

ORIENTAL FINANCIAL GROUP INC

Form 10-Q

August 08, 2008

**Table of Contents**

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

(Mark One)

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

**For the quarterly period ended June 30, 2008**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 001-12647  
Oriental Financial Group Inc.**

Incorporated in the Commonwealth of Puerto Rico.

IRS Employer Identification No. 66-0538893

Principal Executive Offices:

997 San Roberto Street  
Oriental Center 10th Floor  
Professional Offices Park  
San Juan, Puerto Rico 00926  
Telephone Number: (787) 771-6800

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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       Smaller reporting company   
(Do not check if a 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

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

24,292,786 common shares (\$1.00 par value per share)  
outstanding as of July 31, 2008

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>Part I FINANCIAL INFORMATION:</u></b>	
<b><u>Item 1 Financial Statements</u></b>	
<u>Unaudited consolidated statements of financial condition at June 30, 2008 and December 31, 2007</u>	1
<u>Unaudited consolidated statements of income for the quarters and six-month periods ended June 30, 2008 and 2007</u>	2
<u>Unaudited consolidated statements of changes in stockholders' equity for the quarters and six-month periods ended June 30, 2008 and 2007</u>	3
<u>Unaudited consolidated statements of comprehensive income for the quarters and six-month periods ended June 30, 2008 and 2007</u>	3
<u>Unaudited consolidated statements of cash flows for the six-month periods ended June 30, 2008 and 2007</u>	4
<u>Notes to unaudited consolidated financial statements</u>	5
<b><u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b>23</b>
<b><u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b>41</b>
<b><u>Item 4 Controls and Procedures</u></b>	<b>44</b>
<b><u>PART II OTHER INFORMATION:</u></b>	
<b><u>Item 1 Legal Proceedings</u></b>	<b>44</b>
<b><u>Item 1A Risk Factors</u></b>	<b>45</b>
<b><u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	<b>45</b>
<b><u>Item 3 Defaults Upon Senior Securities</u></b>	<b>45</b>
<b><u>Item 4 Submissions of Matters to a Vote of Security Holders</u></b>	<b>45</b>
<b><u>Item 5 Other Information</u></b>	<b>46</b>
<b><u>Item 6 Exhibits</u></b>	<b>46</b>
<b><u>Signatures</u></b>	<b>47</b>
<b><u>Certifications</u></b>	<b>48</b>
<u>EX-31.1 SECTION 302 CERTIFICATION OF THE CEO</u>	

EX-31.2 SECTION 302 CERTIFICATION OF THE CFO

EX-32.1 SECTION 906 CERTIFICATION OF THE CEO

EX-32.2 SECTION 906 CERTIFICATION OF THE CFO

---

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

When used in this Form 10-Q or future filings by Oriental Financial Group Inc. (the Group ) with the Securities and Exchange Commission (the SEC ), in the Group s press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases would be, will allow, intends to, will likely result, are expected to, will continue, is anticipated, estimated, project, believe, expressions are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

The future results of the Group could be affected by subsequent events and could differ materially from those expressed in forward-looking statements. If future events and actual performance differ from the Group s assumptions, the actual results could vary significantly from the performance projected in the forward-looking statements.

The Group wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made and are based on management s current expectations, and to advise readers that various factors, including local, regional and national economic conditions, substantial changes in levels of market interest rates, credit and other risks of lending and investment activities, competitive, and regulatory factors, legislative changes and accounting pronouncements, could affect the Group s financial performance and could cause the Group s actual results for future periods to differ materially from those anticipated or projected. The Group does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

---

Table of Contents**PART I FINANCIAL INFORMATION****ITEM I FINANCIAL STATEMENTS****UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****JUNE 30, 2008 AND DECEMBER 31, 2007***(In thousands, except share data)*

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
<b>Cash and due from banks</b>	\$ 56,486	\$ 88,983
<b>Investments:</b>		
Trading securities, at fair value with amortized cost of \$1,298 (December 31, 2007 \$1,103)	1,311	1,122
Investment securities available-for-sale, at fair value with amortized cost of \$3,467,005 (December 31, 2007 \$3,063,763)		
Securities pledged that can be repledged	3,213,381	2,903,078
Other investment securities	168,926	166,204
<b>Total investment securities available-for-sale</b>	<b>3,382,307</b>	<b>3,069,282</b>
Investment securities held-to-maturity, at amortized cost with fair value of \$1,198,736 (December 31, 2007 \$1,478,112)		
Securities pledged that can be repledged	1,161,754	1,348,159
Other investment securities	76,393	144,728
<b>Total investment securities held-to-maturity</b>	<b>1,238,147</b>	<b>1,492,887</b>
Federal Home Loan Bank (FHLB) stock, at cost	22,062	20,658
Other investments	150	1,661
<b>Total investments</b>	<b>4,643,977</b>	<b>4,585,610</b>
<b>Loans:</b>		
Mortgage loans held-for-sale, at lower of cost or market	42,122	16,672
Loans receivable, net of allowance for loan losses of \$11,885 (December 31, 2007 \$10,161)	1,176,035	1,162,894
<b>Total loans, net</b>	<b>1,218,157</b>	<b>1,179,566</b>
Accrued interest receivable	42,842	52,315
Premises and equipment, net	21,378	21,779

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Deferred tax asset, net	17,249	10,362
Foreclosed real estate	4,906	4,207
Investment in equity indexed options	27,641	40,709
Other assets	27,543	16,324
<b>Total assets</b>	<b>\$ 6,060,179</b>	<b>\$ 5,999,855</b>

**LIABILITIES AND STOCKHOLDERS EQUITY**

**Deposits:**

Demand deposits	\$ 124,140	\$ 119,152
Savings accounts	407,911	387,790
Certificates of deposit	960,368	739,478

<b>Total deposits</b>	<b>1,492,419</b>	<b>1,246,420</b>
-----------------------	------------------	------------------

**Borrowings:**

Federal funds purchased and other short term borrowings	41,583	27,460
Securities sold under agreements to repurchase	3,810,752	3,861,411
Advances from FHLB	331,895	331,898
Subordinated capital notes	36,083	36,083

<b>Total borrowings</b>	<b>4,220,313</b>	<b>4,256,852</b>
-------------------------	------------------	------------------

Securities purchased but not yet received	23,103	111,431
Accrued expenses and other liabilities	23,177	25,691

<b>Total liabilities</b>	<b>5,759,012</b>	<b>5,640,394</b>
--------------------------	------------------	------------------

**Stockholders equity:**

Preferred stock, \$1 par value; 5,000,000 shares authorized; \$25 liquidation value; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding	68,000	68,000
Common stock, \$1 par value; 40,000,000 shares authorized; 25,736,121 shares issued; 24,292,086 shares outstanding (December 31, 2007-25,555,575; 24,120,771)	25,736	25,557
Additional paid-in capital	212,282	210,073
Legal surplus	43,533	40,573
Retained earnings	64,406	45,296
Treasury stock, at cost 1,444,035 shares (December 31, 2007 1,436,426 shares)	(17,136)	(17,023)
Accumulated other comprehensive loss, net of tax of \$4,402 (December 31, 2007 \$2,166)	(95,654)	(13,015)

<b>Total stockholders equity</b>	<b>301,167</b>	<b>359,461</b>
----------------------------------	----------------	----------------

**Commitments and Contingencies**

<b>Total liabilities and stockholders equity</b>	\$ 6,060,179	\$ 5,999,855
--	--------------	--------------

**See notes to unaudited consolidated financial statements.**

-1-

---



**Table of Contents**

**UNAUDITED CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2008 AND 2007**  
*(In thousands, except per share data)*

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2008	2007	2008	2007
<b>Interest income:</b>				
Loans	\$ 19,682	\$ 22,315	\$ 39,510	\$ 44,163
Mortgage-backed securities	47,765	25,268	87,266	50,766
Investment securities and other	17,711	23,218	40,483	37,371
<b>Total interest income</b>	<b>85,158</b>	<b>70,801</b>	<b>167,259</b>	<b>132,300</b>
<b>Interest expense:</b>				
Deposits	12,265	13,601	24,694	25,849
Securities sold under agreements to repurchase	40,208	36,546	80,448	69,334
Advances from FHLB, term notes and other borrowings	3,716	2,198	7,537	4,515
Subordinated capital notes	534	766	1,236	1,524
<b>Total interest expense</b>	<b>56,723</b>	<b>53,111</b>	<b>113,915</b>	<b>101,222</b>
<b>Net interest income</b>	<b>28,435</b>	<b>17,690</b>	<b>53,344</b>	<b>31,078</b>
Provision for loan losses	1,980	1,375	3,630	2,450
<b>Net interest income after provision for loan losses</b>	<b>26,455</b>	<b>16,315</b>	<b>49,714</b>	<b>28,628</b>
<b>Non-interest income:</b>				
Financial service revenues	4,500	4,049	8,740	8,892
Banking service revenues	1,395	2,265	2,922	4,139
Investment banking revenues	12		750	
Mortgage banking activities	545	170	1,551	232
Net gain (loss) on:				
Sale of securities available-for-sale	198		9,522	358
Derivatives	228	88	(7,575)	8,384
Trading securities	16	2	(1)	2
Other investments	16	1,169	116	788
Foreclosed real estate	(260)	30	(510)	67
Other		23	(1)	65
<b>Total non-interest income, net</b>	<b>6,650</b>	<b>7,796</b>	<b>15,514</b>	<b>22,927</b>

**Non-interest expenses:**

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Compensation and employee benefits	7,824	6,916	15,539	13,661
Occupancy and equipment	3,365	3,343	6,652	6,337
Professional and service fees	2,267	1,984	4,147	3,522
Advertising and business promotion	836	1,118	1,910	1,911
Directors and investor relations	303	769	581	1,300
Loan servicing expenses	339	540	670	1,063
Taxes, other than payroll and income taxes	607	489	1,218	937
Electronic banking charges	396	457	814	916
Clearing and wrap fees expenses	313	310	607	675
Communication	325	308	650	646
Insurance	579	211	1,181	427
Foreclosure expenses	201	338	351	405
Printing, postage, stationery and supplies	245	189	522	391
Other	480	505	968	1,113
<b>Total non-interest expenses</b>	<b>18,080</b>	<b>17,477</b>	<b>35,810</b>	<b>33,304</b>
<b>Income before income taxes</b>	<b>15,025</b>	<b>6,634</b>	<b>29,418</b>	<b>18,251</b>
Income tax expense (benefit)	598	187	(1,857)	811
<b>Net income</b>	<b>14,427</b>	<b>6,447</b>	<b>31,275</b>	<b>17,440</b>
Less: Dividends on preferred stock	(1,200)	(1,201)	(2,401)	(2,401)
<b>Income available to common shareholders</b>	<b>\$ 13,227</b>	<b>\$ 5,246</b>	<b>\$ 28,874</b>	<b>\$ 15,039</b>
<b>Income per common share:</b>				
Basic	\$ 0.54	\$ 0.21	\$ 1.19	\$ 0.61
Diluted	\$ 0.54	\$ 0.21	\$ 1.19	\$ 0.61
Average common shares outstanding	24,290	24,488	24,227	24,480
Average potential common shares-options	94	75	110	97
Average diluted common shares outstanding	<b>24,384</b>	<b>24,563</b>	<b>24,337</b>	<b>24,577</b>
Cash dividends per share of common stock	\$ 0.14	\$ 0.14	\$ 0.28	\$ 0.28

See notes to unaudited consolidated financial statements.

-2-

**Table of Contents****UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2008 AND 2007***(In thousands)*

<b>CHANGES IN STOCKHOLDERS' EQUITY:</b>	<b>Six-Month Period Ended June</b>	
	<b>2008</b>	<b>30, 2007</b>
<b>Preferred stock:</b>		
<b>Balance at beginning and end of period</b>	<b>\$ 68,000</b>	<b>\$ 68,000</b>
<b>Common stock:</b>		
Balance at beginning of period	25,557	25,431
Stock options exercised	179	112
<b>Balance at end of period</b>	<b>25,736</b>	<b>25,543</b>
<b>Additional paid-in capital:</b>		
Balance at beginning of period	210,073	209,033
Stock-based compensation expense	252	12
Stock options exercised	1,957	815
<b>Balance at end of period</b>	<b>212,282</b>	<b>209,860</b>
<b>Legal surplus:</b>		
Balance at beginning of period	40,573	36,245
Transfer from retained earnings	2,960	2,067
<b>Balance at end of period</b>	<b>43,533</b>	<b>38,312</b>
<b>Retained earnings:</b>		
Balance at beginning of period	45,296	26,772
Net income	31,275	17,440
Cash dividends declared on common stock	(6,804)	(6,861)
Cash dividends declared on preferred stock	(2,401)	(2,401)
Transfer to legal surplus	(2,960)	(2,067)
<b>Balance at end of period</b>	<b>64,406</b>	<b>32,883</b>
<b>Treasury stock:</b>		
Balance at beginning of period	(17,023)	(12,956)
Stock used to match defined contribution plan 1165(e)	121	175
Stock purchased	(234)	(530)

<b>Balance at end of period</b>	<b>(17,136)</b>	<b>(13,311)</b>
<b>Accumulated other comprehensive loss, net of tax:</b>		
Balance at beginning of period	(13,015)	(16,099)
Other comprehensive loss, net of tax	(82,639)	(31,713)
<b>Balance at end of period</b>	<b>(95,654)</b>	<b>(47,812)</b>
<b>Total stockholders equity</b>	<b>\$ 301,167</b>	<b>\$ 313,475</b>

**UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2008 AND 2007**

*(In thousands)*

COMPREHENSIVE INCOME	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2008	2007	2008	2007
<b>Net income</b>	<b>\$ 14,427</b>	<b>\$ 6,447</b>	<b>\$ 31,275</b>	<b>\$ 17,440</b>
<b>Other comprehensive loss, net of tax:</b>				
Unrealized loss on securities available-for-sale	(51,649)	(31,296)	(79,685)	(26,097)
Realized gain on investment securities available-for-sale included in net income	(198)		(9,522)	(358)
Gains on derivatives designated as cash flow hedges included in net income				(773)
Gain from termination of cash flow hedging				(8,225)
Income tax effect related to unrealized loss on securities available-for-sale	4,156	4,381	6,568	3,740
<b>Other comprehensive loss for the period</b>	<b>(47,691)</b>	<b>(26,915)</b>	<b>(82,639)</b>	<b>(31,713)</b>
<b>Comprehensive loss</b>	<b>\$ (33,264)</b>	<b>\$ (20,468)</b>	<b>\$ (51,364)</b>	<b>\$ (14,273)</b>

See notes to unaudited consolidated financial statements.

**Table of Contents**

**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2008 AND 2007  
(In thousands)**

	<b>Six-Month Period Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Cash flows from operating activities:		
Net income	\$ 31,275	\$ 17,440
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of deferred loan origination fees, net of costs	(214)	(771)
Amortization of premiums, net of accretion of discounts	31	4,143
Depreciation and amortization of premises and equipment	2,613	2,916
Deferred income tax benefit	(319)	(116)
Equity in earnings of investment in limited liability partnership		(75)
Provision for loan losses	3,630	2,450
Common stock used to match defined contribution plan 1165(e)	121	175
Stock-based compensation	252	12
(Gain) loss on:		
Sale of securities available-for-sale	(9,522)	(358)
Mortgage banking activities	(1,551)	(232)
Derivatives	7,575	(8,898)
Foreclosed real estate	510	(67)
Sale of premises and equipment	1	(20)
Originations and purchases of loans held-for-sale	(74,265)	(80,420)
Proceeds from sale of loans held-for-sale	20,918	25,223
Net decrease (increase) in:		
Trading securities	(189)	(305)
Accrued interest receivable	9,473	(17,867)
Other assets	(11,219)	(4,597)
Net increase (decrease) in:		
Accrued interest on deposits and borrowings	604	(4,216)
Other liabilities	(3,332)	1,015
Net cash used in operating activities	(23,608)	(64,568)
Cash flows from investing activities:		
Net increase in securities purchased under agreements to resell		(16,200)
Purchases of:		
Investment securities available-for-sale	(2,790,964)	(1,053,377)
Investment securities held-to-maturity		(10,772)
Other investments		(701)
Equity options	(1,729)	(9,504)
FHLB stock	(7,089)	(17,162)
Maturities and redemptions of:		
Investment securities available-for-sale	1,396,359	70,857

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Investment securities held-to-maturity	254,978	273,663
Other investments	1,511	
FHLB stock	5,685	16,860
Proceeds from sales of:		
Investment securities available-for-sale	943,134	23,032
Foreclosed real estate	2,466	1,414
Premises and equipment	14	
Loan production:		
Origination and purchase of loans, excluding loans held-for-sale	(84,597)	(85,230)
Principal repayment of loans	63,977	77,719
Additions to premises and equipment	(2,227)	(2,133)
Net cash used in investing activities	(218,482)	(731,534)
Cash flows from financing activities:		
Net increase (decrease) in:		
Deposits	260,671	96,770
Securities sold under agreements to repurchase	(50,023)	750,161
Federal funds purchased and other short term borrowings	14,123	11,073
Proceeds from:		
Advances from FHLB	294,750	2,463,370
Exercise of stock options	2,136	927
Repayments of advances from FHLB	(294,750)	(2,465,270)
Repurchase of treasury stock	(234)	(530)
Maturity of term note		(15,000)
Termination of derivative instrument	(7,875)	
Dividend paid on common and preferred stock	(9,205)	(9,262)
Net cash provided by financing activities	209,593	832,239
Net change in cash and due from banks	(32,497)	36,137
Cash and due from banks at beginning of period	88,983	34,070
Cash and due from banks at end of period	\$ 56,486	\$ 70,207
Supplemental Cash Flow Disclosure and Schedule of Noncash Activities:		
Interest paid	\$ 113,311	\$ 96,790
Income tax paid	\$ 37	\$
Mortgage loans securitized into mortgage-backed securities	\$ 29,836	\$
Securities sold but not yet delivered	\$	\$ 46,461
Securities purchased but not yet received	\$ 23,103	\$ 100,067
Transfer from loans to foreclosed real estate	\$ 3,675	\$ 1,454

**See notes to unaudited consolidated financial statements.**

-4-

---

**Table of Contents**

**ORIENTAL FINANCIAL GROUP INC.**

**Notes to Unaudited Consolidated Financial Statements**

**NOTE 1 BASIS OF PRESENTATION**

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

The unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). In the opinion of management, these consolidated financial statements include all adjustments necessary, all of which are of normal recurring nature, to present fairly the consolidated statement of financial condition as of June 30, 2008, and December 31, 2007, and the consolidated results of operations and cash flows for the quarters and six-month periods ended June 30, 2008 and 2007. All significant intercompany balances and transactions have been eliminated in the accompanying unaudited consolidated financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such SEC rules and regulations. Management believes that the disclosures made are adequate to make the information presented not misleading. The results of operations and cash flows for the six-month periods ended June 30, 2008 and 2007 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2007, included in the Group s 2007 annual report on Form 10-K.

