

ORIENTAL FINANCIAL GROUP INC
Form 10-Q
November 09, 2012

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 September 30, 2012

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 x 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 x No

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

Large Accelerated Filer "	Accelerated Filer x	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 x No

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

45,577,920 common shares (\$1.00 par value per share) outstanding as of October 31, 2012

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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 the financial condition, results of operations, plans, objectives, future performance and business of Oriental Financial Group Inc. (“we”, “our” or the “Group”), including, but not limited to, statements with respect to the adequacy of the allowance for loan losses, delinquency trends, market risk and the impact of interest rate changes, capital markets conditions, capital adequacy and liquidity, and the effect of legal proceedings and new accounting standards on the Group’s financial condition and results of operations. All statements contained herein that are not clearly historical in nature are forward-looking, and the words “anticipate,” “believe,” “continues,” “expect,” “estimate,” “intend,” “project” and similar expressions and future or conditional verbs such as “will,” “would,” “should,” “could,” “might,” “can,” “may,” or similar expressions are generally intended to identify forward-looking statements.

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

- the rate of growth in the economy and employment levels, as well as general business and economic conditions;
- changes in interest rates, as well as the magnitude of such changes;
- the fiscal and monetary policies of the federal government and its agencies;
- a credit default by the U.S. or Puerto Rico governments or a downgrade in the credit ratings of the U.S. or Puerto Rico governments;
- changes in federal bank regulatory and supervisory policies, including required levels of capital;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) on the Group’s businesses, business practices and cost of operations;
- the relative strength or weakness of the consumer and commercial credit sectors and of the real estate market in Puerto Rico;
- the performance of the stock and bond markets;
- competition in the financial services industry;
- additional Federal Deposit Insurance Corporation (“FDIC”) assessments;
- possible legislative, tax or regulatory changes;

- the receipt and timing of regulatory approvals required to consummate the acquisition of the Puerto Rico operations of Banco Bilbao Vizcaya Argentaria, S.A. (“BBVA”);
- the Group’s ability to successfully deleverage the investment securities and wholesale funding portfolios of the Group and Banco Bilbao Vizcaya Argentaria Puerto Rico in connection with the acquisition of BBVA’s Puerto Rico operations; and
- difficulties in integrating BBVA’s Puerto Rico operations into the Group’s operations.

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.

ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

SEPTEMBER 30, 2012 AND DECEMBER 31, 2011

	September 30, 2012	December 31, 2011
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents		
Cash and due from banks	\$ 511,478	\$ 587,624
Money market investments	4,017	3,863
Total cash and cash equivalents	515,495	591,487
Securities purchased under agreements to resell	270,000	-
Investments:		
Trading securities, at fair value, with amortized cost of \$1,503 (December 31, 2011 - \$176)	1,514	180
Investment securities available-for-sale, at fair value, with amortized cost of \$2,228,629 (December 31, 2011 - \$2,873,682)	2,293,550	2,959,912
Investment securities held-to-maturity, at amortized cost, with fair value of \$874,921 (December 31, 2011 - \$904,556)	835,084	884,026
Federal Home Loan Bank (FHLB) stock, at cost	22,865	23,779
Other investments	69	73
Total investments	3,153,082	3,867,970
Loans:		
Mortgage loans held-for-sale, at lower of cost or fair value	38,211	26,939
Loans not covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$39,120 (December 31, 2011 - \$37,010)	1,144,519	1,142,978
Loans covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$56,865 (December 31, 2011 - \$37,256)	413,588	496,276
Total loans, net	1,596,318	1,666,193
FDIC shared-loss indemnification asset	328,573	392,367
Foreclosed real estate covered under shared-loss agreements with the FDIC	21,635	13,867
Foreclosed real estate not covered under shared-loss agreements with the FDIC	17,765	13,812
Accrued interest receivable	14,935	20,182
Deferred tax asset, net	35,912	32,023
Premises and equipment, net	19,268	21,520
Servicing assets	10,642	10,454
Derivative assets	18,495	9,317

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Other assets		49,085		54,483
Total assets	\$	6,051,205	\$	6,693,675
LIABILITIES AND STOCKHOLDERS' EQUITY				
Deposits:				
Demand deposits	\$	1,048,410	\$	1,043,031
Savings accounts		250,952		230,672
Certificates of deposit		915,005		1,161,482
Total deposits		2,214,367		2,435,185
Borrowings:				
Securities sold under agreements to repurchase		2,652,366		3,056,238
Advances from FHLB		285,395		281,753
FDIC-guaranteed term notes		-		105,834
Subordinated capital notes		36,083		36,083
Total borrowings		2,973,844		3,479,908
Derivative liabilities		58,269		47,425
Accrued expenses and other liabilities		33,038		35,602
Total liabilities		5,279,518		5,998,120
Stockholders' equity:				
Preferred stock; 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
84,000 shares of Series C issued and outstanding; \$1,000 liquidation value		84,000		-
Common stock, \$1 par value; 100,000,000 shares authorized; 47,841,611 shares issued; 40,745,946 shares outstanding (December 31, 2011 - 47,808,657; 41,244,533)		47,842		47,809
Additional paid-in capital		495,155		499,096
Legal surplus		54,407		50,178
Retained earnings		94,520		68,149
Treasury stock, at cost, 7,095,665 shares (December 31, 2011 - 6,564,124 shares)		(81,300)		(74,808)
Accumulated other comprehensive income, net of tax of -\$2,411 (December 31, 2011 - \$1,848)		9,063		37,131
Total stockholders' equity		771,687		695,555
Total liabilities and stockholders' equity	\$	6,051,205	\$	6,693,675

See notes to unaudited consolidated financial statements

ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2012 AND 2011

	Quarter Ended September 30,		Nine-Month Period Ended	
	2012	2011	2012	2011
	(In thousands, except per share data)			
Interest income:				
Loans not covered under shared-loss agreements with the FDIC	17,964	\$ 17,161	\$ 53,308	\$ 51,095
Loans covered under shared-loss agreements with the FDIC	22,283	18,222	64,167	45,507
Total interest income from loans	40,247	35,383	117,475	96,602
Mortgage-backed securities	24,310	33,515	74,647	128,275
Investment securities and other	1,129	2,638	4,271	6,895
Total interest income	65,686	71,536	196,393	231,772
Interest expense:				
Deposits	7,308	11,492	24,518	35,321
Securities sold under agreements to repurchase	15,344	23,206	49,414	70,878
Advances from FHLB and other borrowings	2,508	3,042	8,438	9,036
FDIC-guaranteed term notes	-	1,021	909	3,063
Subordinated capital notes	323	305	972	916
Total interest expense	25,483	39,066	84,251	119,214
Net interest income	40,203	32,470	112,142	112,558
Provision for non-covered loan and lease losses	3,600	3,800	10,400	11,400
Provision for (recapture of) covered loan and lease losses, net	221	(1,936)	8,845	(1,387)
Total provision for loan and lease losses	3,821	1,864	19,245	10,013
Net interest income after provision for loan and lease losses	36,382	30,606	92,897	102,545
Non-interest income:				
Wealth management revenues	6,042	5,387	17,835	14,644
Banking service revenues	3,006	2,969	9,231	9,496
Mortgage banking activities	2,204	2,758	7,142	7,017
Total banking and wealth management revenues	11,252	11,114	34,208	31,157
Net amortization of FDIC shared-loss indemnification asset	(8,096)	(2,422)	(18,505)	(191)
Net gain (loss) on:				
Sale of securities	36,365	13,971	55,703	23,102
Derivatives	(1,326)	(695)	(1,441)	(8,392)
Foreclosed real estate	(1,209)	(199)	(2,493)	(334)

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Early extinguishment of repurchase agreements	(24,312)	(4,790)	(24,312)	(4,790)
Other	978	(14)	208	148
Total non-interest income, net	13,652	16,965	43,368	40,700
Non-interest expense:				
Compensation and employee benefits	11,323	11,593	32,873	34,511
Professional and service fees	5,779	5,308	16,221	16,506
Occupancy and equipment	4,169	4,369	12,624	12,988
Insurance	1,594	1,302	4,856	4,933
Electronic banking charges	1,415	1,375	4,581	3,984
Taxes, other than payroll and income taxes	1,091	1,184	2,158	3,422
Loan servicing and clearing expenses	607	975	2,530	3,072
Foreclosure, repossession and other real estate expenses	1,060	606	2,745	1,659
Advertising, business promotion, and strategic initiatives	1,594	1,686	4,006	4,386
Communication	419	391	1,246	1,212
Director and investor relations	158	352	809	977
Printing, postage, stationary and supplies	299	292	929	937
Other	871	770	2,428	2,661
Total non-interest expense	30,379	30,203	88,006	91,248
Income before income taxes	19,655	17,368	48,259	51,997
Income tax expense	1,894	580	4,888	5,661
Net income	17,761	16,788	43,371	46,336
Less: dividends on preferred stock	(3,039)	(1,201)	(5,440)	(3,602)
Income available to common shareholders	\$ 14,722	\$ 15,587	\$ 37,931	\$ 42,734
Income per common share:				
Basic	\$ 0.36	\$ 0.35	\$ 0.93	\$ 0.95
Diluted	\$ 0.35	\$ 0.35	\$ 0.92	\$ 0.95
Average common shares outstanding and equivalents	47,978	44,105	43,316	45,141
Cash dividends per share of common stock	\$ 0.06	\$ 0.05	\$ 0.18	\$ 0.15

See notes to unaudited consolidated financial statements

ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2012 AND 2011

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Net income	\$ 17,761	\$ 16,788	\$ 43,371	\$ 46,336
Other comprehensive loss before tax:				
Unrealized gain on securities available-for-sale	25,220	35,471	34,220	57,098
Realized gain on investment securities included in net income	(36,365)	(13,971)	(55,703)	(23,102)
Unrealized loss on cash flow hedges	(2,052)	(34,204)	(10,844)	(48,122)
Other comprehensive loss before taxes	(13,197)	(12,704)	(32,327)	(14,126)
Income tax effect	999	2,550	4,259	1,858
Other comprehensive loss after taxes	(12,198)	(10,154)	(28,068)	(12,268)
Comprehensive income	\$ 5,563	\$ 6,634	\$ 15,303	\$ 34,068

See notes to unaudited consolidated financial statements

ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2012 AND 2011

	Nine-Month Period Ended September 30,	
	2012	2011
	(In thousands)	
Preferred stock:		
Balance at beginning of period	\$ 68,000	\$ 68,000
Issuance of preferred stock	84,000	-
Balance at end of period	152,000	68,000
Common stock:		
Balance at beginning of period	47,809	47,808
Exercised stock options	33	-
Balance at end of period	47,842	47,808
Additional paid-in capital:		
Balance at beginning of period	499,096	498,435
Stock-based compensation expense	1,159	1,001
Exercised stock options	361	-
Lapsed restricted stock units	(483)	(561)
Preferred stock issuance costs	(4,978)	-
Balance at end of period	495,155	498,875
Legal surplus:		
Balance at beginning of period	50,178	46,331
Transfer from retained earnings	4,229	4,943
Balance at end of period	54,407	51,274
Retained earnings:		
Balance at beginning of period	68,149	51,502
Net income	43,371	46,336
Cash dividends declared on common stock	(7,331)	(6,677)
Cash dividends declared on preferred stock	(5,440)	(3,602)
Transfer to legal surplus	(4,229)	(4,943)
Balance at end of period	94,520	82,616
Treasury stock:		
Balance at beginning of period	(74,808)	(16,732)
Stock purchased	(7,022)	(29,242)
Lapsed restricted stock units	483	561
Stock used to match defined contribution plan	47	37
Balance at end of period	(81,300)	(45,376)
Accumulated other comprehensive income, net of tax:		
Balance at beginning of period	37,131	36,987
Other comprehensive loss, net of tax	(28,068)	(12,268)
Balance at end of period	9,063	24,719
Total stockholders' equity	\$ 771,687	\$ 727,916

See notes to unaudited consolidated financial statements

ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2012 AND 2011

Nine-Month Period Ended September 30,
2012 2011

(In thousands)

Cash flows from operating activities:

Net income	\$	43,371	\$	46,336
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Amortization of deferred loan origination fees, net of costs		462		(151)
Amortization of investment securities premiums, net of accretion of discounts		33,480		18,983
Amortization of core deposit intangible		107		107
Net amortization of FDIC shared-loss indemnification asset		18,505		191
Other impairments on securities		-		75
Depreciation and amortization of premises and equipment		3,424		4,109
Deferred income taxes, net		(785)		4,485
Provision for covered and non-covered loan and lease losses, net		19,245		10,013
Stock-based compensation		1,159		1,001
(Gain) loss on:				
Sale of securities		(55,703)		(23,102)
Sale of mortgage loans held for sale		(4,658)		(3,971)
Derivatives		1,441		8,392
Early extinguishment of repurchase agreements		24,312		4,790
Foreclosed real estate		2,493		334
Sale of other repossessed assets		(8)		34
Sale of premises and equipment		(85)		31
Originations and purchases of loans held-for-sale		(140,925)		(149,990)
Proceeds from sale of loans held-for-sale		74,815		55,243
Net (increase) decrease in:				
Trading securities		(1,334)		984
Accrued interest receivable		5,247		4,470
Servicing assets		(188)		(319)
Other assets		5,080		4,708
Net decrease in:				
Accrued interest on deposits and borrowings		(8,227)		(1,097)
Accrued expenses and other liabilities		(8,578)		(31,378)
Net cash provided by (used in) operating activities		12,650		(45,722)

Cash flows from investing activities:

Purchases of:		
Investment securities available-for-sale	(1,102,606)	(493,757)
Investment securities held-to-maturity	(119,026)	(209,112)
FHLB stock	(454)	(1,283)
Swap options	(6,755)	-
Equity options	-	(424)
Maturities and redemptions of:		
Investment securities available-for-sale	691,246	606,699
Investment securities held-to-maturity	160,502	57,509
FHLB stock	1,368	-
Proceeds from sales of:		
Investment securities available-for-sale	1,145,555	506,481
Foreclosed real estate	11,093	8,875
Other repossessed assets	2,500	4,883
Premises and equipment	369	287
Origination and purchase of loans, excluding loans held-for-sale	(172,376)	(138,692)
Principal repayment of loans, including covered loans	195,336	204,537
Reimbursements from the FDIC on shared-loss agreements	63,272	73,267
Additions to premises and equipment	(1,457)	(2,984)
Net change in securities purchased under agreements to resell	(270,000)	(165,000)
Net cash provided by investing activities	598,567	451,286

See notes to unaudited consolidated financial statements

ORIENTAL FINANCIAL GROUP INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS – (Continued)

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2012 AND 2011

	Nine-Month Period Ended September 30,	
	2012	2011
	(In thousands)	
Cash flows from financing activities:		
Net increase (decrease) in:		
Deposits	(222,408)	(207,107)
Short term borrowings	-	4,159
Securities sold under agreements to repurchase	(424,312)	(104,790)
FHLB advances	5,013	-
FDIC-guaranteed term notes	(105,000)	-
Exercise of stock options	394	-
Issuance of preferred stock, net	79,022	-
Purchase of treasury stock	(7,022)	(29,242)
Termination of derivative instruments	(125)	10,095
Dividends paid on preferred stock	(5,440)	(3,602)
Dividends paid on common stock	(7,331)	(6,677)
Net cash used in financing activities	(687,209)	(337,164)
Net change in cash and cash equivalents	(75,992)	68,400
Cash and cash equivalents at beginning of period	591,487	448,936
Cash and cash equivalents at end of period	\$ 515,495	\$ 517,336
Supplemental Cash Flow Disclosure and Schedule of Non-cash Activities:		
Interest paid	\$ 91,823	\$ 120,544
Income taxes paid	\$ 8,031	\$ 4,021
Mortgage loans securitized into mortgage-backed securities	\$ 59,629	\$ 104,617
Transfer from loans to foreclosed real estate	\$ 27,583	\$ 17,754

See notes to unaudited consolidated financial statements

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 (the “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 September 30, 2012 and 2011 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, 2011, included in the Group’s 2011 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 operating subsidiaries, Oriental Bank and Trust (the “Bank” or “Oriental Bank”), Oriental Financial Services Corp. (“Oriental Financial Services”), Oriental Insurance, Inc. (“Oriental Insurance”) and Caribbean Pension Consultants, Inc. (“CPC”). The Group also has a special purpose entity, Oriental Financial (PR) Statutory Trust II (the “Statutory Trust II”). Through these subsidiaries and their respective divisions, the Group provides a wide range of banking and wealth management services such as commercial, consumer and mortgage lending, leasing, financial planning, insurance sales, money management and investment banking and brokerage services, as well as corporate and individual trust services.

