

ORIENTAL FINANCIAL GROUP INC

Form 10-Q

May 09, 2011

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

(Mark One)

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

**For the quarterly period ended March 31, 2011**

**or**

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

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

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

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

Principal Executive Offices:

997 San Roberto Street

Oriental Center 10th Floor

Professional Offices Park

San Juan, Puerto Rico 00926

Telephone Number: (787) 771-6800

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

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☐

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

Large Accelerated Filer ☐

Accelerated Filer ☒

Non-Accelerated Filer ☐

Smaller Reporting  
Company ☐

(Do not check if a smaller  
reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

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

45,274,338 common shares (\$1.00 par value per share) outstanding as of April 30, 2011



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**FORWARD-LOOKING STATEMENTS**

The information included in this quarterly report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to Oriental Financial Group Inc. (the Group) financial condition, results of operations, plans, objectives, future performance and business, including, but not limited to, statements with respect to the adequacy of the allowance for loan and lease losses, delinquency trends, market risk and the impact of interest rate changes, capital markets conditions, capital adequacy and liquidity, and the effect of legal proceedings and new accounting standards on the Group's financial condition and results of operations. All statements contained herein that are not clearly historical in nature are forward-looking, and the words anticipate, believe, continues, expect, estimate, intend, project and expressions and future or conditional verbs such as will, would, should, could, might, can, may, or similar are generally intended to identify forward-looking statements.

These statements are not guarantees of future performance and involve certain risks, uncertainties, estimates and assumptions by management that are difficult to predict. Various factors, some of which, by their nature are beyond the Group's control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements. Factors that might cause such a difference include, but are not limited to:

- the rate of growth in the economy and employment levels, as well as general business and economic conditions;

- changes in interest rates, as well as the magnitude of such changes;

- the fiscal and monetary policies of the federal government and its agencies;

- changes in federal bank regulatory and supervisory policies, including required levels of capital;

- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) on our businesses, business practices and cost of operations;

- the relative strength or weakness of the consumer and commercial credit sectors and of the real estate market in Puerto Rico;

- the performance of the stock and bond markets;

- competition in the financial services industry;

- additional Federal Deposit Insurance Corporation (FDIC) assessments; and

- possible legislative, tax or regulatory changes.

Other possible events or factors that could cause results or performance to differ materially from those expressed in these forward-looking statements include the following: negative economic conditions that adversely affect the general economy, housing prices, the job market, consumer confidence and spending habits which may affect, among other things, the level of non-performing assets, charge-offs and provision expense; changes in interest rates and market liquidity which may reduce interest margins, impact funding sources and affect the ability to originate and distribute financial products in the primary and secondary markets; adverse movements and volatility in debt and equity capital markets; changes in market rates and prices which may adversely impact the value of financial assets and liabilities; liabilities resulting from litigation and regulatory investigations; changes in accounting standards, rules and interpretations; increased competition; the Group's ability to grow its core businesses; decisions to downsize, sell or close units or otherwise change the Group's business mix; and management's ability to identify and manage these and other risks.

All forward-looking statements included in this quarterly report on Form 10-Q are based upon information available to the Group as of the date of this report, and other than as required by law, including the requirements of applicable

securities laws, the Group assumes no obligation to update or revise any such forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

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**ORIENTAL FINANCIAL GROUP INC.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**MARCH 31, 2011 AND DECEMBER 31, 2010**

	March 31, 2011	December 31, 2010
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents		
Cash and due from banks	\$ 315,351	\$ 337,218
Money market investments	2,060	111,728
Total cash and cash equivalents	317,411	448,946
Investments:		
Trading securities, at fair value, with amortized cost of \$1,447 (December 31, 2010 - \$1,306)	1,444	1,330
Investment securities available-for-sale, at fair value, with amortized cost of \$3,562,745 (December 31, 2010 - \$3,661,146)	3,587,930	3,700,064
Investment securities held-to-maturity, at amortized cost, with fair value of \$855,816 (December 31, 2010 - \$675,721)	875,494	689,917
Federal Home Loan Bank (FHLB) stock, at cost	22,496	22,496
Other investments	150	150
Total investments	4,487,514	4,413,957
Loans:		
Mortgage loans held-for-sale, at lower of cost or fair value	34,216	33,979
Loans not covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$32,727 (December 31, 2010 - \$31,430)	1,108,324	1,117,859
Loans covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$53,480 (December 31, 2010 - \$49,286)	589,912	620,732
Total loans, net	1,732,452	1,772,570
FDIC shared-loss indemnification asset	436,889	471,872
Foreclosed real estate covered under shared-loss agreements with the FDIC	17,302	15,962
Foreclosed real estate not covered under shared-loss agreements with the FDIC	12,793	11,969
Accrued interest receivable	28,634	28,716
Deferred tax asset, net	30,404	30,350
Premises and equipment, net	23,353	23,941
Forward settlement swaps	7,203	11,023
Investment in equity indexed options	11,764	9,870
Investment in swap options	7,804	7,422
Other assets	62,606	64,422

<b>Total assets</b>	<b>\$ 7,176,129</b>	<b>\$ 7,311,020</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Deposits:</b>		
Demand deposits	\$ 947,526	\$ 954,554
Savings accounts	240,863	235,690
Certificates of deposit	1,313,083	1,398,644
<b>Total deposits</b>	<b>2,501,472</b>	<b>2,588,888</b>
<b>Borrowings:</b>		
Short-term borrowings	32,335	42,470
Securities sold under agreements to repurchase	3,456,605	3,456,781
Advances from FHLB	281,687	281,753
FDIC-guaranteed term notes	105,112	105,834
Subordinated capital notes	36,083	36,083
<b>Total borrowings</b>	<b>3,911,822</b>	<b>3,922,921</b>
FDIC net settlement payable	1,774	23,082
Accrued expenses and other liabilities	47,933	43,798
<b>Total liabilities</b>	<b>6,463,001</b>	<b>6,578,689</b>
<b>Stockholders equity:</b>		
Preferred stock, \$1 par value; 10,000,000 shares authorized; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding, \$25 liquidation value.	68,000	68,000
Common stock, \$1 par value; 100,000,000 shares authorized; 47,807,984 shares issued; 45,375,090 shares outstanding (December 31, 2010 - 47,807,734; 46,348,667)	47,808	47,808
Treasury stock, at cost, 2,432,894 shares (December 31, 2010 - 1,459,067 shares)	(28,746)	(16,732)
Additional paid-in capital	498,303	498,435
Legal surplus	46,717	46,331
Retained earnings	50,727	51,502
Accumulated other comprehensive income, net of tax of (\$1,807) (December 31, 2010 - (\$2,108))	30,319	36,987
<b>Total stockholders equity</b>	<b>713,128</b>	<b>732,331</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 7,176,129</b>	<b>\$ 7,311,020</b>

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



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**ORIENTAL FINANCIAL GROUP INC.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010**

	<b>Quarter ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands, except per share data)</b>	
<b>Interest income:</b>		
Loans		
Loans not covered under shared-loss agreements with the FDIC	\$ 17,841	\$ 17,637
Loans covered under shared-loss agreements with the FDIC	14,226	
Mortgage-backed securities	43,738	43,594
Investment securities and other	2,105	9,105
<b>Total interest income</b>	<b>77,910</b>	<b>70,336</b>
<b>Interest expense:</b>		
Deposits	12,214	11,243
Securities sold under agreements to repurchase	24,159	25,285
Advances from FHLB and other borrowings	3,049	3,012
FDIC-guaranteed term notes	1,021	1,021
Subordinated capital notes	302	298
<b>Total interest expense</b>	<b>40,745</b>	<b>40,859</b>
<b>Net interest income</b>	<b>37,165</b>	<b>29,477</b>
Provision for non-covered loan and lease losses	3,800	4,014
Provision for covered loan and lease losses, net	549	
<b>Net interest income after provision for loan and lease losses</b>	<b>32,816</b>	<b>25,463</b>
<b>Non-interest income:</b>		
Wealth management revenues	4,682	3,978
Banking service revenues	3,835	1,622
Mortgage banking activities	1,959	1,797
<b>Total banking and wealth management revenues</b>	<b>10,476</b>	<b>7,397</b>
Total loss on other-than-temporarily impaired securities		(39,590)
Portion of loss on securities recognized in other comprehensive income		38,958
Other-than-temporary impairments on securities		(632)
Accretion of FDIC loss-share indemnification asset, net	1,211	
Net gain (loss) on:		
Sale of securities	(2)	12,020
Derivatives	(3,968)	(10,636)
Trading securities	(31)	(3)

Foreclosed real estate	(132)	(117)
Other	(27)	9
<b>Total non-interest income, net</b>	<b>7,527</b>	<b>8,038</b>
<b>Non-interest expenses:</b>		
Compensation and employee benefits	11,688	8,250
Professional and service fees	5,451	2,153
Occupancy and equipment	4,405	3,594
Insurance	1,985	1,833
Electronic banking charges	1,454	678
Taxes, other than payroll and income taxes	1,380	857
Advertising and business promotion	1,165	699
Loan servicing and clearing expenses	1,021	724
Foreclosure and repossession expenses	729	302
Communication	397	342
Director and investors relations	287	315
Printing, postage, stationery and supplies	282	203
Other	546	443
<b>Total non-interest expenses</b>	<b>30,790</b>	<b>20,393</b>
<b>Income before income taxes</b>	<b>9,553</b>	<b>13,108</b>
Income tax expense	6,472	1,172
<b>Net income</b>	<b>3,081</b>	<b>11,936</b>
Less: Dividends on preferred stock	(1,201)	(1,201)
<b>Income available to common shareholders</b>	<b>\$ 1,880</b>	<b>\$ 10,735</b>
<b>Income per common share:</b>		
Basic	<b>\$ 0.04</b>	<b>\$ 0.42</b>
Diluted	<b>\$ 0.04</b>	<b>\$ 0.41</b>
Average common shares outstanding and equivalents	<b>46,179</b>	<b>25,932</b>
Cash dividends per share of common stock	<b>\$ 0.05</b>	<b>\$ 0.04</b>

See notes to unaudited consolidated financial statements.

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**ORIENTAL FINANCIAL GROUP INC.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010**

	<b>Quarter Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
<b>Preferred stock:</b>		
<b>Balance at beginning and end of period</b>	<b>\$ 68,000</b>	<b>\$ 68,000</b>
<b>Common stock:</b>		
Balance at beginning of period	47,808	25,739
Issuance of common stock		8,740
<b>Balance at end of period</b>	<b>47,808</b>	<b>34,479</b>
<b>Additional paid-in capital:</b>		
Balance at beginning of period	498,435	213,445
Issuance of common stock		90,896
Stock-based compensation expense	368	263
Exercised restricted stock units with treasury shares	(500)	
Common stock issuance cost		(5,062)
<b>Balance at end of period</b>	<b>498,303</b>	<b>299,542</b>
<b>Legal surplus:</b>		
Balance at beginning of period	46,331	45,279
Transfer from retained earnings	386	1,201
<b>Balance at end of period</b>	<b>46,717</b>	<b>46,480</b>
<b>Retained earnings:</b>		
Balance at beginning of period	51,502	77,584
Net income	3,081	11,936
Cash dividends declared on common stock	(2,269)	(1,322)
Cash dividends declared on preferred stock	(1,201)	(1,201)
Transfer to legal surplus	(386)	(1,201)
<b>Balance at end of period</b>	<b>50,727</b>	<b>85,796</b>
<b>Treasury stock:</b>		
Balance at beginning of period	(16,732)	(17,142)
Stock purchased under the repurchase program	(12,530)	
Exercised restricted stock units with treasury shares	500	
Stock used to match defined contribution plan	16	15
<b>Balance at end of period</b>	<b>(28,746)</b>	<b>(17,127)</b>
<b>Accumulated other comprehensive income (loss), net of tax:</b>		

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Balance at beginning of period	36,987	(82,739)
Other comprehensive income (loss), net of tax	(6,668)	29,743
<b>Balance at end of period</b>	<b>30,319</b>	<b>(52,996)</b>
<b>Total stockholders' equity</b>	<b>\$ 713,128</b>	<b>\$ 464,174</b>

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

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**ORIENTAL FINANCIAL GROUP INC.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010**

	<b>Quarter Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
<b>Net income</b>	<b>\$ 3,081</b>	<b>\$ 11,936</b>
<b>Other comprehensive income (loss):</b>		
Unrealized gain (loss) on securities available-for-sale arising during the period	(13,738)	44,610
Realized (gain) loss on investment securities included in net income	2	(12,020)
Total loss on other- than-temporarily impaired securities		39,590
Portion of loss on securities recognized in other comprehensive income		(38,958)
Unrealized gains on cash flow hedges arising during the period	7,123	
Income tax effect	(55)	(3,479)
<b>Other comprehensive income (loss) for the period</b>	<b>(6,668)</b>	<b>29,743</b>
<b>Comprehensive income (loss)</b>	<b>\$ (3,587)</b>	<b>\$ 41,679</b>

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

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**ORIENTAL FINANCIAL GROUP INC.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010**