***Nature of Operations***

The Group is a publicly-owned financial holding company incorporated under the laws of the Commonwealth of Puerto Rico. It has four direct subsidiaries, Oriental Bank and Trust (the Bank ), Oriental Financial Services Corp. ( Oriental Financial Services ), Oriental Insurance, Inc. ( Oriental Insurance ) and Caribbean Pension Consultants, Inc., which is located in Boca Raton, Florida. The Group also has two special purpose entities, Oriental Financial (PR) Statutory Trust I (the Statutory Trust I , presently inactive) and Oriental Financial (PR) Statutory Trust II (the Statutory Trust II ). Through these subsidiaries and its divisions, the Group provides a wide range of financial services such as mortgage, commercial and consumer lending, financial planning, insurance sales, money management and investment banking and brokerage services, as well as corporate and individual trust services. Note 10 to the unconsolidated financial statements presents further information about the operations of the Group s business segments.

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 24 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 ( OCIF ) and the Federal Deposit Insurance Corporation ( FDIC ). The Bank offers banking services such as commercial and consumer lending, saving and time deposit products, financial planning, and corporate and individual trust services, and capitalizes on its commercial banking network to provide mortgage lending products to its clients. Oriental International Bank Inc. ( OIB ), a wholly-owned subsidiary of the Bank, operates as an international banking entity ( IBE ) pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended. OIB offers the Bank certain Puerto Rico tax advantages. OIB activities are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.

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

The Group s mortgage banking activities are conducted through a division of the Bank, and also through its mortgage lending subsidiary, Oriental Mortgage Corporation. The mortgage banking activities primarily consist of the origination and purchase of residential mortgage loans for the Group s own portfolio and from time to time, if the conditions so warrant, the Group may engage in the sale of such loans to other financial institutions in the secondary market. The Group originates Federal Housing Administration ( FHA )-insured and Veterans Administration ( VA )-guaranteed mortgages that are primarily securitized for issuance of Government National Mortgage Association



( GNMA ) mortgage-backed securities which can be resold to individual or institutional investors in the secondary market. Conventional loans that meet the underwriting requirements for sale or exchange under standard Federal National Mortgage Association (the FNMA ) or 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 Group is an approved seller of FNMA, as well as

**Table of Contents**

FHLMC, mortgage loans for issuance of FNMA and FHLMC mortgage-backed securities. The Group is also an approved issuer of GNMA mortgage-backed securities. The Group continues to outsource the servicing of the GNMA, FNMA and FHLMC pools that it issues and of its mortgage loan portfolio.

In January 2008, the Group entered into an exclusive alliance with Primerica Financial Services, Inc., a wholly-owned subsidiary of Citigroup, in which the Group is the supplier of a mortgage platform and related services for Primerica in its program to market home loans to its clients in Puerto Rico.

***Significant Accounting Policies***

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

***Allowance for Loan Losses***

The Group follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan 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 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, as provided in the Statement of Financial Accounting Standards (SFAS) No. 114, *Accounting by Creditors for Impairment of a Loan-an amendment of FASB Statements No. 5 and 15* (SFAS 114). 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 under the provisions of SFAS No. 5, *Accounting for Contingencies* (SFAS 5), as amended, and loans that are recorded at fair value or at the lower of cost or market. The Group measures for impairment all commercial loans over \$250,000 and over 90-days past-due. The portfolios of mortgage 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 loan portfolio category based on historical credit losses adjusted for current conditions and trends. This delinquency-based calculation is the starting point for management's determination of the required level of the allowance for loan losses. Other data considered in this determination includes: the overall historical 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 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 losses, factors beyond the Group's control such as those affecting general economic conditions may require future changes to the allowance.

***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.

-6-

---

**Table of Contents**

SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), establishes a fair value hierarchy that prioritizes the inputs to 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 under SFAS 157 are described below:

**Basis of Fair Value Measurement**

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;
- Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. For further details regarding the Group's investment securities and fair value measurements, refer to Note 2 and Note 8, respectively, of the unaudited consolidated financial statements.

***Impairment of Investment Securities***

The Group evaluates its securities available-for-sale and held-to-maturity for impairment. An impairment charge in the unaudited consolidated statements of income is recognized when the decline in the fair value of investments below their cost basis is judged to be other-than-temporary. The Group considers various factors in determining whether it should recognize an impairment charge, including, but not limited to the length of time and extent to which the fair value has been less than its cost basis, and the Group's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value. For debt securities, the Group also considers, among other factors, the investors repayment ability on its debt obligations and its cash and capital generation ability.

***Income Taxes***

In preparing the unconsolidated 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 rate in the year of resolution. Unfavorable settlement of any particular issue could increase the effective rate and may require the use of cash in the year of resolution.

The Group maintained an effective tax rate lower than the maximum marginal statutory rate of 39% for 2008 and 2007, mainly due to the interest income arising from investments exempt from Puerto Rico income taxes, net of expenses attributable to the exempt income. Exempt interest relates mostly to interest earned on obligations of the United States and Puerto Rico governments and certain mortgage-backed securities, including securities held by OIB. 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 income. Management evaluates the realizability of the deferred tax assets on a regular basis and assesses the need for a valuation allowance. Changes in valuation allowance from period to period are included in the Group's tax provision in the period of change. As of June 30, 2008, a valuation allowance of approximately \$1.5 million was recorded to offset deferred tax asset that the Group believes it is more likely than not would be realized in future periods.

In addition to valuation allowances, the Group establishes accruals for certain tax contingencies when, despite the belief that Group's tax return positions are fully supported, the Group believes that certain positions are likely to be challenged. The tax contingency accruals are adjusted in light of changing facts and circumstances,

-7-

---

**Table of Contents**

such as the progress of tax audits, case law and emerging legislation. The Group's tax contingency accruals are reflected as income tax payable as a component of accrued expenses and other liabilities.

Beginning with the adoption of Financial Accounting Standard Board ( FASB ) Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* , on January 1, 2007, the Group recognized the effect of income tax positions only if those positions are more likely than not of being sustained. Unrecognized tax benefits are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Prior to the adoption of FIN 48, the Group recognized the effect of income tax positions only if such positions were probable of being sustained.

The total amount of gross unrecognized tax benefits as of the date of adoption that would affect the effective tax rate was \$5.7 million. The Group classifies unrecognized tax benefits in income taxes payable. No adjustments resulted from the implementation of FIN 48. These gross unrecognized tax benefits would affect the effective tax rate if realized. On January 13, 2008, \$2.4 million in unrecognized tax benefits expired due to the statute of limitations. The Group does not anticipate any other significant changes in unrecognized tax benefits during 2008. The balance of unrecognized tax benefits at June 30, 2008 was \$4.0 million (December 31, 2007 – \$5.7 million). The tax periods ended June 30, 2004, and 2005, and December 31, 2005, 2006 and 2007, remain subject to examination by the Puerto Rico Department of Treasury.

The Group's policy to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the unaudited consolidated statements of income did not change as a result of implementing the provisions of FIN 48. As of the date of adoption of FIN 48, the Group had accrued \$1.3 million (June 30, 2008-\$1.3 million; December 31, 2007-\$1.9 million) for the payment of interest and penalties relating to unrecognized tax benefits.

***Equity-Based Compensation Plans***

On April 25, 2007, the Board of Directors (the Board ) adopted the Oriental Financial Group Inc. 2007 Omnibus Performance Incentive Plan (the Omnibus Plan ), which was subsequently approved by the Group's stockholders at their annual meeting held on June 27, 2007. 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 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.

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. Only the Committee may exercise authority in respect of Awards granted to such participants.

The Omnibus Plan replaced and superseded the Oriental Financial Group Inc. 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.

Effective July 1, 2005, the Group adopted SFAS No. 123R *Share-Based Payment* ( SFAS 123R ), an amendment of SFAS No. 123 *Accounting for Stock-Based Compensation* using the modified prospective transition method. SFAS

123R 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. SFAS No. 123R applies to all awards unvested and granted after this effective date and awards modified, repurchased, or cancelled after that date.

The following assumptions were used in estimating the fair value of the options granted:

-8-

---

**Table of Contents**

	<b>Six-Month Period Ended</b>	
	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
Weighted Average Assumptions:		
Dividend yield	4.40%	4.54%
Expected volatility	31.86%	33.34%
Risk-free interest rate	4.33%	4.65%
Expected life (in years)	8.5	8.5

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

**Recent Accounting Developments:****FASB Staff Position (FSP) FAS No. 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions.**

In February 2008, the FASB issued FSP FAS No. 140-3, which requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously or in contemplation of the initial transfer to be evaluated as a linked transaction under SFAS No. 140 unless certain criteria are met, including that the transferred asset must be readily obtainable in the marketplace. FSP No. 140-3 is effective for fiscal years beginning after November 15, 2008, and will be applied to new transactions entered into after the date of adoption. Early adoption is prohibited. The Group is currently evaluating the impact of adopting FSP No. 140-3 on its financial condition and cash flows. Adoption of FSP No. 140-3 will have no effect on the Group's results of operations.

**SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133.**

In March 2008, the FASB issued SFAS No. 161, requiring enhanced disclosures about an entity's derivative and hedging activities, and is effective for financial statements issued for fiscal years beginning after November 15, 2008, with early application encouraged. The Group will adopt SFAS No. 161 in the first quarter of 2009. Since SFAS No. 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS No. 161 will not affect the Group's financial condition, results of operations or cash flows.

**FASB Staff Position (FSP) No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.**

In June 2008, the FASB issued FSP EITF No. 03-6-1, which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in the earnings allocation in calculating earnings per share under the two-class method described in SFAS No. 128, Earnings per Share. The FSP requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share. The FSP is effective for fiscal years beginning after December 15, 2008; earlier application is not permitted. The Group does not expect adoption of FSP EITF No. 03-6-1 to have a material effect on its results of operations or earnings per share.

**NOTE 2 INVESTMENT SECURITIES****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 June 30, 2008, and December 31, 2007, cash equivalents included as part of cash and due from banks amounted to \$44.9 million and \$66.1 million, respectively.

**Investment Securities**

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the investment securities as of June 30, 2008, and December 31, 2007, were as follows:



**Table of Contents**

	<b>June 30, 2008 (In thousands)</b>				<b>Weighted Average Yield</b>
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	
<b>Available-for-sale</b>					
Puerto Rico Government and agency obligations	\$ 16,564	\$ 13	\$ 706	\$ 15,871	5.58%
Obligations of US Government sponsored agencies	750,784	7,013	210	757,587	5.69%
Structured credit investments	85,548		16,440	69,108	4.74%
<b>Total investment securities</b>	<b>852,896</b>	<b>7,026</b>	<b>17,356</b>	<b>842,566</b>	
FNMA and FHLMC certificates	1,518,229	4,729	15,983	1,506,975	5.81%
GNMA certificates	49,385	684	260	49,809	5.68%
Non-agency collateralized mortgage obligations (CMOs)	710,041		53,374	656,667	5.61%
CMOs issued by US Government sponsored agencies	336,454	14	10,178	326,290	5.37%
<b>Total mortgage-backed-securities and CMOs</b>	<b>2,614,109</b>	<b>5,427</b>	<b>79,795</b>	<b>2,539,741</b>	
<b>Total securities available-for-sale</b>	<b>3,467,005</b>	<b>12,453</b>	<b>97,151</b>	<b>3,382,307</b>	<b>5.67%</b>
<b>Held-to-maturity</b>					
Puerto Rico Government and agency obligations	55,164		3,745	51,419	5.29%
Obligations of US Government sponsored agencies	224,860	1,497		226,357	4.78%
Structured credit investments	96,171		29,682	66,489	4.48%
<b>Total investment securities</b>	<b>376,195</b>	<b>1,497</b>	<b>33,427</b>	<b>344,265</b>	
FNMA and FHLMC certificates	583,107	83	7,544	575,646	5.06%
GNMA certificates	152,260	115	1,715	150,660	5.37%
CMOs issued by US Government sponsored agencies	126,585	1,917	337	128,165	5.15%
<b>Total mortgage-backed-securities and CMOs</b>	<b>861,952</b>	<b>2,115</b>	<b>9,596</b>	<b>854,471</b>	

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

<b>Total securities held-to-maturity</b>	<b>1,238,147</b>	<b>3,612</b>	<b>43,023</b>	<b>1,198,736</b>	<b>5.02%</b>
<b>Total</b>	<b>\$ 4,705,152</b>	<b>\$ 16,065</b>	<b>\$ 140,174</b>	<b>\$ 4,581,043</b>	<b>5.50%</b>

	<b>December 31, 2007 (In thousands)</b>				<b>Weighted Average Yield</b>
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	
<b>Available-for-sale</b>					
Puerto Rico Government and agency obligations	\$ 18,331	\$ 63	\$ 937	\$ 17,457	5.69%
Obligations of US Government sponsored agencies	1,279,977	14,933		1,294,910	5.91%
Structured credit investments	85,548		7,188	78,360	5.46%
<b>Total investment securities</b>	<b>1,383,856</b>	<b>14,996</b>	<b>8,125</b>	<b>1,390,727</b>	
FNMA and FHLMC certificates	998,008	10,681	223	1,008,466	5.85%
GNMA certificates	48,907	869	216	49,560	5.69%
Non-agency collateralized mortgage obligations (CMOs)	632,992	42	12,505	620,529	5.49%
<b>Total mortgage-backed-securities and CMOs</b>	<b>1,679,907</b>	<b>11,592</b>	<b>12,944</b>	<b>1,678,555</b>	
<b>Total securities available-for-sale</b>	<b>3,063,763</b>	<b>26,588</b>	<b>21,069</b>	<b>3,069,282</b>	<b>5.78%</b>
<b>Held-to-maturity</b>					
Puerto Rico Government and agency obligations	55,206		3,781	51,425	5.29%
Obligations of US Government sponsored agencies	418,731	902	1,980	417,653	4.92%
Structured credit investments	96,171		11,949	84,222	6.69%
<b>Total investment securities</b>	<b>570,108</b>	<b>902</b>	<b>17,710</b>	<b>553,300</b>	
FNMA and FHLMC certificates	624,267	4,331	3,560	625,038	5.03%
GNMA certificates	161,647	1,504	1,204	161,947	5.36%
CMOs issued by US Government sponsored agencies	136,865	1,489	527	137,827	5.14%
<b>Total mortgage-backed-securities and CMOs</b>	<b>922,779</b>	<b>7,324</b>	<b>5,291</b>	<b>924,812</b>	

<b>Total securities held-to-maturity</b>	<b>1,492,887</b>	<b>8,226</b>	<b>23,001</b>	<b>1,478,112</b>	<b>5.16%</b>
<b>Total</b>	<b>\$ 4,556,650</b>	<b>\$ 34,814</b>	<b>\$ 44,070</b>	<b>\$ 4,547,394</b>	<b>5.58%</b>

-10-

---

**Table of Contents**

The amortized cost and fair value of the Group's investment securities available-for-sale and held-to-maturity at June 30, 2008, by contractual maturity, are shown in the next table. Securities not due on a single contractual maturity date, such as collateralized mortgage obligations, are classified in the period of final contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<i>(In thousands)</i>			
	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<b>Investment securities</b>				
Due within 1 year	\$ 1,499	\$ 1,499	\$	\$
Due after 1 to 5 years			125,000	126,355
Due after 5 to 10 years	347,738	337,210	60,000	41,775
Due after 10 years	503,659	503,857	191,195	176,135
	<b>852,896</b>	<b>842,566</b>	<b>376,195</b>	<b>344,265</b>
<b>Mortgage-backed securities</b>				
Due within 1 year	27	27		
Due after 1 to 5 years	660	688		
Due after 5 to 10 years			58,425	56,442
Due after 10 years	2,613,422	2,539,026	803,527	798,029
	<b>2,614,109</b>	<b>2,539,741</b>	<b>861,952</b>	<b>854,471</b>
	<b>\$3,467,005</b>	<b>\$3,382,307</b>	<b>\$1,238,147</b>	<b>\$1,198,736</b>

In keeping with the Group's investment strategy, during the six-month periods ended June 30, 2008 and 2007, 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. Proceeds from the sale of investment securities available-for-sale during the six-month periods ended June 30, 2008 and 2007, totaled \$943.1 million and \$23.0 million, respectively. Realized gains on those sales during the six-month periods ended June 30, 2008 and 2007, were \$9.5 million and \$358,000, respectively. There were no realized losses on those sales during the six-month periods ended June 30, 2008 and 2007.

