

ORIENTAL FINANCIAL GROUP INC

Form 10-K

March 11, 2010

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

**Form 10-K**

- þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended December 31, 2009,**
- or**
- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Transition Period from        to        .**

**Commission File No. 001-12647**

**ORIENTAL FINANCIAL GROUP INC.**  
*Incorporated in the Commonwealth of Puerto Rico*

**IRS Employer Identification No. 66-0538893**

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

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

**Common Stock**

**(\$1.00 par value per share)**

**7.125% Noncumulative Monthly Income Preferred Stock, Series A  
(\$1.00 par value per share, \$25.00 liquidation preference per share)**

**7.0% Noncumulative Monthly Income Preferred Stock, Series B  
(\$1.00 par value per share, \$25.00 liquidation preference per share)**

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

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

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

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  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

The aggregate market value of the common stock held by non-affiliates of Oriental Financial Group Inc. (the Group) was \$235.0 million based upon the reported closing price of \$9.70 on the New York Stock Exchange as of June 30, 2009.

As of February 28, 2010, the Group had 24,179,686 shares of common stock outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Group's annual report to shareholders for the year 2009 are incorporated herein by reference in response to Items 5 through 9A of Part II and Item 15(a)(1) of Part IV.

Portions of the Group's definitive proxy statement relating to the 2009 annual meeting of shareholders are incorporated herein by reference in response to Items 10 through 14 of Part III.

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**ORIENTAL FINANCIAL GROUP INC.**

**FORM 10-K**

**For the Year Ended December 31, 2009**

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**FORWARD-LOOKING STATEMENTS**

When used in this Form 10-K 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 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.

**PART I**

**ITEM 1. BUSINESS**

**General**

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

The Group provides comprehensive financial services to its clients through a complete range of banking and financial solutions, including mortgage, commercial and consumer lending; checking and savings accounts; financial planning, insurance, wealth management, and investment brokerage; and corporate and individual trust and retirement services. The Group operates through three major business segments: Banking, Financial Services, and Treasury, and distinguishes itself based on quality service and marketing efforts focused on mid and high net worth individuals and families, including professionals and owners of small and mid-sized businesses, primarily in Puerto Rico. The Group has 21 financial centers in Puerto Rico and a subsidiary, Caribbean Pension Consultants Inc. (CPC), based in Boca Raton, Florida. The Group's long-term goal is to strengthen its banking and financial services franchise by expanding its lending businesses, increasing the level of integration in the marketing and delivery of banking and financial services, continuing to maintain effective asset-liability management, growing non-interest revenues from banking and financial services, and improving operating efficiencies.

The Group's strategy involves:

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

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

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

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

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

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

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

## **Segment Disclosure**

The Group has three reportable segments: Banking, Financial Services, and Treasury. Management established the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Group's organizational structure, nature of products, distribution channels and economic characteristics of the products were also considered in the determination of the reportable segments. The Group measures the performance of these reportable segments based on pre-established goals involving different financial parameters such as net income, interest spread, loan production, and fees generated.

For detailed information regarding performance of the Group's operating segments, please refer to Note 17 to the Group's accompanying consolidated financial statements.

## **Banking Activities**

Oriental Bank and Trust (the Bank), the Group's main subsidiary, is a full-service Puerto Rico commercial bank with its main office located in San Juan, Puerto Rico. The Bank has 21 branches throughout Puerto Rico and was incorporated in 1964 as a federal mutual savings and loan association. It became a federal mutual savings bank in July 1983 and converted to a federal stock savings bank in April 1987. Its conversion from a federally-chartered savings bank to a commercial bank chartered under the banking law of the Commonwealth of Puerto Rico, on June 30, 1994, allowed the Bank to more effectively pursue opportunities in its market and obtain more flexibility in its businesses, placing the Bank in the mainstream of financial services in Puerto Rico. As a Puerto Rico-chartered commercial bank, it is subject to examination by the Federal Deposit Insurance Corporation (the FDIC) and the Office of the Commissioner of Financial Institutions of Puerto Rico (the OCFI). The Bank offers banking services such as commercial 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.

The Bank operates an international banking entity ( IBE ) pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended (the IBE Act ), which is a wholly-owned subsidiary of the Bank, named Oriental International Bank Inc. (the IBE subsidiary ) organized in November 2003. The IBE subsidiary offers the Bank certain Puerto Rico tax advantages and its services are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.



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

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

Servicing assets represent the contractual right to service loans for others. Servicing assets are included as part of other assets in the consolidated statements of financial condition. Loan servicing fees, which are based on a percentage of the principal balances of the loans serviced, are credited to income as loan payments are collected. Servicing assets are initially recognized at fair value. For subsequent measurement of servicing rights, the Group has elected the amortization method with periodic testing for impairment.

**Loan Underwriting**

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

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

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**Sale of Loans and Securitization Activities**

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

**Financial Services Activities**

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

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

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

OFSC also manages and participates in public offerings and private placements of debt and equity securities in Puerto Rico and engages in municipal securities business with the Commonwealth of Puerto Rico and its instrumentalities, municipalities, and public corporations. Investment banking revenue from such activities include gains, losses, and fees, net of syndicate expenses, arising from securities offerings in which OFSC acts as an underwriter or agent. Investment banking revenue also includes fees earned from providing merger-and-acquisition and financial restructuring advisory services. Investment banking management fees are recorded on the offering date, sales concessions on settlement date, and underwriting fees at the time the underwriting is completed and the income is reasonably determinable.