The main offices of the Group and its subsidiaries are located in San Juan, Puerto Rico, except for CPC, which is located in Boca Raton, Florida. The Group is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) under the U.S. Bank Holding Company Act of 1956, as amended, and the Dodd-Frank Act.

The Bank operates through 28 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 (the “OCFI”) and the Federal Deposit Insurance Corporation (the “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, is an international banking entity pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended. OIB offers the Bank certain Puerto Rico tax advantages. OIB’s activities are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.

Oriental Financial Services is a securities broker-dealer and is subject to the supervision, examination and regulation of the Financial Industry Regulatory Authority (the “FINRA”), the SEC, and the OCFI. Oriental Financial Services is also a member of the Securities Investor Protection Corporation. Oriental Insurance is an insurance agency and is subject to the supervision, examination and regulation of the Office of the Commissioner of Insurance of Puerto Rico.

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

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Business Combinations

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.”

On June 28, 2012, the Group entered into a definitive Acquisition Agreement (the “Acquisition Agreement”) with Banco Bilbao Vizcaya Argentaria, S.A. (“BBVA”), pursuant to which BBVA agreed to sell to the Group, and the Group agreed to purchase from BBVA, all of the outstanding common stock of each of (i) BBVAPR Holding Corporation (“BBVAPR Holding”), the sole shareholder of Banco Bilbao Vizcaya Argentaria Puerto Rico (“BBVAPR Bank”), a Puerto Rico chartered commercial bank, and BBVA Seguros, Inc. (“BBVA Seguros”), a subsidiary offering insurance services, and (ii) BBVA Securities of Puerto Rico, Inc. (“BBVA Securities”), a registered broker-dealer. This transaction is referred to as the “BBVAPR Acquisition” and BBVAPR Holding, BBVAPR Bank, BBVA Seguros and BBVA Securities are collectively referred to as the “BBVAPR Companies.”

The Group will acquire all of the outstanding common stock of each of BBVAPR Holding and BBVA Securities with total assets at June 30, 2012 amounting to \$5.0 billion, including \$3.6 billion in loans (net of allowance for loan and lease losses), and \$3.4 billion in deposits for an aggregate purchase price of \$500 million. Immediately following the closing of the BBVAPR Acquisition, the Group will merge BBVAPR Bank with and into Oriental Bank, with Oriental Bank continuing as the surviving entity. The unaudited consolidated financial statements do not contemplate the effect of the BBVAPR Acquisition as the transaction has not been consummated at September 30, 2012.

Closing of the transaction is targeted for the fourth quarter of 2012. Consummation of the BBVAPR Acquisition is subject to certain customary conditions, including the receipt of required regulatory approvals without the imposition of a materially burdensome regulatory condition, as described in the Acquisition Agreement. On October 10, 2012, the OCFI approved the Group’s acquisition of BBVAPR Bank and the merger of BBVAPR Bank with and into Oriental Bank, with Oriental Bank as the surviving entity.

Under the Acquisition Agreement, the Group may be subject to a reverse break-up fee of \$25 million if the closing of the BBVAPR Acquisition does not occur before one year after execution of the Acquisition Agreement (or before fifteen months after execution of the Acquisition Agreement in certain circumstances), the Acquisition Agreement is terminated, and the failure to close within one year (or such later date) is due to our inability to raise the specified additional funds or to obtain certain regulatory approvals or any other reason other than certain breaches by BBVA, subject to certain conditions. In addition, BBVA could seek damages in excess of \$25 million if BBVA terminates the Acquisition Agreement due to our failure to satisfy the funding requirement or if our willful and knowing breach of

the Acquisition Agreement is the proximate cause of the BBVAPR Acquisition not having been consummated, and BBVA suffers losses as a result in excess of the \$25 million termination fee. If BBVA decides to terminate the Acquisition Agreement and collect the termination fee, such additional damages would be limited to BBVA's losses in excess of the termination fee, and could not exceed an additional \$25 million. Such limit would not apply if BBVA does not elect to terminate the Acquisition Agreement and collect the termination fee.

In connection with the BBVAPR Acquisition, the Group has completed the sale of:

- (i) 84,000 shares of its 8.750% Non-Cumulative Convertible Perpetual Preferred Stock, Series C (the "Convertible Preferred Stock"), on July, 3, 2012 at a purchase price of \$1,000 per share in a private placement;
- (ii) 4,829,267 shares of its common stock on October 31, 2012 at a public offering price of \$11.10 and a purchase price of \$10.66 per share in a registered public offering; and
- (iii) 960,000 shares of its 7.125% Non-Cumulative Perpetual Preferred Stock, Series D (the "Series D Preferred Stock") on November 5, 2012 at a public offering price of \$25 and purchase price of \$24 per share in a registered public offering.

The Group intends to use the net proceeds of the foregoing issuances together with its own excess capital to fund the BBVAPR Acquisition.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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 (“FASB”) Accounting Standards Codification (“ASC”) and with the general practices within the banking industry. In preparing the unaudited 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 unaudited 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.

Investment Securities

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

The Group has classified certain agency-issued mortgage-backed securities as held-to-maturity. The Group has both the intent and ability to hold such securities until their maturities. Furthermore, the Group believes it will be able to recover substantially all of its recorded investment mainly because these are agency-issued mortgage-backed securities, and also because the securities cannot be contractually prepaid or otherwise settled before their stated maturity by the issuing agency, except for the principal prepayments that may occur throughout their terms based on the payment behavior of the collateral loans. Certain securities of the Group that have been classified as held-to-maturity were classified as such in response to management’s asset-liability management strategy. The Group believes that it can accomplish its asset-liability management goals and still maximize net interest income without having all its securities classified as available-for-sale. This designation is consistent with held-to-maturity classification requirements, specifically those stated in section 25-18 of ASC 320-10-25.

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

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

Premiums and discounts are amortized to interest income over the life of the related securities using the interest method. Net realized gains or losses on sales of investment securities and unrealized gains and losses valuation adjustments considered other than temporary, if any, on securities classified as either available-for-sale or held-to-maturity are reported separately in the statements of operations. The cost of securities sold is determined by the specific identification method. During the quarter ended September 30, 2012, the Group made a change in one of the estimates applied in the calculation of the amortization of premiums/discounts in the mortgage-backed securities portfolio. The estimate involves the period used in measuring the repayment experience of each security and the change consists of using a 12-month look-back period instead of a 3-month period for these purposes. The Group believes that this extended period better reflects the portfolio behavior, especially considering the seasonality cycle of the U.S. housing market, and also reduces the volatility that affects interest income recognition when using a more limited prepayment history experience in periods of greater market volatility. The impact of this change during the quarter ended September 30, 2012 was an increase of \$3.3 million in interest income from mortgage-backed securities.

Financial Instruments

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

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

Impairment of Investment Securities

The Group conducts periodic reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairments. The Group separates the amount of total impairment into credit and noncredit-related amounts. The term “other-than-temporary impairment” is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with a credit loss is recognized in income, while the remaining noncredit-related component is 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 it to the present value of cash flows expected to be

collected from the security discounted at the rate equal to the yield used to accrete current and prospective beneficial interest for the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the “credit loss.”

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

- the identification and evaluation of investments that have indications of possible other-than-temporary impairment;
- the analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position, and the expected recovery period;
- the financial condition of the issuer or issuers;
- the creditworthiness of the obligor of the security;
- actual collateral attributes;
- any rating changes by a rating agency;
- current analysts’ evaluations;
- the payment structure of the debt security and the likelihood of the issuer being able to make payments;
- current market conditions;
- adverse conditions specifically related to the security, industry, or a geographic area;
- the Group’s intent to sell the debt security;
- whether it is more-likely-than-not that the Group will be required to sell the debt security before its anticipated recovery; and
- other qualitative factors that could support or not an other-than-temporary impairment.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Derivative Instruments and Hedging Activities

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

Derivative instruments that are used as part of the Group's interest rate risk-management strategy include interest rate swaps, forward-settlement swaps, futures contracts, and option contracts that have indices related to the pricing of specific balance sheet assets and liabilities. Interest rate swaps generally involve the exchange of fixed and variable-rate interest payments between two parties, based on a common notional principal amount and maturity date. Interest rate futures generally involve exchange-traded contracts to buy or sell U.S. Treasury bonds and notes in the future at specified prices. Interest rate options represent contracts that allow the holder of the option to (i) receive cash or (ii) purchase, sell, or enter into a financial instrument at a specified price within a specified period. Some purchased option contracts give the Group the right to enter into interest rate swaps and cap and floor agreements with the writer of the option. In addition, the Group enters into certain transactions that contain embedded derivatives. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated and carried at fair value.

The Group also has offered its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index ("S&P 500 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 S&P 500 Index over the average of the monthly index observations in a five-year period in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings. The embedded option in the certificates of deposit is bifurcated, and the changes in the value of that option are also recorded in earnings.

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

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

As part of this hedging strategy started in the first quarter of 2011, the Group formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash flow hedges to (i) specific assets and liabilities on the balance sheet or (ii) specific firm commitments or forecasted transactions. The Group also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The changes in fair value of the forward-settlement swaps are recorded in accumulated other comprehensive income to the extent there is no significant ineffectiveness.

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

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

Loans and Allowance for Loan and Lease Losses

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

Non-Covered Loans

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

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

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

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

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

The Group, using a rating system, applies an overall allowance percentage to each non-covered loan portfolio segment based on historical credit losses adjusted for current conditions and trends. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Group over the most recent twelve months. The actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: the credit grading assigned to commercial loans, levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff, including the bank's loan review system as graded by regulatory agencies in their last examination; local economic trends and conditions; industry conditions; effects of external factors such as competition and regulatory requirements on the level of estimated credit losses in the current portfolio; and effects of changes in credit concentrations and collateral value. Additional impact from the historical loss experience is applied based on levels of delinquency and loan classification. During the quarter ended September 30, 2012, the Group revised this severity impact applied to historical loss factors based on delinquency buckets and loan classifications to further segregate these impacts between loans secured by real estate and unsecured loans. The following portfolio segments have been

identified: mortgage loans; commercial loans; consumer loans; and leasing.

Mortgage Loans: These loans are further divided into four classes: traditional mortgages, non-traditional mortgages, loans in loan modification programs and home equity secured personal loans. Traditional mortgage loans include loans secured by a dwelling, fixed coupons and regular amortization schedules. Non-traditional mortgages include loans with interest-first amortization schedules and loans with balloon considerations as part of their terms. Mortgages in loan modification programs are loans that are being serviced under such programs. Home equity loans are mainly equity lines of credit. The allowance factor on these loans is impacted by the historical loss factors on the sub-segments, vintages, the environmental risk factors described above and by delinquency buckets. During the second quarter of 2012, the traditional mortgage loans were further segregated by vintages.

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

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

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Leasing: This segment consists of personal loans guaranteed by vehicles in the form of lease financing. The allowance factor on these loans is impacted by the historical losses on the segment, the environmental risk factors described above and by delinquency buckets.

Loan loss ratios and credit risk categories are updated at least quarterly and are applied in the context of GAAP as prescribed by ASC and the importance of depository institutions having prudent, conservative, but not excessive loan allowances that fall within an acceptable range of estimated losses. While management uses current available information in estimating possible loan and lease losses, factors beyond the Group's control, such as those affecting general economic conditions, may require future changes to the allowance.

Covered Loans

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

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

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

The excess of undiscounted expected cash flows at acquisition over the initial fair value of acquired loans is referred to as the “accretable yield” and is recorded as interest income over the estimated life of the loans using the effective yield method if the timing and amount of the future cash flows is reasonably estimable. Subsequent to acquisition, the Group aggregates loans into pools of loans with common risk characteristics to account for the acquired loans. Increases in expected cash flows over those originally estimated increase the accretable yield and are recognized as interest income prospectively or reverse previously recognized allowance for loan and lease losses. Decreases in expected cash flows compared to those originally estimated decrease the accretable yield and are recognized by recording a provision for covered loan and lease losses and establishing an allowance for loan and lease losses.

ASC 310-30-40-1 states that, once a pool of loans is assembled, the integrity of the pool shall be maintained. A loan shall be removed from a pool of loans only if (a) the investor sells, forecloses, or otherwise receives assets in satisfaction of the loan or (b) the loan is written off. A refinancing or restructuring of a loan shall not result in the removal of a loan from a pool. Events that result in a loan being removed from a pool are often referred to as “confirming events.” When a confirming event occurs and a loan is removed from a pool, ASC 310-30 indicates that the loan should be removed at its carrying amount. ASC 310-30-35-15 states that, if a loan is removed from a pool of loans, the difference between the loan’s carrying amount and the fair value of the collateral or other assets received shall not affect the percentage yield calculation used to recognize accretable yield on the pool of loans. That is, the pool’s yield should be unaffected by the removal. The Group removes such loans on an “as expected” basis, which assumes cash or other assets received are equal to the original expectation of cash flows.