The table below presents an analysis of the gross realized gains and losses by category for the six-month periods ended June 30, 2008 and 2007:

**Six-month period ended June 30, 2008***In thousands*

Description	Original Face	Original Cost	Sale Proceeds	Sale Book		
				Value	Gains	Losses

**Gain on Sale of Securities****Available-for-Sale****Investment securities**

Puerto Rico Government and agency obligations	\$ 1,830	\$ 1,843	\$ 1,862	\$ 1,804	\$ 58	\$
Obligations of U.S. Government sponsored agencies	709,300	708,957	718,291	709,070	9,221	
<b>Total investment securities</b>	<b>711,130</b>	<b>710,800</b>	<b>720,153</b>	<b>710,874</b>	<b>9,279</b>	

**Mortgage-backed securities and CMOs**

FNMA and FHLMC certificates	250,287	250,506	198,348	198,229	119	
GNMA certificates	24,958	26,440	24,633	24,509	124	

**Total mortgage-backed securities and CMOs**

	275,245	276,946	222,981	222,738	243	
	<b>\$986,375</b>	<b>\$987,746</b>	<b>\$943,134</b>	<b>\$933,612</b>	<b>\$9,522</b>	<b>\$</b>

**Table of Contents****Six-month period ended June 30, 2007***In thousands*

Description	Original Face	Original Cost	Sale Proceeds	Sale Book Value	Gains	Losses
<b>Gain on sale of securities available-for-sale</b>						
<b>Investment securities</b>						
Corporate bonds and other	\$25,000	\$ 24,909	\$23,032	\$22,674	\$358	\$
	<b>\$25,000</b>	<b>\$ 24,909</b>	<b>\$23,032</b>	<b>\$22,674</b>	<b>\$358</b>	<b>\$</b>

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 June 30, 2008, and December 31, 2007.

-12-

**Table of Contents****June 30, 2008****Available-for-sale***(In thousands)*

	<b>Less than 12 months</b>		
	<b>Amortized Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>
Obligations of U.S. government entities	\$ 19,285	\$ 210	\$ 19,075
Mortgage-backed securities and CMOs	1,339,361	30,260	1,309,101
Structured credit investments	60,000	14,100	45,900
	<b>1,418,646</b>	<b>44,570</b>	<b>1,374,076</b>
	<b>12 months or more</b>		
	<b>Amortized Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>
Puerto Rico government and agency obligations	16,184	706	15,478
Mortgage-backed securities and CMOs	592,327	49,535	542,792
Structured credit investments	25,548	2,340	23,208
	<b>634,059</b>	<b>52,581</b>	<b>581,478</b>
	<b>Amortized Cost</b>	<b>Total Unrealized Loss</b>	<b>Fair Value</b>
Obligations of U.S. government entities	19,285	210	19,075
Puerto Rico government and agency obligations	16,184	706	15,478
Mortgage-backed securities and CMOs	1,931,688	79,795	1,851,893
Structured credit investments	85,548	16,440	69,108
	<b>\$ 2,052,705</b>	<b>\$ 97,151</b>	<b>\$ 1,955,554</b>

**Held-to-maturity***(In thousands)*

	<b>Less than 12 months</b>		
	<b>Amortized Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>
Mortgage-backed securities and CMOs	\$ 636,823	\$ 6,470	\$ 630,353
Structured credit investments	96,171	29,682	66,489
	<b>732,994</b>	<b>36,152</b>	<b>696,842</b>

	<b>12 months or more</b>		
	<b>Amortized Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>
Puerto Rico government and agency obligations	55,164	3,745	51,419
Mortgage-backed securities and CMOs	83,618	3,126	80,492
	<b>138,782</b>	<b>6,871</b>	<b>131,911</b>
	<b>Amortized Cost</b>	<b>Total Unrealized Loss</b>	<b>Fair Value</b>
Puerto Rico government and agency obligations	55,164	3,745	51,419
Mortgage-backed securities and CMOs	720,441	9,596	710,845
Structured credit investments	96,171	29,682	66,489
	<b>\$ 871,776</b>	<b>\$ 43,023</b>	<b>\$ 828,753</b>

-13-



**Table of Contents****December 31, 2007****Available-for-sale***(In thousands)*

	<b>Less than 12 months</b>		
	<b>Amortized Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>
Puerto Rico Government and agency obligations	\$ 1,996	\$ 325	\$ 1,671
Mortgage-backed-securities and CMOs	118,616	336	118,280
Structured credit investments	85,548	7,188	78,360
	<b>206,160</b>	<b>7,849</b>	<b>198,311</b>
	<b>12 months or more</b>		
	<b>Amortized Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>
Puerto Rico Government and agency obligations	14,152	612	13,540
Mortgage-backed-securities and CMOs	634,910	12,608	622,302
	<b>649,062</b>	<b>13,220</b>	<b>635,842</b>
	<b>Amortized Cost</b>	<b>Total Unrealized Loss</b>	<b>Fair Value</b>
Puerto Rico Government and agency obligations	16,148	937	15,211
Mortgage-backed-securities and CMOs	753,526	12,944	740,582
Structured credit investments	85,548	7,188	78,360
	<b>\$ 855,222</b>	<b>\$ 21,069</b>	<b>\$ 834,153</b>

**Held-to-maturity***(In thousands)*

	<b>Less than 12 months</b>		
	<b>Amortized Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>
Puerto Rico Government and agency obligations	\$ 4,238	\$ 54	\$ 4,184
Mortgage-backed-securities and CMOs	18,403	129	18,274
Structured credit investments	96,171	11,949	84,222

	<b>118,812</b>	<b>12,132</b>	<b>106,680</b>
	<b>Amortized Cost</b>	<b>12 months or more Unrealized Loss</b>	<b>Fair Value</b>
Obligations of US Government sponsored agencies	124,998	1,980	123,018
Puerto Rico Government and agency obligations	50,968	3,727	47,241
Mortgage-backed-securities and CMOs	373,122	5,162	367,960
	<b>549,088</b>	<b>10,869</b>	<b>538,219</b>
	<b>Amortized Cost</b>	<b>Total Unrealized Loss</b>	<b>Fair Value</b>
Obligations of US Government sponsored agencies	124,998	1,980	123,018
Puerto Rico Government and agency obligations	55,206	3,781	51,425
Mortgage-backed-securities and CMOs	391,525	5,291	386,234
Structured credit investments	96,171	11,949	84,222
	<b>\$ 667,900</b>	<b>\$ 23,001</b>	<b>\$ 644,899</b>

At June 30, 2008, mortgage-backed securities include approximately \$710.0 million in non-agency collateralized mortgage obligations with unrealized losses of \$53.4 million in the Group's available-for-sale investment securities portfolio. These obligations are collateralized by pools of mortgage loans originated in the U.S., and are senior classes having subordination of losses ranging from 4.7% to 16.6%, which provide the capacity to absorb estimated collateral losses. These issues, including one that is backed by Alternative-A (Alt-A) loan collateral originated in 2006, are rated AAA by Standard & Poor's and Aaa by Moody's.

At June 30, 2008, the investment securities portfolio includes structured credit investments issued by U.S. institutions with balances of \$85.5 million in the available-for-sale portfolio, and \$96.2 million in the held-to-maturity portfolio, with unrealized losses of approximately \$16.4 million and \$29.7 million, respectively. The unrealized loss position is a reflection of the credit markets' recent activity, with credit spreads widening significantly. The underlying collateral on the structures that the Group owns has performed adequately, with no defaults to date, and none of the structured credit investments has been downgraded.

All other securities in an unrealized loss position at June 30, 2008, are mainly composed of securities issued or backed by U.S. government agencies and U.S. government sponsored agencies. These investments are primarily highly liquid securities that have a large and efficient secondary market. Valuations are performed on a monthly basis using a third party provider and dealer quotes. The Group's management believes that the unrealized losses

**Table of Contents**

of such other securities at June 30, 2008, are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuer.

At June 30, 2008, management has the intent and ability to hold these investments until a period of time sufficient to allow for any recovery in fair value or maturity up to (or beyond) the cost of these investments. The Group is closely monitoring these securities for any decline in value that the Group's management may consider to be other-than-temporary.

**NOTE 3 LOANS AND ALLOWANCE FOR LOAN LOSSES****Loans**

The Group's credit activities are mainly with customers located in Puerto Rico. The Group's loan transactions are encompassed within three main categories: mortgage, commercial and consumer. The composition of the Group's loan portfolio at June 30, 2008, and December 31, 2007, was as follows:

	<i>(In thousands)</i>	
	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>Loans secured by real estate:</b>		
Residential mortgage loans	\$ 968,875	\$ 960,704
Home equity loans, secured personal loans and others	26,210	28,783
Commercial	153,509	135,070
Deferred loan fees, net	(3,320)	(2,887)
	1,145,274	1,121,670
<b>Other loans:</b>		
Commercial	17,335	22,128
Personal consumer loans and credit lines	25,479	29,245
Deferred loan (fees) cost, net	(168)	12
	42,646	51,385
<b>Loans receivable</b>	<b>1,187,920</b>	<b>1,173,055</b>
Allowance for loan losses	(11,885)	(10,161)
<b>Loans receivable, net</b>	<b>1,176,035</b>	<b>1,162,894</b>
Mortgage loans held-for-sale	42,122	16,672
<b>Total loans, net</b>	<b>\$ 1,218,157</b>	<b>\$ 1,179,566</b>

**Allowance for Loan Losses**

The Group maintains an allowance for loan 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 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. Refer to Table 4 of the Management's Discussion and Analysis of Financial Condition and Results of Operations for additional details related to the changes in the allowance for loan losses for the quarters and six-month periods ended June 30, 2008 and 2007.

The Group evaluates all loans, some individually, and others as homogeneous groups, for purposes of determining impairment. At June 30, 2008, and December 31, 2007, the total balance of impaired loans was \$1.6 million and \$1.1 million, respectively. The impaired loans were measured based on the fair value of collateral. The Group's management determined that impaired loans did not require a valuation allowance in accordance with SFAS 114.

-15-

---

**Table of Contents****NOTE 4 PLEDGED ASSETS**

At June 30, 2008, residential mortgage loans amounting to \$500.0 million were pledged to secure advances and borrowings from the FHLB. Investment securities with fair values totaling \$4.133 billion, \$130.2 million, and \$113.0 million at June 30, 2008, were pledged to secure securities sold under agreements to repurchase, public fund deposits and other funds, respectively. Also, investment securities with fair value totaling \$120,000 at June 30, 2008, were pledged to the Puerto Rico Treasury Department.

As of June 30, 2008, investment securities available-for-sale and held-to-maturity not pledged amounted to \$168.9 million and \$76.4 million, respectively. As of June 30, 2008, mortgage loans not pledged amounted to \$533.8 million.

**NOTE 5 OTHER ASSETS**

Other assets at June 30, 2008, and December 31, 2007 include the following:

	<i>(In thousands)</i>	
	<b>June 30, 2008</b>	<b>December 31, 2007</b>
Prepaid expenses	\$ 5,004	\$ 2,645
Mortgage tax credits	4,992	69
Servicing asset	2,934	2,526
Goodwill	2,006	2,006
Investment in Statutory Trust	1,086	1,086
Deferred charges	893	910
Accounts receivable and other assets	10,628	7,082
	<b>\$ 27,543</b>	<b>\$ 16,324</b>

Mortgage tax credits in the table above, are related to the approval on December 14, 2007, of the Act Number 97 ( the Act ) to stimulate the economy and private investment by stimulating the real estate industry, in particular the sale of housing. Under the terms of the Act certain home mortgage loans qualify for a government credit of up to \$25,000. The Group disburses 100% of the residence purchase price not covered by down payment and records a loan for the amount disbursed less the government credit. The government credit is recorded as a mortgage tax credit, which can be used as a reduction of the Group's income tax liability commencing with calendar year 2008. Mortgage tax credits are transferable.

**NOTE 6 BORROWINGS*****Short Term Borrowings***

At June 30, 2008, short term borrowings amounted to \$41.6 million (December 31, 2007 \$27.5 million) which mainly consist of federal funds purchased with a weighted average rate of 1.75% (December 31, 2007 1.83%).

***Securities Sold under Agreements to Repurchase***

At June 30, 2008, 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.

Securities sold under agreements to repurchase, excluding accrued interest in the amount of \$10.8 million at June 30, 2008, mature as follows:

**Table of Contents**

	<i>(In thousands)</i>
	<b>Balance</b>
<b>Short-term repurchase agreements</b>	
Due within 30 days	\$ 50,000
<b>Structured repurchase agreements</b>	
Due after 1 to 3 years	100,000
Due after 3 to 5 years	1,800,000
Due after 5 to 10 years	1,850,000
<b>Sub-total structured repurchase agreements</b>	3,750,000
<b>Total repurchase agreements</b>	<b>\$ 3,800,000</b>

During the fourth quarter of 2006 and throughout 2007, the Group restructured most of its short-term repurchase agreements portfolio into longer-term, structured repurchase agreements. The terms of these structured positions range between three and ten years, and the counterparts have the right to exercise put options before their contractual maturity from one to three years after the agreements' settlement dates. The following table shows a summary of these agreements and their terms at June 30, 2008:

*(In thousands)*

Borrowing Balance	Weighted- Average Coupon	Settlement Date	Maturity Date	Next Put Date
\$ 450,000	4.34%	12/28/2006	12/28/2011	12/28/2008
450,000	4.22%	12/28/2006	12/28/2011	9/28/2008
250,000	4.44%	3/02/2007	3/02/2017	3/2/2009
500,000	4.46%	3/02/2007	3/02/2017	3/2/2009
150,000	4.31%	3/06/2007	12/06/2012	12/7/2009
900,000	3.71%	3/06/2007	3/06/2017	3/6/2009
350,000	4.26%	5/09/2007	5/09/2012	8/9/2008
100,000	3.71%	3/06/2007	3/06/2017	3/6/2009
100,000	4.67%	7/27/2007	7/27/2014	1/27/2010
100,000	4.39%	8/14/2007	8/16/2010	8/14/2008
100,000	4.50%	8/14/2007	8/14/2012	8/14/2009
300,000	4.47%	9/13/2007	9/13/2012	9/13/2009
<b>\$ 3,750,000</b>	<b>4.19%</b>			

**Advances from the Federal Home Loan Bank**

At June 30, 2008, the advances from the FHLB, excluding accrued interest in the amount of \$1.9 million, mature as follows:

	<i>(In thousands)</i>
	<b>Balance</b>
<b>Short-term FHLB advances</b>	

Due after 60 to 90 days	\$	50,000
<b>Structured FHLB advances</b>		
Due after 3 to 5 years		225,000
Due after 5 to 10 years		55,000
<b>Sub-total structured FHLB advances</b>		<b>280,000</b>
<b>Total FHLB advances</b>	<b>\$</b>	<b>330,000</b>

-17-

---

**Table of Contents**

During 2007, the Group restructured most of its FHLB advances portfolio into longer-term, structured advances. The terms of these advances range between five and seven years, and the FHLB has the right to exercise put options before the contractual maturity of the advances from six months to one year after the advances' settlement dates. The following table shows a summary of these advances and their terms at June 30, 2008:

*(In thousands)*

Borrowing Balance	Weighted- Average Coupon	Settlement Date	Maturity Date	Next Put Date
\$ 25,000	4.37%	5/04/2007	5/04/2012	8/5/2008
25,000	4.20%	5/08/2007	5/08/2014	8/8/2008
30,000	4.22%	5/11/2007	5/11/2014	8/13/2008
25,000	4.57%	7/24/2007	7/24/2012	7/24/2008
25,000	4.26%	7/30/2007	7/30/2012	7/30/2008
50,000	4.33%	8/10/2007	8/10/2012	8/10/2008
100,000	4.09%	8/16/2007	8/16/2012	8/16/2008
<b>\$ 280,000</b>	<b>4.24%</b>			

**Subordinated Capital Notes**

Subordinated capital notes amounted to \$36.1 million at June 30, 2008, and December 31, 2007.

In October 2001 and August 2003, the Statutory Trust I and the Statutory Trust II, respectively, special purpose entities of the Group, were formed for the purpose of issuing trust redeemable preferred securities. In December 2001 and September 2003, \$35.0 million of trust redeemable preferred securities were issued by each of the Statutory Trust I and the Statutory Trust II, respectively, 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 these issuances were used by the Statutory Trust I and the Statutory Trust II to purchase a like amount of floating rate junior subordinated deferrable interest debentures (subordinated capital notes) issued by the Group. The call provision of the subordinated capital note purchased by the Statutory Trust I was exercised by the Group in December 2006. The other subordinated capital note has a par value of \$36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (5.76% at June 30, 2008; 7.94% at December 31, 2007), 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 (September 2008). The trust redeemable preferred securities have the same maturity and call provisions as the subordinated capital notes. The subordinated deferrable interest debentures issued by the Group are accounted for as a liability denominated as subordinated capital notes on the unaudited consolidated statements of financial condition.

The subordinated capital notes are treated as Tier 1 capital for regulatory purposes. Under Federal Reserve Board rules, restricted core capital elements, which are qualifying trust preferred securities, qualifying cumulative perpetual preferred stock (and related surplus) and certain minority interests in consolidated subsidiaries, are limited in the aggregate to no more than 25% of a bank holding company's core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability.

