

ORIENTAL FINANCIAL GROUP INC

Form S-3

July 21, 2010

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As filed with the Securities and Exchange Commission on July 21, 2010

Registration No. 333-

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

**Form S-3
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

ORIENTAL FINANCIAL GROUP INC.

(Exact name of registrant as specified in its charter)

Commonwealth of Puerto Rico

*(State or other jurisdiction of
incorporation or organization)*

66-0538893

*(I.R.S. Employer
Identification No.)*

**Professional Offices Park
997 San Roberto Street
San Juan, Puerto Rico 00926
(787) 771-6800**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Carlos O. Souffront
General Counsel
Professional Offices Park
997 San Roberto Street
San Juan, Puerto Rico 00926
(787) 771-6800**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Iván G. Marrero
McConnell Valdés LLC
270 Muñoz Rivera Avenue
San Juan, Puerto Rico 00918
(787) 250-2606

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Skadden, Arps, Slate, Meagher & Flom LLP
300 South Grand Avenue
Los Angeles, California 90071
(213) 687-5000

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box.

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
 (Do not check if a smaller reporting company)

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price per Unit(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, \$1.00 par value per share	13,320,000 shares	\$13.42	\$178,754,400.00	\$12,745.19

- (1) Pursuant to Rule 416(a) of the Securities Act of 1933, as amended, this Registration Statement also covers such additional shares as may hereafter be offered or issued to prevent dilution resulting from stock splits, stock dividends, recapitalizations or similar transactions.
- (2) Estimated solely for the purpose of computing the amount of the registration fee in accordance with Rule 457(c) under the Securities Act of 1933, as amended, based on the average of the high and low prices of the Common Stock shares as reported on the New York Stock Exchange on July 19, 2010.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Commission acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. The securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting offers to buy these securities in any state or other jurisdiction where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED JULY 21, 2010

PROSPECTUS

Oriental Financial Group Inc.

13,320,000 Shares of Common Stock

This prospectus relates to the resale from time to time by the selling securityholders identified in this prospectus of 13,320,000 shares of Oriental Financial Group Inc. common stock, par value \$1.00 per share. In this prospectus, we also refer to the shares of common stock as the securities.

The securities are being registered to permit the selling securityholders to sell the securities from time to time through ordinary brokerage transactions or through any other means described in this prospectus. The price at which the selling securityholders may sell the securities will be determined by the prevailing market for the securities or in negotiated transactions. See Plan of Distribution.

We will not receive any proceeds from the sale of the securities by the selling securityholders.

Our common stock is listed on the New York Stock Exchange under the symbol OFG. On July 20, 2010, the last reported sale price of our common stock was \$13.98 per share.

Investing in our securities involves risks. You should carefully read and consider the risk factors described in this prospectus, any accompanying prospectus supplement and in the documents incorporated by reference into this prospectus. See Risk Factors on page 3.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is _____, 2010

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ABOUT THIS PROSPECTUS

This prospectus is part of a shelf registration statement on Form S-3 that we filed with the Securities and Exchange Commission (the SEC) using a shelf registration process. Under the shelf registration rules, using this prospectus and, if required, one or more prospectus supplements, the securityholders identified in this prospectus may sell, from time to time, the securities covered by this prospectus in one or more offerings.

We may provide a prospectus supplement containing specific information about the terms of a particular offering by any of the selling securityholders. The prospectus supplement may also add, update or change information contained in this prospectus. If the information in this prospectus is inconsistent with a prospectus supplement, you should rely on the information in that prospectus supplement. We recommend that you carefully read this entire prospectus and any applicable prospectus supplement, especially the section entitled Risk Factors on page 3, before making a decision to invest in the securities covered by this prospectus. You should also carefully read the additional information and documents described under Where You Can Find More Information.

You should only rely on the information contained in this prospectus and any applicable prospectus supplement. We have not authorized any person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. This prospectus is not an offer to sell the securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus or any applicable prospectus supplement is accurate as of the date on the front cover of such document and that any information incorporated by reference is accurate as of the date of the document incorporated by reference. Our business, financial condition, results of operations, and prospects may have changed since that date.

