual report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, José Rafael Fernández, President and Chief Executive Officer of Oriental, hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. §1350), that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Oriental.

In witness whereof, I execute this certification in San Juan, Puerto Rico, this 9th day of March, 2012.

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

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. §1350)

In connection with Oriental Financial Group Inc.'s ("Oriental") annual report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ganesh Kumar, Executive Vice President and Chief Financial Officer of Oriental, hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. §1350), that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Oriental.

In witness whereof, I execute this certification in San Juan, Puerto Rico, this 9th day of March, 2012.

By: /s/ Ganesh Kumar
Ganesh Kumar
Executive Vice President and Chief Financial Officer

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General Information

Main Office
Oriental Group Tower
Marginal San Roberto #997
Professional Offices Park
San Juan, PR 00927
Telephone: (787) 771-6800

Transfer Agent and Register
American Stock Transfer & Trust Company
6201 15th Avenue
Brooklyn, NY 11219
Telephone: (718) 921-8275

Dividend Reinvestment Plan
Ganesh Kumar
Oriental Financial Services
PO Box 195119
San Juan, PR 00919
Telephone: (787) 474-1993
E-mail: gkumar@orientalfg.com

Independent Certified Public Accountants
KPMG LLP
250 Muñoz Rivera Avenue, Suite 1100
San Juan, PR 00918

Form 10-K
Annual Report on Form 10-K filed with the SEC is available on request from:
www.proxyvote.com
Annual Meeting

The Annual Meeting of Stockholders
will be held April 25, 2012 at 9:30 am
Training Room - 8th Floor
Oriental Tower
Professional Office Park
Marginal San Roberto #997
San Juan, PR 00927

Branch Offices:
Aguadilla
Arecibo
Bayamón - Plaza del Sol
Caguas - Bairoa
Caguas - Las Catalinas Mall
Canóvanas - The Outlet Mall
Carolina - 65th Infantry
Carolina - Plaza Escorial
Ceiba
Cidra
Condado
Galería San Patricio
Guayama
Hatillo
Hato Rey - Ave. Muñoz Rivera
Hato Rey - Torre Chardón
Humacao Plaza Mall
Las Piedras
Manati
Mayaguez Mall
Mayaguez University
Miramar
Ponce
Ponce - Hostos
Río Piedras - Las Cumbres
Río Piedras - San Roberto
Río Piedras - San Francisco
San Lorenzo
Santurce - Villa Palmeras
Yabucoa

Annual Certifications-
Our President and CEO has submitted to the NYSE the Domestic Company Section 303A Annual CEO Certification for 2011 regarding our compliance with the corporate governance listing standards of the NYSE. Also, we have filed with the SEC, as exhibits 31.1 and 31.2 to our annual report on Form 10-K for fiscal 2011, the Sarbanes-Oxley Act Section 302 Certifications of both our CEO and CFO regarding the quality of our public disclosures.

DESIGN: ID GROUP / EDITORIAL TEXT: ANREDER & COMPANY / PRINTING: MODEL OFFSET PRINTING

Business Lines

Oriental Financial Group (NYSE:OFG)

Banking: Consumer, Commercial & Corporate
Mortgage
Brokerage
Trust
Insurance
Pension Plans
Leasing

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