	<b>Quarter Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net income	<b>\$ 3,081</b>	<b>\$ 11,936</b>
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of deferred loan origination fees, net of costs	10	135
Amortization of premiums, net of accretion of discounts	7,638	5,559
Amortization of core deposit intangible	36	
Accretion of FDIC loss-share indemnification asset, net	(1,211)	
Other-than-temporary impairments on securities		632
Depreciation and amortization of premises and equipment	1,468	1,333
Deferred income taxes, net	(109)	(3,979)
Provision for loan and lease losses, net	4,349	4,014
Stock-based compensation	368	263
Fair value adjustment of servicing asset	(440)	(449)
(Gain) loss on:		
Sale of securities	2	(12,020)
Sale of mortgage loans held for sale	(799)	(862)
Derivatives	3,968	10,636
Sale of foreclosed real estate	132	117
Sale of premises and equipment	8	(14)
Originations and purchases of loans held-for-sale	(52,807)	(49,958)
Proceeds from sale of loans held-for-sale	17,970	17,633
Net (increase) decrease in:		
Trading securities	(114)	230
Accrued interest receivable	112	(3,444)
Other assets	2,374	419
Net increase (decrease) in:		
Accrued interest on deposits and borrowings	(312)	(563)
Accrued expenses and other liabilities	(17,143)	4,476
<b>Net cash used in operating activities</b>	<b>(31,419)</b>	<b>(13,906)</b>

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

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**ORIENTAL FINANCIAL GROUP INC.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010**

	<b>Quarter Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
<b>Cash flows from investing activities:</b>		
Purchases of:		
Investment securities available-for-sale	(222,947)	(2,104,008)
Investment securities held-to-maturity	(209,112)	
Equity options	(525)	(524)
Maturities and redemptions of:		
Investment securities available-for-sale	303,270	915,890
Investment securities held-to-maturity	22,042	
Proceeds from sales of:		
Investment securities available-for-sale	44,528	1,238,588
Foreclosed real estate	2,397	2,228
Other repossessed assets	589	
Premises and equipment	(26)	(75)
Origination and purchase of loans, excluding loans held-for-sale	(25,155)	(28,153)
Principal repayment of loans	54,868	30,642
Shared-loss agreements reimbursements from the FDIC	39,839	
Additions to premises and equipment	(861)	(40)
<b>Net cash provided by investing activities</b>	<b>8,907</b>	<b>54,548</b>
<b>Cash flows from financing activities:</b>		
Net increase (decrease) in:		
Deposits	(89,422)	69,377
Short term borrowings	(10,135)	(11,226)
Proceeds from issuance of common stock, net		94,574
Purchase of treasury stock	(12,530)	
Termination of derivative instruments	6,534	(236)
Dividends paid on preferred stock	(1,201)	(1,201)
Dividends paid on common stock	(2,269)	(972)
<b>Net cash provided by (used in) financing activities</b>	<b>(109,023)</b>	<b>150,316</b>
<b>Net change in cash and cash equivalents</b>	<b>(131,535)</b>	<b>190,958</b>
Cash and cash equivalents at beginning of period	448,946	277,123
Cash and cash equivalents at end of period	<b>\$ 317,411</b>	<b>\$ 468,081</b>

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

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**ORIENTAL FINANCIAL GROUP INC.  
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010**

	<b>Quarter Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
<b>Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:</b>		
Interest paid	\$ 41,057	\$ 41,445
Mortgage loans securitized into mortgage-backed securities	\$ 32,599	\$ 32,873
Securities sold but not yet delivered	\$	\$ 116,747
Securities purchased but not yet received	\$	\$ 171,813
Transfer from loans to foreclosed real estate and other repossessed assets	\$ 4,693	\$ 2,916

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



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**ORIENTAL FINANCIAL GROUP INC.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 BASIS OF PRESENTATION**

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

The unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). All significant intercompany balances and transactions have been eliminated in consolidation. These unaudited statements are, in the opinion of management, a fair statement of the results for the periods reported and include all necessary adjustments, all of a normal recurring nature, for a fair statement of such results. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations.

Management believes that the disclosures made are adequate to make the information presented not misleading. The results of operations and cash flows for the periods ended March 31, 2011 and 2010 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2010, included in the Group s 2010 annual report on Form 10-K.

***Nature of Operations***

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

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

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

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

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

mortgage-backed securities. The Group is an approved seller of FNMA, as well as 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 is the master

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servicer of the GNMA, FNMA and FHLMC pools that it issues and of its mortgage loan portfolio, but entered into a subservicing arrangement with a third party.

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

### ***Significant Accounting Policies***

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

### ***Loans and Allowance for Loan and Lease Losses***

Because of the loss protection provided by the FDIC, the risks of the FDIC-assisted transaction acquired loans are significantly different from those loans not covered under the FDIC loss sharing agreements. Accordingly, the Group presents loans subject to the loss sharing agreements as covered loans and loans that are not subject to the FDIC loss sharing agreements as non-covered loans . Non-covered loans include any loans made outside of the FDIC shared-loss agreements before or after the April 30, 2010 FDIC-assisted acquisition. Non-covered loans also include credit cards balances acquired in the FDIC-assisted acquisition.

### ***Non-Covered Loans***

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

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

Interest recognition is discontinued when loans are 90 days or more in arrears on principal and/or interest based on contractual terms, except for well collateralized residential mortgage loans in process of collection for which recognition is discontinued when these become 365 days or more past due based on contractual terms and are then written down, if necessary, based on the specific evaluation of the collateral underlying the loan. Loans for which the recognition of interest income has been discontinued are designated as non-accruing. Collections are accounted for on the cash method thereafter, until qualifying to return to accrual status. Such loans are not reinstated to accrual status until interest is received on a current basis and other factors indicative of doubtful collection cease to exist.

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

and lease losses on non-covered loans.

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

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

The Group, using a rating system, applies an overall allowance percentage to each non-covered loan portfolio segment based on historical credit losses adjusted for current conditions and trends. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Group over the most recent 12 months. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: the credit grading assigned to commercial loans, levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: mortgage loans; commercial loans; consumer loans; and leasing.

**Mortgage Loans:** These loans were further segregated into four classes: traditional mortgages, non-traditional mortgages, loans in loan modification programs and personal mortgage collateral loans. Traditional mortgage loans include loans secured by dwelling, fixed coupons and regular amortization schedules. Non-traditional mortgages include loans with interest-first amortization schedules and loans with balloon considerations as part of their terms. Mortgages in loan modification program are those loans that are being serviced under such program. The personal mortgage collateral loans are mainly equity lines of credits. The allowance factor on these loans is impacted by the historical loss factors on the sub-segments, the environmental risk factors described above and by delinquency buckets.

**Commercial loans:** These loans consist mainly of commercial loans secured by existing commercial real estate properties. The allowance factor assigned to these loans are impacted by historical loss factors, by the environmental risk factors described above and by the credit risk gradings assigned to the loans. These credit risk gradings are based on relevant information about the ability of borrowers to service their debt such as: economic conditions, portfolio risk characteristics, prior loss experience, and results of periodic credit reviews of individual loans.

**Consumer loans:** these consist of smaller retail loans such as retail credit cards, overdrafts, unsecured personal lines of credit, and personal unsecured loans. The allowance factor on these loans is impacted by the historical loss factors on the segment, the environmental risk factors described above and by delinquency buckets.

**Leasing:** This segment consists of personal loans guaranteed by vehicles in the form of lease financing or in the form of automobile and equipment loans. The allowance factor on these loans is impacted by the historical losses on the segment, the environmental risk factors described above and by delinquency buckets. This is a new business introduced in 2010, as such, the historical loss factor have been matched to consumer loans due to the lack of historical losses on leases.

Loan loss ratios and credit risk categories are updated at least quarterly and are applied in the context of GAAP as prescribed by ASC and the importance of depository institutions having prudent, conservative, but not excessive loan allowances that fall within an acceptable range of estimated losses. While management uses current available

information in estimating possible loan and lease losses, factors beyond the Group's control, such as those affecting general economic conditions, may require future changes to the allowance.

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### ***Covered Loans***

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

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

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

The excess of undiscounted expected cash flows at acquisition over the initial fair value of acquired loans is referred to as the accretable yield and is recorded as interest income over the estimated life of the loans using the effective yield method if the timing and amount of the future cash flows is reasonably estimable. Subsequent to acquisition, the Group aggregates loans into pools of loans with common risk characteristics to account for the acquired loans.

Increases in expected cash flows over those originally estimated increase the accretable yield and are recognized as interest income prospectively. Decreases in expected cash flows compared to those originally estimated decrease the accretable yield and are recognized by recording a provision for loan and lease losses and establishing an allowance for loan and lease losses.

Loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest income may be recognized on a cash basis or as a reduction of the principal amount outstanding.

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

### ***Lease Financing***

The Group leases vehicles and equipment for personal and commercial use to individual and corporate customers. The direct finance lease method of accounting is used to recognize revenue on leasing contracts that meet the criteria specified in the guidance for leases in ASC Topic 840. Aggregate rentals due over the term of the leases less unearned income are included in lease financing contracts receivable. Unearned income is amortized using a method over the average life of the leases as an adjustment to the interest yield.

Revenue for other leases is recognized as it becomes due under the terms of the relevant contract.

### ***Financial Instruments***

Certain financial instruments, including derivatives, trading securities and investment securities available-for-sale, are recorded at fair value and unrealized gains and losses are recorded in other comprehensive income or as part of non-interest income, as appropriate. Fair values are based on listed market prices, if available. If listed market prices

are not available, fair value is determined based on other relevant factors, including price quotations for similar instruments. The fair values of certain derivative contracts are derived



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from pricing models that consider current market and contractual prices for the underlying financial instruments as well as time value and yield curve or volatility factors underlying the positions.

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

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

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

**Level 3** - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, for which the determination of fair value requires significant management judgment or estimation. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

### ***Impairment of Investment Securities***

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

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

- identification and evaluation of investments that have indications of possible other-than-temporary impairment;

- analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position and the expected recovery period;

- the financial condition of the issuer or issuers;

- the creditworthiness of the obligor of the security;

- actual collateral attributes;

any rating changes by a rating agency;

current analysts' evaluations;

the payment structure of the debt security and the likelihood of the issuer being able to make payments;

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current market conditions;

adverse conditions specifically related to the security, industry, or a geographic area;

the Group's intent to sell the debt security;

whether it is more-likely-than-not that the Group will be required to sell the debt security before its anticipated recovery;

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

### ***Derivative Instruments and Hedging Activities***

The Group maintains an overall interest rate risk-management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The Group's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net-interest margin is not, on a material basis, adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. Also, for some fixed-rate asset or liabilities. The effect of this variability in earnings is expected to be substantially offset by the Group's gains and losses on the derivative instruments that are linked to the forecasted cash flows of these hedged assets and liabilities. The Group considers its strategic use of derivatives to be a prudent method of managing interest-rate sensitivity, as it reduces the exposure of earnings and the market value of its equity to undue risk posed by changes in interest rates. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the Group's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result of interest rate fluctuations is that the contractual interest income and interest expense of hedged variable-rate assets and liabilities, respectively, will increase or decrease. Derivative instruments that are used as part of the Group's interest rate risk-management strategy include interest rate swaps, forward-settlement swaps, futures contracts, and option contracts that have indices related to the pricing of specific balance sheet assets and liabilities. Interest rate swaps generally involve the exchange of fixed and variable-rate interest payments between two parties, based on a common notional principal amount and maturity date. Interest rate futures generally involve exchange-traded contracts to buy or sell US Treasury bonds and notes in the future at specified prices. Interest rate options represent contracts that allow the holder of the option to (1) receive cash or (2) purchase, sell, or enter into a financial instrument at a specified price within a specified period. Some purchased option contracts give the Group the right to enter into interest rate swaps and cap and floor agreements with the writer of the option. In addition, the Group enters into certain transactions that contain embedded derivatives. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated and carried at fair value.

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

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

cash or value of the collateral delivered as part of the transactions in as far as it exceeds the fair value of the derivative. The Group minimizes the credit (or repayment) risk in derivative instruments by entering into transactions with high-quality counterparties.

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

The Group uses forward-settlement swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings, attributable to changes in LIBOR. Once the forecasted wholesale borrowings transactions occur, the interest rate swap will effectively lock-in the Group's interest rate payments on an amount of forecasted interest expense attributable to the one-month LIBOR

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corresponding to the swap notional. By employing this strategy, the Group minimizes its exposure to volatility in LIBOR.

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

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

### ***FDIC Shared-Loss Indemnification Asset***

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

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

### ***Core Deposit Intangible***

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

### ***Foreclosed Real Estate and Other Repossessed Property***

#### ***Non-covered Foreclosed Real Estate***

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

the carrying value over the estimated fair value, less estimated costs to

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sell, is charged to non-interest expenses. The costs and expenses associated to holding these properties in portfolio are expensed as incurred.

### ***Covered Foreclosed Real Estate and Other Repossessed Property***

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

### ***Income Taxes***

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

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of the Group's net deferred tax assets assumes that the Group will be able to generate sufficient future taxable income based on estimates and assumptions. If these estimates and related assumptions change in the future, the Group may be required to record valuation allowances against its deferred tax assets resulting in additional income tax expense in the consolidated statements of operations. Management evaluates the realizability of the deferred tax assets on a regular basis and assesses the need for a valuation allowance. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in valuation allowance from period to period are included in the Group's tax provision in the period of change.