**NOTE 7 DERIVATIVE ACTIVITIES**

The Group may use various derivative instruments as part of its asset and liability management. These transactions involve both credit and market risks. The notional amounts are amounts on which calculations, payments, and the value of the derivatives are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. The actual risk of loss is the cost of replacing, at market, these contracts in the event of default by the counterparties. The Group controls the credit risk of its derivative financial instrument agreements through credit approvals, limits, monitoring procedures



and collateral, when considered necessary.

Derivative instruments are generally negotiated over-the-counter ( OTC ) contracts. Negotiated OTC derivatives are generally entered into between two counterparties that negotiate specific contractual terms, including the underlying instrument, amount, exercise price and maturity.

-18-

---

**Table of Contents**

The Group generally uses interest rate swaps and options in managing its interest rate risk exposure. Certain swaps were entered into to convert the forecasted rollover of short-term borrowings into fixed rate liabilities for longer periods and provide protection against increases in short-term interest rates. Under these swaps, the Group paid a fixed monthly or quarterly cost and received a floating thirty or ninety-day payment based on LIBOR. Floating rate payments received from the swap counterparties partially offset the interest payments to be made on the forecasted rollover of short-term borrowings.

During the six-month period ended June 30, 2008, losses of \$7.6 million were recognized and reflected as Derivatives in the unaudited consolidated statements of income. This was mainly due to an interest-rate swap contract that the Group entered in on January 2008 to manage the Group's interest rate risk exposure with a notional amount of \$500 million. Such contract was subsequently terminated, resulting in a loss to the Group of approximately \$7.9 million. For the six-month period ended June 30, 2007, gains of \$8.4 million were recognized and reflected as Derivatives in the unaudited consolidated statements of income, which included and \$8.2 million gain from the elimination of forecasted transactions on interest rate swaps unwound in 2006. There were no outstanding interest-rate swap contracts at June 30, 2008 and December 31, 2007.

The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market 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 in accordance with SFAS No. 133, as amended.

There were no derivatives designated as a hedge as of June 30, 2008, and December 31, 2007. Derivatives not designated as a hedge, consist of purchased options used to manage the exposure to the stock market on stock indexed deposits with notional amounts of \$150,335,000 and \$152,530,000 as of June 30, 2008, and December 31, 2007, respectively; embedded options on stock indexed deposits with notional amounts of \$141,524,605 and \$147,073,000 as of June 30, 2008, and December 31, 2007, respectively.

At June 30, 2008, and December 31, 2007, the purchased options used to manage the exposure to the stock market on stock indexed deposits amounted represented and asset of \$27.6 million and \$40.7 million, respectively; the options sold to customers embedded in the certificates of deposit and recorded as deposits in the unaudited consolidated statement of financial condition, represented a liability of \$26.2 million and \$38.8 million, respectively.

**NOTE 8 FAIR VALUE**

As discussed in Note 1, effective January 1, 2008, the Group adopted SFAS 157, which provides a framework for measuring fair value under GAAP.

***Fair Value Measurement***

SFAS 157 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. SFAS 157 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:

**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 SFAS 159) whose value is determined using a pricing model

with

-19-

---

**Table of Contents**

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. The following is a description of the valuation methodologies used for instruments measured at fair value:

**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 values is based upon externally developed models that use both observable and unobservable inputs depending on the market activity of the instrument. Structured credit investments and a non-agency collateralized mortgage obligation backed by Alternative-A (Alt-A) loan collateral originated in 2006 are not trading actively in the current market; accordingly, they do not exhibit readily observable prices. Based on their valuation methodology, such investments are classified as Level 3. The estimated fair value of the structured credit investments and the non-agency collateralized mortgage obligation backed by Alternative-A (Alt-A) loan collateral originated in 2006 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, delinquency and loss rates. The assumptions used are drawn from a combination of internal and external data sources. A third-party valuation of these investments, in which all economic assumptions are determined by this third-party (external-based valuation), is obtained at least on a quarterly basis and is used by management as a benchmark to evaluate the adequacy of the cash flow model and the reasonableness of the assumptions and fair value estimates developed internally for the internal-based valuation. The external-based valuations are analyzed and assumptions are evaluated and incorporated in the internal-based valuation model when deemed necessary and agreed by management.

**Derivative instruments**

The fair values of the derivative instruments were provided by valuation experts and counterparties. Certain derivatives with limited market activity are valued using externally developed models that consider unobservable market parameters. The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index (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 from counterparties or an external pricing source and validated by management. Based on their valuation methodology, are classified as Level 3. These options are tied in to Asian options whose payoff 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 used which are uncertain and require a degree of judgment, include primarily S&P Index volatility and leverage. The external-based valuations are analyzed and assumptions are evaluated and incorporated in either an internal-based valuation model when deemed necessary or compared to counterparties prices and agreed by management.

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:

<i>(In thousands)</i>	<b>June 30, 2008</b>		
	<b>Fair Value Measurements</b>		
	Level 1	Level 2	Level 3
Investment securities available-for-sale	\$	\$ 3,171,129	\$ 211,178
Money market instruments	44,902		
Derivative asset			27,641
Derivative liability			(26,177)
	\$ 44,902	\$ 3,171,129	\$ 212,642



**Table of Contents**

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarter and six-month period ended June 30, 2008.

<b>Level 3 Instruments Only</b> <i>(In thousands)</i>	<b>Total Fair Value Measurements (Quarter ended June 30, 2008)</b>			<b>Total Fair Value Measurements (Six-month period ended June 30, 2008)</b>		
	Investment securities available for-sale	Derivative asset	Derivative liability	Investment securities available for-sale	Derivative asset	Derivative liability
Beginning balance	\$ 73,658	\$ 34,475	\$ (32,806)	\$ 78,360	\$ 40,709	\$ (38,793)
Total gains (losses) (realized/unrealized):						
Included in earnings		(712)	939		(3,873)	4,172
Included in other comprehensive income	(4,550)			(9,252)		
New instruments acquired		2,574	(2,541)		3,384	(3,344)
Principal repayment and amortization		(8,696)	8,231		(12,579)	11,788
Transfer of non-agency CMOs to Level 3	142,070			142,070		
Ending balance	\$ 211,178	\$ 27,641	\$ (26,177)	\$ 211,178	\$ 27,641	\$ (26,177)

**NOTE 9 SEGMENT REPORTING**

The Group segregates its businesses into the following major reportable segments: Banking, Treasury, and Financial Services. 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 products, distribution channels and economic characteristics of the products were also considered in the determination of the reportable segments. The Group measures the performance of these reportable segments based on pre-established goals of different financial parameters such as net income, net interest income, loan production and fees generated. In March 2008, management decided to reclassify and present investment banking revenues in the Financial Services segment, rather than in the Treasury segment. This reclassification was retroactively presented in the table below.

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 principal activity is to originate mortgage loans for the Group's own portfolio, and Oriental Mortgage Corporation, the Bank's mortgage lending subsidiary. As part of its mortgage banking activities, the Group may sell loans directly into the secondary market or securitize conforming loans into mortgage-backed securities. The Treasury segment encompasses all of the Group's asset and liability management activities such as: purchases and sales of investment securities, interest rate risk management, derivatives, and borrowings.

Financial services 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 brokerage services, insurance sales, investment banking, corporate and individual trust and retirement services, as well as pension plan administration services.

Inter-segment 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 followed by the Group, which are 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 for the quarters and six-month periods ended June 30, 2008 and 2007:



**Table of Contents****Unaudited (In thousands)**

	<b>Banking</b>	<b>Treasury</b>	<b>Financial Services</b>	<b>Total Segments</b>	<b>Eliminations</b>	<b>Consolidated Total</b>
<b>Quarter ended June 30, 2008</b>						
Interest income	\$ 20,567	\$ 64,569	\$ 22	\$ 85,158	\$	\$ 85,158
Interest expense	(8,322)	(48,401)		(56,723)		(56,723)
Net interest income	12,245	16,168	22	28,435		28,435
Non-interest income (loss)	2,589	(41)	4,102	6,650		6,650
Non-interest expenses	(14,181)	(945)	(2,954)	(18,080)		(18,080)
Intersegment revenue	852			852	(852)	
Intersegment expense		(150)	(702)	(852)	852	
Provision for loan losses	(1,980)			(1,980)		(1,980)
<b>Income (loss) before income taxes</b>	<b>\$ (475)</b>	<b>\$ 15,032</b>	<b>\$ 468</b>	<b>\$ 15,025</b>	<b>\$</b>	<b>\$ 15,025</b>
<b>Total assets at June 30, 2008</b>	<b>\$ 1,573,026</b>	<b>\$ 4,768,752</b>	<b>\$ 11,003</b>	<b>\$ 6,352,781</b>	<b>\$ (292,602)</b>	<b>\$ 6,060,179</b>
<b>Quarter ended June 30, 2007</b>						
Interest income	\$ 22,666	\$ 48,078	\$ 57	\$ 70,801	\$	\$ 70,801
Interest expense	(9,307)	(43,572)	(232)	(53,111)		(53,111)
Net interest income (expense)	13,359	4,506	(175)	17,690		17,690
Non-interest income	1,747	2,194	3,855	7,796		7,796
Non-interest expenses	(13,683)	(848)	(2,946)	(17,477)		(17,477)
Intersegment revenue	928			928	(928)	
Intersegment expense		(152)	(776)	(928)	928	
Provision for loan losses	(1,375)			(1,375)		(1,375)
<b>Income (loss) before income taxes</b>	<b>\$ 976</b>	<b>\$ 5,700</b>	<b>\$ (42)</b>	<b>\$ 6,634</b>	<b>\$</b>	<b>\$ 6,634</b>
<b>Total assets at June 30, 2007</b>	<b>\$ 1,748,466</b>	<b>\$ 3,829,549</b>	<b>\$ 12,077</b>	<b>\$ 5,590,092</b>	<b>\$ (299,443)</b>	<b>\$ 5,290,649</b>

**Unaudited (In thousands)**

	<b>Banking</b>	<b>Treasury</b>	<b>Financial Services</b>	<b>Total Segments</b>	<b>Eliminations</b>	<b>Consolidated Total</b>
<b>Six-month period ended June 30, 2008</b>						
Interest income	\$ 40,391	\$ 126,810	\$ 58	\$ 167,259	\$	\$ 167,259
Interest expense	(18,006)	(95,909)		(113,915)		(113,915)



Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Net interest income	22,385	30,901	58	53,344		53,344
Non-interest income	5,223	1,234	9,057	15,514		15,514
Non-interest expenses	(27,760)	(2,011)	(6,039)	(35,810)		(35,810)
Intersegment revenue	1,792			1,792	(1,792)	
Intersegment expense		(342)	(1,450)	(1,792)	1,792	
Provision for loan losses	(3,630)			(3,630)		(3,630)
<b>Income (loss) before income taxes</b>	<b>\$ (1,990)</b>	<b>\$ 29,782</b>	<b>\$ 1,626</b>	<b>\$ 29,418</b>		<b>\$ 29,418</b>

**Total assets at June 30, 2008**                    **\$ 1,573,026**   **\$ 4,768,752**   **\$ 11,003**   **\$ 6,352,781**   **\$ (292,602)**   **\$ 6,060,179**

**Six-month period ended June 30, 2007**

Interest income	\$ 45,009	\$ 87,161	\$ 130	\$ 132,300		\$ 132,300
Interest expense	(17,716)	(83,065)	(441)	(101,222)		(101,222)
Net interest income (expense)	27,293	4,096	(311)	31,078		31,078
Non-interest income	3,024	11,146	8,757	22,927		22,927
Non-interest expenses	(25,734)	(1,579)	(5,991)	(33,304)		(33,304)
Intersegment revenue	1,876			1,876	(1,876)	
Intersegment expense		(298)	(1,578)	(1,876)	1,876	
Provision for loan losses	(2,450)			(2,450)		(2,450)
<b>Income before income taxes</b>	<b>\$ 4,009</b>	<b>\$ 13,365</b>	<b>\$ 877</b>	<b>\$ 18,251</b>		<b>\$ 18,251</b>

**Total assets at June 30, 2007**                    **\$ 1,748,466**   **\$ 3,829,549**   **\$ 12,077**   **\$ 5,590,092**   **\$ (299,443)**   **\$ 5,290,649**

Table of Contents**ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****SELECTED FINANCIAL DATA****FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2008 AND 2007***(In thousands, except per share data)*

	Quarter ended June 30,		Variance %	Six-months ended June 30,		Variance %
	2008	2007		2008	2007	
<b>EARNINGS DATA:</b>						
Interest income	\$ 85,158	\$ 70,801	20.3%	\$ 167,259	\$ 132,300	26.4%
Interest expense	56,723	53,111	6.8%	113,915	101,222	12.5%
<b>Net interest income</b>	<b>28,435</b>	<b>17,690</b>	<b>60.7%</b>	<b>53,344</b>	<b>31,078</b>	<b>71.6%</b>
Provision for loan losses	1,980	1,375	44.0%	3,630	2,450	48.2%
<b>Net interest income after provision for loan losses</b>	<b>26,455</b>	<b>16,315</b>	<b>62.2%</b>	<b>49,714</b>	<b>28,628</b>	<b>73.7%</b>
Non-interest income	6,650	7,796	-14.7%	15,514	22,927	-32.3%
Non-interest expenses	18,080	17,477	3.5%	35,810	33,304	7.5%
<b>Income before taxes</b>	<b>15,025</b>	<b>6,634</b>	<b>126.5%</b>	<b>29,418</b>	<b>18,251</b>	<b>61.2%</b>
Income tax expense (benefit)	598	187	219.8%	(1,857)	811	-329.0%
<b>Net Income</b>	<b>14,427</b>	<b>6,447</b>	<b>123.8%</b>	<b>31,275</b>	<b>17,440</b>	<b>79.3%</b>
Less: dividends on preferred stock	(1,200)	(1,201)	-0.1%	(2,401)	(2,401)	
<b>Net income available to common shareholders</b>	<b>\$ 13,227</b>	<b>\$ 5,246</b>	<b>152.1%</b>	<b>\$ 28,874</b>	<b>\$ 15,039</b>	<b>92.0%</b>
<b>PER SHARE DATA:</b>						
Basic	\$ 0.54	\$ 0.21	157.1%	\$ 1.19	\$ 0.61	95.1%
Diluted	\$ 0.54	\$ 0.21	157.1%	\$ 1.19	\$ 0.61	95.1%
Average common shares outstanding	<b>24,290</b>	<b>24,488</b>	-0.8%	<b>24,227</b>	<b>24,480</b>	-1.0%
Average potential common share-options	<b>94</b>	<b>75</b>	25.3%	<b>110</b>	<b>97</b>	13.4%
Average shares and shares equivalents	<b>24,384</b>	<b>24,563</b>	-0.7%	<b>24,337</b>	<b>24,577</b>	-1.0%
Book value per common share	\$ 9.60	\$ 9.99	-3.9%	\$ 9.60	\$ 9.99	-3.9%
Market price at end of period	\$ 14.26	\$ 10.91	30.7%	\$ 14.26	\$ 10.91	30.7%

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Cash dividends declared per common share	\$ 0.14	\$ 0.14	0.0%	\$ 0.28	\$ 0.28	0.0%
Cash dividends declared on common share	\$ 3,405	\$ 3,433	-0.8%	\$ 6,804	\$ 6,861	-0.8%
Return on average assets (ROA)	0.95%	0.49%	93.9%	1.01%	0.70%	44.3%
Return on average common equity (ROE)	20.65%	7.87%	162.4%	20.64%	11.22%	84.0%
Equity-to-assets ratio	4.97%	5.93%	-16.2%	4.97%	5.93%	-16.2%
Efficiency ratio	51.82%	72.30%	-28.3%	53.20%	75.11%	-29.2%
Expense ratio	0.78%	0.78%	0.0%	0.74%	0.81%	-8.6%
Interest rate spread	1.68%	1.17%	43.6%	1.53%	1.04%	47.1%
Interest rate margin	1.90%	1.40%	35.7%	1.80%	1.30%	38.5%
Number of financial centers	24	24	0.0%	24	24	0.0%

-23-

**Table of Contents**

	<b>June 30,</b>	<b>December</b>	
	<b>2008</b>	<b>31,</b>	<b>Variance</b>
<b>PERIOD END BALANCES AND CAPITAL RATIOS:</b>		<b>2007</b>	<b>%</b>
<i>(In thousands)</i>			
<b>Investments and loans</b>			
Investments securities	\$ 4,643,977	\$ 4,585,610	1.27%
Loans (including loans held-for-sale), net	1,218,157	1,179,566	3.27%
	<b>\$ 5,862,134</b>	<b>\$ 5,765,176</b>	<b>1.68%</b>
<b>Deposits and Borrowings</b>			
Deposits	\$ 1,492,419	\$ 1,246,420	19.74%
Repurchase agreements	3,810,752	3,861,411	-1.31%
Other borrowings	409,561	395,441	3.57%
Securities purchased but not yet received	23,103	111,431	-79.27%
	<b>\$ 5,735,835</b>	<b>\$ 5,614,703</b>	<b>2.16%</b>
<b>Stockholders equity</b>			
Preferred equity	\$ 68,000	\$ 68,000	0.00%
Common equity	233,167	291,461	-20.00%
	<b>\$ 301,167</b>	<b>\$ 359,461</b>	<b>-16.22%</b>
<b>Capital ratios</b>			
Leverage capital	<b>6.80%</b>	<b>6.69%</b>	<b>1.64%</b>
Tier 1 risk-based capital	<b>17.26%</b>	<b>18.59%</b>	<b>-7.15%</b>
Total risk-based capital	<b>17.76%</b>	<b>19.06%</b>	<b>-6.82%</b>
Trust assets managed	\$ 1,936,804	\$ 1,962,226	-1.30%
Broker-dealer assets gathered	1,294,010	1,281,168	1.00%
<b>Assets managed</b>	<b>3,230,814</b>	<b>3,243,394</b>	<b>-0.39%</b>
Assets owned	6,060,179	5,999,855	1.01%
<b>Total financial assets managed and owned</b>	<b>\$ 9,290,993</b>	<b>\$ 9,243,249</b>	<b>0.52%</b>

**OVERVIEW OF FINANCIAL PERFORMANCE****Introduction**

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 pension administration). Although all of these businesses, to varying degrees, are affected by interest rate and financial

markets fluctuations and other external factors, the Group's commitment is to continue producing a balanced and growing revenue stream.