Unless otherwise indicated or unless the context requires otherwise, all references in this prospectus to Oriental Financial Group, the Company, we, us, our or similar references mean Oriental Financial Group Inc.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. We have also filed with the SEC a registration statement on Form S-3 relating to the securities covered by this prospectus. This prospectus, which forms part of the registration statement, does not contain all of the information included in the registration statement. For further information about us and the securities covered by this prospectus, you should refer to the registration statement and its exhibits.

You may read and copy any document filed by us with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. We file our SEC materials electronically with the SEC, so you can also review our filings by accessing the website maintained by the SEC at <http://www.sec.gov>. This site contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. You can also obtain more information about us by visiting our website at <http://www.orientalonline.com>.

The SEC allows us to incorporate by reference the information we file with the SEC, which means we can disclose important information to you by referring to these documents. The information included in the following documents is incorporated by reference and is considered a part of this prospectus. The most recent information that we file with the SEC automatically updates and supersedes previously filed information. We have previously filed the following documents with the SEC and are incorporating them by reference into this prospectus:

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our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, filed with the SEC on March 11, 2010, including portions incorporated by reference therein to our Definitive Proxy Statement on Schedule 14A, filed with the SEC on March 17, 2010;

our Quarterly Reports on Form 10-Q for the fiscal quarter ended March 31, 2010, filed with the SEC on May 7, 2010;

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our Current Reports on Form 8-K filed with the SEC on March 15, 2010, March 16, 2010, March 19, 2010, May 3, 2010, May 6, 2010, as amended on July 16, 2010, June 14, 2010, and July 1, 2010; and

the description of our common stock contained in our registration statement on Form 8-B, filed with the SEC on January 10, 1997, including any amendment or report filed thereafter for the purpose of updating such information.

We also incorporate by reference all documents filed by us pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, after the date of this prospectus and until all the shares being offered by this prospectus are sold. You should rely only on the information incorporated by reference or provided in this prospectus or any prospectus supplement.

We will provide, at no cost, to each person, including a beneficial owner, to whom this prospectus is delivered, upon written or oral request, a copy of any or all of the documents incorporated herein by reference, other than exhibits to these documents unless such exhibits are specifically incorporated by reference into such documents. Requests for copies should be directed to:

Oriental Financial Group Inc.
Investor Relations c/o Anreder & Company
286 Madison Avenue, Suite 907
New York, NY 10017
Telephone: (212) 532-3232 or (800) 421-1003
Fax: (212) 679-7999
E-mail: ofg@anreder.com

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus and the documents incorporated by reference in this prospectus may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Private Securities Litigation Reform Act). We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements of the Private Securities Litigation Reform Act. In some cases, you can identify these statements by our use of forward-looking words such as may, will, should, anticipate, estimate, expect, plan, predict, potential, intend, project, forecasts, goals, could have, may have and similar expressions. You should be aware that these statements and any other forward-looking statements in these documents only reflect our expectations and are not guarantees of performance. These statements involve risks, uncertainties and assumptions, which we describe in more detail elsewhere herein and in other documents filed by us with the SEC.

Various factors could cause actual results or outcomes to differ materially from our expectations. We wish to caution readers not to place undue reliance on any such forward-looking statements and to advise readers that various factors, including regional and national economic conditions, substantial changes in levels of market interest rates, credit and other risks of lending and investment activities, the integration of Eurobank assets with our operations, competitive, and regulatory factors, legislative changes and accounting pronouncements, could affect our financial performance and could cause our actual results for future periods to differ materially from those anticipated or projected. Further, any forward-looking statement speaks only as of the date on which it is made and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which factors, if any, will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from

those contained in any forward-looking statement. All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by this cautionary note.

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SUMMARY

This summary highlights selected information contained elsewhere or incorporated by reference in this prospectus and may not contain all the information that you need to consider in making your investment decision. You should carefully read this entire prospectus, including the Risk Factors section and the documents incorporated by reference, before deciding to invest in our securities.

About Oriental Financial Group Inc.