Under the accounting guidance of ASC 310-30 for acquired loans, the allowance for loan and lease losses on covered loans is measured at each financial reporting period, or measurement date, based on expected cash flows. Accordingly, decreases in expected cash flows on these loans compared to those expected cash flows previously forecasted 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.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Lease Financing

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

Troubled Debt Restructuring

A troubled debt restructuring (“TDR”) is the restructuring of a receivable in which the Group, as creditor, grants a concession for legal or economic reasons due to the debtor’s financial difficulties. A concession is granted when, as a result of the restructuring, the Group does not expect to collect all amounts due, including interest accrued at the original contract rate. These concessions may include a reduction of the interest rate, principal or accrued interest, extension of the maturity date or other actions intended to minimize potential losses.

To assess whether the debtor is having financial difficulties, the Group evaluates whether it is probable that the debtor will default on any of its debt in the foreseeable future.

Receivables that are restructured in a TDR are presumed to be impaired and are subject to a specific impairment-measurement method. If the payment of principal at original maturity is primarily dependent on the value of collateral, the Group considers the current value of that collateral in determining whether the principal will be paid. For non-collateral dependent loans, the specific reserve is calculated based on the present value of expected cash flows discounted at the loan’s effective interest rate. Loans modified in TDRs are placed on non-accrual status until the Group determines that future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrate performance according to the restructured terms for a period of at least nine months.

Reserve for Unfunded Commitments

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

FDIC Shared-Loss Indemnification Asset

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

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

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Core Deposit Intangible

Core deposit intangible (“CDI”) is a measure of the value of checking and savings deposits acquired in a business combination. The fair value of the CDI stemming from any given business combination is based on the present value of the expected cost savings attributable to the core deposit funding, relative to an alternative source of funding. CDI is amortized straight-line over a 10-year period. The Group evaluates such identifiable intangible for impairment when an indication of impairment exists. No impairment charges were required to be recorded in the quarters and nine-month periods ended September 30, 2012 and 2011.

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

Covered Foreclosed Real Estate and Other Repossessed Property

Covered foreclosed real estate and other repossessed property is initially recorded at their estimated fair value on the acquisition date, based on appraisal value less estimated selling costs. Any subsequent write-downs due to declines in fair value and costs and expenses associated with holding these properties in portfolio are charged as incurred to non-interest expense with a partially offsetting non-interest income for the loss reimbursement under the FDIC shared-loss agreement. Any recoveries of previous write-downs are credited to non-interest expense 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 on a regular basis whether the deferred tax assets can be realized and assesses the need for a valuation allowance. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in valuation allowance from period to period are included in the Group's tax provision in the period of change.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

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

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

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

tax or AMT on income earned from all sources. The AMT is payable if it exceeds regular income tax. The excess of AMT over regular income tax paid in any one year may be used to offset regular income tax in future years, subject to certain limitations.

Equity-Based Compensation Plan

The Group's 2007 Omnibus Performance Incentive Plan, as amended and restated (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, (b) if earlier, the date the Omnibus Plan is terminated by the Group's Board of Directors.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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. For stock options issued during 2012, the expected volatilities are based on both historical and implied volatility of the Group's shares of common stock.

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 September 30, 2012, and has adjusted and disclosed those events that have occurred that would require adjustment or disclosure in the unaudited consolidated financial statements.

Refer to Note 1 *Business Combinations* section for details of preferred stock and common stock issued after September 30, 2012 in connection to the prospective BBVAPR Acquisition.

Reclassifications

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

Recent Accounting Developments

Comprehensive Income — FASB Accounting Standards Update (“ASU”) 2011-12, “Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05” (Topic 220) was issued in December 2011. This update defers the effective date for the presentation of reclassification adjustments. The amendments are being made to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated comprehensive income on the components of net income and other comprehensive income for all periods presented. The amendments in this update are effective for interim and annual reporting periods beginning after December 15, 2011. The Group adopted this guidance for the deferment of the presentation of reclassifications of items out of accumulated comprehensive income.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Fair Value Measurement — FASB ASU 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs” (Topic 820) was issued in May 2011. This update establishes common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Among the changes, additional information about the sensitivity of a fair value measurement categorized within Level 3 of the fair value hierarchy to changes in unobservable inputs and any interrelationships between those unobservable inputs will be required. Also, entities now will be required to categorize by level of the fair value hierarchy items that are not measured at fair value in the statement of financial position, but for which the fair value of such items is required to be disclosed. The amendments in this update are effective during interim and annual periods beginning after December 15, 2011, are to be applied prospectively. The Group adopted this guidance for fair value measurements.

Repurchase Agreements — FASB ASU 2011-03, “Reconsideration of Effective Control for Repurchase Agreements” (Topic 860) was issued in April 2011. This update removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control are not changed by the amendments in this update. The amendments in this update are effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption was not permitted. The Group adopted this guidance for the repurchase agreements.

Intangibles—Goodwill and Other – FASB ASU 2012-02, “Testing Indefinite-Lived Intangible Assets for Impairment (Topic 350) was issued in July 2012. This update establish that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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 in the FDIC-assisted acquisition of Eurobank. 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, whereby the FDIC covers a substantial portion of any losses on loans (and related unfunded loan commitments), foreclosed real estate and other repossessed properties.

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

The assets acquired and liabilities assumed as of April 30, 2010 were presented at their fair value. In many cases, the determination of these fair values required management to make estimates about discount rates, expected cash flows, market conditions and other future events that are highly subjective in nature and were subject to change. The fair values initially assigned to the assets acquired and liabilities assumed 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 process was completed on April 29, 2011.

The Bank has agreed to make a true-up payment, also known as clawback liability, to the FDIC on the date that is 45 days following the last day (such day, the "True-Up Measurement Date") of the final shared-loss month, or upon the final disposition of all covered assets under the shared-loss agreements in the event losses thereunder fail to reach expected levels. Under the shared-loss agreements, the Bank will pay to the FDIC 50% of the excess, if any, of: (i) 20% of the Intrinsic Loss Estimate of \$906.0 million (or \$181.2 million) (as determined by the FDIC) less (ii) the sum of: (A) 25% of the asset discount (per bid) (or \$227.5 million); plus (B) 25% of the cumulative shared-loss payments (defined as the aggregate of all of the payments made or payable to the Bank minus the aggregate of all of the payments made or payable to the FDIC); plus (C) the sum of the period servicing amounts for every consecutive twelve-month period prior to and ending on the True-Up Measurement Date in respect of each of the shared-loss agreements during which the shared-loss provisions of the applicable shared-loss agreement is in effect (defined as the product of the simple average of the principal amount of shared-loss loans and shared-loss assets at the beginning and end of such period times 1%). The true-up payment represents an estimated liability of \$14.8 million and \$13.3 million, net of discount, as of September 30, 2012 and December 31, 2011, respectively. This estimated liability is accounted for as a reduction of the indemnification asset. The indemnification asset represents the portion of estimated losses covered by the shared-loss agreements between the Bank and the FDIC.

The operating results of the Group for the quarters and nine-month periods ended September 30, 2012 and 2011 include the operating results produced by the acquired assets and assumed liabilities from the FDIC-assisted

acquisition.

The FDIC shared-loss indemnification asset activity for the nine-month periods ended September 30, 2012 and 2011 is as follows:

	Nine-Month Period Ended September 30,	
	2012	2011
	(In thousands)	
Balance at beginning of period	\$ 392,367	\$ 473,629
Shared-loss agreements reimbursements from the FDIC	(63,272)	(73,267)
Increase (decrease) in expected credit losses to be		
covered under shared-loss agreements, net	10,764	(10,659)
Amortization of FDIC shared-loss indemnification asset,		
net	(18,505)	(191)
Incurred expenses to be reimbursed under shared-loss		
agreements	7,219	2,584
Balance at end of period	\$ 328,573	\$ 392,096

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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 September 30, 2012 and December 31, 2011, money market instruments included as part of cash and cash equivalents amounted to \$4.0 million and \$3.9 million, respectively.

Securities Purchased Under Agreements to Resell

Securities purchased under agreements to resell consist of short-term investments and are carried at the amounts at which the assets will be subsequently resold as specified in the respective agreements. At September 30, 2012, securities purchased under agreements to resell amounted to \$270.0 million. At December 31, 2011, there were no securities purchased under agreements to resell.

The amounts advanced under those agreements are reflected as assets in the unaudited consolidated statements of financial condition. It is the Group's policy to take possession of securities purchased under agreements to resell. Agreements with third parties specify the Group's right to request additional collateral based on its monitoring of the fair value of the underlying securities on a daily basis. The fair value of the collateral securities held by the Group on these transactions as of September 30, 2012 was approximately \$275.4 million.

Investment Securities

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the securities owned by the Group at September 30, 2012 and December 31, 2011 were as follows:

	September 30, 2012					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield	
	(In thousands)					
Available-for-sale						
Mortgage-backed securities	\$ 1,530,787	\$ 68,843	\$ 1	\$ 1,599,629	3.10%	

FNMA and FHLMC certificates					
GNMA certificates	17,336	1,404	8	18,732	4.89%
CMOs issued by US Government sponsored agencies	193,543	1,770	208	195,105	1.78%
Total mortgage-backed securities	1,741,666	72,017	217	1,813,466	2.97%
Investment securities					
US Treasury securities	387,992	2	-	387,994	0.04%
Obligations of US Government sponsored agencies	25,017	118	-	25,135	1.40%
Obligations of Puerto Rico Government and					
political subdivisions	22,240	126	12	22,354	5.41%
Structured credit investments	36,424	-	7,422	29,002	2.10%
Other debt securities	15,290	309	-	15,599	3.44%
Total investment securities	486,963	555	7,434	480,084	0.62%
Total securities available-for-sale	2,228,629	72,572	7,651	2,293,550	2.45%
Held-to-maturity					
Mortgage-backed securities					
FNMA and FHLMC certificates	722,823	38,283	-	761,106	3.30%
CMOs issued by US Government sponsored agencies	112,261	1,554	-	113,815	1.97%
Total securities held-to-maturity	835,084	39,837	-	874,921	3.12%
Total investments	\$ 3,063,713	\$ 112,409	\$ 7,651	\$ 3,168,471	2.63%

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2011					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value		Weighted Average Yield
	(In thousands)					
Available-for-sale						
Mortgage-backed securities						
FNMA and FHLMC certificates	\$ 2,583,881	\$ 92,899	\$ -	\$ 2,676,780		3.61%
GNMA certificates	26,186	2,151	-	28,337		5.94%
CMOs issued by US Government sponsored agencies	128,505	1,739	199	130,045		2.33%
Total mortgage-backed securities	2,738,572	96,789	199	2,835,162		3.57%
Investment securities						
Obligations of Puerto Rico Government and political subdivisions	72,437	225	1,204	71,458		5.37%
Structured credit investments	46,904	-	9,616	37,288		2.92%
Other debt securities	15,769	235	-	16,004		3.42%
Total investment securities	135,110	460	10,820	124,750		4.29%
Total securities available-for-sale	2,873,682	97,249	11,019	2,959,912		3.60%
Held-to-maturity						
Mortgage-backed securities						
FNMA and FHLMC certificates	884,026	20,530	-	904,556		3.34%
Total investments	\$ 3,757,708	\$ 117,779	\$ 11,019	\$ 3,864,468		3.54%

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The amortized cost and fair value of the Group's investment securities at September 30, 2012, 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.

	September 30, 2012			
	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Mortgage-backed securities				
Due after 5 to 10 years				
FNMA and FHLMC certificates	\$ 44,430	\$ 45,805	\$ -	\$ -
Total due after 5 to 10 years	44,430	45,805	-	-
Due after 10 years				
FNMA and FHLMC certificates	1,486,357	1,553,824	722,823	761,106
GNMA certificates	17,336	18,732	-	-
CMOs issued by US Government sponsored agencies	193,543	195,105	112,261	113,815
Total due after 10 years	1,697,236	1,767,661	835,084	874,921
Total mortgage-backed securities	1,741,666	1,813,466	835,084	874,921
Investment securities				
Due in less than one year				
US Treasury securities	387,992	387,994	-	-
Total due in less than one year	387,992	387,994	-	-
Due from 1 to 5 years				
Other debt securities	10,000	10,017	-	-
Obligations of Puerto Rico Government and political subdivisions	398	397	-	-
Total due from 1 to 5 years	10,398	10,414	-	-
Due after 5 to 10 years				
Obligations of Puerto Rico Government and political subdivisions	11,380	11,426	-	-
Structured credit investments	36,424	29,002	-	-
Obligations of US Government and sponsored agencies	25,017	25,135	-	-

Total due after 5 to 10 years	72,821	65,563	-	-
Due after 10 years				
Obligations of Puerto Rico Government and political subdivisions	10,462	10,531	-	-
Other debt securities	5,290	5,582	-	-
Total due after 10 years	15,752	16,113	-	-
Total investment securities	486,963	480,084	-	-
Total investments	\$ 2,228,629	\$ 2,293,550	\$ 835,084	\$ 874,921

Keeping with the Group's investment strategy, during the nine-month period ended September 30, 2012 and 2011, 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. The Group is also pursuing the strategy of selling securities subject to higher prepayment speeds. During the quarter ended September 30, 2012, the Group sold \$532.4 million of investment securities and extinguished \$400 million of securities repurchase agreements prior to their contractual maturities in furtherance of the Group's plan to deleverage its balance sheet in connection with the BBVAPR Acquisition.

Premiums and discounts are amortized to interest income over the life of the related securities using the interest method. Net realized gains or losses on sales of investment securities and unrealized gains and losses valuation adjustments considered other than temporary, if any, on securities classified as either available-for-sale or held-to-maturity are reported separately in the statements of operations. The cost of securities sold is determined by the specific identification method. During the quarter ended September 30, 2012, the Group made a change in one of the estimates applied in the calculation of the amortization of premiums/discounts in the

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

mortgage-backed securities portfolio. The estimate involves the period used in measuring the repayment experience of each security and the change consists of using a 12-month look-back period instead of a 3-month period for these purposes. The Group believes that this extended period better reflects the portfolio behavior, especially considering the seasonality cycle of the U.S. housing market, and also reduces the high volatility that affects interest income recognition when using a more limited prepayment history experience in periods of greater market volatility. The impact of this change during the quarter ended September 30, 2012 was an increase of \$3.3 million in interest income from mortgage-backed securities.

The Group, as part of its asset/liability management, may purchase U.S. Treasury securities and U.S. 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.