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

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

**Treasury Activities**

Treasury activities encompass all of the Group's treasury-related functions. The Group's investment portfolio consists of mortgage-backed securities, obligations of U.S. Government sponsored agencies, Puerto Rico Government and agency obligations, structured credit investments, and money market instruments. Agency mortgage-

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backed securities, the largest component, consist principally of pools of residential mortgage loans that are made to consumers and then resold in the form of pass-through certificates in the secondary market, the payment of interest and principal of which is guaranteed by GNMA, FNMA or FHLMC.

## **Market Area and Competition**

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

## **Regulation and Supervision**

### ***General***

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

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

Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity provided it does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Gramm-Leach-Bliley Act specifically provides that the following activities have been determined to be financial in nature: (a) lending, trust and other banking activities; (b) insurance activities; (c) financial, investment or economic advisory services; (d) securitization of assets; (e) securities underwriting and dealing; (f) existing bank holding company domestic activities; (g) existing bank holding company foreign activities; and (h) merchant banking activities.

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

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

The Bank is regulated by various agencies in the United States and the Commonwealth of Puerto Rico. Its main regulators are the OCFI and the FDIC. The Bank is subject to extensive regulation and examination by the OCFI and

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

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

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

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

***Holding Company Structure***

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

Under Federal Reserve Board policy, a bank holding company, such as the Group, is expected to act as a source of financial and managerial strength to its banking subsidiaries and to also commit resources to support them. This support may be required at times when, absent such policy, the bank holding company might not otherwise provide such support. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. The Bank is currently the only depository institution subsidiary of the Group.

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

***Dividend Restrictions***

The principal source of funds for the Group's holding company is the dividends from the Bank. The ability of the Bank to pay dividends on its common stock is restricted by the Puerto Rico Banking Act of 1933, as amended (the Banking Act), the FDIA and FDIC regulations. In general terms, the Banking Act provides that when the

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expenditures of a bank are greater than receipts, the excess of expenditures over receipts shall be charged against the undistributed profits of the bank and the balance, if any, shall be charged against the required reserve fund of the bank. If there is no sufficient reserve fund to cover such balance in whole or in part, the outstanding amount shall be charged against the bank's capital account. The Banking Act provides that until said capital has been restored to its original amount and the reserve fund to 20% of the original capital, the bank may not declare any dividends from the reserve account. In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding a bank. For more information see Note 13 to the accompanying consolidated financial statements.

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

***Federal Home Loan Bank System***

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

As a system member, the Bank is entitled to borrow from the FHLB of New York (the FHLB-NY ) and is required to invest in FHLB-NY stock in an amount equal to the greater of \$500; 1% of the Bank's aggregate unpaid principal of its home mortgage loans, home purchase contracts, and similar obligations; or 5% of the Bank's aggregate amount of outstanding advances by the FHLB-NY. The Bank is in compliance with the stock ownership rules described above with respect to such advances, commitments, home mortgage loans and similar obligations. All loans, advances and other extensions of credit made by the FHLB-NY to the Bank are secured by a portion of the Bank's mortgage loan portfolio, certain other investments, and the capital stock of the FHLB-NY held by the Bank. At no time may the aggregate amount of outstanding advances made by the FHLB-NY to the Bank exceed 20 times the amount paid in by the Bank for capital stock in the FHLB-NY.

***Federal Deposit Insurance Corporation Improvement Act***

Under FDICIA the federal banking regulators must take prompt corrective action in respect to depository institutions that do not meet minimum capital requirements. FDICIA, and the regulations issued thereunder, established five capital tiers: (i) well capitalized, if it has a total risk-based capital ratio of 10.0% or more, has a Tier I risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more, and is not subject to any written capital order or directive; (ii) adequately capitalized, if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well capitalized, (iii) undercapitalized, if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances), (iv) significantly undercapitalized, if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital



ratio that is less than 3.0%, and (v) critically undercapitalized, if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. A depository institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives a less than satisfactory examination rating in any of the following categories: asset, management, earnings, and liquidity. The Bank is a well-capitalized institution.

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

***FDIC Insurance Assessments***

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

On May 10, 2009, President Barack Obama signed the Helping Families Save Their Home Act which extends the temporary increase in the standard maximum deposit insurance amount (SMDIA) to \$250,000 per depositor through December 31, 2013. The legislation provides that the SMDIA limit will return to \$100,000 on January 1, 2014. The legislation did not increase coverage for retirement accounts, which continues to be \$250,000.