During the second quarter of 2008, the strategies in place enabled the Group to continue to perform well despite the turbulent credit market and the recession in Puerto Rico. Highlights for the second quarter included:

The sixth consecutive quarter of net interest margin improvement, to 1.90% from 1.40% in the year ago quarter and 1.68% in the previous quarter

Significant reduction in cost of funds to 4.01%, down 9.7% from the year ago quarter and down 4.8% from the previous quarter

Growth in loan originations, which totaled \$92.6 million for the second quarter, representing increases of 7.2% from the year ago quarter and 39.8% from the previous quarter, while maintaining high credit quality

A continued year over year increase in profitability even though the Group's total assets are at the same level as at December 31, 2007 and slightly lower than at March 31, 2008

**Table of Contents****Income Available to Common Shareholders**

For the quarter and six-month periods ended June 30, 2008, the Group's income available to common shareholders totaled \$13.2 million and \$28.9 million, respectively, compared to \$5.2 million and \$15.0 million, respectively, in the comparable year-ago quarter and six-month period. Earnings per basic and fully diluted common share were \$0.54 for the quarter ended June 30, 2008, compared to \$0.21 per basic and fully diluted common share in the same year-ago quarter, and \$1.19 for the six-month period ended June 30, 2008, compared to \$0.61 in the year ago period.

**Return on Average Assets and Common Equity**

Return on average common equity (ROE) for the quarter and six-month period ended June 30, 2008, was 20.65% and 20.64%, respectively, up from 7.87% and 11.22%, for the quarter and six-months ended June 30, 2007, respectively. Return on average assets (ROA) for the quarter and six-month period ended June 30, 2008, was 0.95% and 1.01%, respectively, up from 0.49% and 0.70%, for the quarter and six-months ended June 30, 2007, respectively, representing an increase of 93.9% and 44.3% over the same year-ago periods.

**Net Interest Income after Provision for Loan Losses**

Net interest income after provision for loan losses increased 62.2% for the quarter and 73.7% for the six-month period ended June 30, 2008, totaling \$26.5 million and \$49.7 million, respectively, compared with \$16.3 million and \$28.6 million for the same periods last year. The increase of 20.3% and 26.4% in interest income for the quarter and six-month period ended June 30, 2008, totaling \$85.2 million and \$167.3 million, respectively, compared with \$70.8 million and \$132.3 million, respectively, for the same periods last year was mainly due to higher investment securities volumes and higher average yields. Interest expense increased by 6.8% and 12.5% for the quarter and six-month periods ended June 30, 2008, as compared to same periods last year, primarily due to higher average balances in the deposits and borrowings portfolios. Net interest margin for the quarter and six-month periods ended June 30, 2008, was 1.90% and 1.80%, respectively, compared to 1.40% and 1.30%, respectively, for the same periods last year.

**Non-Interest Income**

Total non-interest income was \$6.7 million and \$15.5 million, respectively, for the quarter and six-month period ended June 30, 2008, representing a decrease of 14.7% and of 32.3%, when compared to the corresponding periods ended June 30, 2007. Total banking and financial services revenues of \$6.5 million for the quarter ended June 30, 2008, remained level when compared to the same period a year ago, and amounted to \$14.0 million for the six-month period ended June 30, 2008, an increase of 5.3% from the \$13.3 million for the same period a year ago. Securities, derivatives and trading activities revenues for the quarter and six-month period ended June 30, 2008 amounted to \$458,000 and \$2.1 million, respectively, compared to \$292,000 and \$9.5 million, for the same periods year-ago, mainly due to a gain of \$8.2 million that resulted from the elimination of forecasted transactions on the cash flow hedges of interest rate swaps contracts that were terminated in July and December 2006.

**Non-Interest Expenses**

Non-interest expenses totaled \$18.1 million and \$35.8 million, respectively, for the quarter and six-month period ended June 30, 2008, compared to \$17.5 million and \$33.3 million, respectively, in the year ago periods, primarily as a result of higher insurance, professional fees and compensation expense.

**Income Tax Expense**

The income tax expense (benefit) was \$598,000 and (\$1.9) million, respectively, for the quarter and six-month period ended June 30, 2008, compared to an expense \$187,000 and \$811,000 for the respective periods ended June 30, 2007, mainly due to the expiration of certain tax contingencies and the reassessment of the valuation allowance for the deferred tax asset.

**Group's Financial Assets**

The Group's total financial assets include owned assets and the assets managed by the trust division, the securities broker-dealer subsidiary, and the private pension plan administration subsidiary. At June 30, 2008, total financial assets reached \$9.291 billion, compared to \$9.243 billion at December 31, 2007, a 0.52% increase. When compared to December 31, 2007, there was 1.01% increase in assets owned as of June 30, 2008, while assets managed by the trust division and the broker-dealer subsidiary remained leveled at \$3.2 billion. Owned assets are approximately 95% owned by the Group's banking subsidiary and its IBE subsidiary.



**Table of Contents**

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 Caribbean Pension Consultants, Inc. (CPC) manages the administration of private pension plans. At June 30, 2008, total assets managed by the Group's trust division and CPC amounted to \$1.937 billion, compared to \$1.962 billion at December 31, 2007. 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 June 30, 2008, total assets gathered by the broker-dealer from its customer investment accounts increased to \$1.294 billion, compared to \$1.281 billion at December 31, 2007.

**Interest Earning Assets**

The investment portfolio amounted to \$4.644 billion at June 30, 2008, a 1.27% increase compared to \$4.586 billion at December 31, 2007, while the loan portfolio increased 3.27% to \$1.218 billion at June 30, 2008, compared to \$1.180 billion at December 31, 2007.

The mortgage loan portfolio totaled \$1.034 billion at June 30, 2008, a 1.60% increase from \$1.018 billion at June 30, 2007, and an increase of 3.10%, from \$1.003 billion at December 31, 2007. Mortgage loan production for the six-month period ended June 30, 2008, totaled \$125.3 million, which represents a 7.2% decrease compared to the same period last year. This decrease was due, in part, to a reduction in consumer demand, and the result of tighter underwriting standards adopted by the Group in view of the current economic environment.

**Interest Bearing Liabilities**

Total deposits amounted to \$1.492 billion at June 30, 2008, an increase of 19.74% compared to \$1.246 billion at December 31, 2007, primarily due to increased retail certificate of deposit and savings accounts, and a \$117.4 million increase during the second quarter of 2008 in wholesale certificates of deposit that are used as a more economical and flexible alternative for replacing higher cost deposits and short-term repurchase agreements.

**Stockholders' Equity**

Stockholders' equity at June 30, 2008, was \$301.2 million, compared to \$359.5 million at December 31, 2007, reflecting decreased mark-to-market valuation on the available-for-sale investment securities portfolio, partially offset by a 42.2% increase in retained earnings.

The Group's capital ratios remain above regulatory capital requirements, with risk-based capital ratios significantly above regulatory capital adequacy guidelines. At June 30, 2008, Tier 1 Leverage Capital Ratio was 6.80% (1.7 times the minimum of 4.00%), Tier 1 Risk-Based Capital Ratio was 17.26% (4.3 times the minimum of 4.00%), and Total Risk-Based Capital Ratio was 17.76% (2.2 times the minimum of 8.00%).



**Table of Contents****TABLE 1 QUARTERLY ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE****FOR THE QUARTERS ENDED JUNE 30, 2008 AND 2007***(In thousands)*

	Interest		Variance		Average rate		Average balance		Variance
	2008	2007	in %	2008	2007	Variance in BPS	2008	2007	in %
<b>TAX EQUIVALENT SPREAD</b>									
Interest-earning assets	\$ 85,158	\$70,801	20.3%	5.69%	5.61%	8	\$5,984,658	\$5,046,727	18.6%
Tax equivalent adjustment	28,113	26,920	4.4%	1.88%	2.13%	(25)			
<b>Interest-earning assets tax equivalent</b>	<b>113,271</b>	<b>97,721</b>	<b>15.9%</b>	<b>7.57%</b>	<b>7.74%</b>	<b>(17)</b>	<b>5,984,658</b>	<b>5,046,727</b>	<b>18.6%</b>
Interest-bearing liabilities	56,722	53,111	6.8%	4.01%	4.44%	(43)	5,664,472	4,781,106	18.5%
<b>Tax equivalent net interest income / spread</b>	<b>\$ 56,549</b>	<b>\$44,610</b>	<b>26.8%</b>	<b>3.56%</b>	<b>3.30%</b>	<b>26</b>	<b>\$ 320,186</b>	<b>\$ 265,621</b>	<b>20.5%</b>
<b>Tax equivalent interest rate margin</b>				<b>3.78%</b>	<b>3.53%</b>	<b>25</b>			
<b>NORMAL SPREAD</b>									
<b>Interest-earning assets:</b>									
<b>Investments:</b>									
Investment securities	\$ 64,858	\$47,595	36.3%	5.49%	5.11%	38	\$4,728,682	\$3,727,268	26.9%
Trading securities	4	3	33.3%	5.00%	6.45%	(145)	320	186	72.2%
Money market investments	614	888	-30.9%	5.16%	5.73%	(57)	47,558	61,965	-23.3%
	<b>65,476</b>	<b>48,486</b>	<b>35.0%</b>	<b>5.48%</b>	<b>5.12%</b>	<b>36</b>	<b>4,776,560</b>	<b>3,789,419</b>	<b>26.0%</b>
<b>Loans:</b>									
Mortgage	16,608	16,888	-1.7%	6.47%	6.78%	(31)	1,026,184	995,669	3.1%
Commercial	2,438	4,554	-46.5%	6.26%	7.93%	(167)	155,889	229,750	-32.1%
Consumer	636	873	-27.1%	9.78%	10.95%	(117)	26,025	31,889	-18.4%
	<b>19,682</b>	<b>22,315</b>	<b>-11.8%</b>	<b>6.52%</b>	<b>7.10%</b>	<b>(58)</b>	<b>1,208,098</b>	<b>1,257,308</b>	<b>-3.9%</b>
	<b>85,158</b>	<b>70,801</b>	<b>20.3%</b>	<b>5.69%</b>	<b>5.61%</b>	<b>8</b>	<b>5,984,658</b>	<b>5,046,727</b>	<b>18.6%</b>
<b>Interest-bearing liabilities:</b>									
<b>Deposits:</b>									
Non-interest bearing deposits							37,874	35,827	5.7%
Now accounts	187	206	-9.2%	1.05%	1.19%	(14)	71,306	69,131	3.1%

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Savings	3,313	3,351	-1.1%	3.04%	4.27%	(123)	435,257	314,151	38.6%
Certificates of deposit	8,765	10,044	-12.7%	3.97%	4.66%	(69)	883,467	861,244	2.6%
	<b>12,265</b>	<b>13,601</b>	<b>-9.8%</b>	<b>3.44%</b>	<b>4.25%</b>	<b>(81)</b>	<b>1,427,904</b>	<b>1,280,353</b>	<b>11.5%</b>
<b>Borrowings:</b>									
Repurchase agreements	40,208	36,542	10.0%	4.20%	4.46%	(26)	3,832,251	3,274,576	17.0%
Financing fees		(25)	-100.0%	0.00%	0.00%	0			
Total repurchase agreements	<b>40,208</b>	<b>36,517</b>	<b>10.1%</b>	<b>4.20%</b>	<b>4.46%</b>	<b>(26)</b>	<b>3,832,251</b>	<b>3,274,576</b>	<b>17.0%</b>
FHLB advances	3,507	1,981	77.0%	4.24%	4.57%	(33)	330,559	173,419	90.6%
Subordinated capital notes	534	766	-30.4%	5.91%	8.75%	(284)	36,083	35,000	3.1%
Term notes		6	-100.0%	0.00%	2.19%	(219)		1,108	-100.0%
Other borrowings	209	240	-12.8%	2.22%	5.77%	(355)	37,675	16,650	126.3%
	<b>44,458</b>	<b>39,510</b>	<b>12.5%</b>	<b>4.20%</b>	<b>4.51%</b>	<b>(31)</b>	<b>4,236,568</b>	<b>3,500,753</b>	<b>21.0%</b>
	<b>56,723</b>	<b>53,111</b>	<b>6.8%</b>	<b>4.01%</b>	<b>4.44%</b>	<b>(43)</b>	<b>5,664,472</b>	<b>4,781,106</b>	<b>18.5%</b>
<b>Net interest income / spread</b>	<b>\$ 28,435</b>	<b>\$ 17,690</b>	<b>60.7%</b>	<b>1.68%</b>	<b>1.17%</b>	<b>51</b>			
<b>Interest rate margin</b>				<b>1.90%</b>	<b>1.40%</b>	<b>50</b>			
<b>Excess of average interest-earning assets over average interest-bearing liabilities</b>							<b>\$ 320,186</b>	<b>\$ 265,621</b>	<b>20.5%</b>
<b>Average interest-earning assets over average interest-bearing liabilities ratio</b>							<b>105.65%</b>	<b>105.56%</b>	

**C. Changes in net interest income due to:**

	<b>Volume</b>	<b>Rate</b>	<b>Total</b>
<b>Interest Income:</b>			
Investments	\$ 12,631	\$ 4,358	\$ 16,989
Loans	(873)	(1,759)	(2,632)
	<b>11,758</b>	<b>2,599</b>	<b>14,357</b>
<b>Interest Expense:</b>			
Deposits	1,567	(2,903)	(1,336)
Repurchase agreements	6,219	(2,526)	3,693
Other borrowings	2,357	(1,101)	1,256
	<b>10,143</b>	<b>(6,530)</b>	<b>3,613</b>
<b>Net Interest Income</b>	<b>\$ 1,615</b>	<b>\$ 9,129</b>	<b>\$ 10,744</b>



**Table of Contents****TABLE 1A YEAR-TO-DATE ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE****FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2008 AND 2007***(In thousands)*

	Interest			Average rate			Average balance		
	2008	2007	Variance in %	2008	2007	Variance in BPS	2008	2007	Variance in %
<b>TAX EQUIVALENT SPREAD</b>									
Interest-earning assets	\$ 167,259	\$ 132,300	26.4%	5.65%	5.54%	11	\$ 5,921,928	\$ 4,777,612	24.0%
Non-equivalent adjustment	55,246	50,572	9.2%	1.87%	2.12%	(25)			
Interest-earning assets tax equivalent	<b>222,505</b>	<b>182,872</b>	<b>21.7%</b>	<b>7.52%</b>	<b>7.66%</b>	<b>(14)</b>	<b>5,921,928</b>	<b>4,777,612</b>	<b>24.0%</b>
Interest-bearing liabilities	113,915	101,222	12.5%	4.12%	4.50%	(38)	5,528,851	4,501,685	22.8%
Non-equivalent net interest income / spread	<b>\$ 108,590</b>	<b>\$ 81,650</b>	<b>33.0%</b>	<b>3.40%</b>	<b>3.16%</b>	<b>24</b>	<b>\$ 393,077</b>	<b>\$ 275,927</b>	<b>42.5%</b>
Non-equivalent interest rate margin				<b>3.67%</b>	<b>3.42%</b>	<b>25</b>			
<b>NORMAL SPREAD</b>									
<b>Interest-earning assets:</b>									
<b>Investments:</b>									
Investment securities	\$ 126,273	\$ 87,069	45.0%	5.40%	5.00%	40	\$ 4,680,539	\$ 3,483,777	34.4%
Investment management fees		(290)	-100.0%	0.00%	-0.02%	2			
Total investment securities	126,273	86,779	45.5%	5.40%	4.98%	42	4,680,539	3,483,777	34.4%
Trading securities	9	14	-35.7%	3.99%	4.28%	(29)	451	654	-31.0%
Money market investments	1,467	1,344	9.2%	4.31%	5.76%	(145)	68,060	46,682	45.8%
	<b>127,749</b>	<b>88,137</b>	<b>44.9%</b>	<b>5.38%</b>	<b>4.99%</b>	<b>39</b>	<b>4,749,050</b>	<b>3,531,113</b>	<b>34.5%</b>
<b>Loans:</b>									
Mortgage	32,932	33,215	-0.9%	6.46%	6.77%	(31)	1,019,699	981,416	3.9%
Commercial	5,251	9,156	-42.6%	8.24%	7.90%	34	127,401	231,915	-45.1%
Consumer	1,327	1,792	-25.9%	10.30%	10.81%	(51)	25,778	33,168	-22.3%
	<b>39,510</b>	<b>44,163</b>	<b>-10.5%</b>	<b>6.74%</b>	<b>7.09%</b>	<b>(35)</b>	<b>1,172,878</b>	<b>1,246,499</b>	<b>-5.9%</b>
	<b>167,259</b>	<b>132,300</b>	<b>26.4%</b>	<b>5.65%</b>	<b>5.54%</b>	<b>11</b>	<b>5,921,928</b>	<b>4,777,612</b>	<b>24.0%</b>
<b>Interest-bearing liabilities:</b>									
<b>Deposits:</b>									
Non-interest bearing deposits							36,513	36,266	0.7%
Now accounts	398	409	-2.6%	1.27%	1.16%	11	62,977	70,282	-10.4%
Time deposits	7,701	6,268	22.9%	3.66%	4.18%	(52)	420,841	299,900	40.3%

