

ORIENTAL FINANCIAL GROUP INC

Form 10-KT

June 27, 2006

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

Form 10-K

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

For the Fiscal Year Ended ,

or

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

For the Transition Period from July 1, 2005 to December 31, 2005.

Commission File No. 001-12647

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

IRS Employer Identification No. 66-0538893

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

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

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

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

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

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the

Act. Yes ☐ No ☒

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

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

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

Large Accelerated Filer ☐

Accelerated Filer ☒

Non-Accelerated Filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of the common stock held by non-affiliates of Oriental Financial Group Inc. (the "Group") was \$268.1 million based upon the reported closing price of \$12.36 on the New York Stock Exchange as of December 31, 2005.

As of May 31, 2006, the Group had 24,622,629 shares of common stock outstanding.

Documents Incorporated By Reference

None.

ORIENTAL FINANCIAL GROUP INC.

FORM 10-K

FOR THE TRANSITION PERIOD ENDED DECEMBER 31, 2005

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FORWARD-LOOKING STATEMENTS

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

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

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

PART I

ITEM 1. BUSINESS

General

The Group is a diversified, publicly-owned financial holding company, incorporated on June 14, 1996 under the laws of the Commonwealth of Puerto Rico, providing a full range of financial services through its subsidiaries. The Group is subject to the provisions of the U.S. Bank Holding Company Act of 1956, as amended, (the "BHC Act") and, accordingly, subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). As of December 31, 2005, the Group had, on a consolidated basis, \$7.6 billion in total financial assets owned and under management, including total investments and loans of \$4.4 billion, total deposits of \$1.3 billion and stockholders' equity of \$341.8 million.

The Group provides comprehensive financial services to its clients through a complete range of banking and financial solutions, including mortgage, commercial and consumer lending; checking and savings accounts; financial planning, insurance, asset management, and investment brokerage; and corporate and individual trust and retirement services. The Group operates through three major business segments: Banking, Treasury and Financial Services, and distinguishes itself based on quality service and marketing efforts focused on professional individuals and owners of small and mid-sized businesses, primarily in Puerto Rico. The Group has 24 financial centers in Puerto Rico and a subsidiary, Caribbean Pension Consultants Inc. ("CPC"), based in Boca Raton, Florida. The Group's long-term goal is to strengthen its banking-financial services franchise by expanding its commercial and consumer lending businesses, increasing the level of integration in the marketing and delivery of banking and financial services, continuing to maintain effective asset-liability management, growing non-interest revenues from banking and financial services and improving operating efficiencies.

In the fiscal year ended June 30, 2004, the Group embarked on a strategy designed to become a more traditional asset-based financial institution. The strategy involves:

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

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- (2) Focusing on greater growth in mortgage, commercial and consumer lending; insurance products, trust and wealth management services, which traditionally have been one of the Group's greatest strengths; and increasing the level of integration in the marketing and delivery of such banking and financial services;
- (3) Opening, expanding or relocating branch offices; improving operating efficiencies; and continuing to maintain effective asset-liability management; and
- (4) Implementing The Oriental Way, a broad ranging effort to instill in both employees and customers alike the Group's determination to effectively serve its customer base in a responsive and professional manner.

Together with the establishment of a highly experienced group of senior and mid level executives, this strategy has generally resulted in sustained growth in the Group's mortgage, commercial and consumer lending activities, allowing it to distinguish itself in a highly competitive industry. The increasing interest rate environment of recent years has validated the strategy's basic premise for greater revenue diversity, which remains an integral part of the Group's long-term goal.

While progress is expected to continue, the Group is not immune from general and local financial and economic conditions. However, the Group remains well capitalized, with one of the strongest regulatory capital positions in the Puerto Rico banking industry, and it is strongly situated, along with its active, ongoing efforts to reduce non-interest expenses, to carry forward this strategy. Past experience is not necessarily indicative of future performance, specially given current market uncertainties, but based on a reasonable time horizon of three to five years, the strategy is expected to maintain its steady progress towards the Group's long-term goal.