The Temporary Liquidity Guarantee Program (TLGP) of the FDIC is intended to strengthen confidence and encourage liquidity in the banking system. The TLGP is comprised of the Debt Guarantee Program (DGP) and the Transaction Account Guarantee Program (TAGP). The DGP guarantees all newly issued senior unsecured debt (e.g., promissory notes, unsubordinated unsecured notes and commercial paper) up to prescribed limits issued by participating entities, including bank holding companies, beginning on October 14, 2008 and continuing through October 31, 2009. For eligible debt issued by that date, the FDIC provides the guarantee coverage until the earlier of the maturity date of the debt or June 30, 2012. The TAGP offers a full guarantee for non interest-bearing transaction deposit accounts held at FDIC-insured depository institutions. The unlimited deposit coverage is voluntary for eligible institutions and is in addition to the \$250,000 FDIC deposit insurance per depositor that was included as part of the EESA. The TAGP coverage became effective on October 14, 2008 and will continue for participating institutions until June 30, 2010. The Group opted to become a participating entity on both of these programs and will pay applicable fees for participation. Participants in the DGP program have a fee structure based on a sliding scale, depending on length of maturity. Shorter-term debt has a lower fee structure and longer-term debt has a higher fee. The range is 50 basis points on debt of 180 days or less, and a maximum of 100 basis points for debt with maturities of one year or longer, on an annualized basis. Any eligible entity that has not chosen to opt out of the TAGP is assessed, on a quarterly basis, an annualized 10 cents per \$100 fee on balances in non-interest bearing transaction accounts that exceed the existing deposit insurance limit of \$250,000. The Group's banking subsidiary issued in March 2009 \$105 million in notes guaranteed under the TLGP. These notes are due on March 16, 2012, bear interest at a 2.75% fixed rate, and are backed by the full faith and credit of the United States. Interest on the notes is payable on the 16th of each March and September. An annual fee of 100 basis points is paid to the FDIC to maintain the FDIC guarantee coverage until the

maturity of the notes.

On February 27, 2009, the FDIC adopted a final rule to alter the way in which the FDIC's risk-based assessment system differentiates for risk, change deposit insurance assessment rates, and make technical and other changes to the rules governing the risk-based assessment system. Under this final rule, risk-based rates will range between 12 and 45 cents per \$100 of domestic deposits (annualized) and between 7 and 77.5 cents per \$100 of domestic deposits

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after adjustments, effective April 1, 2009. Most institutions will be charged between 7 and 24 cents per \$100 of deposits. Also on February 27, 2009, the FDIC adopted an interim final rule to impose an emergency special assessment of 20 cents per \$100 of deposits on June 30, 2009, and to allow the FDIC to impose emergency special assessments after June 30, 2009 of 10 cents per \$100 of deposits if the reserve ratio of the DIF is estimated to fall to a level that the FDIC believes would adversely affect public confidence or to a level that is close to zero or negative at the end of a calendar quarter. The Group's special assessment was \$2.9 million.

On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 30, 2009, along with each institution's risk-based deposit insurance assessment for the third quarter of 2009. The Bank's prepayment of the assessment for 2010, 2011 and 2012 amounted to \$22.6 million.

***Brokered Deposits***

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well capitalized institutions are not subject to limitations on brokered deposits, while adequately-capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the interest paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits. As of December 31, 2009, the Bank was a well capitalized institution and was therefore not subject to these limitations on brokered deposits.

***Regulatory Capital Requirements***

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

Tier 3 Capital consists of qualifying unsecured subordinated debt. The sum of Tier 2 and Tier 3 Capital may not exceed the amount of Tier 1 Capital.

The Federal Reserve Board has adopted regulations with respect to risk-based and leverage capital ratios that require most intangibles, including core deposit intangibles, to be deducted from Tier 1 Capital. The regulations, however, permit the inclusion of a limited amount of intangibles related to originated and purchased mortgage servicing rights and purchased credit card relationships and include a grandfathered provision permitting inclusion of certain existing intangibles.

In addition, the Federal Reserve Board has established minimum leverage ratio (Tier 1 Capital to total assets) guidelines for bank holding companies and member banks. These guidelines provide for a minimum leverage ratio of 3% for bank holding companies and member banks that meet certain specified criteria including that they have the highest regulatory rating. All other bank holding companies and member banks are required to maintain a minimum ratio of Tier 1 Capital to total assets of 4%. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the

minimum supervisory levels without significant reliance on intangible assets. Furthermore, the guidelines state that the Federal Reserve Board will continue to consider a tangible Tier 1 leverage ratio and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet the capital guidelines could subject an institution to a variety of enforcement actions including the termination of deposit insurance by the FDIC and to certain restrictions on its business. At December 31, 2009, the

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Group was in compliance with all capital requirements. For more information, please refer to Note 13 to the accompanying consolidated financial statements.

***Safety and Soundness Standards***

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

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

***Activities and Investments of Insured State-Chartered Banks***

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

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

***Transactions with Affiliates and Related Parties***

Transactions between the Bank and any of its affiliates are governed by sections 23A and 23B of the Federal Reserve Act. These sections are important statutory provisions designed to protect a depository institution from transferring to its affiliates the subsidy arising from the institution's access to the Federal safety net. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. Generally, sections 23A and 23B (1) limit the extent to which a bank or its subsidiaries may engage in covered transactions

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with any one affiliate to an amount equal to 10% of the bank's capital stock and surplus, and limit such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus, and (2) require that all such transactions be on terms that are consistent with safe and sound banking practices. The term covered transactions includes the making of loans, purchase of or investment in securities issued by the affiliate, purchase of assets, issuance of guarantees and other similar types of transactions. Most loans by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100 to 130 percent of the loan amount, depending on the nature of the collateral. In addition, any covered transaction by a bank with an affiliate and any sale of assets or provision of services to an affiliate must be on terms that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with nonaffiliated companies.