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

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

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

On January 31, 2011, the Governor of Puerto Rico signed into law the Internal Revenue Code for a New Puerto Rico, which was subsequently amended (the 2011 Code). As such, the Puerto Rico Internal Revenue Code of 1994, as amended, (the 1994 Code) would be gradually repealed by the 2011 Code as its provisions started to take effect, with some exceptions, as of January 1, 2011. For corporate taxpayers, the 2011 Code retains the 20% regular income tax rate but establishes significant lower surtax rates. The 2011 Code provides a surtax rate from 5% to 10% for years

starting after December 31, 2010, but before January 1, 2014. That surtax rate may be reduced to 5% after December 31, 2013, if certain economic and budgetary control tests are met by the Government of Puerto Rico. If such economic tests are not met, the reduction of the surtax rate will start when such economic tests are met. In the case of a controlled group of corporations the determination of



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which surtax rate applies will be made by adding the net taxable income of each of the entities members of the controlled group reduced by the surtax deduction. The 2011 Code also provides a surtax deduction of \$750,000. In the case of controlled group of corporations, the surtax deduction should be distributed among the members of the controlled group. The alternative minimum tax is 20%. The 2011 Code eliminates the 5% additional surtax which was established by Act No. 7 of March 9, 2009, and the 5% recapture of the benefit of the income tax tables.

### ***Equity-Based Compensation Plan***

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

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

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

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

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

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

### ***Subsequent Events***

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

### ***Reclassifications***

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

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### ***Recent Accounting Developments:***

**Fair Value Measurements and Disclosures** FASB Accounting Standards Update 2010-06, Fair Value Measurements and Disclosures (FASB ASC Topic 820) Improving Disclosures about Fair Value Measurements, issued in January 2010, requires new disclosures and clarifies some existing disclosure requirements about fair value measurements as set forth in FASB ASC Subtopic 820-10. This update amends Subtopic 820-10 and now requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfer. Also in the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances and settlements. In addition, this update clarifies existing disclosures as follows: (i) for purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities, and (ii) a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This update is effective for interim and annual reporting periods beginning after December 15, 2009 except for the disclosures about purchases, sales, issuances, and settlements in the roll-forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. This Level 3 disclosure guidance was adopted on the Group's unaudited consolidated financial statements for the quarter ended March 31, 2011.

**Credit Quality and Allowance for Credit Losses Disclosures** In July 2010, FASB issued ASU No. 2010-20, Disclosures about Credit Quality of Financing Receivables and Allowance for Credit Losses. The ASU requires a greater level of disaggregated information about the allowance for credit losses and the credit quality of financing receivables. The period-end balance disclosure requirements for loans and the allowance for loan and lease losses is effective for reporting periods ending on or after December 15, 2010, while disclosures for activity during a reporting period that occurs in the loan and allowance for loan and lease losses accounts will be effective for reporting periods beginning on or after December 15, 2010. The Group adopted this guidance for period-end balance disclosures for loans and the allowance for loan and lease losses. Refer to Note 5 to the unaudited consolidated financial statements for additional information. In January 2011, FASB issued ASU No. 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20, which temporarily delays the effective date of the disclosures regarding troubled debt restructurings in ASU No. 2010-20 for public entities. The anticipated effective date is for interim and annual reporting periods beginning on or after June 15, 2011.

**Troubled Debt Restructuring** In January 2011, FASB issued ASU No. 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20, which temporarily delays the effective date of the disclosures regarding troubled debt restructurings in ASU No. 2010-20 for public entities. In April 2011, FASB issued ASU No. 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. ASU No. 2011-02 requires that when evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: a) the restructuring constitutes a concession; b) The debtor is experiencing financial difficulties. Also, the ASU sets the effective date when an entity should disclose the information deferred by ASU No. 2011-01, for interim and annual periods beginning on or after June 15, 2011. The Group is in the process of evaluating the effect this accounting guidance may have on the Group's unaudited consolidated financial statements.

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

### **NOTE 2 FDIC-ASSISTED ACQUISITION AND FDIC SHARED-LOSS INDEMNIFICATION ASSET**

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

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

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

The Bank and the FDIC have been engaged in ongoing discussions that impacted certain assets acquired or certain liabilities assumed by the Bank. The Bank and the FDIC have had several preliminary settlements since the FDIC-assisted acquisition that have been adjusted as re-measurement figures of the assets acquired and liabilities assumed on April 30, 2010. At March 31, 2011 there are \$1.8 million in FDIC net settlement payable. On April 29, 2011, following the anniversary of the FDIC-assisted acquisition, Oriental Bank and Trust and the FDIC reached a final settlement as part of the Purchase and Assumption Agreement.

The Bank has agreed to make a true-up payment, also known as clawback liability, to the FDIC on the date that is 45 days following the last day of the final shared loss month, or upon the final disposition of all covered assets under the loss sharing agreements in the event losses thereunder fail to reach expected levels. Under the loss sharing agreements, the Bank will pay to the FDIC 50% of the excess, if any, of: (i) 20% of the Intrinsic Loss Estimate of \$906.0 million (or \$181.2 million) (as determined by the FDIC) less (ii) the sum of: (A) 25% of the asset discount (per bid) (or (\$227.5 million)); plus (B) 25% of the cumulative shared-loss payments (defined as the aggregate of all of the payments made or payable to the Bank minus the aggregate of all of the payments made or payable to the FDIC); plus (C) the sum of the period servicing amounts for every consecutive twelve-month period prior to and ending on the True-Up Measurement Date in respect of each of the loss sharing agreements during which the loss sharing provisions of the applicable loss sharing agreement is in effect (defined as the product of the simple average of the principal amount of shared loss loans and shared loss assets at the beginning and end of such period times 1%). The true-up payment represents an estimated liability of \$13.8 million at April 30, 2010. This estimated liability is accounted for as part of the indemnification asset. The indemnification asset represents the portion of estimated losses covered by the loss sharing agreements between the Bank and the FDIC.

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

The FDIC shared-loss indemnification asset activity for the quarter ended March 31, 2011 is as follows:

	<b>Quarter Ended March 31, 2011 (In thousands)</b>
Balance at December 31, 2010	\$ 471,872
Shared-loss agreements reimbursements from the FDIC	(39,839)
Credit impairment losses to be covered under shared-loss agreements	3,645
Accretion of FDIC shared-loss indemnification asset, net	1,211
Balance at March 31, 2011	\$ 436,889

Table of Contents**NOTE 3 INVESTMENTS*****Money Market Investments***

The Group considers as cash equivalents all money market instruments that are not pledged and that have maturities of three months or less at the date of acquisition. At March 31, 2011, and December 31, 2010, cash equivalents included as part of cash and due from banks amounted to \$2.1 million and \$111.7 million, respectively.

***Investment Securities***

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

	Amortized Cost	Gross Unrealized Gains	March 31, 2011 Gross Unrealized Losses (In thousands)	Fair Value	Weighted Average Yield
<b>Available-for-sale</b>					
Obligations of Puerto Rico Government and political subdivisions	\$ 81,152	\$ 60	\$ 3,954	\$ 77,258	5.14%
Structured credit investments	61,725		16,563	45,162	3.69%
<b>Total investment securities</b>	<b>142,877</b>	<b>60</b>	<b>20,517</b>	<b>122,420</b>	
FNMA and FHLMC certificates	3,156,825	33,471	3,004	3,187,292	3.78%
GNMA certificates	108,905	8,805		117,710	5.23%
CMOs issued by US Government sponsored agencies	154,138	6,400	30	160,508	4.98%
<b>Total mortgage-backed securities</b>	<b>3,419,868</b>	<b>48,676</b>	<b>3,034</b>	<b>3,465,510</b>	
<b>Total securities available-for-sale</b>	<b>3,562,745</b>	<b>48,736</b>	<b>23,551</b>	<b>3,587,930</b>	<b>3.91%</b>
<b>Held-to-maturity</b>					
<b>Mortgage-backed securities</b>					
FNMA and FHLMC certificates	875,494		19,678	855,816	3.77%
<b>Total</b>	<b>\$ 4,438,239</b>	<b>\$ 48,736</b>	<b>\$ 43,229</b>	<b>\$ 4,443,746</b>	<b>3.88%</b>

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

The amortized cost and fair value of the Group's investment securities at March 31, 2011, by contractual maturity, are shown in the next table. Securities not due on a single contractual maturity date, such as collateralized mortgage obligations, are classified in the period of final contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

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	March 31, 2011			
	Available-for-sale		Held-to-maturity	
	Amortized Cost (In thousands)	Fair Value	Amortized Cost (In thousands)	Fair Value
<b>Investment securities</b>				
Due from 1 to 5 years				
Obligations of Puerto Rico Government and political subdivisions	\$ 10,386	\$ 10,341	\$	\$
<b>Total due from 1 to 5 years</b>	<b>10,386</b>	<b>10,341</b>		
Due after 5 to 10 years				
Obligations of Puerto Rico Government and political subdivisions	13,702	12,814		
Structured credit investments	11,977	9,427		
<b>Total due after 5 to 10 years</b>	<b>25,679</b>	<b>22,241</b>		
Due after 10 years				
Obligations of Puerto Rico Government and political subdivisions	57,064	54,103		
Structured credit investments	49,748	35,735		
<b>Total due after 10 years</b>	<b>106,812</b>	<b>89,838</b>		
<b>Total investment securities</b>	<b>142,877</b>	<b>122,420</b>		
<b>Mortgage-backed securities</b>				
Due after 5 to 10 years				
FNMA and FHLMC certificates	<b>12,779</b>	<b>13,526</b>		
Due after 10 years				
FNMA and FHLMC certificates	3,144,047	3,173,766	875,494	855,816
GNMA certificates	108,905	117,710		
CMOs issued by US Government sponsored agencies	154,137	160,508		
<b>Total due after 10 years</b>	<b>3,407,089</b>	<b>3,451,984</b>	<b>875,494</b>	<b>855,816</b>
<b>Total mortgage-backed securities</b>	<b>3,419,868</b>	<b>3,465,510</b>	<b>875,494</b>	<b>855,816</b>
<b>Total</b>	<b>\$ 3,562,745</b>	<b>\$ 3,587,930</b>	<b>\$ 875,494</b>	<b>\$ 855,816</b>

Keeping with the Group's investment strategy, during the quarters ended March 31, 2011 and 2010, there were certain sales of available-for sale securities because the Group felt at the time of such sales that gains could be realized while at the same time having good opportunities to invest the proceeds in other investment securities with attractive yields

and terms that would allow the Group to continue to protect its net interest margin. Also, the Group, as part of its asset/liability management, purchases US government sponsored agencies discount notes close to their maturities as a short term vehicle to reinvest the proceeds of sale transactions until investment securities with attractive yields can be purchased. During the quarters ended March 31, 2011 and March 31, 2010, the Group sold approximately \$10.6 million and \$267.0 million, respectively, of discount notes with minimal aggregate gross gains and losses, which amounted to less than \$1 thousand.



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The tables below present an analysis of the gross realized gains and losses by category for the quarters ended March 31, 2011 and 2010:

Description	Face Value	Cost	Quarter Ended March 31, 2011			
			Sale Price	Sale Book Value	Gross Gains	Gross Losses
			(In thousands)			
<b>Sale of Securities</b>						
<b>Available-for-Sale</b>						
<b>Investment securities</b>						
Obligations of U.S. Government sponsored agencies	\$ 10,600	\$ 10,599	\$ 10,600	\$ 10,600	\$	\$
<b>Total investment securities</b>	10,600	10,599	10,600	10,600		
<b>Mortgage-backed securities</b>						
FNMA and FHLMC certificates	1,056	1,073	1,073	1,073		
GNMA certificates	32,599	32,795	32,855	32,857		2
<b>Total mortgage-backed securities</b>	33,655	33,868	33,928	33,930		2
<b>Total</b>	<b>\$ 44,255</b>	<b>\$ 44,467</b>	<b>\$ 44,528</b>	<b>\$ 44,530</b>	<b>\$</b>	<b>\$ 2</b>

Description	Face Value	Cost	Quarter Ended March 31, 2010		Gross Gains	Gross Losses
			Sale Price	Sale Book Value		
			(In thousands)			
<b>Sale of Securities</b>						
<b>Available-for-Sale</b>						
<b>Investment securities</b>						
Obligations of U.S. Government sponsored agencies	\$ 267,000	\$ 265,990	\$ 266,996	\$ 266,996	\$	\$
<b>Mortgage-backed securities</b>						
FNMA and FHLMC certificates	902,967	750,615	687,211	675,191	12,020	
GNMA certificates	32,873	32,927	32,912	32,912		
Non-agency collateralized mortgage obligations	626,619	623,695	368,216	368,216		

<b>Total mortgage-backed securities</b>	1,562,459	1,407,237	1,088,339	1,076,319	12,020	
<b>Total</b>	<b>\$ 1,829,459</b>	<b>\$ 1,673,227</b>	<b>\$ 1,355,335</b>	<b>\$ 1,343,315</b>	<b>\$ 12,020</b>	<b>\$</b>

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

## March 31, 2011 Available-for-sale (In thousands)

	Less than 12 months		
	Amortized Cost	Unrealized Loss	Fair Value
FNMA and FHLMC certificates	\$ 291,849	\$ 3,004	\$ 288,845
Obligations of Puerto Rico Government and political subdivisions	19,974	119	19,855
CMOs issued by U.S. Government sponsored agencies	2,572	30	2,542
	<b>314,395</b>	<b>3,153</b>	<b>311,242</b>

	12 months or more		
	Amortized Cost	Unrealized Loss	Fair Value
Structured credit investments	61,725	16,563	45,162
Obligations of Puerto Rico Government and political subdivisions	50,792	3,835	46,957
	<b>112,517</b>	<b>20,398</b>	<b>92,119</b>

	Amortized Cost	Total Unrealized Loss	Fair Value
FNMA and FHLMC certificates	291,849	3,004	288,845
Structured credit investments	61,725	16,563	45,162
Obligations of Puerto Rico Government and political subdivisions	70,766	3,954	66,812
CMOs issued by US Government sponsored agencies	2,572	30	2,542
	<b>\$ 426,912</b>	<b>\$ 23,551</b>	<b>\$ 403,361</b>

## March 31, 2011 Held-to-maturity (In thousands)

	Less than 12 months		
	Amortized Cost	Unrealized Loss	Fair Value
FNMA and FHLMC certificates	\$ 875,494	\$ 19,678	\$ 855,816

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**December 31, 2010**  
**Available-for-sale**  
**(In thousands)**

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

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

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

**December 31, 2010**  
**Held-to-maturity**  
**(In thousands)**

	<b>Less than 12 months</b>		
	<b>Amortized Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>
FNMA and FHLMC certificates	<b>\$ 689,917</b>	<b>\$ 14,196</b>	<b>\$ 675,721</b>

The Group conducts quarterly reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairments. On April 1, 2009, the Group adopted 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.