Oriental Financial Group Inc. is a diversified financial holding company headquartered in San Juan, Puerto Rico, offering a full range of financial services through its wholly owned subsidiaries Oriental Bank and Trust, Oriental Financial Services Corp., Oriental Insurance, Inc. and Caribbean Pension Consultants, Inc. We currently operate through a network of 43 financial centers located throughout Puerto Rico and one location in Boca Raton, Florida, which serves as the headquarters of our wholly owned subsidiary Caribbean Pension Consultants, Inc.

We have developed a financial services platform that provides a comprehensive suite of financial products and services for our retail and institutional customers. We have organized our operations under three business lines: Banking, Financial Services and Treasury. Our core businesses are mortgage banking, trust and money management services, financial planning, securities brokerage, investment banking, commercial banking, consumer banking and insurance brokerage. In order to more effectively compete, we have focused our retail and commercial banking and financial planning efforts on professionals and owners of small and mid-size businesses and on the mid and high net worth individuals and families in Puerto Rico. We believe these segments of the market have been largely underserved.

On April 30, 2010, we issued and sold 200,000 shares of our newly authorized Mandatorily Convertible Non-Cumulative Non-Voting Perpetual Preferred Stock, Series C (the Series C Preferred Stock) at a purchase price and liquidation preference of \$1,000 per share. On June 30, 2010, our shareholders approved the conversion of the Series C Preferred Stock into our common stock and each share of the Series C Preferred Stock converted into approximately 66.6 shares of our common stock, for an aggregate of 13,320,000 shares of our common stock. Holders of Series C Preferred Stock received cash in lieu of fractional shares of common stock.

Oriental Bank and Trust

Our main operating subsidiary is Oriental Bank and Trust, a Puerto Rico full service commercial bank insured by the Federal Deposit Insurance Corporation (the FDIC) and a member of the Federal Home Loan Bank of New York.

Oriental Bank and Trust offers mortgage, commercial and consumer lending, demand, savings and time deposits, financial planning, and corporate and individual trust services in Puerto Rico. Through its trust department, Oriental Bank and Trust provides a complete range of fiduciary and custodial services to individuals, families and businesses. It has an international banking entity subsidiary, Oriental International Bank Inc., which offers Oriental Bank and Trust certain Puerto Rico tax advantages and its services are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico.

On April 30, 2010, Oriental Bank and Trust acquired all of the retail deposits, certain assets and substantially all of the operations of Eurobank, a Puerto Rico commercial bank (Eurobank), from the FDIC, as receiver of Eurobank. The acquisition was made pursuant to a Purchase and Assumption Agreement Whole Bank, All Deposits, dated as of April 30, 2010 (the P&A Agreement), by and between Oriental Bank and Trust and the FDIC. Based on the closing

with the FDIC as of April 30, 2010, the fair value of the assets acquired consisted of \$839.5 million in loans, \$20.6 million in foreclosed real estate and other repossessed property, \$89.8 million in cash and cash equivalents, \$10.1 million in Federal Home Loan Bank of New York stock, and \$5.3 million in other assets. The fair value of the liabilities assumed consisted of \$729.5 million in deposits and \$15.8 million in other liabilities. These loans are subject to loss sharing arrangements pursuant to which the FDIC will bear 80% of qualifying losses, beginning with the first dollar amount of qualifying losses.

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All of Eurobank's 22 banking offices located in Puerto Rico have reopened as branches of Oriental Bank and Trust.

Oriental Financial Services

Oriental Financial Services Corp. is our securities brokerage and investment banking subsidiary. Through a highly trained and customer service focused employee base, Oriental Financial Services provides financial planning services to individuals and investment banking services, encompassing both public and corporate finance, to corporations and the Puerto Rico government. Oriental Financial Services offers its customers a wide array of investment alternatives such as tax-advantaged fixed income securities, mutual funds, and various other equity and fixed income securities. It also manages and participates in public offerings and private placements of debt and equity securities in Puerto Rico. Oriental Financial Services is a Puerto Rico corporation and a full service, registered broker-dealer.