Regulation W of the Federal Reserve Board comprehensively implements sections 23A and 23B. The regulation unified and updated staff interpretations issued over the years prior to its adoption, incorporated several interpretative proposals (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate), and addressed issues arising as a result of the expanded scope of non-banking activities engaged in by banks and bank holding companies and authorized for financial holding companies under the Gramm-Leach-Bliley Act.

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

***Community Reinvestment Act***

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

***USA Patriot Act***

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



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

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

***Privacy Policies***

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

***Sarbanes-Oxley Act***

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

The Group includes in its annual report on Form 10-K the management assessment regarding the effectiveness of the Group's internal control over financial reporting. The internal control report includes a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the Group; management's assessment as to the effectiveness of the Group's internal control over financial reporting based on management's evaluation, as of year-end; and the framework used by management as criteria for evaluating the effectiveness of the Group's internal control over financial reporting. As of December 31, 2009, the Group's management concluded that its internal control over financial reporting was effective.

***Puerto Rico Banking Act***

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

The Banking Act requires that a minimum of 10% of the Bank's net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid in capital on common and preferred stock. At December 31, 2009, legal surplus amounted to \$45.3 million (December 31, 2008 - \$43.0 million). The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders. In addition, the Federal Reserve Board has issued a policy statement that bank holding companies should generally pay dividends only from operating earnings of the current and preceding two years.

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

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

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

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

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

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

### ***International Banking Center Regulatory Act of Puerto Rico***

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

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

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

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### **Employees**

At December 31, 2009, the Group had 526 employees. None of its employees is represented by a collective bargaining group. The Group considers its employee relations to be good.

### **Internet Access to Reports**

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

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

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

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

#### ***We may incur a significant impairment charge in connection with a decline in the market value of our investment securities portfolio, including our non-agency collateralized mortgage obligations and structured credit investments***

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

When the fair value of a security declines, management must assess whether the decline is other-than-temporary. When the decline in fair value is deemed other-than-temporary, the amortized cost basis of the investment security is reduced to its then current fair value. On April 1, 2009, we adopted FASB Accounting Standard Codification (ASC) 320-10-65-1, which changed the accounting requirements for other than temporary impairments for debt securities and, in certain circumstances, separates the amount of total impairment into credit and noncredit-related amounts. The review takes into consideration current market conditions, issuer rating changes and trends, the credit worthiness of the obligator of the security, current analysts' evaluations, failure of the issuer to make scheduled interest or principal payments, our intent to not sell the security or whether it is more-likely-than-not that we will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term other than temporary impairments is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term

recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, computed using original yield as the discount rate, to the amortized cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is

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considered to be the credit loss. Such impairment charges reflect non-cash losses at the time of recognition. Subsequent disposition or sale of such assets could further affect our future results of operations, as they are based on the difference between the sale prices received and adjusted amortized cost of such assets at the time of sale. The review of whether a decline in fair value is other-than-temporary considers numerous factors and many of these factors involve significant judgment.

For more information about our investment securities portfolio and our other-than-temporary impairment losses on securities in 2009, see Note 2 to the accompanying consolidated financial statements.

***Changes in interest rates may hurt our business***

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

***We are at risk because most of our business is conducted in Puerto Rico, which is experiencing a downturn in the economy and in the real estate market***

Because most of our business activities are conducted in Puerto Rico and a substantial portion of our credit exposure is in Puerto Rico, we are at risk from adverse economic, political or business developments and natural hazards that affect Puerto Rico.

Since 2006, the Puerto Rico economy has been experiencing recessionary conditions. Based on information published by the Puerto Rico Planning Board, the Puerto Rico real gross national product decreased 3.7% during the fiscal year ended June 30, 2009.

The Commonwealth of Puerto Rico government is currently addressing a fiscal deficit. It is implementing a multi-year budget plan for reducing the deficit, as its access to the municipal bond market and its credit ratings depend, in part, on achieving a balanced budget. Some of the measures implemented by the government included reducing expenses, including public-sector employment through employee layoffs. Since the government is an important source of employment on the Island, these measures could have the effect of intensifying the current recessionary cycle. The Puerto Rico Labor Department reported an unemployment rate of 14.3% for December 2009, compared with an unemployment rate of 13.1% for December 2008.

Pursuant to the Declaration of Fiscal Emergency and Omnibus Plan for Economic Stabilization and Restoration of the Puerto Rican Credit Act of March 2, 2009, for tax years beginning after December 31, 2008, and ending before January 1, 2012, every corporation engaged in trade or business in Puerto Rico, including banks, insurance companies, and international banking entities, will be subject to an additional five percent (5%) surcharge on corporate income tax. This temporary tax was enacted as a measure to generate additional revenues to address the fiscal crisis that the government of Puerto Rico is currently facing.

A period of reduced economic growth or a recession has historically resulted in a reduction in lending activity and an increase in the rate of defaults in commercial loans, consumer loans and residential mortgages. A recession may have a significant adverse impact on our net interest income and fee income. We may also experience significant losses on



the loan portfolio due to a higher level of defaults on commercial loans, consumer loans and residential mortgages.

The decline in Puerto Rico's economy has 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. Among other things, we have experienced an increase in the level of our non-performing assets and loan loss

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provision, which adversely affects our profitability. If the decline in economic activity continues, additional increases in the allowance for loan losses could be necessary and there could be further adverse effects on our profitability. The reduction in consumer spending may also continue to impact growth in our other interest and non-interest revenue sources.