ASC 320-10-65-1 requires the Group to consider various factors during its review, which include, but are not limited to:

identification and evaluation of investments that have indications of possible other-than-temporary impairment;

analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position and the expected recovery period;

the financial condition of the issuer or issuers;

the creditworthiness of the obligor of the security;

actual collateral attributes;

any rating changes by a rating agency;

current analysts' evaluations;

the payment structure of the debt security and the likelihood of the issuer being able to make payments;

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current market conditions;

adverse conditions specifically related to the security, industry, or a geographic area;

the Group's intent to sell the debt security;

whether it is more-likely-than-not that the Group will be required to sell the debt security before its anticipated recovery;

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

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

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

With regards to the structured credit investments with an unrealized loss position, the Group performs a detailed analysis of other-than-temporary impairments, which is explained in the following paragraphs. Other securities in an unrealized loss position at March 31, 2011 are mainly composed of securities issued or backed by U.S. government agencies and U.S. government-sponsored entities. These investments are primarily highly liquid securities that have a large and efficient secondary market. Valuations are performed on a monthly basis. The Group's management believes that the unrealized losses of such other securities at March 31, 2011, are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuer or guarantor. At March 31, 2011, the Group does not have the intent to sell these investments in unrealized loss position.

At March 31, 2011, the Group's portfolio of structured credit investments amounted to \$61.7 million (amortized cost) in the available-for-sale portfolio, with net unrealized losses of approximately \$16.6 million. The Group's structured credit investments portfolio consist of two types of instruments: synthetic collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs).

The CLOs are collateralized mostly by senior secured (via first liens) middle market commercial and industrial loans, which are securitized in the form of obligations. The Group invested in three of such instruments in 2007, and as of March 31, 2011, have an aggregate amortized cost of \$36.2 million and unrealized losses of \$7.4 million. These investments are all floating rate notes, which reset quarterly based on the three-month LIBOR rate.

The determination of the credit loss assumption in the discounted cash flow analysis related to the Group's structured credit investments is similar to the one used for the non-agency collateralized mortgage obligations, the difference being that the underlying data for each type of security is different, which affects the cash flow calculations. In the case of the CLOs, the determination of the future cash flows is based on the following factors:

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

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

Estimated default probabilities for each loan in the CLO. These are based on the credit ratings for each company in the structure, and this information also is obtained directly from the trustee's reports for each CLO

security. The default probabilities are adjusted based on the credit rating assuming the highest default probabilities for the loans of those entities with the lowest credit ratings. In addition to determining the current default probabilities, estimates are developed to calculate the cumulative default probabilities in successive years. To establish the reasonability of the default estimates, market-implied default rates are compared to historical credit ratings-based default rates.

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

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

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

The Group owns a corporate bond that partially holds a synthetic CDO with an amortized cost of \$25.5 million and unrealized losses of \$9.2 million as of March 31, 2011. Due to the nature of this corporate bond, the Group's analysis focuses primarily on the CDO. The basis for the determination of other-than-temporary impairments on this security consists on a series of analyses that include: the ongoing review of the level of subordination (attachment and detachment) that the structure maintains at each quarter end to determine the level of protection that remains after events of default may affect any of the entities in the CDO's reference portfolio; simulations performed on such reference portfolio to determine the probability of default by any of the remaining entities; the review of the credit default spreads for each entity in the reference portfolio to monitor their specific performance; and the constant monitoring of the CDO's credit rating.

As a result of the aforementioned analysis, the Group estimates that it will recover all interest and principal invested in the bond. This is based on the results of the analysis mentioned above which show that the subordination level (attachment/detachment) available under the structure of the CDO is sufficient to allow the Group to recover the value of its investment.

As a result of the aforementioned analyses, no other-than-temporary losses were recorded during the quarter ended March 31, 2011.

### **NOTE 4 PLEDGED ASSETS**

At March 31, 2011, residential mortgage loans amounting to \$592.6 million were pledged to secure advances and borrowings from the Federal Home Loan Bank ( FHLB ). Investment securities with fair values totaling \$3.8 billion, \$69.8 million and \$45.1 million at March 31, 2011, were pledged to secure securities sold under agreements to repurchase, Puerto Rico public fund deposits and deposits of the Puerto Rico Cash & Money Market Fund, respectively. Also, at March 31, 2011, investment securities with fair values totaling \$1.0 million were pledged against interest rate swaps contracts, while others with fair values of \$123 thousand were pledged as a bond for Trust operations to the OCFI. At December 31, 2010, residential mortgage loans amounting to \$512.0 million were pledged to secure advances and borrowings from the FHLB. Investment securities with fair values totaling \$3.8 billion, \$73.4 million, \$19.1 million, and \$47.5 million at December 31, 2010, were pledged to secure securities sold under agreements to repurchase, Puerto Rico public fund deposits, Federal Reserve Bank of New York advances, and deposits of the Puerto Rico Cash & Money Market Fund, respectively. Also, at December 31, 2010, investment securities with fair values totaling \$9.9 million were pledged against interest rate swaps contracts, while others with fair values of \$124 thousand were pledged as a bond for the Bank's trust operations to the OCFI.

As of March 31, 2011, and December 31, 2010, investment securities available-for-sale not pledged amounted to \$529.5 million and \$422.1 million, respectively. As of March 31, 2011, and December 31, 2010, mortgage loans not pledged amounted to \$464.9 million and \$394.4 million, respectively.



**Table of Contents****NOTE 5 LOANS RECEIVABLE AND ALLOWANCE FOR LOAN AND LEASE LOSSES****Loans Receivable Composition**

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

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
<b>Loans non-covered under shared-loss agreements with FDIC:</b>		
<b>Loans secured by real estate:</b>		
Residential - 1 to 4 family	\$ 837,645	\$ 847,402
Home equity loans, secured personal loans and others	23,957	25,080
Commercial	214,365	210,530
Deferred loan fees, net	(4,029)	(3,931)
	1,071,938	1,079,081
<b>Other loans:</b>		
Commercial	16,923	24,462
Personal consumer loans and credit lines	38,788	35,912
Leasing	13,763	10,257
Deferred loan fees, net	(361)	(423)
	69,113	70,208
<b>Loans receivable</b>	<b>1,141,051</b>	<b>1,149,289</b>
Allowance for loan and lease losses	(32,727)	(31,430)
<b>Loans receivable, net</b>	<b>1,108,324</b>	<b>1,117,859</b>
Mortgage loans held-for-sale	34,216	33,979
<b>Total loans non-covered under shared-loss agreements with FDIC, net</b>	<b>1,142,540</b>	<b>1,151,838</b>
<b>Loans covered under shared-loss agreements with FDIC:</b>		
Loans secured by 1-4 family residential properties	161,145	166,865
Construction and development secured by 1-4 family residential properties	16,516	17,253
Commercial and other construction	378,961	388,261
Leasing	69,630	79,093
Consumer	17,140	18,546
<b>Total loans covered under shared-loss agreements with FDIC</b>	<b>643,392</b>	<b>670,018</b>
Allowance for loan and lease losses on covered loans	(53,480)	(49,286)
<b>Total loans covered under shared-loss agreements with FDIC, net</b>	<b>589,912</b>	<b>620,732</b>
<b>Total loans receivable, net</b>	<b>\$ 1,732,452</b>	<b>\$ 1,772,570</b>



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The following table presents the aging of the recorded investment in gross loans as of March 31, 2011 and December 31, 2010 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans Past Due Over 90 Days and Still Accruing
<b>March 31, 2011:</b>							
<b>Loans not covered under shared-loss agreements with the FDIC:</b>							
<b>Mortgage</b>							
Residential							
Traditional	\$ 23,089	\$ 9,760	\$ 72,293	\$ 105,142	\$ 626,009	\$ 731,151	\$ 30,636
Non-traditional	1,843	835	10,582	13,260	63,847	77,107	3,163
Loss mitigation program	2,816	918	9,474	13,208	40,081	53,289	5,963
	27,748	11,513	92,349	131,610	729,937	861,547	39,762
Home equity loans, secured personal loans	148		333	481	995	1,476	
Other			55	55		55	
	<b>27,896</b>	<b>11,513</b>	<b>92,737</b>	<b>132,146</b>	<b>730,932</b>	<b>863,078</b>	<b>39,762</b>
<b>Commercial</b>	<b>1,742</b>	<b>1,557</b>	<b>22,685</b>	<b>25,984</b>	<b>205,304</b>	<b>231,288</b>	
<b>Consumer</b>							
Personal consumer loans and credit lines secured	74	13	45	132	5,733	5,865	
Personal consumer loans and credit lines unsecured	412	124	124	660	17,775	18,435	
Credit cards	323	114	268	705	3,804	4,509	
Overdrafts			6	6	8,497	8,503	
	<b>809</b>	<b>251</b>	<b>443</b>	<b>1,503</b>	<b>35,809</b>	<b>37,312</b>	
<b>Leasing</b>		<b>207</b>	<b>395</b>	<b>602</b>	<b>13,161</b>	<b>13,763</b>	
<b>Total loans not covered under</b>	<b>\$ 30,447</b>	<b>\$ 13,528</b>	<b>\$ 116,260</b>	<b>\$ 160,235</b>	<b>\$ 985,206</b>	<b>\$ 1,145,441</b>	<b>\$ 39,762</b>

**shared-loss  
agreements with  
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	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans Past Due Over 90 Days and Still Accruing
<b>December 31, 2010:</b>							
<b>Loans not covered under shared-loss agreements with the FDIC:</b>							
<b>Mortgage</b>							
Residential							
Traditional	\$ 22,093	\$ 9,414	\$ 76,604	\$ 108,111	\$ 638,158	\$ 746,269	\$ 37,850
Non-traditional	837	845	12,016	13,698	66,056	79,754	4,953
Loss mitigation program	2,528	1,043	9,336	12,907	33,497	46,404	6,060
	25,458	11,302	97,956	134,716	737,711	872,427	48,863
Home equity loans, secured personal loans	149		340	489	961	1,450	
Other			55	55		55	
	<b>25,607</b>	<b>11,302</b>	<b>98,351</b>	<b>135,260</b>	<b>738,672</b>	<b>873,932</b>	<b>48,863</b>
<b>Commercial</b>	<b>1,123</b>	<b>9,367</b>	<b>13,390</b>	<b>23,880</b>	<b>210,396</b>	<b>234,276</b>	
<b>Consumer</b>							
Personal consumer loans and credit lines secured	23			23	4,853	4,876	
Personal consumer loans and credit lines unsecured	419	207	136	762	17,576	18,338	
Credit cards	262	173	285	720	3,620	4,340	
Overdrafts					7,624	7,624	
	<b>704</b>	<b>380</b>	<b>421</b>	<b>1,505</b>	<b>33,673</b>	<b>35,178</b>	
<b>Leasing</b>		<b>79</b>	<b>35</b>	<b>114</b>	<b>10,143</b>	<b>10,257</b>	
<b>Total loans not covered under</b>	<b>\$ 27,434</b>	<b>\$ 21,128</b>	<b>\$ 112,197</b>	<b>\$ 160,759</b>	<b>\$ 992,884</b>	<b>\$ 1,153,643</b>	<b>\$ 48,863</b>

**shared-loss  
agreements with  
the FDIC**

***Non-covered Loans***

The Group's credit activities are mainly with customers located in Puerto Rico. The Group's loan transactions are encompassed within four main categories: mortgage, commercial, consumer and leases. The latter business was added to the Group's credit activities as a result of the FDIC-assisted acquisition.