Oriental Insurance

Oriental Insurance, Inc. is a Puerto Rico corporation and a licensed insurance producer that offers, as agent for unaffiliated insurance companies, annuities and life insurance products, property and casualty insurance, and title insurance for individual and commercial clients. Oriental Insurance's licensed personnel has increasingly partnered with various business groups within the company to develop new insurance business opportunities and to better serve our clients.

Caribbean Pension Consultants

Caribbean Pension Consultants, Inc. is a Florida corporation headquartered in Boca Raton, Florida. It is engaged in the business of pension and retirement plan administration, focused on 401(k) and Keogh retirement plans in Puerto Rico, the United States and the Bahamas. Caribbean Pension Consultants, Inc. is the largest third party administrator of pension and retirement accounts in Puerto Rico.

Our principal executive offices are located at Professional Offices Park, 997 San Roberto Street, San Juan, Puerto Rico, and our telephone number is (787) 771-6800. We maintain a website at <http://www.orientalfg.com>.

Summary of the Offering

Issuer	Oriental Financial Group Inc., a Puerto Rico corporation.
Seller	One or more selling securityholders, see Selling Securityholders. We are not selling any of the securities.
Common Shares Offered	13,320,000 shares of our common stock, par value \$1.00 per share. The selling securityholders may from time to time offer and sell any or all of the securities under this prospectus; however, the selling securityholders are not obligated to sell the securities.
Use of Proceeds	All securities sold pursuant to this prospectus will be offered and sold by the selling securityholders. We will not receive any proceeds from the sale of the securities offered by the selling securityholders.
Risk Factors	For a discussion of risks involved with an investment in our common stock, see Risk Factors beginning on page 3 of this prospectus.

NYSE Symbol

OFG.

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RISK FACTORS

An investment in our common stock involves certain risks. Before making an investment decision, you should read carefully and consider the risk factors below relating to this offering. You should also refer to other information contained in or incorporated by reference in this prospectus and any accompanying prospectus supplement, including the risk factors included in our Annual Report on Form 10-K, as updated by our quarterly reports on Form 10-Q and other filings we make with the SEC under the Securities Exchange Act of 1934, as amended. Additional risks and uncertainties not presently known to us at this time or that we currently deem immaterial may also materially and adversely affect our business, financial condition and results of operations.

Risks Related to Our Business

We may fail to realize the anticipated benefits of our acquisition of Eurobank.

The success of our acquisition of all of the retail deposits and substantially all of the assets and operations of Eurobank on April 30, 2010 from the FDIC, as receiver for Eurobank, will depend on, among other things, our ability to realize anticipated cost savings and to integrate the acquired Eurobank assets and operations in a manner that permits growth opportunities and does not materially disrupt our existing customer relationships or result in decreased revenues resulting from any loss of customers. If we are not able to successfully achieve these objectives, the anticipated benefits of the acquisition may not be realized fully or at all or may take longer to realize than expected. Additionally, we will make fair value estimates of certain assets and liabilities in recording the acquisition. Actual values of these assets and liabilities could differ from our estimates, which could result in our not achieving the anticipated benefits of the acquisition.

We cannot assure you that our acquisition of Eurobank will have positive results, including results relating to: correctly assessing the asset quality of the assets acquired; the total cost of integration, including management attention and resources; the time required to complete the integration successfully; the amount of longer-term cost savings; being able to profitably deploy funds acquired in the transaction; or the overall performance of the combined business.

Our future growth and profitability depends, in part, on our ability to successfully manage the combined operations. Integration of an acquired business can be complex and costly, sometimes including combining relevant accounting and data processing systems and management controls, as well as managing relevant relationships with employees, clients, suppliers and other business partners. Integration efforts could divert management attention and resources, which could adversely affect our operations or results. The loss of key employees in connection with this acquisition could adversely affect our ability to successfully conduct the combined operations.

Given the continued economic recession in Puerto Rico, notwithstanding our loss-sharing arrangements with the FDIC with respect to certain Eurobank assets that we acquired, we may continue to experience increased credit costs or need to take additional markdowns and make additional provisions to the allowances for loan losses on the assets and loans acquired that could adversely affect our financial condition and results of operations in the future. There is no assurance that as our integration efforts continue in connection with this transaction, other unanticipated costs, including the diversion of personnel, or losses, will not be incurred.