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

***Financial results are constantly exposed to market risk***

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

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

We use an asset-liability management software to project future movements in our 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.

We are subject to interest rate risk because of the following factors:

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

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

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

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

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

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

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

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

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

***Our risk management policies, procedures and systems may be inadequate to mitigate all risks inherent in our various businesses***

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

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

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

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

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

The housing market in the U.S. is undergoing a correction of historic proportions. After a period of several years of booming housing markets, fueled by liberal credit conditions and rapidly rising property values, the sector has been in the midst of a substantial correction since early 2007. The general level of property values in the U.S., as

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measured by several indices widely followed by the market, has declined. These declines are the result of ongoing market adjustments that are aligning property values with income levels and home inventories. The supply of homes in the market has increased substantially, and additional property value decreases may be required to clear the overhang of excess inventory in the U.S. market.

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

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

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

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

***Our decisions regarding credit risk and the allowance for loan losses may materially and adversely affect our business and results of operations***

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

the duration of the loan;

credit risks of a particular borrower;

changes in economic or industry conditions; and

in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral.

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

Although we believe that our allowance for loan losses is currently sufficient given the constant monitoring of the risk inherent in our loan portfolio, there is no precise method of predicting loan losses and therefore we always face

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the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. In addition, the FDIC as well as the Office of the Commissioner of Financial Institutions of Puerto Rico may require us to establish additional reserves. Additions to the allowance for loan losses would result in a decrease of our net earnings and capital and could hinder our ability to pay dividends.

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

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

***Competition with other financial institutions could adversely affect our profitability***

We face substantial competition in originating loans and in attracting deposits and assets to manage. The competition in originating loans and attracting assets comes principally from other U.S., Puerto Rico and foreign banks, investment advisors, broker/dealers, mortgage banking companies, consumer finance companies, credit unions, insurance companies, and other institutional lenders and purchasers of loans. We will encounter greater competition as we expand our operations. Increased competition may require us to increase the rates we pay on deposits or lower the rates we charge on loans which could adversely affect our profitability.

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

We are subject to extensive regulation, supervision and examination by federal and Puerto Rico banking authorities. As a result of the recent turmoil in U.S. financial markets, there may be significant changes and increased regulation of banks and bank holding companies in the future. Any change in applicable federal or Puerto Rico laws or regulations could significantly affect our powers, authority and operations, and could have a material adverse effect on our financial condition and results of operations. Regulatory changes could also impose additional costs which could negatively impact our profitability. Further, regulators, in the performance of their supervisory and enforcement duties, have significant discretion and power to prevent or remedy unsafe and unsound practices or violations of laws by banks and bank holding companies. The exercise of this regulatory discretion and power may have a negative impact on us.

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

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



financial condition, results of operations or cash flows.

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***Competition in attracting talented people could adversely affect our operations***

We depend on our ability to attract and retain key personnel and we rely heavily on our management team. The inability to recruit and retain key personnel or the unexpected loss of key managers may adversely affect our operations. Our success to date has been influenced strongly by our ability to attract and retain senior management experienced in banking and financial services. Retention of senior managers and appropriate succession planning will continue to be critical to the successful implementation of our strategies.

***We may engage in FDIC-assisted transactions, which could present risk to our business***

We may have opportunities to acquire the assets and liabilities of failed banks in FDIC-assisted transactions. Although these transactions typically provide for FDIC assistance to an acquirer to mitigate certain risks, such as sharing exposure to loan losses and providing indemnification against certain liabilities of the failed institution, we would still be subject to many of the same risks we would face in acquiring another bank in a negotiated transaction, including risks associated with maintaining customer relationships and failure to realize the anticipated acquisition benefits in the amounts and within the timeframes we expect. In addition, because these transactions are structured in a manner that would not allow us the time and access to information normally associated with preparing for and evaluating a negotiated transaction, we may face additional risk in FDIC-assisted transactions, including additional strain on management resources, management of problem loans, problems related to integration of personnel and operating systems and impact to our capital resources requiring us to raise additional capital. We may not be successful in overcoming these risks or any other problems encountered in connection with FDIC-assisted transactions. Our inability to overcome these risks could have a material effect on our business, financial condition and results of operations.

***Stock price volatility***

The trading price of our common stock could be subject to significant fluctuations due to a change in sentiment in the market regarding the operations, business prospects or industry outlook. Risk factors may include the following:

- operating results that may be worse than the expectations of management, securities analysts and investors;
- developments in the business or in the financial sector in general;
- regulatory changes affecting the industry in general or the business and operations;
- the operating and securities price performance of peer financial institutions;
- announcements of strategic developments, acquisitions and other material events by us or our competitors;
- changes in the credit, mortgage and real estate markets, including the markets for mortgage-related securities; and
- changes in global financial markets and global economies and general market conditions.

Stock markets, in general, and our common stock in particular, have recently experienced significant price and volume volatility and the market price of our common stock may continue to be subject to similar market fluctuations that may be unrelated to the operating performance or prospects.

***Dividends on our common stock***

Holders of our common stock are only entitled to receive such dividends as our board of directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on the common stock, we are not required to do so. The Group expects to continue to pay dividends but its ability to pay future dividends at current levels will necessarily depend upon its earnings, financial condition, and market conditions.