At March 31, 2011 and December 31, 2010, the Group had \$81.4 million and \$73.4 million, respectively, of non-accrual non-covered loans including credit cards accounted under ASC 310-20. At March 31, 2011 and December 31, 2010, loans of which terms have been extended that are not included in non-performing assets amounted to \$30.0 million and \$35.0 million, respectively. The covered loans that may have been classified as non-performing loans by the acquired banks are no longer classified as non-performing because these loans are accounted for on a pooled basis. Management's judgment is required in classifying loans in pools subject to ASC Subtopic 310-30 as performing loans, and is dependent on having a reasonable expectation about the timing and amount of the pool cash flows to be collected, even if certain loans within the pool are contractually past due.

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

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
<b>Mortgage</b>		
Residential		
Traditional	\$ 41,656	\$ 38,754
Non-traditional	7,419	7,063
Loss mitigation program	3,511	3,276
	52,586	49,093
Home equity loans, secured personal loans	333	340
Other	55	55
	<b>52,974</b>	<b>49,488</b>
 <b>Commercial</b>	 <b>27,562</b>	 <b>23,619</b>
 <b>Consumer</b>		
Personal consumer loans and credit lines    unsecured	176	136
Credit cards	268	285
	<b>444</b>	<b>421</b>
 <b>Leasing</b>	 <b>395</b>	 <b>35</b>
 <b>Total</b>	 <b>\$ 81,375</b>	 <b>\$ 73,563</b>

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

***Credit Quality Indicators***

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

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

Included in the review of individual loans are those that are impaired. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or as a practical

expedient, at the observable market price of the loan or the fair value of the collateral, if the loan is collateral dependent. Loans are individually evaluated for impairment, except large groups of small balance homogeneous loans that are collectively evaluated for impairment, and loans that are recorded at fair value or at the lower of cost or fair value. The Group measures for impairment all commercial loans over \$250 thousand and over 90-days past-due. The portfolios of loans secured by real estate (except commercial), leases and consumer loans are considered homogeneous, and are evaluated collectively for impairment.



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The Group uses the following definitions for risk ratings:

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

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

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

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

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

	Balance Outstanding at March 31, 2011	Pass	Special Mention	Delinquency Substandard	Doubtful	ASC 310-10-35
				(In thousands)		
Commercial	\$ 231,288	\$ 181,278	\$ 5,682	\$ 16,516	\$ 141	\$ 27,671

	Balance Outstanding at December 31, 2010	Pass	Special Mention	Delinquency Substandard	Doubtful	ASC 310-10-35
				(In thousands)		
Commercial	\$ 234,276	\$ 188,281	\$ 5,908	\$ 14,046	\$ 143	\$ 25,898

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

	<b>Balance Outstanding at March 31, 2011</b>	<b>0-90 days</b>	<b>91-120 days</b>	<b>Delinquency 121-365 days (In thousands)</b>	<b>Over 365 days</b>	<b>ASC 310-10-35</b>
Mortgage						
Traditional	\$ 731,151	\$ 658,858	\$ 4,880	\$ 25,756	\$ 41,657	\$
Non-traditional	77,107	66,525	209	2,954	7,419	
Loss mitigation program	53,289	16,041	88	1,101	2,852	33,207
	861,547	741,424	5,177	29,811	51,928	33,207
Home equity loans, secured personal loans	1,476	1,143			333	
Other	55				55	
	863,078	742,567	5,177	29,811	52,316	33,207
Consumer	37,312	36,869	185	258		
Leasing	13,763	13,368	200	195		
<b>Total</b>	<b>\$ 914,153</b>	<b>\$ 792,804</b>	<b>\$ 5,562</b>	<b>\$ 30,264</b>	<b>\$ 52,316</b>	<b>\$ 33,207</b>

	<b>Balance Outstanding at December 31, 2010</b>	<b>0-90 days</b>	<b>91-120 days</b>	<b>Delinquency 121-365 days (In thousands)</b>	<b>Over 365 days</b>	<b>ASC 310-10-35</b>
Mortgage						
Traditional	\$ 746,269	\$ 669,665	\$ 5,560	\$ 32,291	\$ 38,753	\$
Non-traditional	79,754	67,738	1,012	3,941	7,063	
Loss mitigation program	46,404	7,738		2,064	2,553	34,049
	872,427	745,141	6,572	38,296	48,369	34,049
Home equity loans, secured personal loans	1,450	1,110			340	
Other	55				55	
	873,932	746,251	6,572	38,296	48,764	34,049
Consumer	35,178	33,817	1,129	232		
Leasing	10,257	10,222	8	27		
<b>Total</b>	<b>\$ 919,367</b>	<b>\$ 790,290</b>	<b>\$ 7,709</b>	<b>\$ 38,555</b>	<b>\$ 48,764</b>	<b>\$ 34,049</b>

For covered loans, the Group also evaluates credit quality based on the delinquency status of the loan, comparing information from acquisition date through March 31, 2011.

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The Group also evaluates covered loans using severity factors. From the acquisition date through March 31, 2011, there have been no adverse changes from those originally estimated that would cause changes to the initial loss severity factors estimated for these loans. The majority of covered loans are secured by existing commercial real estate properties. There has been no recent adverse experiences, different to the originally estimated, that would require a change in the expectation on collateral values, and the corresponding assumptions.

**Allowance for Loan and Lease Losses****Non-Covered Loans**

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

The following table presents the changes and the balance in the allowance for loan and lease losses and the recorded investment in gross loans by portfolio segment and based on impairment method as of March 31, 2011:

	<b>Mortgage</b>	<b>Commercial</b>	<b>Consumer</b>	<b>Leasing</b>	<b>Unallocated</b>	<b>Total</b>
<b>March 31, 2011</b>						
<b>Allowance for loan and lease losses for non-covered loans:</b>						
Balance at beginning of period	\$ 16,179	\$ 11,153	\$ 2,286	\$ 860	\$ 952	\$ 31,430
Charge-offs	(1,821)	(309)	(448)	(60)		(2,638)
Recoveries	45	37	53			135
Provision for non-covered loan and lease losses	3,462	1,126	(6)	158	(940)	3,800
Balance at end of period	\$ 17,865	\$ 12,007	\$ 1,885	\$ 958	\$ 12	\$ 32,727
 Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 2,229	\$ 1,164	\$	\$	\$	\$ 3,393
Collectively evaluated for impairment	15,636	10,843	1,885	958	12	29,334
 Total ending allowance balance	\$ 17,865	\$ 12,007	\$ 1,885	\$ 958	\$ 12	\$ 32,727
 <b>Loans:</b>						
Individually evaluated for impairment	\$ 33,207	\$ 27,671	\$	\$	\$	\$ 60,878
	828,395	203,617	38,788	13,763		1,084,563

Collectively evaluated  
for impairment

Total ending non-covered loans balance	\$ 861,602	\$ 231,288	\$ 38,788	\$ 13,763	\$	\$ 1,145,441
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	<b>Mortgage</b>	<b>Commercial</b>	<b>Consumer</b>	<b>Leasing</b>	<b>Unallocated</b>	<b>Total</b>
<b>March 31, 2010</b>						
<b>Allowance for loan and lease losses for non-covered loans:</b>						
Balance at beginning of period	\$ 15,044	\$ 7,112	\$ 864	\$	\$ 252	\$ 23,272
Charge-offs	(1,096)	(110)	(186)			(1,392)
Recoveries		11	72			83
Provision for non-covered loan and lease losses	3,841	(701)	(72)		946	4,014
Balance at end of period	\$ 17,789	\$ 6,312	\$ 678	\$	\$ 1,198	\$ 25,977
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 706	\$ 624	\$	\$	\$	\$ 1,330
Collectively evaluated for impairment	17,083	5,688	678		1,198	24,647
Total ending allowance balance	\$ 17,789	\$ 6,312	\$ 678	\$	\$ 1,198	\$ 25,977
<b>Loans:</b>						
Individually evaluated for impairment	\$ 10,490	\$ 16,594	\$	\$	\$	\$ 27,084
Collectively evaluated for impairment	895,792	187,145	22,954			1,105,891
Total ending non-covered loans balance	\$ 906,282	\$ 203,739	\$ 22,954	\$	\$	\$ 1,132,975

The Group evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. At March 31, 2011, the total investment in impaired commercial loans was \$27.7 million (December 31, 2010 \$25.9 million). The impaired commercial loans were measured based on the fair value of collateral. The valuation allowance for impaired commercial loans amounted to approximately \$1.2 million and \$823 thousand at March 31, 2011 and December 31, 2010, respectively. At March 31, 2011, the total investment in impaired mortgage loans was \$33.2 million (December 31, 2010 \$34.0 million). Impairment on mortgage loans assessed as troubled debt restructuring was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately \$2.2 million and \$2.3 million at March 31, 2011 and December 31, 2010, respectively.



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

<b>March 31, 2011</b>					
	<b>Unpaid Principal</b>	<b>Recorded Investment</b>	<b>Specific Allowance (In thousands)</b>	<b>Coverage</b>	<b>Average Recorded Investment</b>
Impaired loans with specific allowance					
Commercial	\$ 18,025	\$ 16,146	\$ 1,164	7%	\$ 16,576
Residential loss mitigation program	33,207	33,207	2,229	7%	34,324
Impaired loans with no specific allowance					
Commercial	11,525	11,525		0%	10,541
<b>Total investment in impaired loans</b>	<b>\$ 62,757</b>	<b>\$ 60,878</b>	<b>\$ 3,393</b>	<b>6%</b>	<b>\$ 61,441</b>

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

The impaired commercial loans were measured based on the fair value of collateral. Impairment on mortgage loans assessed as troubled debt restructuring was measured using the present value of cash flows.

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

<b>Interest Income Recognized For the Quarter Ended March 31,</b>		
	<b>2011</b>	<b>2010</b>
Impaired loans with specific allowance		
Commercial	\$ 144	\$ 108
Residential Loss mitigation program	484	156



Impaired loans with no specific allowance				
Commercial		197		98
<b>Total interest income from impaired loans</b>		<b>\$ 825</b>	<b>\$</b>	<b>362</b>

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**Table of Contents*****Covered Loans under ASC 310-30***

The Group's acquired loans under the FDIC-assisted acquisition of Eurobank were initially recorded at fair value and no separate valuation allowance was recorded at the date of acquisition. The Group is required to review each loan at acquisition to determine if it should be accounted for under ASC 310-30 and if so, determines whether each loan is to be accounted for individually or whether loans will be aggregated into pools of loans based on common risk characteristics. The Group has performed its analysis of the loans to be accounted for as impaired under ASC 310-30 ( Impaired Loans in the tables below). For the loans acquired in the FDIC-assisted acquisition that are not within the scope of ASC 310-30 ( Non-Impaired Loans in the tables below), the Group followed the income recognition and disclosure guidance in ASC 310-30. During the evaluation of whether a loan was considered impaired under ASC 310-30, the Group considered a number of factors, including the delinquency status of the loan, payment options and other loan features (i.e. reduced documentation, interest only, or negative amortization features), the geographic location of the borrower or collateral and the risk rating assigned to the loans. Based on the criteria, the Group considered the entire Eurobank portfolio, except for credit cards, to be impaired and accounted for under ASC 310-30. Credit cards were accounted under ASC 310-20. During the fourth quarter of 2010, these credit cards were cancelled and new agreements were made with to these customers.

To the extent credit deterioration occurs in covered loans after the date of acquisition, the Group would record an allowance for loan and lease losses. Also, the Group would record an increase in the FDIC loss-share indemnification asset for the expected reimbursement from the FDIC under the shared-loss agreements. For the quarter ended March 31, 2011, there have been deviations between actual and expected cash flows in several pools of loans acquired in the FDIC-assisted acquisition. These deviations are both positive and negative in nature. Even though actual cash flows for the aggregate pools acquired were more than the expected cash flows for the year ended March 31, 2011 the Group continues to evaluate these deviations to assess whether there have been additional deterioration since the acquisition. At March 31, 2011 the Group concluded that certain pools reflect a higher than expected credit deterioration and as such has recorded impairment on the pools impacted. In addition, for other pools, positive deviations have been also assessed as temporary in nature and no additions to accretable discount have been recorded at March 31, 2011. In the event that in future periods the positive trend continues, there may be additions to the accretable discount which will increase the yield on the pools that have positive deviations between actual and expected cash flows.