Our acquisition of Eurobank may also result in business disruptions that cause us to lose customers or cause customers to move their accounts or business to competing financial institutions. It is possible that the integration process related to this acquisition could disrupt our ongoing business or result in inconsistencies in customer service that could

adversely affect our ability to maintain relationships with clients, customers, depositors and employees.

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Loans that we acquired in the Eurobank transaction may not be covered by the loss sharing agreements if the FDIC determines that we have not adequately performed under these agreements or if the loss sharing agreements have ended.

Although the FDIC has agreed to reimburse us for 80% of qualifying losses on covered loans, the FDIC has the right to refuse or delay payment for loan losses if the loss sharing agreements are not performed by the Company in accordance with their terms. Additionally, the loss sharing agreements have limited terms. Therefore, any charge-offs that we experience after the terms of the loss sharing agreements have ended would not be recoverable from the FDIC.

Certain provisions of the loss sharing agreements entered into with the FDIC may have anti-takeover effects and could limit the ability of the Company to engage in certain strategic transactions our Board of Directors believes would be in the best interests of shareholders.

The FDIC's agreement to bear 80% of qualifying losses on single family residential loans for ten years and commercial loans for five years is a significant asset of the Company and a feature of the Eurobank acquisition without which we would not have entered into the transaction. Our agreement with the FDIC requires that we receive prior FDIC consent, which may be withheld by the FDIC in its sole discretion, prior to us or our shareholders engaging in certain transactions. If any such transaction is completed without prior FDIC consent, the FDIC would have the right to discontinue the loss sharing arrangement.

Among other things, prior FDIC consent is required for (a) a merger or consolidation of the Company with or into another company if our shareholders will own less than 2/3 of the combined company and (b) a sale of shares by one or more of our shareholders that will effect a change in control of Oriental Bank and Trust, as determined by the FDIC with reference to the standards set forth in the Change in Bank Control Act (generally, the acquisition of between 10% and 25% of the Company's voting securities where the presumption of control is not rebutted, or the acquisition of more than 25% of the Company's voting securities). Such a sale by shareholders may occur beyond the Company's control. If the Company or any shareholder desired to enter into any such transaction, there can be no assurances that the FDIC would grant its consent in a timely manner, without conditions, or at all. If one of these transactions were to occur without prior FDIC consent and the FDIC withdrew its loss share protection, there could be a material adverse impact on the Company.

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

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

When the fair value of a security declines, management must assess whether the decline is other-than-temporary. When the decline in fair value is deemed other-than-temporary, the amortized cost basis of the investment security is reduced to its then current fair value. On April 1, 2009, we adopted FASB Accounting Standard Codification (ASC) 320-10-65-1, which changed the accounting requirements for other-than-temporary impairments for debt securities and, in certain circumstances, separates the amount of total impairment into credit and noncredit-related amounts. The

review takes into consideration current market conditions, issuer rating changes and trends, the credit worthiness of the obligor of the security, current analysts' evaluations, failure of the issuer to make scheduled interest or principal payments, our intent to not sell the security or whether it is more-likely-than-not that we will be required to sell the debt security before

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its anticipated recovery, as well as other qualitative factors. The term "other-than-temporary impairments" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income. A credit loss is determined by assessing whether the amortized cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, computed using original yield as the discount rate, to the amortized cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is considered to be the "credit loss." Such impairment charges reflect non-cash losses at the time of recognition. Subsequent disposition or sale of such assets could further affect our future results of operations, as they are based on the difference between the sale prices received and adjusted amortized cost of such assets at the time of sale. The review of whether a decline in fair value is other-than-temporary considers numerous factors and many of these factors involve significant judgment.

Changes in interest rates may hurt our business.

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

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

Because most of our business activities are conducted in Puerto Rico and a substantial portion of our credit exposure is in Puerto Rico, we are at risk from adverse economic, political or business developments and natural hazards that affect Puerto Rico. Since 2006, the Puerto Rico economy has been experiencing recessionary conditions. Based on information published by the Puerto Rico Planning Board, the Puerto Rico real gross national product decreased 3.7% during the fiscal year ended June 30, 2009.