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Certificates of deposit	16,595	19,172	-13.4%	4.29%	4.56%	(27)	773,648	840,369	-7.9%
	<b>24,694</b>	<b>25,849</b>	<b>-4.5%</b>	<b>3.82%</b>	<b>4.15%</b>	<b>(33)</b>	<b>1,293,979</b>	<b>1,246,817</b>	<b>3.8%</b>
<b>Borrowings:</b>									
Repurchase agreements	80,448	69,636	15.5%	4.20%	4.60%	(40)	3,828,410	3,025,163	26.6%
Interest rate risk management		(773)	-100.0%	0.00%	-0.05%	5			
Financing fees		441	-100.0%	0.00%	0.03%	(3)			
Commercial repurchase agreements	<b>80,448</b>	<b>69,304</b>	<b>16.1%</b>	4.20%	4.58%	(38)	<b>3,828,410</b>	<b>3,025,163</b>	<b>26.6%</b>
Commercial advances	7,046	3,905	80.4%	4.24%	4.60%	(36)	332,402	169,725	95.8%
Coordinated capital notes	1,236	1,524	-18.9%	6.85%	8.58%	(173)	36,083	35,539	1.5%
Commercial notes		195	-100.0%	0.00%	5.12%	(512)		7,044	-100.0%
Other borrowings	491	445	10.3%	2.58%	5.29%	(271)	37,977	17,397	118.3%
	<b>89,221</b>	<b>75,373</b>	<b>18.4%</b>	<b>4.21%</b>	<b>4.63%</b>	<b>(42)</b>	<b>4,234,872</b>	<b>3,254,868</b>	<b>30.1%</b>
	<b>113,915</b>	<b>101,222</b>	<b>12.5%</b>	<b>4.12%</b>	<b>4.50%</b>	<b>(38)</b>	<b>5,528,851</b>	<b>4,501,685</b>	<b>22.8%</b>
Net interest income / spread	\$ 53,344	\$ 31,078	71.6%	1.53%	1.04%	49			
Interest rate margin				1.80%	1.30%	50			

Excess of average interest-earning assets over average interest-bearing liabilities							\$ 393,077	\$ 275,927	42.5%
Average interest-earning assets over average interest-bearing liabilities ratio							107.11%	106.13%	

**C. Changes in net interest income due to:**

	Volume	Rate	Total
<b>Interest Income:</b>			
Investments	\$30,400	\$ 9,213	\$39,613
Loans	(2,609)	(2,045)	(4,654)
	<b>27,791</b>	<b>7,168</b>	<b>34,959</b>
<b>Interest Expense:</b>			
Deposits	978	(2,133)	(1,155)
Repurchase agreements	18,402	(7,258)	11,144
Other borrowings	4,670	(1,966)	2,704
	<b>24,050</b>	<b>(11,357)</b>	<b>12,693</b>
<b>Net Interest Income</b>	<b>\$ 3,741</b>	<b>\$ 18,525</b>	<b>\$22,266</b>

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). Typically, bank liabilities re-price in line with changes in short-term

rates, while many asset positions are affected by longer-term rates. The Group constantly monitors the composition and re-pricing of its assets and liabilities to maintain its net interest income at adequate levels.

-28-

---

**Table of Contents**

For the quarter and six-month period ended June 30, 2008, net interest income amounted to \$28.4 million and \$53.3 million, respectively, an increase of 60.7% and 71.6% from \$17.7 million and \$31.1 million, in the same periods of the previous year. The increase for the quarter and six-month period reflects a 20.3% and 26.4% increase in interest income, due to a positive volume variance \$11.8 million and \$27.8 million, respectively, and a positive rate variance of \$2.6 million and \$7.2 million, respectively. The increase of 6.8% and 12.5% in interest expense for the quarter and six-month period ended June 30, 2008, was primarily the result of an increase of \$10.1 million and \$24.1 million, respectively in interest expense from higher volume of interest-bearing liabilities, offset by reduced rates on such interest-bearing liabilities. Interest rate spread increased 51 basis points to 1.68% for the quarter ended June 30, 2008, from 1.17% in the June 30, 2007 quarter, and 49 basis points to 1.53% for the six-month period ended June 30, 2008 from 1.04% for the year ago period. These increases reflect the full benefits of the actions taken by the Group to reposition the available-for-sale investment securities portfolio and its funding in late 2006 and during 2007. For the quarter and six-month period ended June 30, 2008, the average balances of total interest-earnings assets were \$5.985 billion and \$5.922 billion, an 18.6% and 24.0% increase from the same periods last year. The increase in the quarterly average balance reflects increases of 26.0% to \$4.777 billion in the investment portfolio, partially offset by a decrease of 3.9% to \$1.208 billion in the loans portfolio for the 2008 quarter. The increase in the six-month period average balance reflects increases of 34.5% to \$4.749 billion in the investment portfolio, partially offset by a decrease of 5.9% to \$1.173 billion in the loans portfolio for the 2008 six-month period.

For the quarter and six-month period ended June 30, 2008, the average yield on interest-earning assets was 5.69% and 5.65%, respectively, compared to 5.61% and 5.54% in the same period last year, due to higher average yields in the investment portfolio, offset by lower yields in the loan portfolio. The investment portfolio yield increased to 5.48% and 5.38% in the quarter and six-month period ended June 30, 2008, respectively, versus 5.12% and 4.99%, in the same period last year, respectively, due to additions of higher-yielding investments.

For the quarter and six-month period ended June 30, 2008, interest expense amounted to \$56.7 million and \$113.9 million, respectively, an increase of 6.8% and 12.5%, respectively, from \$53.1 million and \$101.2 million, in the same period last year, mainly resulting from higher volume of interest-bearing liabilities.

For the quarter ended June 30, 2008, the cost of deposits decreased 81 basis points to 3.44%, as compared to the same period a year ago. For the six-month period ended June 30, 2008, the cost of deposits decreased 33 basis points to 3.82%, as compared to the same period a year ago. The decrease reflects lower average rates paid on higher balances, most significantly in savings and certificates of deposit accounts. For the quarter and six-month period ended June 30, 2008, the cost of borrowings decreased 31 basis points and 42 basis points, respectively, to 4.20% and 4.21%, respectively, from the same period last year.

**TABLE 2 NON-INTEREST INCOME SUMMARY:****FOR THE QUARTERS AND SIX-MONTHS PERIODS ENDED JUNE 30, 2008 AND 2007***(In thousands)*

	Quarter ended June 30,			Six-Month period ended June 30,		
	2008	2007	Variance %	2008	2007	Variance %
Financial service revenues	\$ 4,500	\$ 4,049	11.1%	\$ 8,740	\$ 8,892	-1.7%
Banking service revenues	1,395	2,265	-38.4%	2,922	4,139	-29.4%
Investment banking revenues	12		100.0%	750		100.0%
Mortgage banking activities	545	170	220.6%	1,551	232	568.5%
<b>Total banking and financial service revenues</b>	<b>6,452</b>	<b>6,484</b>	<b>-0.5%</b>	<b>13,963</b>	<b>13,263</b>	<b>5.3%</b>

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Securities net activity	198	10	1880.0%	9,512	369	2477.8%
Derivatives net gain (loss)	228	88	159.1%	(7,575)	8,384	-190.4%
Trading net gain (loss)	16	2	700.0%	(1)	2	-150.0%
Income from other investments	16	192	-91.7%	126	701	-82.0%
<b>Securities, derivatives and trading activities</b>	<b>458</b>	<b>292</b>	<b>56.8%</b>	<b>2,062</b>	<b>9,456</b>	<b>-78.2%</b>
Equity in earnings of investment in limited liability partnership		967	100.0%		76	100.0%
Gain (loss) on foreclosed real estate	(260)	30	-966.7%	(510)	67	-861.2%
Other		23	100.0%	(1)	65	-101.5%
<b>Total non-interest income</b>	<b>\$ 6,650</b>	<b>\$ 7,796</b>	<b>-14.7%</b>	<b>\$ 15,514</b>	<b>\$ 22,927</b>	<b>-32.3%</b>

-29-



**Table of Contents**

Non-interest income is affected by the amount of securities, derivatives and trading transactions, the level of trust assets under management, transactions generated by the gathering of financial assets by the securities broker-dealer subsidiary, the level of investment and mortgage banking activities, and the fees generated from loans, deposit accounts, and insurance activities.

Non-interest income totaled \$6.7 million and \$15.5 million in the quarter and six-month periods ended June 30, 2008, a decrease of 14.7% and 32.3% when compared to \$7.8 million and \$22.9 million in the same periods last year.

Decreases in revenues from securities and derivatives activities were partially offset by increases in revenues generated mortgage and investment banking activities.

Financial service revenues, generated from trust, mortgage banking, investment banking, brokerage, and insurance activities is the principal recurring component of non-interest income. For the quarter and six-month periods ended June 30, 2008, revenues from such activities were \$6.5 million and \$14.0 million, an decrease of 0.5% when compared with the quarter last year and an increase of 5.3% compared with June 2007, from the \$6.5 million and \$13.3 million recorded by the Group for the same respective period last year. Financial service revenues increased by 11.1% to \$4.5 million for the quarter and decreased by 1.7% to \$8.7 million for the six-month periods ended June 30, 2008, from \$4.0 million and \$8.9 million in the same corresponding period last year. Revenues from mortgage banking activities for the quarter and six-month periods ended June 30, 2008, were \$545,000 and \$1.6 million, a considerable increase when compared to \$170,000 and \$232,000 for the same period a year ago. Investment banking revenues for the quarter and six-month periods ended June 30, 2008, amounted to \$12,000 and \$750,000.

Banking service revenue, another major component of non-interest income, consists primarily of fees generated by deposit accounts, electronic banking services, and bank service commissions. For the quarter and six-month periods ended June 30, 2008, these revenues were \$1.4 million and \$2.9 million, a decrease of 38.4% and 29.4% from \$2.3 million and \$4.1 million for the same period last year, reflecting reduced consumer banking activity.

For the quarter and six-month periods ended June 30, 2008, gains from securities, derivatives and trading activities were \$458,000 and \$2.1 million, compared to \$292,000 and \$9.5 million for the same period last year. During the six-month period ended June 30, 2008, losses of \$7.6 million were recognized and reflected as Derivatives in the unaudited consolidated statements of income. This was mainly due to an interest-rate swap contract that the Group entered in on January 2008 to manage the Group's interest rate risk exposure with a notional amount of \$500 million. Such contract was subsequently terminated, resulting in a loss to the Group of approximately \$7.9 million. For the six-month period ended June 30, 2007, gains of \$8.4 million were recognized and reflected as Derivatives in the unaudited consolidated statements of income, which included and \$8.2 million gain from the elimination of forecasted transactions on interest rate swaps unwound in 2006.

**Table of Contents****TABLE 3 NON-INTEREST EXPENSES SUMMARY  
FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2008 AND 2007***(In thousands)*

	Quarter Ended June 30,			Six-Month Period Ended June 30,		
	2008	2007	Variance %	2008	2007	Variance %
Compensation and employee benefits	\$ 7,824	\$ 6,916	13.1%	\$ 15,539	\$ 13,661	13.7%
Occupancy and equipment	3,365	3,343	0.7%	6,652	6,337	5.0%
Professional and service fees	2,267	1,984	14.3%	4,147	3,522	17.7%
Advertising and business promotion	836	1,118	-25.2%	1,910	1,911	-0.1%
Loan servicing expenses	339	540	-37.2%	670	1,063	-37.0%
Directors and investor relations expenses	303	769	-60.6%	581	1,300	-55.3%
Taxes, other than payroll and income taxes	607	489	24.1%	1,218	937	30.0%
Electronic banking charges	396	457	-13.3%	814	916	-11.1%
Clearing and wrap fees expenses	313	310	1.0%	607	675	-10.1%
Communications	325	308	5.5%	650	646	0.6%
Insurance	579	211	174.4%	1,181	427	176.6%
Foreclosure expenses	201	338	-40.5%	351	405	-13.3%
Printing, postage, stationery and supplies	245	189	29.6%	522	391	33.5%
Other expenses	480	505	-5.0%	968	1,113	-13.0%
<b>Total non-interest expenses</b>	<b>\$ 18,080</b>	<b>\$ 17,477</b>	<b>3.5%</b>	<b>\$ 35,810</b>	<b>\$ 33,304</b>	<b>7.5%</b>

**Relevant ratios and data:**

Compensation and benefits to non-interest expenses	<b>43.3%</b>	<b>39.6%</b>	<b>43.4%</b>	<b>41.0%</b>
Compensation to total assets (annualized)	<b>0.52%</b>	<b>0.52%</b>	<b>0.51%</b>	<b>0.52%</b>
Average compensation per employee (annualized)	<b>\$ 56.6</b>	<b>\$ 53.6</b>	<b>\$ 56.5</b>	<b>\$ 52.1</b>
Average number of employees	<b>553</b>	<b>516</b>	<b>550</b>	<b>524</b>
Assets owned per average employee	<b>\$ 10,959</b>	<b>\$ 10,253</b>	<b>\$ 11,019</b>	<b>\$ 10,097</b>

Non-interest expenses for the quarter and six-month period ended June 30, 2008, were \$18.1 million and \$35.8 million, representing increases of 3.5% and 7.5%, respectively, when compared to \$17.5 million and \$33.3 million in the same period a year ago, primarily as a result of higher professional fees, insurance expense and compensation expense. The non-interest expense results reflect an efficiency ratio of 51.82% for the quarter ended June 30, 2008, compared to 72.30% in the same quarter last year. For the six-month period ended June 30, 2007, the efficiency ratio was 53.20% compared to 75.11% for the same period last year. The efficiency ratio measures how much of a company's revenue is used to pay operating expenses. The Group computes its efficiency ratio by dividing non-interest expenses by the sum of its net interest income and non-interest income, but excluding gains on sale of

investments securities, derivatives gains or losses 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 \$1.6 million and \$9.7 million for the six-month period ended June 30, 2008 and 2007, respectively.

-31-

---

Table of Contents**TABLE 4 ALLOWANCE FOR LOAN LOSSES SUMMARY  
FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2008 AND 2007***(In thousands)*

	Quarter Ended June 30,		Change in %	Six-Month Period Ended June 30,		Change in %
	2008	2007		2008	2007	
<b>Balance at beginning of period</b>	\$ 11,092	\$ 8,046	37.9%	\$ 10,161	\$ 8,016	26.8%
Provision for loan losses	1,980	1,375	44.0%	3,630	2,450	48.2%
Net credit losses see Table 5	(1,187)	(989)	20.0%	(1,906)	(2,034)	-6.3%
<b>Balance at end of period</b>	<b>\$ 11,885</b>	<b>\$ 8,432</b>	<b>41.0%</b>	<b>\$ 11,885</b>	<b>\$ 8,432</b>	<b>41.0%</b>

**Selected Data and Ratios:**

Outstanding gross loans at June 30,		\$ 1,230,042	\$ 1,280,609	-3.9%
Allowance coverage ratios:				
Total loans		0.97%	0.65%	49.23%
Non-performing loans		17.27%	16.70%	3.41%
Non-mortgage non-performing loans		299.67%	217.30%	37.91%

**TABLE 5 NET CREDIT LOSSES STATISTICS***(In thousands)*

	Quarter Ended June 30,		Change in %	Six-Month Period Ended June 30,		Change in %
	2008	2007		2008	2007	
<b>Mortgage</b>						
Charge-offs	\$ (314)	\$ (480)	-34.6%	\$ (480)	\$ (1,026)	-53.2%
Recoveries						
	<b>(314)</b>	<b>(480)</b>	<b>-34.6%</b>	<b>(480)</b>	<b>(1,026)</b>	<b>-53.2%</b>
<b>Commercial</b>						
Charge-offs	(142)	(14)	914.3%	(142)	(14)	914.3%
Recoveries	1	13	-92.3%	14	22	-36.4%
	<b>(141)</b>	<b>(1)</b>	<b>14000.0%</b>	<b>(128)</b>	<b>8</b>	<b>-1700.0%</b>
<b>Consumer</b>						
Charge-offs	(801)	(611)	31.1%	(1,432)	(1,232)	16.2%
Recoveries	69	103	-33.0%	134	216	-38.0%
	<b>(732)</b>	<b>(508)</b>	<b>44.1%</b>	<b>(1,298)</b>	<b>(1,016)</b>	<b>27.8%</b>
<b>Net credit losses</b>						
Total charge-offs	(1,257)	(1,105)	13.8%	(2,054)	(2,272)	-9.6%
Total recoveries	70	116	-39.7%	148	238	-37.8%

\$	(1,187)	\$	(989)	20.0%	\$	(1,906)	\$	(2,034)	-6.3%
----	---------	----	-------	-------	----	---------	----	---------	-------

**Net credit losses  
(recoveries) to  
average loans  
outstanding (1):**

Mortgage	0.12%	0.19%		0.09%	0.21%
Commercial	0.36%	0.00%		0.20%	-0.01%
Consumer	11.25%	6.37%		10.07%	6.13%
<b>Total</b>	<b>0.39%</b>	<b>0.31%</b>		<b>0.33%</b>	<b>0.33%</b>

**Recoveries to  
charge-offs**

<b>5.57%</b>	<b>10.50%</b>	-47.0%	<b>7.21%</b>	<b>10.48%</b>	-31.2%
--------------	---------------	--------	--------------	---------------	--------

**Average loans:**

Mortgage	\$ 1,026,184	\$ 995,669	3.1%	\$ 1,019,699	\$ 981,416	3.9%
Commercial	155,889	229,750	-32.1%	127,401	231,915	-45.1%
Consumer	26,025	31,889	-18.4%	25,778	33,168	-22.3%
<b>Total</b>	<b>\$ 1,208,098</b>	<b>\$ 1,257,308</b>	<b>-3.9%</b>	<b>\$ 1,172,878</b>	<b>\$ 1,246,499</b>	<b>-5.9%</b>

(1) Annualized  
ratios

**Table of Contents****TABLE 6 ALLOWANCE FOR LOSSES BREAKDOWN  
AS OF JUNE 30, 2008 AND 2007, AND DECEMBER 31, 2007***(In thousands)*

	June 30, 2008	December 31, 2007	Variance %	June 30, 2007
<b>Allowance for loan losses breakdown:</b>				
Mortgage	\$ 6,618	\$ 5,958	11.1%	\$ 4,476
Commercial	2,618	1,838	42.4%	1,953
Consumer	1,967	2,006	-1.9%	1,711
Unallocated allowance	682	359	90.0%	292
	<b>\$ 11,885</b>	<b>\$ 10,161</b>	<b>17.0%</b>	<b>\$ 8,432</b>
<b>Allowance composition:</b>				
Mortgage	55.7%	58.7%		53.1%
Commercial	22.0%	18.1%		23.2%
Consumer	16.6%	19.7%		20.3%
Unallocated allowance	5.7%	3.5%		3.5%
	<b>100.0%</b>	<b>100.0%</b>		<b>100.0%</b>

The provision for loan losses for the quarter and six-month periods ended June 30, 2008, totaled \$1.9 million and \$3.6 million, representing an increase of 44.0% and 48.2% from the \$1.4 million and \$2.5 million reported for the same quarter last year. Based on an analysis of the credit quality and composition of the loan portfolio, the Group determined that the provision for the quarter and six-month period ended June 30, 2008, was adequate in order to maintain the allowance for loan losses at an appropriate level.