The Group recorded a net gain on sale of securities of \$55.7 million and \$23.1 million during the nine-month periods ended September 30, 2012 and 2011, respectively. The tables below present the gross realized gains and losses by category for the nine-month periods ended September 30, 2012 and 2011:

<u>Description</u>	Nine-Month Period Ended September 30, 2012			
	Sale Price	Book Value at Sale	Gross Gains	Gross Losses
	(In thousands)			
Sale of Securities Available-for-Sale				
Mortgage-backed securities				
FNMA and FHLMC certificates	\$ 936,779	\$ 881,834	\$ 54,945	\$ -
GNMA certificates	62,639	62,638	1	-
CMOs issued by US Government sponsored agencies	19,725	18,372	1,353	-
Total mortgage-backed securities and CMOs	1,019,143	962,844	56,299	-
Investment securities				
US Treasury securities	80,000	80,000	-	-
Obligations of Puerto Rico Government and political subdivisions	35,882	36,478	32	628
Structured credit investments	10,530	10,530	-	-
Total investment securities	126,412	127,008	32	628
Total	\$ 1,145,555	\$ 1,089,852	\$ 56,331	\$ 628

<u>Description</u>	Nine-Month Period Ended September 30, 2011			
	Sale Price	Sale Book Value	Gross Gains	Gross Losses

(In thousands)

Sale of Securities Available-for-Sale

Mortgage-backed securities					
FNMA and FHLMC certificates	\$	309,112	\$	293,580	\$ 15,532 \$ -
GNMA certificates		183,269		175,699	7,571 1
Total mortgage-backed securities		492,381		469,279	23,103 1
Investment securities					
Obligations of U.S. Government sponsored agencies		14,100		14,100	- -
Total investment securities		14,100		14,100	- -
Total	\$	506,481	\$	483,379	\$ 23,103 \$ 1

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ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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The following tables show the Group's gross unrealized losses and fair value of investment securities available-for-sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2012 and December 31, 2011:

	Amortized Cost	September 30, 2012 12 months or more Unrealized Loss (In thousands)	Fair Value
Securities Available-for-sale			
Structured credit investments	\$ 36,424	\$ 7,422	\$ 29,002
Obligations of Puerto Rico Government and political subdivisions	1,653	12	1,641
CMOs issued by US Government sponsored agencies	2,243	183	2,060
	\$ 40,320	\$ 7,617	\$ 32,703

	Amortized Cost	Less than 12 months Unrealized Loss (In thousands)	Fair Value
Securities Available-for-sale			
CMOs issued by US Government sponsored agencies	\$ 13,803	\$ 25	\$ 13,778
Obligations of Puerto Rico Government and political subdivisions	125	-	125
GNMA certificates	85	8	77
FNMA and FHLMC certificates	68	1	67
	\$ 14,081	\$ 34	\$ 14,047

	Amortized Cost	TOTAL Unrealized Loss (In thousands)	Fair Value
Securities Available-for-sale			
Structured credit investments	\$ 36,424	\$ 7,422	\$ 29,002
Obligations of Puerto Rico Government and political subdivisions	1,778	12	1,766
CMOs issued by US Government sponsored agencies	16,046	208	15,838
FNMA and FHLMC certificates	68	1	67
GNMA certificates	85	8	77
	\$ 54,401	\$ 7,651	\$ 46,750

**December 31, 2011
12 months or more**

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

At December 31, 2011, there were no available-for-sale securities in a continuous unrealized loss position for less than 12 months. In addition, at September 30, 2012 and December 31, 2011, there were no individual held-to-maturity securities in an unrealized loss position.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Group conducts quarterly reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairment.

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

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

At September 30, 2012, the Group’s portfolio of structured credit investments amounted to \$36.4 million (amortized cost) in the available-for-sale portfolio, with net unrealized losses of approximately \$7.4 million. The Group’s structured credit investments portfolio consist of three 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. These investments are all floating rate notes, which reset quarterly based on the three-month LIBOR rate.

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

- Identification of the estimated fair value of the contractual coupon of the loans underlying the CLO. Such fair values are calculated based on information that is obtained directly from the trustee’s reports for each CLO security.
- Calculation of the yield-to-maturity for each loan in the CLO, and determination of the interest rate spread (yield less the risk-free rate).

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

The three CLOs held by the Group have face values of \$12 million, \$10 million and \$15 million. In light of the other-than-temporary impairment analyses described below, the Group has determined that it is more likely than not that it will recover all interest and principal invested in the CLOs.

The cash flow analysis performed by the Group for the \$12 million CLO did not reflect any scenario where there was a principal impairment. Moreover, the CLO has maintained its "AA-" S&P rating and its "A2" Moody's rating since November 2011. In addition, as of September 30, 2012 and December 31, 2011, the CLO's subordination level is 26.18%.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

With respect to the \$10 million CLO, the cash flow analysis performed by the Group also did not reflect any scenario where there was a principal impairment. The CLO has maintained its “A+” S&P rating and its “A2” Moody’s rating since February 2012. Also, as of September 30, 2012 and December 31, 2011, the CLO’s subordination level is 20.64%.

The cash flow analysis performed by the Group for the \$15 million CLO as of September 30, 2012, detected that there was a principal impairment in 10 out of 100 scenarios, with average losses of 3.42%. and no scenarios where the impairment amount is 100% of the Group’s investment. The CLO has maintained its “BBB+” S&P rating and its “Baa2” Moody’s rating since August 2011. Also, as of September 30, 2012 and December 31, 2011, the CLO’s subordination level is 7.54%.

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

On January 12, 2012, the Group made the strategic decision to sell its \$25.5 million investment in a corporate bond that was partially invested in a synthetic collateralized debt obligation (CDO) at a loss of \$15.0 million. This loss was accounted for as an other-than-temporary impairment in the fourth quarter of 2011, and no additional gain or loss was realized on the sale in January 2012, since this asset was sold at the same value reflected at December 31, 2011. The main considerations underlying the Group’s decision to sell the security included the continued deteriorating credit conditions surrounding the underlying reference portfolio of the CDO, including an event of default that occurred during the fourth quarter of 2011, and a projected analysis prepared by a third-party specialist that showed defaults in excess of the deal’s subordination level in more than 50% of the scenarios modeled. The corporate bond sold was a unique and completely distinguishable investment from the rest of the Group’s portfolio, including the remaining structured credit investments. As a result of this transaction, the Group continued to reduce its exposure to non-agency securities, as well as to credit risk in the U.S. economy, and also was able to improve its risk-based capital position.

Other securities in an unrealized loss position at September 30, 2012 are mainly composed of highly liquid securities that in most cases have a large and efficient secondary market. Valuations are performed on a monthly basis. The Group’s management believes that the unrealized losses of such other securities at September 30, 2012 are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuer or guarantor. At September 30, 2012, the Group does not have the intent to sell these investments in an unrealized loss position.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 4 - PLEDGED ASSETS

The following table shows a summary of pledged and not pledged assets at September 30, 2012 and December 31, 2011. Investment securities are presented at fair value, and residential mortgage loans, commercial loans and leases are presented at amortized cost:

	September 30, 2012		December 31, 2011
	(In thousands)		
Pledged investment securities to secure:			
Securities sold under agreements to repurchase	\$ 2,885,058	\$	3,399,145
Puerto Rico public fund deposits	8,522		71,863
Puerto Rico Cash & Money Market Fund	72,312		62,739
Interest rate risk swap contracts	56,444		56,189
Federal Reserve Bank Credit Facility	10,254		15,560
Bond for the Bank's trust operations	125		126
Total pledged investment securities	3,032,715		3,605,622
Pledged residential mortgage loans to secure:			
Advances from the Federal Home Loan Bank	515,669		548,809
Pledged commercial loans to secure:			
Advances from the Federal Home Loan Bank	54,614		40,937
Puerto Rico public fund deposits	2,271		-
	56,885		40,937
Pledged leases to secure:			
Federal Reserve Bank Credit Facility	8,543		7,821
Total pledged assets	\$ 3,613,812	\$	4,203,189
Financial assets not pledged:			
Investment securities	\$ 135,757	\$	258,845
Residential mortgage loans	428,465		435,716
Commercial loans	590,795		603,444
Consumer loans	54,577		49,663
Leases	37,369		54,069
Total assets not pledged	\$ 1,246,963	\$	1,401,737

At September 30, 2012 and December 31, 2011, OIB held a certificate of deposit free of liens in the amount of \$300 thousand as the legal reserve required for international banking entities under Puerto Rico law. Such certificate of deposit cannot be withdrawn by OIB without the OCFI's prior written approval.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 5 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN AND LEASE LOSSES

Loans Receivable Composition

The composition of the Group's loan portfolio at September 30, 2012 and December 31, 2011 was as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
Loans not covered under shared-loss agreements with FDIC:		
Loans secured by real estate:		
Residential	\$ 770,979	\$ 819,651
Home equity loans and others	768	1,411
Commercial	239,654	218,261
Deferred loan fees, net	(3,962)	(4,300)
	1,007,439	1,035,023
Other loans:		
Commercial	98,710	83,312
Personal consumer loans and credit lines	43,631	36,130
Leasing	33,772	25,768
Deferred loan costs (fees), net	87	(245)
	176,200	144,965
Loans receivable	1,183,639	1,179,988
Allowance for loan and lease losses on non-covered loans	(39,120)	(37,010)
Loans receivable, net	1,144,519	1,142,978
Mortgage loans held-for-sale	38,211	26,939
Total loans not covered under shared-loss agreements with FDIC, net	1,182,730	1,169,917
Loans covered under shared-loss agreements with FDIC:		
Loans secured by 1-4 family residential properties	138,138	140,824
Construction and development secured by 1-4 family residential properties	7,933	16,976
Commercial and other construction	301,383	325,832
Leasing	12,140	36,122
Consumer	10,859	13,778
Total loans covered under shared-loss agreements with FDIC	470,453	533,532
Allowance for loan and lease losses on covered loans	(56,865)	(37,256)
Total loans covered under shared-loss agreements with FDIC, net	413,588	496,276
Total loans receivable, net	\$ 1,596,318	\$ 1,666,193

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Non-Covered Loans

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

The following table presents the aging of the recorded investment in gross loans not covered under shared-loss agreements with the FDIC, excluding mortgage loans held for sale, as of September 30, 2012 and December 31, 2011 by class of loans:

	September 30, 2012						Total Loans
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due (In thousands)	Total Past Due	Current		
Mortgage							
Traditional							
(by origination year):							
Up to the year 2002	\$ 3,760	\$ 793	\$ 10,501	\$ 15,054	\$ 87,484	\$ 102,538	
Years 2003 and 2004	7,051	2,398	16,956	26,405	127,625	154,030	
Year 2005	1,538	681	8,027	10,246	73,744	83,990	
Year 2006	4,085	1,251	14,129	19,465	98,143	117,608	
Years 2007, 2008 and 2009	1,655	738	9,414	11,807	115,050	126,857	
Years 2010, 2011 and 2012	801	398	670	1,869	43,162	45,031	
Non-traditional Loss mitigation program	18,890	6,259	59,697	84,846	545,208	630,054	
Home equity secured personal loans	2,153	460	11,177	13,790	48,107	61,897	
	6,047	1,475	17,010	24,532	54,496	79,028	
	27,090	8,194	87,884	123,168	647,811	770,979	
	-	-	12	12	756	768	

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	27,090	8,194	87,896	123,180	648,567	771,747
Commercial						
Commercial secured by real estate	1,041	369	15,768	17,178	222,476	239,654
Other commercial and industrial	240	267	2,425	2,932	95,778	98,710
	1,281	636	18,193	20,110	318,254	338,364
Consumer	396	229	254	879	42,752	43,631
Leasing	578	109	11	698	33,074	33,772
Total loans not covered under shared-loss agreements with the FDIC	\$ 29,345	\$ 9,168	\$ 106,354	\$ 144,867	\$ 1,042,647	\$ 1,187,514

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	December 31, 2011											
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due (In thousands)	Total Past Due	Current	Total Loans						
Mortgage												
Traditional												
(by origination year):												
Up to the year	\$	2,009	\$	1,514	\$	15,638	\$	19,161	\$	95,886	\$	115,047
2002												
Years 2003 and		7,835		3,140		19,692		30,667		138,490		169,157
2004												
Year 2005		2,137		2,573		10,325		15,035		77,256		92,291
Year 2006		4,018		1,358		17,673		23,049		107,526		130,575
Years 2007, 2008												
and 2009		2,562		655		8,996		12,213		124,594		136,807
Years 2010, 2011												
and 2012		370		194		513		1,077		40,848		41,925
Non-traditional		18,931		9,434		72,837		101,202		584,600		685,802
Loss mitigation		1,109		819		10,857		12,785		57,240		70,025
program		4,887		2,113		13,323		20,323		43,501		63,824
Home equity		24,927		12,366		97,017		134,310		685,341		819,651
secured personal loans		142		-		323		465		946		1,411
		25,069		12,366		97,340		134,775		686,287		821,062
Commercial												
Commercial secured		1,205		1,697		27,741		30,643		187,618		218,261
by real estate												
Other commercial		1,536		99		616		2,251		81,061		83,312
and industrial												
		2,741		1,796		28,357		32,894		268,679		301,573
Consumer		557		226		334		1,117		35,013		36,130
Leasing		339		-		102		441		25,327		25,768
Total loans not covered under shared-loss												
agreements with the FDIC	\$	28,706	\$	14,388	\$	126,133	\$	169,227	\$	1,015,306	\$	1,184,533

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the recorded investment in non-covered loans on non-accrual status by class of loans as of September 30, 2012 and December 31, 2011:

	September 30, 2012	December 31, 2011
	(In thousands)	
Mortgage		
Traditional		
(by origination year):		
Up to the year 2002	\$ 10,501	\$ 15,637
Years 2003 and 2004	16,956	19,693
Year 2005	8,027	10,325
Year 2006	14,129	17,673
Years 2007, 2008	9,414	8,996
and 2009		
Years 2010, 2011	670	513
and 2012	59,697	72,837
Non-traditional	11,177	10,857
Loss mitigation program	17,010	13,323
	87,884	97,017
Home equity secured personal loans	12	323
	87,896	97,340
Commercial		
Commercial secured by real estate	26,959	34,789
Other commercial and industrial	2,690	2,199
	29,649	36,988
Consumer	276	334
Leasing	11	102
Total non-accrual loans	\$ 117,832	\$ 134,764

At September 30, 2012 and December 31, 2011, loans whose terms have been extended and which are classified as troubled-debt restructuring that are not included in non-accrual loans amounted to \$56.6 million and \$41.3 million, respectively.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Credit Quality Indicators

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

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

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

The Group uses the following definitions for risk ratings:

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

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

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

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

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

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

As of September 30, 2012 and December 31, 2011, 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	September 30, 2012 Risk Ratings				Individually Measured for Impairment
		Pass (In thousands)	Special Mention	Substandard	Doubtful	
Commercial						
Commercial secured						
by real estate	\$ 239,654	\$ 182,898	\$ 23,390	\$ 1,957	\$ 99	\$ 31,310
Other commercial						
and industrial	98,710	86,886	6,823	394	-	4,607
Total	\$ 338,364	\$ 269,784	\$ 30,213	\$ 2,351	\$ 99	\$ 35,917

	Balance Outstanding	December 31, 2011 Risk Ratings				Individually Measured for Impairment
		Pass (In thousands)	Special Mention	Substandard	Doubtful	
Commercial						
Commercial secured						
by real estate	\$ 218,261	\$ 148,894	\$ 25,185	\$ 1,957	\$ 13	\$ 42,212
Other commercial	83,312	74,714	3,517	929	-	4,152

and industrial Total	\$	301,573	\$	223,608	\$	28,702	\$	2,886	\$	13	\$	46,364
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ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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For residential and consumer loan classes, the Group also evaluates credit quality based on the delinquency status of the loan. As of September 30, 2012 and December 31, 2011, 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:

Balance	September 30, 2012 Delinquency						Impairment		
	Individually Measured for		Outstanding						
			0-29 days	30-59 days	60-89 days	90-119 days	120-364 days	365+ days	
	(In thousands)								
Mortgage Traditional									
(by origination year):									
Up to the year 2002	\$ 102,538	\$ 87,483	\$ 3,760	\$ 793	\$ 846	\$ 2,580	\$ 7,076	\$ -	
Years 2003 and 2004	154,030	127,625	7,051	2,398	596	4,857	11,503	-	
Year 2005	83,990	73,745	1,538	681	204	2,916	4,906	-	
Year 2006	117,608	98,143	4,085	1,251	641	4,588	8,900	-	
Years 2007, 2008									
and 2009	126,857	115,050	1,655	738	514	3,582	5,318	-	
Years 2010, 2011									
and 2012	45,031	43,162	801	398	-	165	505	-	
	630,054	545,208	18,890	6,259	2,801	18,688	38,208	-	
Non-traditional	61,897	48,107	2,153	460	289	2,623	8,265	-	
Loss mitigation program	79,028	9,856	344	177	54	912	2,815	64,870	
	770,979	603,171	21,387	6,896	3,144	22,223	49,288	64,870	
Home equity secured									
personal loans	768	756	-	-	-	-	12	-	
	771,747	603,927	21,387	6,896	3,144	22,223	49,300	64,870	
Consumer	43,631	42,752	396	229	100	151	3	-	
Leasing	33,772	33,074	578	109	4	1	6	-	
Total	\$ 849,150	\$ 679,753	\$ 22,361	\$ 7,234	\$ 3,248	\$ 22,375	\$ 49,309	\$ 64,870	

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Balance	December 31, 2011 Delinquency		Individually Measured for	Outstanding	0-29	30-59	60-89	90-119	120-364	365+	Impairment
	days	days			days	days	days	days			
Mortgage Traditional											
(by origination year)											
Up to the year 2002	\$ 115,047	\$ 95,886	\$ 2,009	\$ 1,514	\$ 406	\$ 4,972	\$ 10,260	\$ -			
Years 2003 and 2004	169,157	138,490	7,835	3,140	939	7,318	11,435	-			
Year 2005	92,291	77,255	2,137	2,573	945	3,117	6,264	-			
Year 2006	130,575	107,526	4,018	1,358	446	7,416	9,811	-			
Years 2007, 2008											
and 2009	136,807	124,595	2,562	655	1,039	3,224	4,732	-			
Years 2010 and 2011	41,925	40,848	370	194	-	410	103	-			
	685,802	584,600	18,931	9,434	3,775	26,457	42,605	-			
Non-traditional	70,025	57,240	1,109	819	849	2,725	7,283	-			
Loss mitigation program	63,824	7,928	601	757	-	1,002	2,054	51,482			
	819,651	649,768	20,641	11,010	4,624	30,184	51,942	51,482			
Home equity secured											
personal											
loans	1,411	946	142	-	-	-	323	-			
	821,062	650,714	20,783	11,010	4,624	30,184	52,265	51,482			
Consumer	36,130	35,013	557	226	202	132	-	-			
Leasing	25,768	25,327	339	-	21	81	-	-			
Total	\$ 882,960	\$ 711,054	\$ 21,679	\$ 11,236	\$ 4,847	\$ 30,397	\$ 52,265	\$ 51,482			

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents the troubled-debt restructurings modified during the nine-month periods ended September 30, 2012 and 2011:

Nine-Month Period Ended September 30, 2012

	Pre Modification		Pre-Modification		Post-Modification		Post-Modification	
	Number of contracts	Recorded Investment	Weighted Average Rate	Weighted Average Term (in Months)	Number of contracts	Recorded Investment	Weighted Average Rate	Weighted Average Term (in Months)
Mortgage loans	155	\$ 23,701	6.44%	310	\$ 25,385	4.86%	400	
Commercial loans	7	6,981	6.13%	46	6,550	6.17%	46	

Nine-Month Period Ended September 30, 2011

	Pre Modification		Pre-Modification		Post-Modification		Post-Modification	
	Number of contracts	Recorded Investment	Weighted Average Rate	Weighted Average Term (in Months)	Number of contracts	Recorded Investment	Weighted Average Rate	Weighted Average Term (in Months)
Mortgage loans	101	\$ 14,023	6.88%	329	\$ 15,112	5.87%	379	
Commercial loans	10	13,117	3.61%	77	13,046	3.36%	75	

The following table presents troubled-debt restructurings modified and for which there was a payment default during the twelve-month periods ended September 30, 2012 and 2011:

	Twelve-Month Period Ended September 30, 2012		Twelve-Month Period Ended September 30, 2011	
	Number of contracts	Recorded Investment	Number of contracts	Recorded Investment
Mortgage loans	37	\$ 5,029	28	\$ 3,738
Commercial	-	\$ -	4	\$ 9,254

ORIENTAL FINANCIAL GROUP INC.**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)***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 for the quarters and nine-month periods ended September 30, 2012 and 2011:

	Mortgage	Quarter Ended September 30, 2012				Total
		Commercial	Consumer	Leasing	Unallocated	
	(In thousands)					
Allowance for loan and lease losses for						
non-covered loans:						
Balance at beginning of period	19,788	\$ 15,978	\$ 998	\$ 197	\$ 441	\$ 37,402
Charge-offs	(1,752)	(65)	(198)	(75)	-	(2,090)
Recoveries	131	28	46	3	-	208
Provision for (recapture of) non-covered loan and lease losses	2,886	(502)	328	119	769	3,600
Balance at end of period	21,053	\$ 15,439	\$ 1,174	\$ 244	\$ 1,210	\$ 39,120

Quarter Ended September 30, 2011

	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
	(In thousands)					
Allowance for loan and lease losses for						
non-covered loans:						
Balance at beginning of period	17,770	\$ 13,800	\$ 1,520	\$ 868	\$ 271	\$ 34,229
Charge-offs	(1,391)	(440)	(368)	(82)	-	(2,281)
Recoveries	-	56	63	2	-	121
Provision for (recapture of) non-covered loan and lease losses	4,851	(2,297)	486	659	101	3,800
Balance at end of period	21,230	\$ 11,119	\$ 1,701	\$ 1,447	\$ 372	\$ 35,869

	Nine-Month Period Ended September 30, 2012					
	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total
	(In thousands)					
Allowance for loan and lease losses for						
non-covered loans:						
Balance at beginning of period	21,652	\$ 12,548	\$ 1,423	\$ 845	\$ 542	\$ 37,010
Charge-offs	(4,621)	(3,423)	(563)	(104)	-	(8,711)
Recoveries	131	129	153	8	-	421
Provision for (recapture of) non-covered loan and lease losses	3,891	6,185	161	(505)	668	10,400
Balance at end of period	21,053	\$ 15,439	\$ 1,174	\$ 244	\$ 1,210	\$ 39,120

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Nine-Month Period Ended September 30, 2011						Total
	Mortgage	Commercial	Consumer	Leasing	Unallocated		
	(In thousands)						
Allowance for loan and lease losses for							
non-covered loans:							
Balance at beginning of period	\$ 16,179	\$ 11,153	\$ 2,286	\$ 860	\$ 952	\$ 31,430	
Charge-offs	(4,480)	(1,478)	(1,160)	(174)	-	(7,292)	
Recoveries	45	108	175	3	-	331	
Provision for (recapture of) non-covered loan and lease losses	9,486	1,336	400	758	(580)	11,400	
Balance at end of period	\$ 21,230	\$ 11,119	\$ 1,701	\$ 1,447	\$ 372	\$ 35,869	

The following table presents the recorded investment in gross loans by portfolio segment and based on the impairment method as of September 30, 2012 and 2011:

	September 30, 2012						Total
	Mortgage	Commercial	Consumer	Leasing	Unallocated		
	(In thousands)						
Allowance for loan and lease losses for							
non-covered loans:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 4,833	\$ 1,317	\$ -	\$ -	\$ -	\$ 6,150	
Collectively evaluated for impairment	16,220	14,122	1,174	244	1,210	32,970	
	\$ 21,053	\$ 15,439	\$ 1,174	\$ 244	\$ 1,210	\$ 39,120	

Total ending allowance balance								
Loans:								
Individually evaluated for impairment	\$	64,870	\$	35,917	\$	-	\$	100,787
Collectively evaluated for impairment		706,877		302,447		43,631		1,086,727
						33,772		
Total ending non-covered loans balance	\$	771,747	\$	338,364	\$	43,631	\$	1,187,514
						33,772		
							-	

		September 30, 2011						
	Mortgage	Commercial	Consumer	Leasing	Unallocated	Total		
	(In thousands)							
Allowance for loan and lease losses for non-covered loans:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$	2,973	\$	1,829	\$	-	\$	4,802
Collectively evaluated for impairment		18,257		9,290		1,701		31,067
						1,447		
						372		
Total ending allowance balance	\$	21,230	\$	11,119	\$	1,701	\$	35,869
Loans:								
Individually evaluated for impairment	\$	46,513	\$	35,073	\$	-	\$	81,586
Collectively evaluated for impairment		790,651		235,560		37,241		1,084,735
						21,283		
Total ending non-covered loans balance	\$	837,164	\$	270,633	\$	37,241	\$	1,166,321
						21,283		
							-	

The Group evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. The total investment in impaired commercial loans was \$35.9 million and \$46.4 million at September 30, 2012 and December 31, 2011, respectively. The impaired commercial loans were measured based on the fair value of collateral or the present value of cash flows method, including those identified as troubled-debt restructurings. The valuation allowance for impaired commercial loans amounted to approximately \$1.3 million and \$3.5 million at

September 30, 2012 and December 31, 2011, respectively. The total investment in impaired mortgage loans was \$64.9 million and \$51.5 million at September 30, 2012 and December 31, 2011, respectively. Impairment on mortgage loans assessed as troubled-debt restructurings was measured using the present value of cash flows. The valuation allowance for impaired mortgage loans amounted to approximately \$4.8 million and \$3.4 million at September 30, 2012 and December 31, 2011, respectively.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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 September 30, 2012 and December 31, 2011 are as follows:

		September 30, 2012			
	Unpaid Principal	Recorded Investment (In thousands)	Specific Allowance	Coverage	
Impaired loans with specific allowance					
Commercial	\$	15,323	\$ 12,260	\$ 1,317	11%
Residential troubled-debt restructuring		66,556	64,870	4,833	7%
Impaired loans with no specific allowance					
Commercial		26,709	23,657	N/A	N/A
Total investment in impaired loans	\$	108,588	\$ 100,787	\$ 6,150	6%

		December 31, 2011			
	Unpaid Principal	Recorded Investment (In thousands)	Specific Allowance	Coverage	
Impaired loans with specific allowance					
Commercial	\$	25,974	\$ 23,368	\$ 3,518	15%
Residential troubled-debt restructuring		52,480	51,482	3,355	7%
Impaired loans with no specific allowance					
Commercial		23,780	22,996	N/A	N/A
Total investment in impaired loans	\$	102,234	\$ 97,846	\$ 6,873	7%

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 and nine-month periods ended September 30, 2012 and 2011:

	Quarter Ended September 30,			
	2012		2011	
	Interest Income Recognized	Average Recorded Investment (In thousands)	Interest Income Recognized	Average Recorded Investment
Impaired loans with specific allowance				
Commercial	\$ 40	\$ 9,027	\$ 277	\$ 17,494
Residential troubled-debt restructuring	510	65,932	336	47,350
Impaired loans with no specific allowance				
Commercial	83	28,475	196	18,241
Total interest income from impaired loans	\$ 633	\$ 103,434	\$ 809	\$ 83,085

	Nine-Month Period Ended September 30,			
	2012		2011	
	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment
Impaired loans with specific allowance				
Commercial	\$ 163	\$ 16,686	\$ 810	\$ 16,257
Residential troubled-debt restructuring	1,344	61,622	777	39,912
Impaired loans with no specific allowance				
Commercial	261	24,068	555	15,295
Total interest income from impaired loans	\$ 1,768	\$ 102,376	\$ 2,142	\$ 71,464

ORIENTAL FINANCIAL GROUP INC.**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)****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 reviewed each loan at acquisition to determine if it should be accounted for under ASC 310-30 and, if so, determine whether each loan is to be accounted for individually or whether loans will be aggregated into pools of loans based on common risk characteristics. During the evaluation of whether a loan was considered impaired under ASC 310-30, the Group considered a number of factors, including the delinquency status of the loan, payment options and other loan features (i.e., reduced documentation, interest only, or negative amortization features), the geographic location of the borrower or collateral and the risk ratings assigned to the loans. In instances where it was determined that for some of the loans in the acquired loan pool that it is probable that all the contractual payments would be received (therefore the loans meet the first criteria of ASC 310-30-15-2 but not the second), the Group applied the discount accretion guidance as ASC 310-30, instead of the standard loan discount accretion guidance of ASC 310-20 to those loans (the loans under SOP 03-3). As documented in a letter from the AICPA Depository Institution Expert Panel to the Office of Chief Accountant of the SEC, on December 5, 2009, the SEC addressed the recognition of discount accretion for loans acquired under these circumstances. As referred to in the AICPA's letter, when loans are acquired with at a discount attributable in part to credit (e.g., at a fair value lower than the contractual amounts due) and such loans are not within the scope of ASC 310-30, the AICPA believed that the SEC would not object to an accounting policy based on contractual cash flows or an accounting policy based on expected cash flows, meaning that an entity could either apply the accretion guidance of ASC 310-20 or that of the ASC 310-30 to such loans. Consistent with the AICPA's views, the Group applied the guidance of ASC 310-30 to all loans acquired in the transaction including loans that do not meet the scope of ASC 310-30. Based on the criteria, the Group considered the entire portfolio acquired in the FDIC-assisted acquisition, except for credit cards, to be impaired and accounted for under ASC 310-30. Credit cards were accounted under ASC 310-20.