The carrying amount of these loans included in the balance sheet amount of total loans at March 31, 2011 is as follows:

	<b>Total Loans Acquired (In thousands)</b>
Contractual balance	\$ 1,145,058
Carrying amount	\$ 643,392

The following tables describe the accretable yield and non-accretable discount activity for the quarter ended March 31, 2011:

	<b>Accretable Yield Activity (In thousands)</b>
Balance at December 31, 2010	\$ (148,558)
Accretion	14,226
Transfer to non-accretable discount	4,091
Cost recovery	(294)

Balance at March 31, 2011	\$ (130,535)
	<b>Non-Accrutable Discount Activity (In thousands)</b>
Balance at December 31, 2010	\$ (603,309)
Principal losses	42,863
Transfer from accretable discount	(4,091)
Cost recovery	294
Balance at March 31, 2011	\$ (564,243)

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

	<b>March 31, 2011</b>				
	<b>Unpaid Principal</b>	<b>Recorded Investment</b>	<b>Specific Allowance (In thousands)</b>	<b>Coverage</b>	<b>Average Recorded Investment</b>
Covered Loans					
Impaired covered loans with specific allowance					
Loans secured by 1-4 family residential properties	\$ 63,085	\$ 44,013	\$ 5,019	11%	\$ 44,826
Construction and development secured by 1-4 family residential properties	55,337	11,519	1,670	15%	11,584
Commercial and other construction	620,533	305,006	43,840	14%	310,639
Consumer	26,297	16,985	2,951	17%	18,680
<b>Total investment in impaired covered loans</b>	<b>\$ 765,252</b>	<b>\$ 377,523</b>	<b>\$ 53,480</b>	<b>14%</b>	<b>\$ 385,729</b>

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

Loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest

income may be recognized on a cash basis or as a reduction of the principal amount outstanding.

As a result of impairment on various pools of covered loans the changes in the allowance for loan and lease losses on covered loans for the quarter ended March 31, 2011 was as follows:

	<b>Quarter Ended March 31, 2011 (In thousands)</b>
<b>Balance at beginning of the period</b>	\$ 49,286
Provision for covered loan and lease losses	549
FDIC loss-share portion of provision for covered loan and lease losses	3,645
<b>Balance at end of the period</b>	<b>\$ 53,480</b>

**Table of Contents****NOTE 6 SERVICING ASSETS**

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

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

The fair value of servicing rights is estimated by using a cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration actual and expected loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions. At March 31, 2011 servicing assets are composed of \$9.4 million (\$8.9 million December 31, 2010) related to residential mortgage loans and \$598 thousand of leasing servicing assets acquired in the FDIC-assisted acquisition on April 30, 2010.

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

	<b>Quarter Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
<b>Fair value at beginning of period</b>	\$ 9,695	\$ 7,120
Servicing from mortgage securitizations or assets transfers	520	685
Changes due to payments on loans	(608)	(104)
Changes in fair value due to changes in valuation model inputs or assumptions	356	(132)
<b>Fair value at end of period</b>	<b>\$ 9,963</b>	<b>\$ 7,569</b>

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

	<b>Quarter Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Constant prepayment rate</b>	7.87% - 15.74%	8.40% - 29.58%
<b>Discount rate</b>	11.00% - 14.00%	11.00% - 14.00%

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

	<b>Quarter Ended March 31,</b>
	<b>2011</b>
<b>Discount rate</b>	13.58% - 17.38%



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

	<b>March 31, 2011 (in thousands)</b>
<b>Mortgage related servicing asset</b>	
<b>Carrying value of mortgage servicing asset</b>	\$ 9,365
<b>Constant prepayment rate</b>	
Decrease in fair value due to 10% adverse change	\$ (344)
Decrease in fair value due to 20% adverse change	\$ (668)
<b>Discount rate</b>	
Decrease in fair value due to 10% adverse change	\$ (428)
Decrease in fair value due to 20% adverse change	\$ (820)
<b>Leasing servicing asset</b>	
<b>Carrying value of leasing servicing asset</b>	\$ 598
<b>Discount rate</b>	
Decrease in fair value due to 10% adverse change	(7)
Decrease in fair value due to 20% adverse change	\$ (14)

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

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

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

Servicing fee income is based on a contractual percentage of the outstanding principal and is recorded as income when earned. Servicing fees on mortgage loans totaled \$719 thousand and \$485 thousand for the quarters ended March 31, 2011 and 2010, respectively. There were no late fees and ancillary fees recorded in such periods. Servicing fees on leases amounted to \$441 thousand for the quarter ended March 31, 2011. There were no servicing fees on leases during the quarter ended March 31, 2010.



**Table of Contents****NOTE 7 PREMISES AND EQUIPMENT**

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

	Useful Life (Years)	March 31, 2011 (In thousands)	December 31, 2010
Land		\$ 2,328	\$ 2,328
Buildings and improvements	40	6,295	6,301
Leasehold improvements	5 10	20,440	20,564
Furniture and fixtures	3 7	10,009	10,099
Information technology and other	3 7	19,190	19,074
		58,262	58,366
Less: accumulated depreciation and amortization		(34,909)	(34,425)
		<b>\$ 23,353</b>	<b>\$ 23,941</b>

Depreciation and amortization of premises and equipment for the quarters ended March 31, 2011 and 2010, totaled \$1.5 million and \$1.3 million, respectively. These are included in the consolidated statements of operations as part of occupancy and equipment expenses.

**NOTE 8 DERIVATIVE ACTIVITIES**

During the quarter ended March 31, 2011, losses of \$4.0 million were recognized and reflected as Derivative Activities in the unaudited consolidated statements of operations. These losses were mainly due to realized losses of \$4.3 million from terminations of forward-settlement swaps with a notional amount of \$1.25 billion. These terminations allowed the Group to enter into new forward-settlement swap contracts with a notional amount of \$950 million, all of which were designated as hedging instruments. During the quarter ended March 31, 2010 losses of \$10.6 million were recognized and reflected as Derivative Activities in the unaudited consolidated statements of operations. These losses were mainly due to the fair value adjustment to the forward-settlement swaps held by the Group at March 31, 2010.

***Forward-settlement Swaps***

During the quarter ended March 31, 2011, the Group terminated all of its \$1.250 billion open forward-settlement swaps with realized losses of \$4.3 million. At the same time the Group entered into \$950 million of new forward-settlement swaps, all of which were designated as cash flow hedges. The Group entered into the forward-settlement swaps to hedge the variability of future interest cash flows of forecasted wholesale borrowings, attributable to changes in the one-month LIBOR rate. Once the forecasted wholesale borrowings transactions occur, the interest rate swap will effectively fix the Group's interest payments on an amount of forecasted interest expense attributable to the one-month LIBOR corresponding to the swap notional stated rate.

These forward-settlement swaps were designated as cash flow hedges for the forecasted wholesale borrowings transactions and properly documented as such, therefore, qualifying for cash flow hedge accounting. Changes in the fair value of these derivatives are recorded in accumulated other comprehensive income to the extent there is no significant ineffectiveness in the cash flow hedges. Currently, the Group does not expect to reclassify any amount included in other comprehensive income related to these forward-settlement swaps to earnings in the next twelve months.

There were no derivatives designated as a hedge as of December 31, 2010.

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A derivative asset of \$7.1 million was recognized at March 31, 2011, related to the valuation of these swaps. The following table shows a summary of these swaps and their terms, at March 31, 2011:

Notional Amount (In thousands)	Fixed Rate	Trade Date	Settlement Date	Maturity Date
\$ 100,000	1.1275%	03/18/11	12/28/11	06/28/13
100,000	1.2725%	03/18/11	12/28/11	09/28/13
125,000	1.6550%	03/18/11	05/09/12	02/09/14
100,000	1.5300%	03/18/11	12/28/11	03/28/14
125,000	1.7700%	03/18/11	05/09/12	05/09/14
100,000	1.8975%	03/18/11	05/09/12	08/09/14
100,000	1.9275%	03/18/11	12/28/11	01/28/15
100,000	2.0000%	03/18/11	12/28/11	03/28/15
100,000	2.1100%	03/18/11	12/28/11	06/28/15
<b>\$ 950,000</b>				

A gain of \$7.1 million was recognized in accumulated other comprehensive income related to the valuation of these swaps during the quarter ended March 31, 2011.

**Swap Options**

In November 2010, the Group purchased options to enter into interest rate swaps, not designated as cash flow hedges, with an aggregate notional amount of \$250 million. At March 31, 2011, the purchased options used to manage the exposure on the interest rate swaps represented an asset of \$7.8 million in the consolidated statements of financial position. The following table shows a summary of these swap options and their terms, at March 31, 2011:

Notional Amount (In thousands)	Fixed Rate	Trade Date	Option Maturity Date	Swap Start Date	Swap Maturity Date
\$ 100,000	2.1225%	11/15/10	08/10/12	08/14/12	05/14/15
150,000	2.6400%	11/15/10	12/04/12	12/06/12	06/06/16
<b>\$ 250,000</b>					

**Options tied to Standard & Poor's 500 Stock Market Index**

The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index (S&P Index). The Group uses option agreements with major broker-dealer companies to manage its exposure to changes in this index. Under the terms of the option agreements, the Group receives the average increase in the month-end value of the index in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings. At March 31, 2011 and December 31, 2010, the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of \$11.8 million (notional amount of \$147.5 million) and \$9.9 million (notional amount of \$149.0 million), respectively; the options sold to customers embedded in the certificates of deposit and recorded as deposits in the unaudited consolidated statements of financial condition, represented a liability of \$14.3 million (notional amount of \$142.0 million) and \$12.8 million (notional amount of \$143.4 million), respectively, and are included in other liabilities on the unaudited consolidated statements of financial condition.



**Table of Contents****NOTE 9 ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS**

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

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Loans	\$ 10,913	\$ 11,068
Investments	17,721	17,648
	<b>\$ 28,634</b>	<b>\$ 28,716</b>

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

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Prepaid FDIC insurance	\$ 15,173	\$ 16,796
Servicing assets	9,963	9,695
Other prepaid expenses	8,133	8,224
Goodwill	3,662	3,662
Mortgage tax credits	3,105	3,105
Other repossessed assets (covered by FDIC shared-loss agreements)	2,479	2,341
Debt issuance costs	1,991	2,299
Core deposit intangible	1,292	1,328
Investment in Statutory Trust	1,086	1,086
Accounts receivable and other assets	15,722	15,886
	<b>\$ 62,606</b>	<b>\$ 64,422</b>

On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 31, 2009, along with each institution's risk-based deposit insurance assessment for the third quarter of 2009. The prepayment balance of the assessment for 2010, 2011 and 2012 amounted to \$15.2 million and \$16.8 million at March 31, 2011 and December 31, 2010, respectively.

In December 2007, the Commonwealth of Puerto Rico established mortgage loan tax credits for financial institutions that provided financing for the acquisition of new homes. At March 31, 2011 and December 31, 2010, mortgage loan tax credits for the Group amounted to \$3.1 million in both periods.

Other repossessed assets amounting to \$2.5 million and \$2.4 million at March 31, 2011 and December 31, 2010, respectively, represent covered assets under the FDIC shared-loss agreements and are related to the Eurobank leasing portfolio acquired under the FDIC-assisted acquisition.

In March 2009, the Group's banking subsidiary issued \$105 million in notes guaranteed under the FDIC Temporary Liquidity Guarantee Program. Shortly after issuance of the notes, the Group paid \$3.2 million (equivalent to an annual fee of 100 basis points) to the FDIC to maintain the FDIC guarantee coverage until the maturity of the notes. These costs have been deferred and are being amortized over the term of the notes. At March 31, 2011 and December 31, 2010, this deferred issue cost was \$2.0 million and \$2.3 million, respectively.

**Table of Contents****NOTE 10 DEPOSITS AND RELATED INTEREST**

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

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Non-interest bearing demand deposits	\$ 175,679	\$ 170,705
Interest-bearing savings and demand deposits	1,012,710	1,019,539
Individual retirement accounts	358,688	361,972
Retail certificates of deposit	490,313	477,180
 Total retail deposits	 2,037,390	 2,029,396
Institutional deposits	240,779	280,617
Brokered deposits	223,303	278,875
	<b>\$ 2,501,472</b>	<b>\$ 2,588,888</b>

At March 31, 2011 and December 31, 2010, the weighted average interest rate of the Group's deposits was 1.91%, and 2.12%, respectively, inclusive of non-interest bearing deposits of \$175.6 million, and \$170.6 million, respectively. Interest expense for the quarters ended March 31, 2011 and 2010 is set forth below:

	<b>Quarter Ended March 31, 2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Demand and savings deposits	\$ 4,597	\$ 3,904
Certificates of deposit	7,617	7,339
	<b>\$ 12,214</b>	<b>\$ 11,243</b>

At March 31, 2011 and December 31, 2010, time deposits in denominations of \$100 thousand or higher amounted to \$575.5 million, and \$590.0 million, including public fund deposits from various local government agencies of \$65.1 million and \$65.3 million at a weighted average rate of 0.00% in both periods, which were collateralized with investment securities with fair value of \$69.8 million and \$73.4 million, respectively.

Excluding equity indexed options in the amount of \$14.3 million, which are used by the Group to manage its exposure to the Standard & Poor's 500 stock market index, and also excluding accrued interest of \$5.7 million and unamortized deposit discounts in the amount of \$7.9 million, the scheduled maturities of certificates of deposit at March 31, 2011 are as follows:

	<b>(In thousands)</b>
Within one year:	
Three (3) months or less	\$ 379,282
Over 3 months through 1 year	465,824
	845,106
Over 1 through 2 years	264,556
Over 2 through 3 years	115,852
Over 3 through 4 years	43,202
Over 4 through 5 years	32,341

**\$ 1,301,057**

The aggregate amount of overdraft in demand deposit accounts that were reclassified to loans amounted to \$8.5 million as of March 31, 2011 (\$7.6 million December 31, 2010).