Net credit losses for the quarter and six-month periods ended June 30, 2008, increased from \$1.0 million (0.31% of average loans outstanding) in the quarter ended June 30, 2007, to \$1.2 million (0.39%) in the corresponding quarter of 2008, and decreased from \$2.0 million (0.33% average loans outstanding) in the first six months of 2007, to \$1.9 million (0.33%) for the same period of 2008. The decrease was primarily due to a \$546,000 reduction in net credit losses from mortgage loans. Non-performing loans of \$68.8 million at June 30, 2008, were 36.3% higher than the \$50.5 million at June 30, 2007, but only 4.1% higher than the \$66.1 million at December 31, 2007, and 0.5% lower than the \$69.2 million at March 31, 2008, the first sequential quarter reduction in non-performing loans in two years.

The Group maintains an allowance for loan 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 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 loan 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 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, under the provisions of SFAS 114. 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 under the provisions of SFAS No. 5, and loans that are recorded at fair value or at the lower of cost or market. The portfolios of mortgage and consumer loans are considered homogeneous, and are evaluated collectively for impairment. For the commercial loans portfolio, all loans over \$250,000 and over 90-days past due are evaluated for impairment, under the provisions of SFAS 114. At June 30, 2008, the total investment in impaired loans was \$1.6 million, compared to \$1.1 million at December 31, 2007. Impaired loans are measured based on the fair value of collateral method, since all impaired loans during the period were collateral dependant. The Group determined that no specific impairment allowance was required for such loans, as the loan collateral fair value exceeds the loan's book value.

-33-

---

**Table of Contents**

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 delinquency-based calculation is the starting point for management's determination of the required level of the allowance for loan losses. Other data considered in this determination includes overall historical loss trends and other information, including underwriting standards, economic trends and unusual events.

Loan loss ratios and credit risk categories are updated quarterly and are applied in the context of GAAP and the Joint Interagency Guidance on the importance of depository institutions having 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.

An unallocated allowance is established recognizing the estimation risk associated with the rating system and with the specific allowances. It is based upon management's evaluation of various conditions, the effects of which are not directly measured in determining the rating system and the specific allowances. These conditions include then-existing general economic and business conditions affecting our key lending areas; credit quality trends, including trends in non-performing loans expected to result from existing conditions, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, recent loss experience in particular segments of the portfolio, regulatory examination results, and findings by the Group's management. The evaluation of the inherent loss regarding these conditions involves a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments.



**Table of Contents****FINANCIAL CONDITION****TABLE 7 BANK ASSETS SUMMARY AND COMPOSITION****AS OF JUNE 30, 2008 AND 2007, AND DECEMBER 31, 2007***(In thousands)*

	June 30, 2008	December 31, 2007	Variance %	June 30, 2007
<b>Investments:</b>				
Mortgage-backed securities	\$ 3,401,693	\$ 2,602,766	30.7%	\$ 1,910,348
U.S. Government and agency obligations	982,496	1,698,748	-42.2%	1,618,549
P.R. Government and agency obligations	72,232	72,667	-0.6%	100,070
Other Securities	165,344	189,109	-12.6%	42,482
FHLB stock	22,062	20,658	6.8%	13,908
Other Investments	150	1,662	-91.0%	31,770
	<b>4,643,977</b>	<b>4,585,610</b>	<b>1.27%</b>	<b>3,717,127</b>
<b>Loans:</b>				
Loans receivable	<b>1,187,920</b>	<b>1,173,055</b>	<b>1.3%</b>	<b>1,214,577</b>
Allowance for loan losses	(11,885)	(10,161)	17.0%	(8,432)
<b>Loans receivable, net</b>	<b>1,176,035</b>	<b>1,162,894</b>	<b>1.1%</b>	<b>1,206,145</b>
Mortgage loans held-for-sale	42,122	16,672	152.7%	66,032
<b>Total loans receivable, net</b>	<b>1,218,157</b>	<b>1,179,566</b>	<b>3.3%</b>	<b>1,272,177</b>
<b>Securities sold but not yet delivered</b>			0.0%	46,461
<b>Total securities and loans</b>	<b>5,862,134</b>	<b>5,765,176</b>	<b>1.7%</b>	<b>5,035,765</b>
<b>Other assets:</b>				
Cash and due from banks	56,486	88,983	-36.5%	91,418
Accrued interest receivable	42,842	52,315	-18.1%	45,807
Premises and equipment, net	21,378	21,779	-1.8%	19,390
Deferred tax asset, net	17,249	10,362	66.5%	18,005
Foreclosed real estate, net	4,906	4,207	16.6%	4,971
Investment in equity indexed options	27,641	40,709	-32.1%	43,358
Other assets	27,543	16,324	68.7%	31,935
<b>Total other assets</b>	<b>198,045</b>	<b>234,679</b>	<b>-15.6%</b>	<b>254,884</b>
<b>Total assets</b>	<b>\$ 6,060,179</b>	<b>\$ 5,999,855</b>	<b>1.0%</b>	<b>\$ 5,290,649</b>

**Investments portfolio composition:**

Mortgage-backed securities	73.3%	56.8%	51.4%
U.S. Government securities	21.2%	37.0%	43.5%
P.R. Government securities	1.6%	1.6%	2.7%
FHLB stock and other investments	4.0%	4.6%	2.4%
	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

At June 30, 2008, the Group's total assets amounted to \$6.060 billion, an increase of 1.0%, when compared to \$6.0 billion at December 31, 2007. Interest-earning assets were \$5.862 billion at June 30, 2008, a 1.7% increase compared to \$5.765 billion at December 31, 2007.

Investments principally consist of U.S. government and agency obligations, mortgage-backed securities, collateralized mortgage obligations, and Puerto Rico government bonds. At June 30, 2008, the investment portfolio increased 1.27% to \$4.644 billion, from \$4.586 billion at December 31, 2007. For further details regarding the Group's investment securities, refer to Note 2 of the unaudited consolidated financial statements.

At June 30, 2008, the Group's loan portfolio, the second largest category of the Group's interest-earning assets, amounted to \$1.218 billion, an increase of 3.3% when compared to \$1.180 billion at December 31, 2007. The Group's loan portfolio is mainly comprised of residential loans, home equity loans, and commercial loans collateralized by mortgages on real estate located in Puerto Rico. Loan production and purchases for the quarter and six-month periods ended June 30, 2008, increased 7.2% and 0.1%, respectively, to \$92.6 million and \$158.9 million, compared to the quarter and six-month period ended June 30, 2007.

Table of Contents

**TABLE 8 NON-PERFORMING ASSETS**  
**AS OF JUNE 30, 2008 AND 2007, AND DECEMBER 31, 2007**  
*(In thousands)*

	June 30, 2008	December 31, 2007	Variance %	June 30, 2007
<b>Non-performing assets:</b>				
Non-accruing loans	\$ 30,440	\$ 27,347	11.3%	\$ 19,902
Accruing loans	38,393	38,762	-1.0%	30,598
Total non-performing loans	68,833	66,109	4.1%	50,500
Foreclosed real estate	4,906	4,207	16.6%	4,971
<b>Total non-performing assets</b>	<b>\$ 73,739</b>	<b>\$ 70,316</b>	<b>4.9%</b>	<b>\$ 55,471</b>
<b>Non-performing assets to total assets</b>	<b>1.22%</b>	<b>1.17%</b>		<b>1.05%</b>

**TABLE 9 NON-PERFORMING LOANS**  
**AS OF JUNE 30, 2008 AND 2007, AND DECEMBER 31, 2007**  
*(In thousands)*

	June 30, 2008	December 31, 2007	Variance %	June 30, 2007
<b>Non-performing loans:</b>				
Mortgage	\$ 64,867	\$ 62,878	3.2%	\$ 46,626
Commercial, mainly secured by real estate	3,026	2,413	25.4%	3,204
Consumer	940	818	14.9%	670
<b>Total</b>	<b>\$ 68,833</b>	<b>\$ 66,109</b>	<b>4.1%</b>	<b>\$ 50,500</b>
<b>Non-performing loans composition:</b>				
Mortgage	94.2%	95.1%		92.3%
Commercial, mainly secured by real estate	4.4%	3.7%		6.3%
Consumer	1.4%	1.2%		1.3%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>		<b>100.00%</b>
<b>Non-performing loans to:</b>				
Total loans	<b>5.60%</b>	<b>5.56%</b>	<b>0.72%</b>	<b>3.94%</b>
Total assets	<b>1.14%</b>	<b>1.10%</b>	<b>3.6%</b>	<b>0.95%</b>

During the second quarter of 2008, the Group observed the first sequential quarter reduction in non-performing loans in two years, from \$69.2 million at March 31, 2008, to \$68.8 million at June 30, 2008.

At June 30, 2008, the allowance for loan losses to non-performing loans coverage ratio was 17.27%. Detailed information concerning each of the items that comprise non-performing assets follows:

**Mortgage loans** are placed on a non-accrual basis when they become 365 days or more past due and are written-down, if necessary, based on the specific evaluation of the collateral underlying the loan. At June 30, 2008, the Group's non-performing mortgage loans totaled \$64.9 million (94.2% of the Group's non-performing loans), a 3.2% increase from the \$62.9 million (95.1% of the Group's non-performing loans) reported at December 31, 2007. Non-performing loans in this category are primarily residential mortgage loans.

**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 June 30, 2008, the Group's non-performing commercial loans amounted to \$3.0 million (4.4% of the Group's non-performing loans), a 25.4% increase when compared to non-performing commercial loans of \$2.4 million reported at December 31, 2007 (3.7% of the Group's non-performing loans). Most of this portfolio is collateralized by commercial real estate properties.

**Consumer loans** are placed on non-accrual status when they become 90 days past due and written-off when payments are delinquent 120 days in personal loans and 180 days in credit cards and personal lines of credit. At June 30, 2008, the Group's non-performing consumer loans amounted to \$940,000 (1.4% of the Group's total non-performing loans), an increase from the \$818,000 reported at December 31, 2007 (1.2% of total non-performing loans).

**Table of Contents**

**Foreclosed real estate** is initially recorded at the lower of the related loan balance or fair value at the date of foreclosure. Any excess of the loan balance over the fair value of the property is charged against the allowance for loan losses. Subsequently, any excess of the carrying value over the estimated fair value less disposition cost is charged to operations. Proceeds from sales of foreclosed real estate properties during the quarter ended June 30, 2008, totaled approximately \$1.5 million.

At June 30, 2008, the Group's total liabilities were \$5.759 billion, 2.1% higher than the \$5.640 billion reported at December 31, 2007. Deposits and borrowings, the Group's funding sources, amounted to \$5.713 billion at June 30, 2008, an increase of 3.8% when compared to \$5.503 billion reported at December 31, 2007. At June 30, 2008, borrowings represented 73.9% of interest-bearing liabilities and deposits represented 26.1%, versus 77.4% and 22.6%, respectively, at December 31, 2007.

The FHLB system functions as a source of credit to financial institutions that are members of a regional Federal Home Loan Bank. As a member of the 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 mortgages and investment securities. FHLB advances, including accrued interest, totaled \$331.9 million at June 30, 2008, and December 31, 2007. The Group has the capacity to expand FHLB funding up to a maximum of \$500.0 million based on the assets pledged by the Group on the FHLB.

At June 30, 2008, deposits reached \$1.492 billion, up 19.7%, compared to the \$1.246 billion reported at December 31, 2007. The increase in deposits was driven by savings accounts, which totaled \$407.9 million at June 30, 2008, up 5.2% when compared to the \$387.8 million reported at December 31, 2007, and also by certificates of deposit, which increased \$219.6 million during the quarter ended June 30, 2008, from \$736.2 million at December 31, 2007, to \$955.8 million.

**Table of Contents****TABLE 10 LIABILITIES SUMMARY AND COMPOSITION  
AS OF JUNE 30, 2008 AND 2007, AND DECEMBER 31, 2007***(In thousands)*

	June 30, 2008	December 31, 2007	Variance %	June 30, 2007
<b>Deposits:</b>				
Non-interest bearing deposits	\$ 55,936	\$ 50,149	11.5%	\$ 44,867
Now accounts	68,195	68,994	-1.2%	66,819
Savings accounts	407,907	387,788	5.2%	326,124
Certificates of deposit	955,790	736,186	29.8%	885,184
	<b>1,487,828</b>	<b>1,243,117</b>	<b>19.7%</b>	<b>1,322,994</b>
Accrued interest payable	4,591	3,303	39.0%	6,668
	<b>1,492,419</b>	<b>1,246,420</b>	<b>19.7%</b>	<b>1,329,662</b>
<b>Borrowings:</b>				
Repurchase agreements	3,810,752	3,861,411	-1.3%	3,283,796
Advances from FHLB	331,895	331,898	0.0%	180,895
Subordinated capital notes	36,083	36,083	0.0%	36,083
Federal funds purchased and other short term borrowings	41,583	27,460	51.4%	24,641
	<b>4,220,313</b>	<b>4,256,852</b>	<b>-0.9%</b>	<b>3,525,415</b>
<b>Total deposits and borrowings</b>	<b>5,712,732</b>	<b>5,503,272</b>	<b>3.8%</b>	<b>4,855,077</b>
Securities purchased but not yet received	23,103	111,431	-79.3%	100,067
Other liabilities	23,177	25,691	-9.8%	22,030
<b>Total liabilities</b>	<b>\$ 5,759,012</b>	<b>\$ 5,640,394</b>	<b>2.1%</b>	<b>\$ 4,977,174</b>
<b>Deposits portfolio composition percentages:</b>				
Non-interest bearing deposits	3.8%	4.0%		3.4%
Now accounts	4.6%	5.6%		5.1%
Savings accounts	27.4%	31.2%		24.7%
Certificates of deposit	64.2%	59.2%		66.9%
	<b>100.0%</b>	<b>100.0%</b>		<b>100.0%</b>
<b>Borrowings portfolio composition percentages:</b>				
Repurchase agreements	90.3%	90.7%		93.2%

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Advances from FHLB	7.9%	7.8%	5.1%
Subordinated capital notes	0.8%	0.8%	1.0%
Federal funds purchased and other short term borrowings	1.0%	0.7%	0.7%
	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

**Repurchase agreements**

Amount outstanding at quarter-end	\$ 3,810,752	\$ 3,861,411	\$ 3,283,796
Daily average outstanding balance	\$ 3,828,410	\$ 3,154,369	\$ 3,287,489
Maximum outstanding balance at any month-end	\$ 3,847,633	\$ 3,861,411	\$ 3,319,688

**Stockholders Equity**

At June 30, 2008, the Group's total stockholders' equity was \$301.2 million, a 16.2% decrease when compared to \$359.5 million at December 31, 2007. The change reflects a reduction in the fair value of the available-for-sale investment securities portfolio, primarily due to the widening of credit spreads in the second quarter of 2008. The Group's capital ratios remain above regulatory capital requirements. At June 30, 2008, the Tier 1 Leverage Capital Ratio was 6.80%, the Tier 1 Risk-Based Capital Ratio was 17.26%, and the Total Risk-Based Capital Ratio was 17.76%.