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

Our financial statements are subject to the application of our accounting principles generally accepted in the United States ( GAAP ), which are periodically revised and/or expanded. Accordingly, from time to time we are required

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

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

None.

**ITEM 2. *PROPERTIES***

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

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

At December 31, 2009, the aggregate future rental commitments under the terms of the leases, exclusive of taxes, insurance and maintenance expenses payable by the Group was \$25.4 million.

The Group's investment in premises and equipment, exclusive of leasehold improvements at December 31, 2009, was \$24.2 million.

**ITEM 3. *LEGAL PROCEEDINGS***

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

**ITEM 4. *SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS***

Not applicable.

**PART II**

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

The Group's common stock is traded on the New York Stock Exchange ( NYSE ) under the symbol OFG . Information concerning the range of high and low sales prices for the Group's common stock for each quarter in the years ended

December 31, 2009 and 2008, as well as cash dividends declared for such periods are contained in Table 7 ( Capital, Dividends and Stock Data ) and under the Stockholders Equity caption in the Management s Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ).

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

As of December 31, 2009, the Group had approximately 4,123 holders of record of its common stock, including all directors and officers of the Group, and beneficial owners whose shares are held in street name by securities broker-dealers or other nominees.

The Puerto Rico Internal Revenue Code of 1994, as amended, generally imposes a withholding tax on the amount of any dividends paid by Puerto Rico corporations to individuals, whether residents of Puerto Rico or not, trusts,

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estates, and special partnerships at a special 10% withholding tax rate. Prior to the first dividend distribution for the taxable year, such shareholders may elect to be taxed on the dividends at the regular rates, in which case the special 10% tax will not be withheld from such year's distributions. Dividends distributed by Puerto Rico corporations to foreign corporations or partnerships not engaged in trade or business in Puerto Rico are also generally subject to withholding tax at a 10% rate.

United States citizens who are non-residents of Puerto Rico will not be subject to Puerto Rico tax on dividends if the individual's gross income from sources within Puerto Rico during the taxable year does not exceed \$1,300 if single, or \$3,000 if married, and form AS 2732 of the Puerto Rico Treasury Department Withholding Tax Exemption Certificate for the Purpose of Section 1147 is filed with the withholding agent. U.S. income tax law permits a credit against the U.S. income tax liability, subject to certain limitations, for certain foreign income taxes paid or deemed paid with respect to foreign source income, including that arising from dividends from foreign corporations, such as the Group.

The Group's Amended and Restated 2007 Omnibus Performance Incentive Plan (the Omnibus Plan), which provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units and dividend equivalents, as well as equity-based performance awards. The Omnibus Plan replaced and superseded the 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.

The following table shows certain information pertaining to the Omnibus plan as of December 31, 2009:

| <b>Plan Category</b>                                | <b>(a)</b><br><b>Number of Securities to<br/>Be Issued Upon Exercise<br/>of<br/>Outstanding Options,<br/>warrants and<br/>rights</b> | <b>(b)</b><br><b>Weighted-Average<br/>Exercise Price of<br/>Outstanding<br/>Options,<br/>warrants and<br/>rights</b> | <b>(c)</b><br><b>Number of Securities<br/>Remaining Available for<br/>Future Issuance Under<br/>Equity Compensation<br/>Plans<br/>(excluding those reflected<br/>in<br/>column<br/>(a))</b> |
|---|--|--|---|
| Equity compensation plans approved by shareholders: |  |  |   |
| Omnibus Plan  | 219,301(1)   | 10.47  | 330,699   |

(1) Includes 71,676 stock options and 147,625 restricted stock units.

The Group recorded approximately \$742,000, \$559,000 and \$86,000 related to compensation expense for options issued during the years ended December 31, 2009, 2008, and 2007, respectively.

***Purchases of equity securities by the issuer and affiliated purchasers***

Under the Group's current stock repurchase program it is authorized to purchase in the open market up to \$15.0 million of its outstanding shares of common stock. The shares of common stock repurchased are to be held by the Group as

treasury shares. There were no repurchases made under the program during 2009. The approximate dollar value of shares that may yet be repurchased under the plan amounted to \$11.3 million at December 31, 2009.

***Stock Performance Graph***

*The following performance graph shall not be deemed incorporated by reference by any general statement incorporating by reference this annual report on Form 10-K into any filing under the Securities Act of 1933, as amended (the Securities Act ) or the Exchange Act, except to the extent that the Group specifically incorporates this information by reference, and shall not otherwise be deemed filed under these Acts.*

The following performance graph compares the yearly percentage change in the Group's cumulative total shareholder return on its shares of common stock to that of the Russell 2000 Index and the SNL Bank Index. The peer group and broad equity market indexes used herein are respectively the Russell 2000 Index and SNL Bank Index. The performance graph assumes that \$100 was invested on December 31, 2004 in each of the Group's common stock, the Russell 2000 Index and the SNL Bank Index. The comparisons in this table are set forth in response to SEC disclosure requirements, and are therefore not intended to forecast or be indicative of future performance of the Group's common stock.