To the extent credit deterioration occurs in covered loans after the date of acquisition, the Group will record an allowance for loan and lease losses and an increase in the FDIC shared-loss indemnification asset for the expected reimbursement from the FDIC under the shared-loss agreements. The covered loans carrying amounts included in the balance sheet at September 30, 2012 and December 31, 2011 are as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
Contractual required payments receivable	\$ 918,289	\$ 1,134,524
Less: Non-accretable discount	264,003	412,170
Cash expected to be collected	654,286	722,354
Less: Accretable yield	183,833	188,822
Carrying amount, gross	470,453	533,532
Less: Allowance for covered loan and lease losses	56,865	37,256

Carrying amount, net	\$	413,588	\$	496,276
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ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following tables describe the accretable yield and non-accretable discount activity for the quarters and nine-month periods ended September 30, 2012 and 2011:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Accretable Yield Activity				
Balance at beginning of period	\$ 177,248	\$ 115,722	\$ 188,822	\$ 148,556
Accretion	(22,283)	(18,222)	(64,167)	(45,507)
Transfer from non-accretable discount	28,868	70,906	59,178	65,357
Balance at end of period	\$ 183,833	\$ 168,406	\$ 183,833	\$ 168,406

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Non-Accretable Discount Activity				
Balance at beginning of period	\$ 314,404	\$ 557,938	\$ 412,170	\$ 603,296
Principal losses	(21,533)	(24,930)	(88,989)	(75,837)
Transfer to accretable yield	(28,868)	(70,906)	(59,178)	(65,357)
Balance at end of period	\$ 264,003	\$ 462,102	\$ 264,003	\$ 462,102

For covered loans, as part of the evaluation of actual versus expected cash flows, the Group assesses on a quarterly basis the credit quality of these loans based on delinquency, severity factors and risk ratings, among other assumptions. Migration and credit quality trends are assessed at the pool level, by comparing information from the latest evaluation period through the end of the reporting period. During the first quarter of 2012, the Group reviewed certain pools composed of commercial real estate, construction and development loans, which have been in non-accrual status since acquisition, whose cash flows were lower than the expectations exceeding the established thresholds. The Group reviewed the timing of the collections expected through workouts and/or the timing assessed for the particular workout loan to foreclose for the most significant loans comprising the particular pools selected for review. The credit quality assumptions for these pools were updated to reflect increases in default rates, severities and extension of recovery lags resulting in an increase in the provision for covered loan and lease losses. For other pools composed of performing commercial real estate loans and leases, the Group noted that the actual cash flows were better than expected. Thus, for these pools a reversal of previously recorded allowance and a re-yielding of the leasing pools were recorded. As a result of such assessment, during the first quarter of 2012, the Group recorded a net increase in the allowance for covered loans of \$19.2 million which was partially offset by an increase in the FDIC shared-loss indemnification asset of \$12.0 million. Also, as part of our quarterly assessment of the actual versus

expected cash flows for covered loans, during the second quarter of 2012, the Group reviewed particular loan performances and expected workout developments to derive more assumptions on certain pools secured by real estate and pools of commercial and industrial loans. Certain pools of loans secured by real estate and a pool of loans secured by farmland underperformed in their actual cash flows, and an impairment of \$2.2 million was recorded during that quarter. Such amount was partially offset by an increase in the FDIC shared-loss indemnification asset of \$724 thousand. For the quarter ended September 30, 2012, the assessment of actual versus expected cash flows resulted in a net provision of \$221 thousand as certain pools of real estate backed loans and of commercial and industrial loans underperformed. The net provision also included the reversal of a previously recorded allowance in certain commercial real estate and construction pools whose loans the Group has managed to workout with better outcomes than forecasted.

The loss share portion of the reversal of allowance during the quarter ended September 30, 2012 was proportionally higher than the allowance reversal recorded on the impaired loans. This resulted from the fact that there were some pools in which additional allowance was recognized but no adjustment was done to the FDIC shared-loss indemnification asset as these losses were not covered by a loss share agreement. This resulted in the reduction of the FDIC shared-loss indemnification asset of \$1.9 million that is part of the aforementioned net provision for covered loans of \$221 thousand.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The changes in the allowance for loan and lease losses on covered loans for the quarters and nine-month periods ended September 30, 2012 and 2011 were as follows:

	Quarter Ended September 30,		Nine-Month Period Ended	
	2012	2011	September 30,	2011
	(In thousands)		(In thousands)	
Balance at beginning of the period	\$ 58,628	\$ 53,036	\$ 37,256	\$ 49,286
Provision for (recapture of) covered loan and lease losses, net	221	(1,936)	8,845	(1,387)
FDIC shared-loss portion of provision for (recapture of) covered loan and lease losses, net	(1,984)	(13,860)	10,764	(10,659)
Balance at end of the period	\$ 56,865	\$ 37,240	\$ 56,865	\$ 37,240

The Group's recorded investment in covered loan pools that have recorded impairments and their related allowance for covered loan and lease losses as of September 30, 2012 and December 31, 2011 are as follows:

	September 30, 2012			
	Unpaid Principal	Recorded Investment (In thousands)	Specific Allowance	Coverage
Impaired covered loan pools with specific allowance				
Loans secured by 1-4 family residential properties	\$ 35,689	\$ 24,025	\$ 4,700	20%
Construction and development secured by 1-4 family residential properties	75,641	7,668	7,668	100%
Commercial and other construction	187,108	84,906	43,819	52%
Consumer	16,490	10,859	678	6%
Total investment in impaired covered loan pools	\$ 314,928	\$ 127,458	\$ 56,865	45%

December 31, 2011

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

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ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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 mortgage loans originated by others. Whenever the Group undertakes an obligation to service a loan, management assesses whether a servicing asset and/or liability should be recognized. A servicing asset is recognized whenever the compensation for servicing is expected to more than adequately compensate the Group for servicing the loans and leases. Likewise, a servicing liability would be recognized in the event that servicing fees to be received are not expected to adequately compensate the Group for its expected cost.

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

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

At September 30, 2012, servicing assets are composed of \$10.6 million (\$10.2 million — December 31, 2011) related to residential mortgage loans and \$80 thousand (\$221 thousand — December 31, 2011) of leasing servicing assets acquired in the FDIC-assisted acquisition of Eurobank.

The following table presents the changes in servicing rights measured using the fair value method for the quarters and nine-month periods ended September 30, 2012 and 2011:

	Quarter Ended September 30,		Nine-Month Period Ended	
	2012	2011	September 30,	2011
	(In thousands)		(In thousands)	
Fair value at beginning of period	\$ 10,776	\$ 9,840	\$ 10,454	\$ 9,695
	487	615	1,407	1,828

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Servicing from mortgage securitizations or asset transfers					
Changes due to payments on loans	(307)	(225)	(783)	(705)	
Changes in fair value due to changes in valuation model					
inputs or assumptions	(314)	(216)	(436)	(804)	
Fair value at end of period	\$ 10,642	\$ 10,014	\$ 10,642	\$ 10,014	

The following table presents key economic assumption ranges used in measuring the mortgage-related servicing asset fair value for the quarters and nine-month periods ended September 30, 2012 and 2011:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
Constant prepayment rate	9.43% - 15.80%	10.56% - 39.25%	9.43% - 33.05%	7.87% - 39.25%
Discount rate	10.50% - 12.50%	11.00% - 14.00%	10.50% - 13.50%	11.00% - 14.00%

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table presents key economic assumption ranges used in measuring the leasing-related servicing asset fair value for the quarters and nine-month periods ended September 30, 2012 and 2011:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
Discount rate	13.27% - 15.14%	14.33% - 15.07%	13.19% - 15.52%	13.22% - 17.38%

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 follows:

	September 30, 2012 (In thousands)
<u>Mortgage related servicing asset</u>	
Carrying value of mortgage servicing asset	\$ 10,562
Constant prepayment rate	
Decrease in fair value due to 10% adverse change	\$ (452)
Decrease in fair value due to 20% adverse change	\$ (874)
Discount rate	
Decrease in fair value due to 10% adverse change	\$ (441)
Decrease in fair value due to 20% adverse change	\$ (849)
<u>Leasing servicing asset</u>	
Carrying value of leasing servicing asset	\$ 80
Discount rate	
Decrease in fair value due to 10% adverse change	\$ (1)
Decrease in fair value due to 20% adverse change	\$ (2)

ORIENTAL FINANCIAL GROUP INC.**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

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

Servicing fee income is based on a contractual percentage of the outstanding principal and is recorded as income when earned. Servicing fees on mortgage loans totaled \$920 thousand and \$806 thousand for the quarters ended September 30, 2012 and 2011, respectively. These fees totaled \$2.7 million and \$2.3 million for the nine-month periods ended September 30, 2012 and 2011, respectively. There were no late fees and ancillary fees recorded in such periods because these fees belong to the third party with which the Group is engaged in a subservicing agreement. Servicing fees on leases amounted to \$53 thousand and \$150 thousand for the quarters ended September 30, 2012 and 2011, respectively. These fees totaled \$200 thousand and \$549 thousand for the nine-month periods ended September 30, 2012 and 2011, respectively.

NOTE 7 — PREMISES AND EQUIPMENT

Premises and equipment at September 30, 2012 and December 31, 2011 are stated at cost less accumulated depreciation and amortization as follows:

	Useful Life (Years)	September 30, 2012	December 31, 2011
		(In thousands)	
Land	—	\$ 2,254	\$ 2,254
Buildings and improvements	40	6,282	5,890
Leasehold improvements	5 — 10	18,289	18,182
Furniture and fixtures	3 — 7	9,219	9,718

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Information technology and other	3 — 7	19,533	20,008
		55,577	56,052
Less: accumulated depreciation and amortization		(36,309)	(34,532)
		\$ 19,268	\$ 21,520

Depreciation and amortization of premises and equipment for the quarters ended September 30, 2012 and 2011 totaled \$1.1 million and \$1.4 million, respectively. For the nine-month periods ended September 30, 2012 and 2011, these expenses amounted to \$3.4 million and \$4.1 million, respectively. These are included in the unaudited consolidated statements of operations as part of occupancy and equipment expenses.

ORIENTAL FINANCIAL GROUP INC.**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)****NOTE 8 — DERIVATIVE ACTIVITIES**

During the nine-month period ended September 30, 2012, losses of \$1.4 million were recognized and reflected as “Derivative Activities” in the unaudited consolidated statements of operations. These were mainly related to the amortization of premiums paid on options purchased in July 2012 to enter into interest rate swaps, not designated as cash flow hedges, with an aggregate notional amount of \$200.0 million. The amortization recorded during the quarter ended September 30, 2012, amounted to \$1.5 million. During the nine-month period ended September 30, 2011, losses of \$8.4 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, and to realized losses of \$2.2 million from terminations of options to enter into interest rate swaps with a notional amount of \$250 million.

The following table details “Derivative Assets” and “Derivative Liabilities” as reflected in the unaudited consolidated statements of financial condition at September 30, 2012 and December 31, 2011:

	September 30, 2012	December 31, 2011
	(In thousands)	
Derivative assets:		
Options tied to S&P 500 Index	\$ 13,088	\$ 9,317
Options on interest rate swaps	5,407	-
	\$ 18,495	\$ 9,317
Derivative liabilities:		
Forward settlement swaps and interest rate swaps	\$ 58,269	\$ 47,425

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Forward-Settlement Swaps and Interest Rate Swaps

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

The following table shows a summary of these swaps and their terms at September 30, 2012:

Type	Notional Amount (In thousands)	Fixed Rate	Trade Date	Settlement Date	Maturity Date
Interest Rate Swaps	\$ 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
	25,000	2.4365%	05/05/11	05/04/12	05/04/16
	125,000	1.6550%	03/18/11	05/09/12	02/09/14
	125,000	1.7700%	03/18/11	05/09/12	05/09/14
	100,000	1.8975%	03/18/11	05/09/12	08/09/14
	25,000	2.6200%	05/05/11	07/24/12	07/24/16
	25,000	2.6350%	05/05/11	07/30/12	07/30/16
	50,000	2.6590%	05/05/11	08/10/12	08/10/16
	100,000	2.2225%	05/05/11	08/14/12	05/14/15
	100,000	2.6750%	05/05/11	08/16/12	08/16/16
		\$ 975,000			
Forward-Settlement Swaps	\$ 150,000	2.7795%	05/05/11	12/06/12	06/06/16
	\$ 1,125,000				

An unrealized loss of \$58.3 million was recognized in accumulated other comprehensive income related to the valuation of these swaps at September 30, 2012, and the related liability is being reflected in the accompanying unaudited consolidated statements of financial condition.

ORIENTAL FINANCIAL GROUP INC.**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)***Swap Options*

In July 2012, the Group purchased options to enter into interest rate swaps, not designated as cash flow hedges, with an aggregate notional amount of \$200 million. At September 30, 2012, the purchased options used to manage the exposure on the interest rate swaps represented an asset of \$5.4 million in the consolidated statements of financial position. The following table shows a summary of these swap options and their terms at September 30, 2012:

	Notional Amount	Fixed Rate	Trade Date	Option Maturity Date	Swap Start Date	Swap Maturity Date
	(In thousands)					
\$	100,000	2.2350%	07/06/12	07/07/14	07/09/14	07/09/24
	100,000	1.8400%	07/06/12	01/07/13	01/09/13	01/09/23
\$	200,000					

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

The Group has offered its customers certificates of deposit with an option tied to the performance of the S&P 500 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 September 30, 2012 and December 31, 2011, the purchased options used to manage the exposure to the S&P 500 Index on stock indexed deposits represented an asset of \$13.1 million (notional amount of \$72.2 million) and \$9.3 million (notional amount of \$130.0 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 \$12.6 million (notional amount of \$67.6 million) and \$9.4 million (notional amount of \$125.8 million), respectively.