The Bank is considered well-capitalized under the regulatory framework for prompt corrective action if it meets or exceeds a Tier I Risk-Based Capital Ratio of 6%, a Total Risk-Based Capital Ratio of 10% and a Leverage Capital Ratio of 5%. In addition, the Group and the Bank meet the following minimum capital requirements: a Tier I Risk-Based Capital Ratio of 4%, a Total Risk-Based Capital Ratio of 8% and a Tier 1 Leverage Capital Ratio of 4%. As shown in Table 11, the Group exceeds these benchmarks due to the high level of capital and the quality and conservative nature of its assets.

Under the regulatory framework for prompt corrective action, banks that meet or exceed a Tier I Capital Risk-Based ratio of 6%, a Total Capital Risk-Based Ratio of 10% and a Leverage Ratio of 5% are considered well capitalized. The Bank exceeds those regulatory capital requirements.

**Table of Contents**

The following are the consolidated capital ratios of the Group at June 30, 2008 and 2007, and December 31, 2007:

**TABLE 11 CAPITAL, DIVIDENDS AND STOCK DATA  
AS OF JUNE 30, 2008 AND 2007, AND DECEMBER 31, 2007**

(In thousands, except per share data)

	June 30, 2008	December 31, 2007	Variance %	June 30, 2007
<b>Capital data:</b>				
Stockholders equity	\$ 301,167	\$ 359,461	-16.2%	\$ 313,475
<b>Regulatory Capital Ratios data:</b>				
Leverage Capital Ratio	6.80%	6.69%	1.6%	7.23%
Minimum Leverage Capital Ratio Required	4.00%	4.00%		4.00%
Actual Tier 1 Capital	\$ 413,767	\$ 396,309	4.4%	\$ 381,489
Minimum Tier 1 Capital Required	\$ 243,414	\$ 236,847	2.8%	\$ 210,972
Tier 1 Risk-Based Capital Ratio	17.26%	18.59%	-7.2%	19.32%
Minimum Tier 1 Risk-Based Capital Ratio Required	4.00%	4.00%		4.00%
Actual Tier 1 Risk-Based Capital	\$ 413,767	\$ 396,309	4.4%	\$ 381,489
Minimum Tier 1 Risk-Based Capital Required	\$ 95,867	\$ 85,292	12.4%	\$ 78,970
Total Risk-Based Capital Ratio	17.76%	19.06%	-6.8%	19.75%
Minimum Total Risk-Based Capital Ratio Required	8.00%	8.00%		8.00%
Actual Total Risk-Based Capital	\$ 425,652	\$ 406,470	4.7%	\$ 389,921
Minimum Total Risk-Based Capital Required	\$ 191,735	\$ 170,583	12.4%	\$ 157,940
<b>Stock data:</b>				
Outstanding common shares, net of treasury	24,292	24,121	0.7%	24,520
Book value	\$ 9.60	\$ 12.08	-20.5%	\$ 9.99
Market price at end of period	\$ 14.26	\$ 13.41	6.3%	\$ 10.91



Market capitalization	\$ 346,404	\$ 323,463	7.1%	\$ 267,517
-----------------------	------------	------------	------	------------

	<b>June 30, 2008</b>	<b>June 30, 2007</b>	<b>Variance %</b>
<b>Common dividend data:</b>			
Cash dividends declared	\$ 6,804	\$ 6,861	-0.8%
Cash dividends declared per share	\$ 0.28	\$ 0.28	0.0%
Payout ratio	23.53%	45.90%	-48.7%
Dividend yield	3.06%	4.62%	-33.8%

The following provides the high and low prices and dividend per share of the Group's stock for each quarter of the last three years. Common stock prices and cash dividend per share were adjusted to give retroactive effect to the stock dividend declared on the Group's common stock.

**Table of Contents**

Quarter ended	Price		Cash Dividend per share
	High	Low	
<b>2008</b>			
June 30, 2008	20.57	14.26	0.14
March 31, 2008	23.28	12.79	0.14
<b>2007</b>			
December 31, 2007	14.70	11.12	0.14
September 30, 2007	11.63	8.57	0.14
June 30, 2007	12.42	10.81	0.14
March 31, 2007	14.04	11.65	0.14
<b>2006</b>			
December 31, 2006	13.57	11.47	0.14
September 30, 2006	12.86	11.82	0.14
June 30, 2006	13.99	11.96	0.14
March 31, 2006	14.46	12.41	0.14

At June 30, 2008 and December 31, 2007, the Bank was considered well capitalized under the FDIC regulatory framework for prompt corrective action. To be classified as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios set forth in the following table:

<i>(In thousands)</i>	June 30, 2008	December 31, 2007	Variance %	June 30, 2007
<b>Oriental Bank and Trust Regulatory Capital Ratios:</b>				
Total Tier 1 Capital to Total Assets	5.83%	5.80%	0.5%	5.85%
Actual Tier 1 Capital	\$ 335,433	\$ 331,552	1.2%	\$ 302,160
Minimum Capital Requirement (4%)	\$ 230,318	\$ 228,768	0.7%	\$ 206,615
Minimum to be well capitalized (5%)	\$ 287,897	\$ 285,960	0.7%	\$ 258,269

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Tier 1 Capital to Risk-Weighted Average	15.98%	16.61%	-3.8%	15.52%
Actual Tier 1 Risk-Based Capital	\$ 335,433	\$ 331,552	1.2%	\$ 302,160
Minimum Capital Requirement (4%)	\$ 83,946	\$ 79,829	5.2%	\$ 77,900
Minimum to be well capitalized (6%)	\$ 125,920	\$ 119,743	5.2%	\$ 116,850
Total Capital to Risk-Weighted assets	16.55%	17.12%	-3.3%	15.95%
Actual Total Risk-Based Capital	\$ 347,318	\$ 341,713	1.6%	\$ 310,592
Minimum Capital Requirement (8%)	\$ 167,893	\$ 159,657	5.2%	\$ 155,800
Minimum to be well capitalized (10%)	\$ 209,866	\$ 199,572	5.2%	\$ 194,750

The Group's common stock is traded on the New York Stock Exchange (NYSE) under the symbol OFG. At June 30, 2008, the Group's market capitalization for its outstanding common stock was \$346.4 million (\$14.26 per share). On April 25, 2007, the Board of Directors adopted the Oriental Financial Group Inc. 2007 Omnibus Performance Incentive Plan (the Omnibus Plan), which was subsequently approved at the June 27, 2007 annual meeting of stockholders. 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. Refer to Note 1 of the accompanying unaudited consolidated financial statements for additional information regarding the Omnibus Plan.

-40-

**Table of Contents**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK  
RISK MANAGEMENT**

***Background***

The Group's risk management policies are established by the Board, implemented by management through the adoption of a risk management program overseen and monitored by the Chief Risk Officer and the Risk Management Committee (RMC). 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 risks exposure 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 (See Interest Rate Risk below).

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 Board approved policies. The Board has delegated the management of this risk to the Asset and Liability Management Committee (ALCO) which is composed of certain executive officers from the Group's 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 the policies adopted by the Board.

***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 is responsible for monitoring compliance with the market risk policies approved by the Board and adopting interest risk management strategies. In that role, 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 caps, and any tax or regulatory issues which may be pertinent to these areas. ALCO approves funding decisions in light of the Group's overall growth strategies and objectives.

Each month, the Group performs a net interest income simulation analysis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a one to three-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 the Group's static balance sheet as of the simulation date, and

(2) using a growing balance sheet based on recent growth patterns and 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 cost, 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 an asset-liability management software 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



**Table of Contents**

sensitivity of net interest income to changes in market interest rates. The following table presents the results of the simulations at June 30, 2008, assuming a one-year time horizon:

Change in interest rate (In thousands)	Net Interest Income Risk (one year projection)			
	Static Balance Sheet		Growing simulation	
	Amount Change	Percent Change	Amount Change	Percent Change
+ 200 Basis points	\$ (20,070)	-17.45%	\$ (14,020)	-11.96%
+ 100 Basis points	\$ (7,823)	-6.80%	\$ (5,323)	-4.54%
- 100 Basis points	\$ 771	0.67%	\$ 781	0.67%
- 200 Basis points	\$ (3,431)	-2.98%	\$ (5,539)	-4.72%

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 repricing frequency of the liabilities has been extended to longer terms. The concentration of long-term fixed rate securities has also been reduced.

The Group uses derivative instruments and other strategies to manage its exposure to interest rate risk caused by changes in interest rates beyond management's control. The following summarizes strategies, including derivative activities, used by the Group in managing interest rate risk:

**Interest rate swaps** Interest rate swap agreements generally involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal. The interest rate swaps have been utilized to convert short term repurchase agreements into fix rate to better match the repricing nature of these borrowings. There were no outstanding interest rate swaps at June 30, 2008, or December 31, 2007.

**Structured borrowings** The Group uses structured repurchase agreements and advances from the FHLB, with embedded call options, to reduce the Group's exposure to interest rate risk by lengthening the contractual maturities of its liabilities, while keeping funding costs low. For further details regarding the Group's structured borrowings, refer to Note 6 of the unaudited consolidated financial statements.

The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market 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 those indexes. Under the terms of the option agreements, the Group receives the average increase in the month-end value of the corresponding 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.

Derivatives instruments are generally negotiated over-the-counter (OTC) contracts. Negotiated OTC derivatives are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amount, exercise price and maturity.

At June 30, 2008, and December 31, 2007, the fair value the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of \$27.6 million and \$40.7 million, respectively; and the options sold to customers embedded in the certificates of deposit and recorded as deposits in the unaudited consolidated statement of financial condition, represented a liability of \$26.2 million and \$38.8 million, respectively.

**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. (Refer to the Allowance for Loan Losses and Non-Performing Assets section for further details.)

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.

-42-

---

**Table of Contents**

The Group may also encounter risk of default in relation to its securities portfolio. The securities held by the Group are principally mortgage-backed securities and U.S. Treasury and agency 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, and are deemed to be of the highest credit quality. At June 30, 2008, mortgage-backed securities include approximately \$710.0 million in non-agency collateralized mortgage obligations with unrealized losses of \$53.4 million in the Group's available-for-sale investment securities portfolio. These obligations are collateralized by pools of mortgage loans originated in the U.S., and are senior classes having subordination of losses ranging from 4.7% to 16.6%, which provide the capacity to absorb estimated collateral losses. These issues, including one that is backed by Alternative-A (Alt-A) loan collateral originated in 2006, are rated AAA by Standard & Poor's and Aaa by Moody's.

The unrealized loss position is a reflection of the recent dislocations seen in the financial and credit markets, which have created a significant widening in the market's credit spreads. The underlying reference long portfolios (collateral) on the structures are substantively investment grade, they have performed adequately, there have been no defaults to date, and none of our structured credit investments have been downgraded.

Management's 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.

**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 Group's cash requirements principally consist of deposit withdrawals, contractual loan funding, repayment of borrowings as they mature, and funding of new and existing investment as required.

Effective liquidity management requires that the Group have sufficient cash available at all times to meet its financial commitments, finance planned growth and have a reasonable safety margin for normal as well as unexpected cash needs. ALCO is responsible for managing the Group's liquidity risk in accordance with the policies adopted by the Board. In discharging its liquidity risk management obligations, ALCO approves operating and contingency procedures and monitors their implementation. The Group's Treasurer and CIO is responsible for the implementation of the liquidity risk management policies adopted by the Board and the operating and contingency procedures adopted by ALCO, and for monitoring the Group's liquidity position on an ongoing basis. Using measures of liquidity developed by the Group's Treasury Division under several different scenarios, the Treasury Division, ALCO and the Board review the Group's liquidity position on a daily, monthly and quarterly basis, respectively.

The Group meets its liquidity management objectives by maintaining (i) liquid assets in the form of investment securities, (ii) sufficient unused borrowing capacity in the national money markets, and achieving (iii) consistent growth in core deposits. At June 30, 2008, the Group had approximately \$245.3 million in investments available to cover liquidity needs. Additional asset-driven liquidity is provided by the availability of loan assets to pledge. These sources, in addition to the Group's 6.80% average equity capital base, provide a stable funding base.

The Group utilizes different sources of funding to help ensure that adequate levels of liquidity are available when needed. Diversification of funding sources is of great importance as it protects the Group's liquidity from market disruptions. The principal sources of short-term funds are deposits, securities sold under agreements to repurchase, and lines of credit with the FHLB. ALCO reviews credit availability on a regular basis. The Group securitizes and sells mortgage loans as supplemental source of funding. Long-term certificates of deposit as well as long-term funding through the issuance of notes have also provided additional funding. The cost of these different alternatives, among other things, is taken into consideration. The Group's principal uses of funds are the origination of loans and the repayment of maturing deposit accounts and borrowings.

**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.

-43-

---

**Table of Contents**

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 the office of the General Counsel, 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 RMC.

The Group is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has significantly increased 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 Senior Compliance Officer who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of an enterprise-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.

Puerto Rico is currently in a general economic slowdown that has caused a reduction in private sector employment and consumer spending. These economic concerns and uncertainties in the private and public sectors have had an adverse effect in the credit quality of our loan portfolios as delinquency rates have increased in the short-term and may continue to increase until the economy stabilizes. The reduction in consumer spending may continue to impact growth in our other interest and non-interest revenue sources.

**Item 4. CONTROLS AND PROCEDURES****Disclosure Controls and Procedures**

As of the end of the period covered by this quarterly report on Form 10-Q, 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 (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon such evaluation, the CEO and the CFO have concluded that, as of the end of such period, the Group's disclosure controls and procedures are effective 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 Exchange Act.

**Internal Control over Financial Reporting**

There were no changes in the Group's internal control over financial reporting (as such term is defined on rules 13a-15(e) and 15d-15(e) under the Exchange Act) during the quarter ended June 30, 2008.

**PART II OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS**

On August 11, 2000, the Group filed a lawsuit in the United States District Court for the District of Puerto Rico (the Court ) against Federal Insurance Company, Inc. ( FIC ) for breach of insurance contract, breach of covenant of good faith and fair dealing and damages. On October 3, 2005, a jury rendered a verdict of \$7.5 million in favor of the Group (the 2005 Verdict ). The jury could not reach a decision on a portion of the Group's claim, thus forcing a new trial. After retrial of that portion of the Group's claim, on August 14, 2007, a jury rendered a verdict in favor of FIC and against the Group (the 2007 Verdict ). Judgment pursuant to the aforementioned 2005 and 2007 verdicts was entered on August 15, 2007. By an Opinion and Order dated July 31, 2008, the Court set aside the portion of the 2005 Verdict granting the Group consequential damages in the amount of \$7,078,640.60, and reaffirmed the 2007 Verdict. The Court upheld the award of \$453,000 to the Group under the 2005 Verdict. The Group is considering its options with respect to the Court's decisions described above.

The Group has not recognized any income on these claims since several post-trial motions have not been ruled upon yet and appellate rights have not been exhausted. Thus, the amount to be collected cannot be determined at this time. In addition, 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

-44-

---

**Table of Contents**

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.

**Item 1A. RISK FACTORS**

There have been no material changes to the risk factors as previously disclosed under Item 1A to Part 1 of the Group's annual report on Form 10-K for the fiscal year ended December 31, 2007.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

a) None

b) Not applicable

c) Purchases of equity securities by the issuer and affiliated purchasers.

On July 27 2007, the Board approved a new stock repurchase program pursuant to which the Group is authorized to purchase in the open market up to \$15.0 million of its outstanding share of common stock. The program was announced on July 31, 2007. The shares of common stock so repurchased are to be held by the Group as treasury shares. The new program will substitute the previous program approved on August 30, 2005.

There were no purchases of equity securities under this repurchase program during the quarter ended June 30 2008. The approximate dollar value of shares that may yet be repurchased under the plan amounted to \$11.3 million at June 30, 2008.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS**

The annual meeting of stockholders of the Group was held on June 18, 2008, for (i) the election of three directors for a three-year term expiring at the 2011 annual meeting of shareholders and until their successors are duly elected and qualified; (ii) to consider and approve an amendment to the Oriental Financial Group Inc. 2007 Omnibus Performance Incentive Plan to include a minimum one-year performance period for awards of performance shares and performance units, and a minimum three-year restriction period for awards of restricted stock and restricted units, and (iii) to ratify the selection of KPMG LLP as our independent auditors for the fiscal year ending December 31, 2008. There was no solicitation in opposition to the Board's nominees, which were all elected, the amendment to the Omnibus Plan was approved, and KMPG LLP was ratified. The voting results were as follows:

-45-

---

**Table of Contents**

	<b>For</b>		<b>Withheld</b>	
	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>
<b>Proposal 1-Election of Directors</b>				
<b>Three-year term</b>				
Juan C. Aguayo	19,118,839	94.9%	1,029,205	5.1%
Pablo I. Altieri	19,008,963	94.3%	1,139,081	5.7%
Francisco Arriví	19,087,217	94.7%	1,060,827	5.3%

	<b>For</b>		<b>Against</b>		<b>Abstain</b>		<b>Broker Non-Vote</b>	
	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>
<b>Proposal</b>								
<b>2-Approval of amendment to the Omnibus Plan</b>								
	14,523,306	72.1%	577,220	2.9%	351,804	1.7%	4,695,714	23.3%

	<b>For</b>		<b>Against</b>		<b>Abstain</b>	
	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>
<b>Proposal 3-Ratification of selection of independent auditors</b>						
	19,197,536	95.3%	458,359	2.3%	492,148	2.4%

**Item 5. OTHER INFORMATION**

a) None

b) None

**Item 6. EXHIBITS**

- 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.

**Table of Contents**

**Signatures**

Pursuant to the requirements 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.**  
**(Registrant)**

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

Dated: August 8, 2008

By: /s/ Norberto González  
Norberto González  
Executive Vice President and Chief Financial Officer

Dated: August 8, 2008

-47-