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*Comparison of 5 Year Cumulative Total Return  
Assumes Initial Investment of \$100  
December 2009*

| Index                         | Period Ending |          |          |          |          |          |
|-------------------------------|---------------|----------|----------|----------|----------|----------|
|                               | 12/31/04      | 12/31/05 | 12/31/06 | 12/31/07 | 12/31/08 | 12/31/09 |
| Oriental Financial Group Inc. | 100.00        | 45.36    | 49.64    | 53.84    | 25.43    | 46.29    |
| Russell 2000                  | 100.00        | 104.55   | 123.76   | 121.82   | 80.66    | 102.58   |
| SNL Bank                      | 100.00        | 101.36   | 118.57   | 92.14    | 52.57    | 52.03    |

**ITEM 6. SELECTED FINANCIAL DATA**

The information required by this item is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0. The following ratios of the Group should be read in conjunction with the portions of such report filed as Exhibit 13.0. Selected financial data are presented for the last five fiscal years.

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

| Consolidated Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends: | Year Ended December 31, |       |       |      | Six-Month Period Ended | Fiscal Year Ended |
|--|-------------------------|-------|-------|------|------------------------|-------------------|
|  | 2009                    | 2008  | 2007  | 2006 | December 31, 2005      | June 30, 2005     |
| Excluding Interest on Deposits   | 1.18x                   | 1.07x | 1.22x | (A)  | 1.21x                  | 1.66x             |
| Including Interest on Deposits   | 1.13x                   | 1.05x | 1.17x | (A)  | 1.16x                  | 1.48x             |

(A) During 2006, earnings were not sufficient to cover preferred dividends, and the ratio was less than 1:1. The Group would have had to generate additional earnings of \$10.0 million to achieve a ratio of 1:1 in 2006.

For purposes of computing these consolidated ratios, earnings represent income before income taxes plus fixed charges and amortization of capitalized interest, less interest capitalized. Fixed charges consist of interest expensed and capitalized, amortization of debt issuance costs, and the Group's estimate of the interest component of rental expense. The term preferred stock dividends is the amount of pre-tax earnings that is required to pay dividends on the Group's outstanding preferred stock. As of the dates presented above, the Group had noncumulative preferred stock issued and outstanding amounting to \$68.0 million as follows: (1) Series A amounting to \$33.5 million or 1,340,000 shares at a \$25 liquidation value; and (2) Series B amounting to \$34.5 million or 1,380,000 shares at a \$25 liquidation value.





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

The information required by this item is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0 under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

The information regarding the market risk of the Group is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0, under the caption Risk Management .

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

The information required by this item is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0. The consolidated financial statements of this report set forth the list of all reports required by this item, and they are incorporated herein by reference.

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

Not applicable.

**ITEM 9A. *CONTROLS AND PROCEDURES***

**a. *Disclosure Controls and Procedures***

The Group's management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of December 31, 2009, an evaluation was carried out under the supervision and with the participation of the Group's management, including the Chief Executive Officer ( CEO ) and the Chief Financial Officer ( CFO ), of the effectiveness of the design and operation of the Group's disclosure controls and procedures. Based upon such evaluation, the CEO and CFO have concluded that, as of the end of the period covered by this annual report on Form 10-K, the Group's disclosure controls and procedures were 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 Securities Exchange Act of 1934.

**b. *Management's Report on Internal Control over Financial Reporting***

The Management's Report on Internal Control over Financial Reporting is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0.

**c. *Attestation Report of the Public Accounting Firm***

The registered public accounting firm's attestation report on the Group's internal control over financial reporting is incorporated herein by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0.

**d. *Changes in Internal Control over Financial Reporting***

There have not been any changes in the Group's internal control over financial reporting (as such term is defined in rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the last quarter of the year ended December 31, 2009, that has materially affected, or is reasonably likely to materially affect, the Group's internal control over financial reporting.

**ITEM 9B. *OTHER INFORMATION***

Not applicable.

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**PART III**

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

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

**(a)(1) Financial Statements**

The list of financial statements required by this item is set forth in the financial data index incorporated by reference from portions of the 2009 annual report to shareholders filed as Exhibit 13.0.

**(a)(2) Financial Statement Schedules**

No schedules are presented because the information is not applicable or is included in the consolidated financial statements or in the notes thereto described in (a)(1) above.

**(a)(3) Exhibits**

| <b>Exhibit No.:</b> | <b>Description Of Document:</b>  |
|---------------------|--|
| 3(i)                | Certificate of Incorporation, as amended.(1)   |
| 3(ii)               | By-Laws.(2)  |
| 4.1                 | Certificate of Designation of the 7.125% Noncumulative Monthly Income Preferred Stock, Series A.(3)                                  |
| 4.2                 | Certificate of Designation of the 7.0% Noncumulative Monthly Income Preferred Stock, Series B.(4)                                    |
| 10.5                | Lease Agreement between Oriental Financial Group Inc. and Professional Office Park V, Inc.(5)  |
| 10.6                | First Amendment to Lease Agreement Dated May 18, 2004, between Oriental Financial Group Inc. and Professional Office Park V, Inc.(5) |
| 10.8                | Employment Agreement between Oriental Financial Group Inc. and José Rafael Fernández(6)  |
| 10.12               | Change in Control Compensation Agreement between Oriental Financial Group Inc. and José R. Fernández(5)                              |
| 10.13               | Change in Control Compensation Agreement between Oriental Financial Group Inc. and Norberto González(5)                              |
| 10.14               | Change in Control Compensation Agreement between Oriental Financial Group Inc. and Ganesh Kumar(5)                                   |
| 10.17               | Change in Control Compensation Agreement between Oriental Financial Group Inc. and Mari Evelyn Rodríguez(6)                          |
| 10.18               | Change in Control Compensation Agreement between Oriental Financial Group Inc. and Julio R. Micheo(9)                                |
| 10.19               | Technology Outsourcing Agreement between Oriental Financial Group Inc. and Metavante Corporation(10)                                 |
| 10.20               | Amended and Restated 2007 Omnibus Performance Incentive Plan(11)   |