NOTE 9 — ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

Accrued interest receivable at September 30, 2012 and December 31, 2011 consists of the following:

	September 30, 2012	December 31, 2011
	(In thousands)	
Non-covered loans	\$ 5,588	\$ 5,519
Investments	9,347	14,663
	\$ 14,935	\$ 20,182

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Other assets at September 30, 2012 and December 31, 2011 consist of the following:

	September 30, 2012	December 31, 2011
	(In thousands)	
Prepaid FDIC insurance	\$ 7,705	\$ 11,599
Other prepaid expenses	11,047	6,498
Servicing advances	9,041	13,990
Goodwill	2,701	2,701
Mortgage tax credits	1,303	1,303
Core deposit intangible	1,079	1,185
Investment in Statutory Trust	1,086	1,086
Debt issuance costs	822	1,067
Other repossessed assets (covered by FDIC shared-loss agreements)	396	708
Accounts receivable and other assets	13,905	14,346
	\$ 49,085	\$ 54,483

On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 31, 2009, along with each institution's risk-based deposit insurance assessment for the third quarter of 2009. The prepayment balance of the assessment covering fiscal years 2011 and 2012 amounted to \$7.7 million and \$11.6 million at September 30, 2012 and December 31, 2011, respectively.

Other prepaid expenses amounting to \$11.0 million and \$6.5 million at September 30, 2012 and December 31, 2011, respectively, include prepaid municipal, property and income taxes aggregating to \$7.8 million and \$3.2 million, respectively.

Servicing advances amounting to \$9.0 million and \$14.0 million at September 30, 2012 and December 31, 2011, respectively, represent the advances made to Bayview Loan Servicing, LLC in order to service some of the loans acquired in the FDIC-assisted acquisition of Eurobank.

In December 2007, the Commonwealth of Puerto Rico established mortgage loan tax credits for financial institutions that provided financing for the acquisition of new homes. Under an agreement reached during the quarter ended September 30, 2011 with the Puerto Rico Treasury Department, the Group was allowed to use half of these credits to

reduce taxable income in taxable year 2011, and the remaining half of the credits in taxable year 2012. At September 30, 2012 and December 31, 2011, tax credits for the Group amounted \$1.3 million for both periods.

As part of the FDIC-assisted acquisition of Eurobank, the Group registered a core deposit intangible representing the value of checking and savings deposits acquired. At September 30, 2012 and December 31, 2011, the core deposit intangible amounted to \$1.1 million and \$1.2 million, respectively. Also, as part of this transaction, the Group recorded a goodwill amounting to \$695 thousand.

Other repossessed assets amounting to \$396 thousand and \$708 thousand at September 30, 2012 and December 31, 2011, respectively, represent covered assets under the FDIC shared-loss agreements and are related to the leasing portfolio acquired in the FDIC-assisted acquisition of Eurobank.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 10 — DEPOSITS AND RELATED INTEREST

Total deposits as of September 30, 2012 and December 31, 2011 consist of the following:

	September 30, 2012	December 31, 2011
	(In thousands)	
Non-interest bearing demand deposits	\$ 197,664	\$ 192,256
Interest-bearing savings and demand deposits	1,101,698	1,081,447
Individual retirement accounts	369,680	361,411
Retail certificates of deposit	330,395	375,891
Total retail deposits	1,999,437	2,011,005
Institutional deposits	73,657	168,301
Brokered deposits	141,273	255,879
	\$ 2,214,367	\$ 2,435,185

At September 30, 2012 and December 31, 2011, the weighted average interest rate of the Group's deposits was 1.32%, and 1.87%, respectively, inclusive of non-interest bearing deposits of \$197.7 million and \$192.3 million, respectively. Interest expense for the quarters and nine-month periods ended September 30, 2012 and 2011 is set forth below:

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Demand and savings deposits	\$ 2,547	\$ 4,058	\$ 8,571	\$ 12,683
Certificates of deposit	4,761	7,434	15,947	22,638
	\$ 7,308	\$ 11,492	\$ 24,518	\$ 35,321

At September 30, 2012 and December 31, 2011, demand and interest-bearing deposits and certificates of deposit included deposits of the Puerto Rico Cash & Money Market Fund, which amounted to \$87.2 million and \$64.9 million, respectively, with a weighted average rate of 0.77% and 0.82%, and were collateralized with investment securities with a fair value of \$72.3 million and \$62.7 million, respectively.

At September 30, 2012 and December 31, 2011, time deposits in denominations of \$100 thousand or higher, excluding unamortized discounts, amounted to \$335.1 million and \$456.1 million, including public fund time deposits from various Puerto Rico government agencies of \$195 thousand and \$65.2 million, respectively, at a weighted average rate of 0.5% in both periods.

At September 30, 2012 and December 31, 2011, public fund deposits from various Puerto Rico government agencies were collateralized with investment securities with a fair value of \$8.5 million and \$71.9 million, respectively, and with commercial loans amounting to \$2.3 million at September 30, 2012. There were no commercial loans pledged as collateral for public fund deposits at December 31, 2011.

ORIENTAL FINANCIAL GROUP INC.**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

Excluding equity indexed options in the amount of \$12.6 million, which are used by the Group to manage its exposure to the S&P 500 Index, and also excluding accrued interest of \$2.3 million and unamortized deposit discounts in the amount of \$3.2 million, the scheduled maturities of certificates of deposit at September 30, 2012 are as follows:

	September 30, 2012 (In thousands)
Within one year:	
Three (3) months or less	\$ 167,688
Over 3 months through 1 year	372,340
	540,028
Over 1 through 2 years	199,339
Over 2 through 3 years	74,822
Over 3 through 4 years	76,814
Over 4 through 5 years	12,062
	\$ 903,065

The aggregate amount of overdraft in demand deposit accounts that were reclassified to loans amounted to \$224 thousand and \$456 thousand as of September 30, 2012 and December 31, 2011, respectively.

NOTE 11 — BORROWINGS***Securities Sold under Agreements to Repurchase***

At September 30, 2012, 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 September 30, 2012 and December 31, 2011, securities sold under agreements to repurchase (classified by counterparty), excluding accrued interest in the amount of \$2.4 million and \$6.2 million, respectively, were as follows:

	September 30, 2012		December 31, 2011	
	Borrowing Balance	Fair Value of Underlying Collateral (In thousands)	Borrowing Balance	Fair Value of Underlying Collateral
Credit Suisse Securities (USA) LLC	\$ 1,250,000	\$ 1,299,180	\$ 1,250,000	\$ 1,337,394
UBS Financial Services Inc.	500,000	621,614	500,000	620,888
Deutsche Bank	225,000	243,803	100,000	109,177
JP Morgan Chase Bank NA	200,000	215,069	300,000	357,400
Citigroup Global Markets Inc.	150,000	156,833	900,000	974,286
Goldman Sachs & Co.	125,000	133,555	-	-
Barclays Bank	100,000	109,055	-	-
Wells Fargo	100,000	105,949	-	-
Total	\$ 2,650,000	\$ 2,885,058	\$ 3,050,000	\$ 3,399,145

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The original terms of the Group's remaining structured repurchase agreements is ten years. For the repurchase agreements maturing in 2017 and amounting to \$1.750 billion as of September 30, 2012, the counterparties have the right to exercise put options on such structured repurchase agreements at par on a quarterly basis before their contractual maturities from one to three years after the agreements' settlement dates. The Group's \$500 million repurchase agreement maturing on March 2, 2017 also provides for an optional early termination by either party upon no less than two business days' prior written notice to the other party. In the event of any such optional early termination, the amounts owed by or to the terminating party by the other party on the optional early termination date must take account of the termination value of the transaction, as determined by the calculation agent in the manner described in the repurchase agreement. During the quarter ended September 30, 2012, the Group opted to terminate prior to maturity two repurchase agreements amounting to \$400 million. The early termination fee paid by the Group amounted to \$24.2 million and is presented in the statement of operations as a net loss on the early extinguishment of repurchase agreements for the quarter and nine-month period ended September 30, 2012.

The following table shows a summary of the Group's repurchase agreements and their terms, excluding accrued interest in the amount of \$2.4 million, at September 30, 2012:

Year of Maturity	Borrowing Balance (In thousands)	Weighted- Average Coupon	Settlement Date	Maturity Date	Next Put Date
2012	\$ 100,000	0.53%	9/10/2012	10/9/2012	N/A
	125,000	0.39%	9/10/2012	10/9/2012	N/A
	125,000	0.39%	9/10/2012	10/9/2012	N/A
	100,000	0.41%	9/14/2012	10/15/2012	N/A
	150,000	4.31%	3/6/2007	12/6/2012	N/A
	600,000				
2015	100,000	0.51%	12/28/2011	3/30/2015	N/A
	100,000	0.62%	12/29/2011	1/28/2015	N/A
	100,000	0.56%	12/28/2011	6/28/2015	N/A
	300,000				
2017	500,000	4.67%	3/2/2007	3/2/2017	12/3/2012
	250,000	0.25%	3/2/2007	3/2/2017	12/3/2012
	100,000	0.00%	6/6/2007	3/6/2017	12/6/2012
	900,000	0.00%	3/6/2007	6/6/2017	12/6/2012
	1,750,000				
	\$ 2,650,000	1.28%			

All of the structured repurchase agreements referred to above with maturity dates up to the date of this report were renewed as one-month short-term repurchase agreements.

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 0.00% and 0.25% to at least their next put dates scheduled for December 2012.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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 September 30, 2012, these advances were secured by mortgage and commercial loans amounting to \$515.7 million and \$54.6 million, respectively. Also, at September 30, 2012, the Group had an additional borrowing capacity with the FHLB of \$155.6 million. At September 30, 2012 and December 31 2011, the weighted average remaining maturity of FHLB's advances was 5.0 months and 11.2 months, respectively. The original terms of these advances range between five and seven years, and the FHLB has the right to exercise put options at par on a quarterly basis before the contractual maturity of the advances from nine months to one year after the advances' settlement dates. The following table shows a summary of these advances and their terms, excluding accrued interest in the amount of \$382 thousand, at September 30, 2012:

Year of Maturity	Borrowing Balance (In thousands)	Weighted-Average Coupon	Settlement Date	Maturity Date	Next Put Date
2012	\$ 25,000	0.43%	8/30/2012	10/1/2012	N/A
	25,000	0.41%	9/4/2012	10/4/2012	N/A
	25,000	0.37%	9/24/2012	10/24/2012	N/A
	50,000	0.41%	9/10/2012	10/10/2012	N/A
	100,000	0.40%	9/17/2012	10/16/2012	N/A
	225,000				
2014	25,000	4.20%	5/8/2007	5/8/2014	11/8/2012
	30,000	4.22%	5/11/2007	5/11/2014	11/12/2012
	55,000				
2017	5,013	1.24%	4/3/2012	4/3/2017	N/A
	5,013				
	\$ 285,013	1.15%			

All of the advances referred to above with maturity dates up to the date of this report were renewed as one-month short-term advances.

FDIC-Guaranteed Term Notes — Temporary Liquidity Guarantee Program

On March 16, 2012, the Group's banking subsidiary repaid at maturity the \$105 million in senior unsecured notes that it issued in March 2009 under the FDIC's Temporary Liquidity Guarantee Program.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Subordinated Capital Notes

Subordinated capital notes amounted to \$36.1 million at September 30, 2012 and December 31, 2011.

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 a pooled underwriting transaction. 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 debenture (“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 (3.34% at September 30, 2012; 3.30% at December 31, 2011), is payable quarterly, and matures on September 17, 2033. The subordinated capital note purchased by the Statutory Trust II may be called at par after five years and quarterly thereafter (next call date December 2012). The trust redeemable preferred securities have the same maturity and call provisions as the subordinated capital note. The subordinated deferrable interest debenture issued by the Group are accounted for as a liability denominated as subordinated capital note on the unaudited consolidated statements of financial condition.

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

NOTE 12 — RELATED PARTY TRANSACTIONS

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The Bank grants loans to its directors, executive officers and to certain related individuals or organizations in the ordinary course of business. These loans are offered at the same terms as loans to unrelated third parties. As of September 30, 2012 and December 31, 2011, these loans balances amounted to \$5.0 million and \$3.8 million, respectively. The activity and balance of these loans for the quarters and nine-month periods ended September 30, 2012 and 2011 were as follows:

	Quarter Ended September 30, 2012		2011		Nine-Month Period Ended September 30, 2012		2011	
	(In thousands)				(In thousands)			
Balance at the beginning of period	\$	5,058	\$	3,213	\$	3,772	\$	3,452
New loans		-		582		1,396		582
Repayments		(17)		15		(93)		(37)
Credits of persons no longer considered related parties		(23)		-		(57)		(187)
Balance at the end of period	\$	5,018	\$	3,810	\$	5,018	\$	3,810

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 13 — INCOME TAXES

At September 30, 2012 and December 31, 2011, the Group's net deferred tax asset amounted to \$35.9 million and \$32.0 million, respectively. Income tax expense for the quarters ended September 30, 2012 and 2011 totaled of \$1.9 million and \$580 thousand, respectively. Income tax expense for the nine-month periods ended September 30, 2012 and 2011 totaled \$4.9 million and \$5.7 million, respectively.

At December 31, 2011, OIB had \$2.9 million in the income tax effect of unrecognized gain on available-for-sale securities included in other comprehensive income. Following the change in OIB's applicable tax rate from 5% to 0% as a result of new Puerto Rico legislation adopted in 2011, this remaining tax balance will flow through income as these securities are repaid or sold in future periods. During the quarter and nine-month period ended September 30, 2012, the income tax provision included \$1.1 million and \$1.8 million, respectively, related to this residual tax effect from OIB.

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 September 30, 2012 was \$1.5 million (December 31, 2011 - \$1.4 million). The Group had accrued \$768 thousand at September 30, 2012 (December 31, 2011 - \$342 thousand) for the payment of interest and penalties relating to unrecognized tax benefits.