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Table of Contents**NOTE 11 BORROWINGS*****Short Term Borrowings***

At March 31, 2011, short term borrowings amounted to \$32.3 million (December 31, 2010 \$42.5 million) which mainly consist of overnight borrowings with a weighted average rate of 0.53% (December 31, 2010 0.60%).

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

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

At March 31, 2011 and December 31, 2010, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of \$6.6 million and \$6.8 million, respectively, were as follows:

	<b>March 31, 2011</b>		<b>December 31, 2010</b>	
	<b>Borrowing Balance</b>	<b>Fair Value of Underlying Collateral</b>	<b>Borrowing Balance</b>	<b>Fair Value of Underlying Collateral</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
Citigroup Global Markets Inc.	\$ 1,600,000	\$ 1,739,088	\$ 1,600,000	\$ 1,752,619
Credit Suisse Securities (USA) LLC	1,250,000	1,323,982	1,250,000	1,325,392
UBS Financial Services Inc.	500,000	597,404	500,000	605,706
JP Morgan Chase Bank NA	100,000	119,495	100,000	119,997
<b>Total</b>	<b>\$ 3,450,000</b>	<b>\$ 3,779,969</b>	<b>\$ 3,450,000</b>	<b>\$ 3,803,714</b>

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The original terms of the Group's structured repurchase agreements range between three and ten years, and except for the \$300 million repurchase agreement that settled on March 28, 2011 with a weighted average coupon of 2.86% and maturity of September 28, 2014 (as described below), the counterparties have the right to exercise put options at par on a quarterly basis before their contractual maturity from one to three years after the agreements' settlement dates. The following table shows a summary of these agreements and their terms, excluding accrued interest in the amount of \$6.6 million, at March 31, 2011:

<b>Year of Maturity</b>	<b>Borrowing Balance (In thousands)</b>	<b>Weighted- Average Coupon</b>	<b>Settlement Date</b>	<b>Maturity Date</b>	<b>Next Put Date</b>
2011	\$ 100,000	4.17%	12/28/2006	12/28/2011	6/28/2011
	50,000	4.13%	12/28/2006	12/28/2011	6/28/2011
	100,000	4.29%	12/28/2006	12/28/2011	6/28/2011
	350,000	4.25%	12/28/2006	12/28/2011	6/28/2011
	600,000				
2012	350,000	4.26%	5/9/2007	5/9/2012	5/9/2011
	100,000	4.50%	8/14/2007	8/14/2012	5/16/2011
	100,000	4.47%	9/13/2007	9/13/2012	6/13/2011
	150,000	4.31%	3/6/2007	12/6/2012	6/6/2011
	700,000				
2014	100,000	4.72%	7/27/2007	7/27/2014	4/27/2011
	300,000	2.86%	3/28/2011	9/28/2014	N/A
	400,000				
2017	500,000	4.67%	3/2/2007	3/2/2017	6/2/2011
	250,000	0.25%	3/2/2007	3/2/2017	6/2/2011
	100,000	0.00%	6/6/2007	3/6/2017	6/6/2011
	900,000	0.00%	3/6/2007	6/6/2017	6/6/2011
	1,750,000				
	<b>\$ 3,450,000</b>	<b>2.70%</b>			

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



0.25% to at least their next put dates scheduled for June 2011.

***Advances from the Federal Home Loan Bank***

Advances are received from the FHLB under an agreement whereby the Group is required to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances. At March 31, 2011, these advances were secured by mortgage loans amounting to \$592.6 million. Also, at March 31, 2011, the Group has an additional borrowing capacity with the FHLB of \$153.9 million. At March 31, 2011, the weighted average remaining maturity of FHLB's advances was 20.19 months (December 31, 2010 23.15 months).

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In 2007, the Group restructured most of its FHLB advances portfolio into longer-term, structured advances. The original terms of these advances range between five and seven years, and the FHLB has the right to exercise put options at par on a quarterly basis before the contractual maturity of the advances from six months to one year after the advances' settlement dates. The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of \$1.7 million, at March 31, 2011:

Year of Maturity	Weighted-Average		Settlement Date	Maturity Date	Next Put Date
	Borrowing Balance (In thousands)	Coupon			
2012					
	\$ 25,000	4.37%	5/4/2007	5/4/2012	5/4/2011
	25,000	4.57%	7/24/2007	7/24/2012	4/24/2011
	25,000	4.26%	7/30/2007	7/30/2012	4/31/2011
	50,000	4.33%	8/10/2007	8/10/2012	5/11/2011
	100,000	4.09%	8/16/2007	8/16/2012	5/16/2011
	225,000				
2014					
	25,000	4.20%	5/8/2007	5/8/2014	5/8/2011
	30,000	4.22%	5/11/2007	5/11/2014	5/10/2011
	55,000				
	<b>\$ 280,000</b>	<b>4.24%</b>			

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

***Subordinated Capital Notes***

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

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

The proceeds from this issuance were used by the Statutory Trust II to purchase a like amount of floating rate junior subordinated deferrable interest debentures (subordinated capital note) issued by the Group. The subordinated capital note has a par value of \$36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (3.26% at March 31, 2011; 3.25% at December 31, 2010), payable quarterly, and matures on September 17, 2033. The subordinated capital note purchased by the Statutory Trust II may be called at par after five years and quarterly thereafter (next call date June 2011). The trust redeemable preferred securities have the same maturity and call provisions as the subordinated capital notes. The subordinated deferrable interest debentures issued by the Group are accounted for as a liability denominated as subordinated capital note on the consolidated statements of financial condition.

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

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***FDIC- Guaranteed Term Notes Temporary Liquidity Guarantee Program***

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

**NOTE 12 INCOME TAXES**

On January 31, 2011, the Governor of Puerto Rico signed into law the 2011 Code. As such, the 1994 Code would be gradually repealed by the 2011 Code as its provisions started to take effect, with some exceptions, as of January 1, 2011. For corporate taxpayers, the 2011 Code retains the 20% regular income tax rate but establishes significant lower surtax rates. The 2011 Code provides a surtax rate from 5% to 10% for years starting after December 31, 2010, but before January 1, 2014. That surtax rate may reduce to 5% after December 31, 2013, if certain economic and budgetary control tests are met by the Government of Puerto Rico. If such economic tests are not met, the reduction of the surtax rate will start when such economic tests are met. In the case of a controlled group of corporations the determination of which surtax rate applies will be made by adding the net taxable income of each of the entities members of the controlled group reduced by the surtax deduction. The 2011 Code also provides a surtax deduction of \$750,000. In the case of controlled group of corporations, the surtax deduction should be distributed among the members of the controlled group. The alternative minimum tax (AMT) is 20%. The 2011 Code eliminates the 5% additional surtax which was established by Act No. 7 of March 9, 2009, and the 5% recapture of the benefit of the income tax tables.

Under the 2011 Code all companies are treated as separate taxable entities and are not entitled to file consolidated returns. The Group and its subsidiaries are subject to Puerto Rico regular income tax or AMT on income earned from all sources. The AMT is payable if it exceeds regular income tax. The excess of AMT over regular income tax paid in any one year may be used to offset regular income tax in future years, subject to certain limitations.

The effect of the 2011 Code on net deferred tax asset was \$5.4 million, reflected as income tax expense in the unaudited consolidated statements of operations. The Group classifies unrecognized tax benefits in income taxes payable. These gross unrecognized tax benefits would affect the effective tax rate if realized. The balance of unrecognized tax benefits at March 31, 2011 was \$6.4 million (December 31, 2010 \$6.3 million), and variance is mainly associated with accrued interests. The tax periods from 2005 to 2009, remain subject to examination by the Puerto Rico Department of Treasury.

The Group's policy to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the consolidated statements of operations did not change as a result of implementing these provisions. The Group had accrued \$1.5 million at March 31, 2011 (December 31, 2010 \$1.5 million) for the payment of interest and penalties relating to unrecognized tax benefits.

**NOTE 13 STOCKHOLDERS EQUITY**

***Preferred Stock***

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

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

At the annual meeting of shareholders held on April 30, 2010, the shareholders approved an increase of the number of authorized

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shares of preferred stock, par value \$1.00 per share, from 5,000,000 to 10,000,000.

On April 30, 2010, the Group issued 200,000 shares of Mandatorily Convertible Non-Cumulative Non-Voting Perpetual Preferred Stock, Series C (the Series C Preferred Stock), through a private placement. The Series C Preferred Stock had a liquidation preference of \$1,000 per share and was converted to common stock on July 8, 2010 at a conversion price of \$15.015 per share. The offering resulted in net proceeds of \$189.4 million after deducting offering costs. On May 13, 2010, the Group made a capital contribution of \$179.0 million to its banking subsidiary. The difference between the conversion price of \$15.015 per share and the market price of the common stock on April 30, 2010 (\$16.72) was considered a contingent beneficial conversion feature on June 30, 2010, when the conversion was approved by the majority of the shareholders. Such feature amounted to \$22.7 million at June 30, 2010 and was recorded as a deemed dividend on preferred stock.

**Common Stock**

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

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

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

**Treasury Stock**

In February 2011, the Group announced that its Board of Directors had approved a new stock repurchase program pursuant to which the Group is authorized to purchase in the open market up to \$30.0 million of its outstanding shares of common stock. Any shares of common stock repurchased are to be held by the Group as treasury shares. The Group records treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. The new program replaced the prior \$15.0 million program. During the quarter ended March 31, 2011, the Group repurchased 1,028,579 shares of common stock at a cost of approximately \$12.5 million. The approximate dollar value of shares that may yet be repurchased under the program amounted to \$17.5 million at March 31, 2011. The number of shares that may yet be purchased under the program amounts to 1,396,124, and was calculated by dividing the remaining balance of approximately \$17.5 million by \$12.55 (closing price of the Group's common stock at March 31, 2011).

The following table presents the shares repurchased during the quarter ended March 31, 2011:

	<b>Total number of shares purchased</b>	<b>Average price paid per share</b>	<b>Total number of shares purchased as part of stock repurchase programs</b>
January 2011		\$	
February 2011	476,132	\$ 12.12	476,132
March 2011	552,447	\$ 12.23	552,447
<b>Total</b>	<b>1,028,579</b>	<b>\$ 12.18</b>	<b>1,028,579</b>

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

	Quarter Ended March 31, 2011		2010	
	Shares	Dollar Amount (In thousands)	Shares	Dollar Amount
Beginning of period	1,459	\$ 16,732	\$ 1,504	\$ 17,142
Common shares used for exercise of restricted stock units	(46)	(500)		
Common shares repurchased as part of the stock repurchase program	1,029	12,530		
Common shares used to match defined contribution plan, net	(9)	(16)	(8)	(15)
<b>End of period</b>	<b>2,433</b>	<b>\$ 28,746</b>	<b>1,496</b>	<b>\$ 17,127</b>

**Regulatory Capital Requirements**

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

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

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

	Actual		Minimum Capital Requirement	
	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)			
Group Ratios				
As of March 31, 2011				
Total Capital to Risk-Weighted Assets	\$ 714,936	31.91%	\$ 179,251	8.00%
Tier 1 Capital to Risk-Weighted Assets	\$ 686,202	30.63%	\$ 89,625	4.00%
Tier 1 Capital to Total Assets	\$ 686,202	9.52%	\$ 288,462	4.00%
As of December 31, 2010				
Total Capital to Risk-Weighted Assets	\$ 727,689	32.26%	\$ 180,455	8.00%
Tier 1 Capital to Risk-Weighted Assets	\$ 698,836	30.98%	\$ 90,228	4.00%
Tier 1 Capital to Total Assets	\$ 698,836	9.56%	\$ 292,449	4.00%

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
Bank Ratios						
As of March 31, 2011						
Total Capital to Risk-Weighted Assets	\$ 677,508	30.65%	\$ 176,821	8.00%	\$ 221,027	10.00%
Tier 1 Capital to Risk-Weighted Assets	\$ 649,149	29.37%	\$ 88,411	4.00%	\$ 132,616	6.00%
Tier 1 Capital to Total Assets	\$ 649,149	9.18%	\$ 282,946	4.00%	\$ 353,683	5.00%
As of December 31, 2010						
Total Capital to Risk-Weighted Assets	\$ 694,461	31.17%	\$ 178,226	8.00%	\$ 222,782	10.00%
Tier 1 Capital to Risk-Weighted Assets	\$ 665,952	29.89%	\$ 89,113	4.00%	\$ 133,669	6.00%
Tier 1 Capital to Total Assets	\$ 665,952	9.28%	\$ 287,060	4.00%	\$ 358,825	5.00%

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



**Table of Contents*****Equity-Based Compensation Plan***

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

The activity in outstanding options for the quarters ended March 31, 2011 and 2010 is set forth below:

	Quarter Ended March 31,			
	2011		2010	
	Number Of Options	Weighted Average Exercise Price	Number Of Options	Weighted Average Exercise Price
<b>Beginning of period</b>	765,989	\$ 15.25	514,376	\$ 16.86
Options granted	69,800	11.82	132,700	11.50
Options exercised	(250)	10.29		
Options forfeited	(16,496)	18.08		
<b>End of period</b>	<b>819,043</b>	<b>\$ 14.90</b>	<b>647,076</b>	<b>\$ 15.76</b>

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

	Outstanding			Exercisable	
	Number of Options	Weighted Average Exercise Price	Weighted Average Contract Life Remaining (Years)	Number of Options	Weighted Average Exercise Price
<b>Range of Exercise Prices</b>					
\$5.63 to \$8.45	15,131	\$ 8.28	8.1	1	\$ 7.74
8.45 to 11.27	2,000	10.29	6.4	500	10.29
11.27 to 14.09	572,427	12.14	7.4	170,902	12.41
14.09 to 16.90	62,035	15.60	3.4	54,035	15.68
19.72 to 22.54	25,050	20.68	3.9	20,800	20.44
22.54 to 25.35	83,350	23.99	3.0	83,350	23.99
25.35 to 28.17	59,050	27.46	3.6	59,050	27.46
	<b>819,043</b>	<b>\$ 14.90</b>	<b>6.3</b>	<b>388,638</b>	<b>18.06</b>
<b>Aggregate Intrinsic Value</b>	<b>\$ 392,953</b>			<b>\$ 58,247</b>	

The average fair value of each option granted during the quarter ended March 31, 2011 was \$6.43. The average fair value of each option granted was estimated at the date of the grant using the Black-Scholes option pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no restrictions and are fully transferable and negotiable in a free trading market. Black-Scholes does not consider the employment, transfer or vesting restrictions that are inherent in the Group's stock options. Use of an option valuation

model, as required by GAAP, includes highly subjective assumptions based on long-term predictions, including the expected stock price volatility and average life of each option grant.