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- 10.21 Form of qualified stock option award and agreement(12)
- 10.22 Form of restricted stock award and agreement(13)
- 10.23 Form of restricted unit award and agreement(14)
- 10.24 Agreement between Oriental Financial Group Inc. and José J. Gil de Lamadrid(15)
- 12.0 Computation of Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends  
(included in Item 6 hereof).
- 13.0 Portions of the 2009 annual report to shareholders

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| <b>Exhibit No.:</b> | <b>Description Of Document:</b>  |
|---------------------|--|
| 21.0                | List of subsidiaries   |
| 23.1                | Consent of KPMG LLP  |
| 31.1                | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 31.2                | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 32.1                | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |
| 32.2                | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |
| (1)                 | Incorporated herein by reference from Exhibit No. 3 of the Group's registration statement on Form S-3 filed with the SEC on April 2, 1999.                     |
| (2)                 | Incorporated herein by reference from Exhibit No. 3(ii) of the Group's current report on Form 8-K filed with the SEC on June 23, 2008.                         |
| (3)                 | Incorporated herein by reference from Exhibit No. 4.1 of the Group's registration statement on Form 8-A filed with the SEC on April 30, 1999.                  |
| (4)                 | Incorporated herein by reference from Exhibit No. 4.1 of the Group's registration statement on Form 8-A filed with the SEC on September 26, 2003.              |
| (5)                 | Incorporated herein by reference from Exhibit 10 of the Group's annual report on Form 10-K filed with the SEC on September 13, 2005.                           |
| (6)                 | Incorporated herein by reference from Exhibit 10.1 of the Group's quarterly report on Form 10-Q filed with the SEC on October 17, 2006.                        |
| (7)                 | Incorporated herein by reference from Exhibit 10.2 of the Group's current report on Form 8-K filed with the SEC on December 4, 2006.                           |
| (8)                 | Incorporated herein by reference from Exhibit 10.1 of the Group's current report on Form 8-K filed with the SEC on December 4, 2006.                           |
| (9)                 | Incorporated herein by reference from Exhibit 10 of the Group's current report on Form 10-K filed with the SEC on December 15, 2006                            |
| (10)                | Incorporated herein by reference from Exhibit 10.23 of the Group's annual report on Form 10-K filed with the SEC on March 28, 2007.                            |
| (11)                | Incorporated herein by reference from the Group's definitive proxy statement for the 2009 annual meeting of stockholders filed with the SEC on April 28, 2008. |
| (12)                | Incorporated herein by reference from Exhibit No. 10.1 of the Group's registration statement on Form S-8 filed with the SEC on November 30, 2007.              |
| (13)                |  |

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Incorporated herein by reference from Exhibit No. 10.2 of the Group's registration statement on Form S-8 filed with the SEC on November 30, 2007.

- (14) Incorporated herein by reference from Exhibit 10.27 of the Group's annual report on Form 10-K filed with the SEC on March 16, 2009.
- (15) Incorporated herein by reference from Exhibit 10.28 of the Group's quarterly report on Form 10-Q filed with the SEC on November 6, 2009.

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**SIGNATURES**

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

**ORIENTAL FINANCIAL GROUP INC.**

By: Dated: March 11, 2010  
/s/ José Rafael Fernández

José Rafael Fernández  
President and Chief Executive Officer

By: Dated: March 11, 2010  
/s/ Norberto González

Norberto González  
Executive Vice President and Chief Financial Officer

By: Dated: March 11, 2010  
/s/ César A. Ortiz

César A. Ortiz  
Senior Vice President and Controller

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

By: Dated: March 11, 2010  
/s/ José J. Gil de Lamadrid

José J. Gil de Lamadrid  
Chairman of the Board

By: Dated: March 11, 2010  
/s/ José Rafael Fernández

José Rafael Fernández  
Vice Chairman of the Board

By: Dated: March 11, 2010  
/s/ Juan Carlos Aguayo

Juan Carlos Aguayo  
Director



By:  
/s/ Pablo I. Altieri

Dated: March 11, 2010

Dr. Pablo I. Altieri  
Director

By:  
/s/ Maricarmen Aponte

Dated: March 11, 2010

Maricarmen Aponte  
Director

By:  
/s/ Francisco Arriví

Dated: March 11, 2010

Francisco Arriví  
Director

By:  
/s/ Nelson García

Dated: March 11, 2010

Nelson García  
Director

By:  
/s/ Julian Inclán

Dated: March 11, 2010

Julian Inclán  
Director

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By:  
/s/ Rafael Machargo

Dated: March 11, 2010

Rafael Machargo  
Director

By:  
/s/ Pedro Morazzani

Dated: March 11, 2010

Pedro Morazzani  
Director

By:  
/s/ Josen Rossi

Dated: March 11, 2010

Josen Rossi  
Director