NOTE 14 — STOCKHOLDERS' EQUITY

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 September 30, 2012 and December 31, 2011, the Group and the Bank met all capital adequacy requirements to which they are subject. As of September 30, 2012 and December 31, 2011, 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.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The Group's and the Bank's actual capital amounts and ratios as of September 30, 2012 and December 31, 2011 are as follows:

	Actual		Minimum Capital Requirement	
	Amount	Ratio	Amount	Ratio
(Dollars in thousands)				
Group Ratios				
<u>As of September 30, 2012</u>				
Total capital to risk-weighted assets	\$ 711,987	37.63%	\$ 151,362	8.00%
Tier 1 capital to risk-weighted assets	\$ 687,436	36.33%	\$ 75,681	4.00%
Tier 1 capital to total assets	\$ 687,436	10.91%	\$ 252,145	4.00%
<u>As of December 31, 2011</u>				
Total capital to risk-weighted assets	\$ 688,188	33.12%	\$ 167,929	8.00%
Tier 1 capital to risk-weighted assets	\$ 661,614	31.84%	\$ 83,964	4.00%
Tier 1 capital to total assets	\$ 661,614	9.65%	\$ 274,230	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						
<u>As of September 30, 2012</u>						
Total capital to risk-weighted assets	\$ 685,032	36.77%	\$ 149,049	8.00%	\$ 186,311	10.00%
Tier 1 capital to risk-weighted assets	\$ 660,838	35.47%	\$ 74,525	4.00%	\$ 111,787	6.00%
Tier 1 capital to total assets	\$ 660,838	10.66%	\$ 247,862	4.00%	\$ 309,827	5.00%
<u>As of December 31, 2011</u>						
Total capital to risk-weighted assets	\$ 643,065	31.07%	\$ 165,573	8.00%	\$ 206,967	10.00%
Tier 1 capital to risk-weighted assets	\$ 616,590	29.79%	\$ 82,787	4.00%	\$ 124,180	6.00%
	\$ 616,590	9.06%	\$ 272,177	4.00%	\$ 340,221	5.00%

Tier 1 capital to total
assets

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.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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 nine-month periods ended September 30, 2012 and 2011 is set forth below:

	Nine-Month Period Ended September 30, 2012		2011	
	Number Of Options	Weighted Average Exercise Price	Number Of Options	Weighted Average Exercise Price
Beginning of period	786,704	\$ 15.02	765,989	\$ 15.25
Options granted	204,543	11.83	85,000	11.90
Options exercised	(32,954)	11.98	(550)	9.19
Options forfeited	(23,500)	11.93	(33,142)	14.82
End of period	934,793	\$ 14.51	817,297	\$ 14.89

The following table summarizes the range of exercise prices and the weighted average remaining contractual life of the options outstanding at September 30, 2012:

<u>Range of Exercise Prices</u>	Outstanding		Weighted Average Contract Life Remaining (Years)	Exercisable	
	Number of Options	Weighted Average Exercise Price		Number of Options	Weighted Average Exercise Price
\$5.63 to \$8.45	12,432	\$ 8.28	6.6	5,885	\$ 8.28
8.46 to 11.27	1,000	10.29	4.9	750	10.29

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11.28 to 14.09	691,876	12.06	7.3	196,933	12.39
14.10 to 16.90	62,035	15.60	1.9	62,035	15.60
19.72 to 22.54	25,050	20.68	2.4	22,925	20.57
22.55 to 25.35	83,350	23.99	1.5	83,350	23.99
25.36 to 28.17	59,050	27.46	2.1	59,050	27.46
	934,793	\$ 14.51	6.0	430,928	\$ 17.53
Aggregate Intrinsic Value	\$ 28,078			\$ 13,355	

The average fair value of each option granted during the nine-month period ended September 30, 2012 was \$5.41. 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.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following assumptions were used in estimating the fair value of the options granted during the nine-month periods ended September 30, 2012 and 2011:

	Nine-Month Period Ended September 30,	
	2012	2011
Weighted average assumptions:		
Dividend yield	1.80%	1.63%
Expected volatility	51.13%	59.04%
Risk-free interest rate	1.70%	3.11%
Expected life (in years)	8.0	8.0

The following table summarizes the restricted units' activity under the Omnibus Plan for the nine-month periods ended September 30, 2012 and 2011:

	Nine-Month Period Ended September 30,			
	2012		2011	
	Restricted Units	Weighted Average Grant Date Fair Value	Restricted Units	Weighted Average Grant Date Fair Value
Beginning of period	205,149	\$ 11.27	243,525	\$ 13.43
Restricted units granted	57,350	11.85	39,500	11.88
Restricted units lapsed	(46,210)	8.29	(51,116)	20.44
Restricted units forfeited	(2,789)	11.71	(14,620)	12.21
End of period	213,500	\$ 12.06	217,289	\$ 11.67

Preferred Stock

In connection with the BBVAPR Acquisition, as discussed in Note 1, on July 3, 2012, the Group completed its sale to various institutional purchasers of \$84 million of its Convertible Preferred Stock, with a conversion price, subject to certain conditions, of \$11.77 per share of common stock, through a private placement, pursuant to a Subscription Agreement dated June 28, 2012, between the Group and each of the purchasers.

Additional paid-in capital

Additional paid-in capital represents contributed capital in excess of par value of common and preferred stock net of costs of the issuance. During the quarter ended September 30, 2012, \$4.9 million of preferred stock issue costs were charged against additional paid-in capital. As of September 30, 2012, accumulated issuance costs charged against additional paid in capital amounted to \$7.6 million and \$9.2 million for preferred and common stock, respectively.

Legal Surplus

The Puerto Rico 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 September 30, 2012 and December 31, 2011, legal surplus amounted to \$54.4 million and \$50.2 million, respectively. The amount transferred to the legal surplus account is not available for the payment of dividends to shareholders.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Earnings per Common Share

The calculation of earnings per common share for the quarters and nine-month periods ended September 30, 2012 and 2011 is as follows:

	Quarter Ended September 30,		Nine-Month Period Ended		
	2012	2011	2012	2011	
	(In thousands, except per share data)				
Net income	\$	17,761	\$ 16,788	\$ 43,371	\$ 46,336
Less: Dividends on preferred stock					
Non-convertible preferred stock (Series A and B)		(1,201)	(1,201)	(3,602)	(3,602)
Convertible Preferred Stock (Series C)		(1,838)	-	(1,838)	-
Income available to common shareholders	\$	14,722	\$ 15,587	\$ 37,931	\$ 42,734
Effect of assumed conversion of the Convertible Preferred Stock		1,838	-	1,838	-
Income available to common shareholders assuming conversion	\$	16,560	\$ 15,587	\$ 39,769	\$ 42,734
Weighted average common shares and share equivalents:					
Average common shares outstanding		40,738	44,015	40,828	45,050
Effect of dilutive securities:					
Average potential common shares-options		102	90	109	91
Average potential common shares-assuming conversion of Convertible Preferred Stock		7,138	-	2,379	-
Total weighted average common shares					

outstanding and equivalents		47,978		44,105		43,316		45,141
Earnings per common share - basic	\$	0.36	\$	0.35	\$	0.93	\$	0.95
Earnings per common share - diluted	\$	0.35	\$	0.35	\$	0.92	\$	0.95

In computing diluted earnings per common share, the 84,000 shares of Convertible Preferred Stock, which remained outstanding at September 30, 2012, with a conversion rate, subject to certain conditions, of 84.9798 shares of common stock per share, were included as average potential common shares from the date they were outstanding. Moreover, in computing diluted earnings per common share, the dividends declared during the quarter ended September 30, 2012 on the Convertible Preferred Stock were added back as income available to common shareholders.

For the quarters ended September 30, 2012 and 2011, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 708,976 and 572,284, respectively. For the nine-month periods ended September 30, 2012 and 2011, weighted-average stock options with an anti-dilutive effect on earnings per share not included in the calculation amounted to 707,976 and 558,193, respectively.

Treasury Stock

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

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Any shares of common stock repurchased are held by the Group as treasury shares. The Group records treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. Under the \$30 million program, initiated in February 2011, the Group purchased a total of 2,406,303 shares at an average price of \$12.10 per share. During 2011, the Group purchased approximately 2,783,000 shares under the \$70 million program for a total of \$29.4 million, at an average price of \$10.57 per share. During the nine-month period ended September 30, 2012, the Group purchased approximately 603,000 additional shares under this program for a total of \$7.0 million, at an average price of \$11.61 per share.

The activity in connection with common shares held in treasury by the Group for the nine-month periods ended September 30, 2012 and 2011 is set forth below:

	Nine-Month Period Ended September 30, 2012		2011	
	Shares	Dollar Amount	Shares	Dollar Amount
	(In thousands, except shares data)			
Beginning of period	6,564,124	\$ 74,808	1,459,067	\$ 16,732
Common shares used upon lapsing of restricted stock units	(46,210)	(483)	(51,116)	(561)
Common shares repurchased as part of the stock repurchase program	603,000	7,022	2,406,303	29,242
Common shares used to match defined contribution plan, net	(25,249)	(47)	(20,761)	(37)
End of period	7,095,665	\$ 81,300	3,793,493	\$ 45,376

Accumulated Other Comprehensive Income

Accumulated other comprehensive income, net of income tax, as of September 30, 2012 and December 31, 2011 consisted of:

	September 30, 2012	December 31, 2011
	(In thousands)	
Unrealized gain on securities available-for-sale which are not	\$ 64,921	\$ 86,404

other-than-temporarily impaired		
Income tax effect of unrealized gain on securities available-for-sale	(4,823)	(7,160)
Unrealized loss on cash flow hedges	(58,269)	(47,425)
Income tax effect of unrealized loss on cash flow hedges	7,234	5,312
	\$ 9,063	\$ 37,131

At December 31, 2011, OIB had \$2.9 million in the income tax effect of unrecognized gain on available-for-sale securities included in other comprehensive income. Following the change in OIB's applicable tax rate from 5% to 0% as a result of new Puerto Rico legislation adopted in 2011, this remaining tax balance will flow through income as these securities are repaid or sold in future periods. During the nine-month period ended September 30, 2012, \$1.8 million related to this residual tax effect from OIB were reclassified from accumulated other comprehensive income into income tax provision.

ORIENTAL FINANCIAL GROUP INC.**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)****NOTE 15 — COMMITMENTS***Loan Commitments*

At September 30, 2012 and December 31, 2011, there were \$135.4 million and \$106.1 million, respectively, in loan commitments, which represent unused lines of credit and letters of credit provided to customers. These lines of credit had a reserve of \$603 thousand and \$518 thousand at September 30, 2012 and December 31, 2011, respectively. Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates, bear variable interest and may require payment of a fee. Since the commitments may expire unexercised, the total commitment amounts do not necessarily represent future cash requirements. The Group evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Group upon the extension of credit, is based on management's credit evaluation of the customer. Commitments for loans covered under the FDIC shared-loss agreements amounted to \$14.1 million and \$31.1 million at September 30, 2012 and December 31, 2011, respectively.

At September 30, 2012 and December 31, 2011, commitments to sell or securitize mortgage loans amounted to approximately \$39.3 million and \$66.1 million, respectively.

Lease Commitments

The Group has entered into various operating lease agreements for branch facilities and administrative offices. Rent expense for the quarters ended September 30, 2012 and 2011 amounted to \$1.6 million and 1.5 million, respectively. Rent expense for the nine-month periods ended September 30, 2012 and 2011 amounted to \$4.9 million and \$3.0 million, respectively. Both are included in the "occupancy and equipment" caption in the unaudited consolidated statements of operations. Future rental commitments under leases in effect at September 30, 2012, exclusive of taxes, insurance, and maintenance expenses payable by the Group, are summarized as follows:

<u>Year Ending December 31,</u>	Minimum Rent (In thousands)
2012	\$ 1,142
2013	4,572
2014	4,569
2015	4,323
2016	3,741

Thereafter

17,341

\$

35,688

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

NOTE 16 — CONTINGENCIES

The Group and its subsidiaries are defendants in a number of legal proceedings incidental to their business. In the ordinary course of business, the Group and its subsidiaries are also subject to governmental and regulatory examinations. Certain subsidiaries of the Group, including the Bank, Oriental Financial Services, and Oriental Insurance, are subject to regulation by various U.S., Puerto Rico and other regulators.

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

Subject to the accounting and disclosure framework under the provisions of ASC 450, it is the opinion of the Group's management, based on current knowledge and after taking into account its current legal accruals, that the eventual outcome of all matters would not be likely to have a material adverse effect on the unaudited consolidated financial condition of the Group. Nonetheless, given the substantial or indeterminate amounts sought in certain of these matters, and the inherent unpredictability of such matters, an adverse outcome in certain of these matters could, from time to time, have a material adverse effect on the Group's unaudited consolidated results of operations or cash flows in particular quarterly or annual periods. The Group has evaluated all litigation and regulatory matters where the likelihood of a potential loss is deemed reasonably possible. The Group has determined that the estimate of the reasonably possible loss is not significant.

NOTE 17 - 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 unaudited 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.

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Derivative instruments

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

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

Servicing assets

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

Loans receivable considered impaired that are collateral dependent

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

Foreclosed real estate

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

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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

		September 30, 2012				
		Fair Value Measurements				
	Level 1	Level 2	Level 3	Total		
		(In thousands)				
Recurring fair value measurements:						
Investment securities						
available-for-sale	\$	-	\$ 2,254,531	\$ 39,019	\$	2,293,550
Securities purchased under						
agreements to resell		-	270,000	-		270,000
Money market investments		4,017	-	-		4,017
Derivative assets		-	5,407	13,088		18,495
Servicing assets		-	-	10,642		10,642
Derivative liabilities		-	(58,269)	(12,569)		(70,838)
	\$	4,017	\$ 2,471,669	\$ 50,180	\$	2,525,866
Non-recurring fair value measurements:						
Impaired commercial loans	\$	-	-	\$ 35,917	\$	35,917
Foreclosed real estate		-	-	39,400		39,400
	\$	-	\$ -	\$ 75,317	\$	75,317
		December 31, 2011				
		Fair Value Measurements				
	Level 1	Level 2	Level 3	Total		
		(In thousands)				
Recurring fair value measurements:						
Investment securities						
available-for-sale	\$	-	\$ 2,912,600	\$ 47,312	\$	2,959,912
Money market investments		3,863	-	-		3,863
Derivative assets		-	-	9,317		9,317
Servicing assets		-	-	10,454		10,454
Derivative liabilities		-	(47,425)	(9,362)		(56,787)
	\$	3,863	\$ 2,865,175	\$ 57,721	\$	2,926,759
Non-recurring fair value measurements:						
Impaired commercial loans	\$	-	-	\$ 46,364	\$	46,364
Foreclosed real estate		-	-	27,679		27,679
	\$	-	\$ -	\$ 74,043	\$	74,043

ORIENTAL FINANCIAL GROUP INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarters and nine-month periods ended September 30, 2012 and 2011:

Level 3 Instruments Only	Quarter Ended September 30, 2012							Total
	Investment securities available-for-sale							
	CDOs	CLOs	Other debt securities	Derivative asset (S&P Purchased Options)	Servicing assets	Derivative liability (S&P Embedded Options)		
Balance at beginning of period	\$ -	\$ 27,280	\$ 10,016	\$ 11,367	\$ 10,776	\$ (10,912)	\$ 48,527	
Gains (losses) included in earnings	-	-	-	1,721	-	(1,707)	14	
Changes in fair value of investment securities available for sale included								
in other comprehensive income	-	1,705	1	-	-	-	1,706	
New instruments acquired	-	-	-	-	487	-	487	
Principal repayments	-	-	-	-	(307)	-	(307)	
Amortization	-	17	-	-	-	50	67	
Changes in fair value of servicing assets	-	-	-	-	(314)	-	(314)	
Balance at end of period	\$ -	\$ 29,002	\$ 10,017	\$ 13,088	\$ 10,642	\$ (12,569)	\$ 50,180	

Quarter Ended September 30, 2011
Investment securities available-for-sale

Other	Derivative asset (S&P	Derivative liability (S&P
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