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

	<b>Quarter Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Weighted Average Assumptions:		
Dividend yield	1.63%	1.39%
Expected volatility	59.04%	58.81%
Risk-free interest rate	3.11%	3.44%
Expected life (in years)	8.0	8.0
The following table summarizes the restricted units activity under the Omnibus Plan for the quarters ended March 31, 2011 and 2010:		

	<b>Quarter Ended March 31, 2011</b>		<b>Quarter Ended March 31, 2010</b>	
	<b>Restricted Units</b>	<b>Weighted Average Grant Date Fair Value</b>	<b>Restricted Units</b>	<b>Weighted Average Grant Date Fair Value</b>
<b>Beginning of period</b>	243,525	\$ 13.43	147,625	\$ 14.64
Restricted units granted	39,500	11.82	53,500	11.40
Restricted units lapsed	(45,616)	20.74		
Restricted units forfeited	(9,238)	13.38	(400)	21.86
<b>End of period</b>	<b>228,171</b>	<b>\$ 11.69</b>	<b>200,725</b>	<b>\$ 13.76</b>

***Legal Surplus***

The Banking Act requires that a minimum of 10% of the Bank's net income for the year be transferred to a reserve fund until such fund (legal surplus) equals the total paid in capital on common and preferred stock. At March 31, 2011, legal surplus amounted to \$46.7 million (December 31, 2010 - \$46.3 million). The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders. 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.

***Earnings per Common Share***

The calculation of earnings per common share for the quarters ended March 31, 2011 and 2010 is as follows:

	<b>Quarter ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Net income</b>	\$ 3,081	\$ 11,936
Less: Dividends on preferred stock	(1,201)	(1,201)
<b>Income available to common shareholders</b>	<b>\$ 1,880</b>	<b>\$ 10,735</b>
<b>Average common shares outstanding and equivalents</b>	<b>46,179</b>	<b>25,932</b>
<b>Earnings per common share basic</b>	<b>\$ 0.04</b>	<b>\$ 0.42</b>

<b>Earnings per common share    diluted</b>	<b>\$    0.04</b>	<b>\$    0.41</b>
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For the quarters ended March 31, 2011 and 2010, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 572,875 and 416,176, respectively.

***Accumulated Other Comprehensive Income***

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

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Unrealized gain on securities available-for-sale which are not other-than-temporarily impaired	\$ 25,359	\$ 39,094
Unrealized gain on cash flow hedges	7,123	
Income tax effect	(2,163)	(2,107)
	<b>\$ 30,319</b>	<b>\$ 36,987</b>

**NOTE 14 FAIR VALUE**

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

***Fair Value Measurement***

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

***Money market investments***

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

***Investment securities***

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

**Table of Contents*****Derivative instruments***

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

***Servicing assets***

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

***Loans receivable considered impaired that are collateral dependent***

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

***Foreclosed real estate***

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

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

	<b>Level 1</b>	<b>March 31, 2011 Fair Value Measurements</b>		
		<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
		<b>(In thousands)</b>		
Investment securities available-for-sale		3,532,815	\$ 55,115	\$ 3,587,930
Money market investments	2,060			2,060
Derivative assets		15,007	11,764	26,771
Derivative liabilities			(14,316)	(14,316)
Servicing assets			9,963	9,963
	<b>\$ 2,060</b>	<b>3,547,822</b>	<b>\$ 62,526</b>	<b>\$ 3,612,408</b>

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

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

Total Fair Value Measurements (Quarter ended March 31, 2011)						
Level 3 Instruments Only	Investment securities available-for-sale		Obligations of Puerto Rico Government and political subdivisions (In thousands)	Derivative asset (S&P Options)	Derivative liability (S&P Options)	Servicing assets
	CDO s	CLO s				
Balance at beginning of period	\$ 16,143	\$ 25,550	\$	\$ 9,870	\$ (12,830)	\$ 9,695
Gains (losses) included in earnings				1,749	(564)	
Changes in fair value of investment securities available for sale included in other comprehensive income	237	3,232	(52)			
New instruments acquired			10,005	145	(1,353)	520
Amortization					431	(608)
Changes in fair value of servicing assets						356
Balance at end of period	\$ 16,380	\$ 28,782	\$ 9,953	\$ 11,764	\$ (14,316)	\$ 9,963

**Table of Contents****Total Fair Value Measurements  
(Quarter ended March 31, 2010)****Investment securities  
available-for-sale**

<b>Level 3 Instruments Only</b>	<b>CDO s</b>	<b>CLO s</b>	<b>Non-Agency CMOs</b>	<b>Derivative asset (S&amp;P Options)</b>	<b>Derivative liability (S&amp;P Options)</b>	<b>Servicing assets</b>
			<b>(In thousands)</b>			
Balance at beginning of period	\$ 15,148	\$ 23,235	\$ 71,723	\$ 6,464	\$ (9,543)	\$ 7,120
Gains (losses) included in earnings			(632)	1,125	(1,281)	
Changes in fair value of investment securities available for sale included in other comprehensive income	520	1,187	2,440			
New instruments acquired				327	(342)	685
Amortization			(2,334)	(41)	235	(104)
Changes in fair value of servicing assets						(132)
Balance at end of period	<b>\$ 15,668</b>	<b>\$ 24,422</b>	<b>\$ 71,197</b>	<b>\$ 7,875</b>	<b>\$ (10,931)</b>	<b>\$ 7,569</b>

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

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

	<b>March 31, 2011</b>				
<b>Type</b>	<b>Amortized Cost</b>	<b>Unrealized Losses</b>	<b>Fair Value (In thousands)</b>	<b>Weighted Average Yield</b>	<b>Principal Protection</b>
<b>Obligations of Puerto Rico Government and political subdivisions</b>	\$ 10,005	\$ 52	\$ 9,953	3.50%	
<b>Structured credit investments</b>					
CDO	\$ 25,548	\$ 9,168	\$ 16,380	5.80%	6.22%
CLO	15,000	3,239	11,761	2.44%	7.60%
CLO	11,977	2,549	9,428	1.89%	26.18%
CLO	9,200	1,607	7,593	2.18%	20.64%
	\$ 61,725	\$ 16,563	\$ 45,162	3.68%	
<b>Total</b>	<b>\$ 71,730</b>	<b>\$ 16,615</b>	<b>\$ 55,115</b>	<b>3.67%</b>	



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

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

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	Carrying value at	
	March	December 31,
	31,	2010
	2011	2010
	Level 3	Level 3
	(In	
	thousands)	(In thousands)
Impaired commercial loans	\$ 27,671	\$ 25,898
Foreclosed real estate	30,095	27,931
	<b>\$ 57,766</b>	<b>\$ 53,829</b>

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

Impaired commercial loans, which are measured using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$27.7 million and \$25.9 million at March 31, 2011 and December 31, 2010, respectively, with a valuation allowance of \$1.2 million and \$823 thousand at March 31, 2011 and December 31, 2010, respectively.

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

***Fair Value of Financial Instruments***

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

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

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

	<b>March 31, 2011</b>		<b>December 31, 2010</b>	
	<b>Fair Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Carrying Value</b>
	<b>(In thousands)</b>			
<b>Financial Assets:</b>				
Cash and cash equivalents	\$ 317,411	\$ 317,411	\$ 448,946	\$ 448,946
Trading securities	1,444	1,444	1,330	1,330
Investment securities available-for-sale	3,587,930	3,587,930	3,700,064	3,700,064
Investment securities held-to-maturity	855,816	875,494	675,721	689,917
Federal Home Loan Bank (FHLB) stock	22,496	22,496	22,496	22,496
Total loans (including loans held-for-sale)				
Non-covered loans	1,175,294	1,145,441	1,150,945	1,153,643
Covered loans	553,363	643,392	600,421	670,018
Investment in equity indexed options	11,764	11,764	9,870	9,870
Investment in swap options	7,804	7,804	7,422	7,422
FDIC shared-loss indemnification asset	424,091	436,889	430,383	471,872
Accrued interest receivable	28,634	28,634	28,716	28,716
Derivative assets	7,203	7,203	11,023	11,023
Servicing assets	9,963	9,963	9,695	9,695
<b>Financial Liabilities:</b>				
Deposits	2,527,947	2,501,472	2,585,922	2,588,887
Securities sold under agreements to repurchase	3,680,511	3,456,605	3,701,669	3,456,781
Advances from FHLB	300,825	281,687	303,868	281,753
FDIC-guaranteed term notes	107,889	105,112	106,428	105,834
Subordinated capital notes	36,083	36,083	36,083	36,083
Short term borrowings	32,335	32,335	42,470	42,470
Derivative liabilities	14,316	14,316	12,894	12,894
Accrued expenses and other liabilities	47,933	47,933	43,798	43,798
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The following methods and assumptions were used to estimate the fair values of significant financial instruments at March 31, 2011 and December 31, 2010:

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

Investments in FHLB stock are valued at their redemption value.

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

The FDIC shared-loss indemnification asset is measured separately from each of the covered asset categories as it is not contractually embedded in any of the covered asset categories. The \$424.1 million fair value of the FDIC shared-loss indemnification asset represents the present value of the estimated cash payments (net of amount owed to the FDIC) expected to be received from the FDIC for future losses on covered assets based on the credit assumptions on estimated cash flows for each covered asset pool and the loss sharing percentages. The ultimate collectability of the FDIC shared-loss indemnification asset is dependent upon the performance of the underlying covered loans, the passage of time and claims paid by the FDIC which are impacted by the Bank's adherence to certain guidelines established by the FDIC.

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

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

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

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

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For short-term borrowings, the carrying amount is considered a reasonable estimate of fair value. The subordinated capital note has a par value of \$36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (3.26% at March 31, 2011; 3.25% at December 31, 2010), payable quarterly. The fair value of long-term borrowings is based on the discounted value of the contractual cash flows, using current estimated market discount rates for borrowings with similar terms and remaining maturities and put dates.

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

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

## **NOTE 15 SEGMENT REPORTING**

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

Banking includes the Bank's branches and mortgage banking, with traditional banking products such as deposits and mortgage, commercial and consumer loans. Mortgage banking activities are carried out by the Bank's mortgage banking division, whose principal activity is to originate mortgage loans for the Group's own portfolio. As part of its mortgage banking activities, the Group may sell loans directly into the secondary market or securitize conforming loans into mortgage-backed securities.

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

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

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

	<b>Banking</b>	<b>Wealth Management</b>	<b>Treasury</b>	<b>Total Major Segments (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated Total</b>
<b>Quarter Ended March 31, 2011</b>						
Interest income	\$ 32,058	\$	\$ 45,852	\$ 77,910	\$	\$ 77,910
Interest expense	(9,378)		(31,367)	(40,745)		(40,745)
Net interest income	<b>22,680</b>		<b>14,485</b>	<b>37,165</b>		<b>37,165</b>
Provision for non-covered loan and lease losses	(3,800)			(3,800)		(3,800)
Provision for covered loan and lease losses	(549)			(549)		(549)
Non-interest income (loss)	6,745	4,752	(3,970)	7,527		7,527
Non-interest expenses	(24,241)	(4,017)	(2,532)	(30,790)		(30,790)
Intersegment revenues	412			412	(412)	
Intersegment expenses		(288)	(124)	(412)	412	
<b>Income before income taxes</b>	<b>\$ 1,247</b>	<b>\$ 447</b>	<b>\$ 7,859</b>	<b>\$ 9,553</b>	<b>\$</b>	<b>\$ 9,553</b>
<b>Total assets as of March 31, 2011</b>	<b>\$ 3,207,253</b>	<b>\$ 12,390</b>	<b>\$ 4,673,186</b>	<b>\$ 7,892,829</b>	<b>\$ (716,700)</b>	<b>\$ 7,176,129</b>