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

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

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

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

The decline in Puerto Rico's economy has had an adverse effect in the credit quality of our loan portfolios as delinquency rates have increased in the short-term and may continue to increase until the economy stabilizes. Among other things, we have experienced an increase in the level of our non-performing assets and loan loss provision, which adversely affects our profitability. If the decline in economic activity continues, additional increases in the allowance for loan losses could be necessary and there could be further adverse effects on our profitability. The reduction in consumer spending may also continue to impact growth in our other interest and non-interest revenue sources.

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

Financial results are constantly exposed to market risk.

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

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

We use an asset-liability management software to project future movements in our balance sheet and income statement. The starting point of the projections generally corresponds to the actual values of the balance sheet on the date of the simulations. These simulations are highly complex, and use many simplifying assumptions.

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

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

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

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

The remaining maturity of various assets and liabilities may shorten or lengthen as interest rates change. For example, if long-term mortgage interest rates decline sharply, mortgage-backed securities held in the securities available-for-sale portfolio may prepay significantly earlier than anticipated, which could reduce portfolio

income. If prepayment rates increase, we would be required to amortize net premiums into income over a shorter period of time, thereby reducing the corresponding asset yield and net interest income. Prepayment risk also has a significant impact on mortgage-backed securities and collateralized mortgage obligations, since prepayments could shorten the weighted average life of these portfolios.

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

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

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

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

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

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

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

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

The residential mortgage loan origination business has historically been cyclical, enjoying periods of strong growth and profitability followed by periods of lower volumes and industry-wide losses. The market for residential mortgage loan originations is currently in decline, and this trend could also reduce the level of mortgage loans that we may originate in the future and may adversely impact our business. During periods of rising interest rates, refinancing

originations for many mortgage products tend to decrease as the economic incentives for borrowers to refinance their existing mortgage loans are reduced. In addition, the residential mortgage loan origination business is impacted by home values. A recent trend of decreasing values in certain housing segments has also been noted. There is a risk that a reduction in housing values could negatively impact our loss levels on the mortgage portfolio because the value of the homes underlying the loans is a primary source of repayment in the event of foreclosure.

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

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

The housing market in the U.S. is undergoing a correction of historic proportions. After a period of several years of booming housing markets, fueled by liberal credit conditions and rapidly rising property values, the sector has been in the midst of a substantial correction since early 2007. The general level of property values in the U.S., as measured by several indices widely followed by the market, has declined. These declines are the result of ongoing market adjustments that are aligning property values with income levels and home inventories. The supply of homes in the market has increased substantially, and additional property value decreases may be required to clear the overhang of excess inventory in the U.S. market.

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

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

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

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

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

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

the duration of the loan;

credit risks of a particular borrower;

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changes in economic or industry conditions; and

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

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

Although we believe that our allowance for loan losses is currently sufficient given the constant monitoring of the risk inherent in our loan portfolio, there is no precise method of predicting loan losses and therefore we always face the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. In addition, the FDIC as well as the Office of the Commissioner of Financial Institutions of Puerto Rico may require us to establish additional reserves. Additions to the allowance for loan losses would result in a decrease of our net earnings and capital and could hinder our ability to pay dividends.

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

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

Competition with other financial institutions could adversely affect our profitability.

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

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

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

could have a materially adverse impact on us, including increasing our tax burden or otherwise adversely affecting our financial condition, results of operations or cash flows.

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The Puerto Rico Economic Stabilization and Restoration Act imposed a temporary 5% special income tax on international banking entities, among others, which until the enactment of such law were tax exempt financial institutions in Puerto Rico. This special income tax is applicable for tax years 2009, 2010 and 2011.

Competition in attracting talented people could adversely affect our operations.

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

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

Our financial statements are subject to the application of our accounting principles generally accepted in the United States (GAAP), which are periodically revised and/or expanded. Accordingly, from time to time we are required to adopt new or revised accounting standards issued by FASB. Market conditions have prompted accounting standard setters to promulgate new guidance which further interprets or seeks to revise accounting pronouncements related to financial instruments,