Banking Activities

Oriental Bank and Trust (the Bank), the Group's main subsidiary, is a full-service Puerto Rico commercial bank with its main office located in San Juan, Puerto Rico. The Bank has 24 branches throughout Puerto Rico and was incorporated in 1964 as a federal mutual savings and loan association. It became a federal mutual savings bank in July 1983 and converted to a federal stock savings bank in April 1987. Its conversion from a federally-chartered savings bank to a commercial bank chartered under the banking laws of the Commonwealth of Puerto Rico, on June 30, 1994, allowed the Bank to more effectively pursue opportunities in its market and obtain more flexibility in its businesses, placing the Bank in the mainstream of financial services in Puerto Rico. As a Puerto Rico-chartered commercial bank, it is subject to examination by the Federal Deposit Insurance Corporation (the FDIC) and the Office of the Commissioner of Financial Institutions of Puerto Rico (the OCFI). The Bank offers banking services such as commercial and consumer lending, saving and time deposit products, financial planning, and corporate and individual trust services, and, through its residential mortgage lending division, Oriental Mortgage, capitalizes on its banking network to provide residential mortgage loans to its clients. The Bank also operates two international banking entities pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended (the IBE Act), one operates as a unit of the Bank, named O.B.T. International Bank (the IBE unit), and the other operates as a wholly owned subsidiary of the Bank, named Oriental International Bank Inc. (the IBE subsidiary) organized in November 2003. The Group transferred most of the assets and liabilities of the IBE unit to the IBE subsidiary as of January 1, 2004. The international banking entities offer the Bank certain Puerto Rico tax advantages and their services are limited under Puerto Rico law to persons and assets/liabilities located outside Puerto Rico.

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

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

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resold to individual or institutional investors in the secondary market. Conventional loans that meet the underwriting requirements for sale or exchange under standard Federal National Mortgage Association (the "FNMA") or the Federal Home Loan Mortgage Corporation (the "FHLMC") programs are referred to as conforming mortgage loans and are also securitized for issuance of FNMA or FHLMC mortgage-backed securities. Until December 2005, the Group outsourced the securitization of GNMA, FNMA and FHLMC mortgage-backed securities. In March 2006, and after FNMA's approval for the Group to sell FNMA-conforming conventional mortgage loans directly in the secondary market, the Group became an approved seller of FNMA, as well as FHLMC, mortgage loans for issuance of FNMA and FHLMC mortgage-backed securities. The Group is also an approved issuer of GNMA mortgage-backed securities. The Group will continue to outsource the servicing of the GNMA, FNMA and FHLMC pools that it issues and its mortgage loan portfolio to a third party.

Loan Underwriting

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

Sale of Loans and Securitization Activities

The Group may engage in the sale or securitization of a portion of the residential mortgage loans that it originates and purchases and utilizes various channels to sell its mortgage products. The Group is an approved issuer of GNMA-guaranteed mortgage-backed securities, which involve the packaging of FHA loans, Rural Housing Service ("RHS") loans or VA loans into pools of mortgage-backed securities for sale primarily to securities broker-dealers and other institutional investors. The Group can also act as issuer in the case of conforming conventional loans in order to group them into pools of FNMA or FHLMC-issued mortgage-backed securities, which the Group then sells to securities broker-dealers. Until the December 2005 quarter, the Group used a third party as the issuer of mortgage-backed securities. The issuance of mortgage-backed securities provides the Group with flexibility in selling the mortgage loans that it originates or purchases and also provides income by increasing the value and marketability of such loans. In the case of conforming conventional loans, the Group also has the option to sell such loans through the FNMA and FHLMC cash window program.

Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities

The Group recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

The Group is not engaged in sales of mortgage loans and mortgage-backed securities subject to recourse provisions, except for those provisions that allow for the repurchase of loans as a result of a breach of certain representations and warranties, other than those related to the credit quality of the loans included in the sale transactions. In addition, the servicing rights on mortgage loans originated and held by the Group are sold to another financial institution.

According to Statement of Financial Accounting Standards 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS 140"), a transfer of financial assets (or all or a portion of the financial asset) in which the Group surrenders control over these financial assets shall be accounted for as a sale to the extent that consideration, other than beneficial interests in the transferred assets, is received in exchange. The Group has

surrendered control over transferred assets if and only if all of the following conditions are met:

- a. The transferred assets have been isolated from the Group put presumptively beyond the reach of the Group and its creditors, even in bankruptcy or other receivership.

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- b. Each transferee has the right to pledge or exchange the assets it received, and no condition both constrains the transferee from taking advantage of its rights to pledge or exchange and provided more than a trivial benefit to the Group.
- c. The Group does not maintain effective control over the transferred assets through either (1) an agreement that both entitled and obligates the Group to repurchase or redeem them before their maturity, or (2) the ability to unilaterally cause the holder to return specific assets other than through a cleanup call.

If a transfer of financial assets in exchange for cash or other consideration (other than beneficial interests in the transferred assets) does not meet the criteria for a sale as described above, the Group would account for the transfer as a secured borrowing with pledge of collateral.

Treasury Activities

Treasury activities encompass all of the Group's treasury-related functions. The Group's investment portfolio consists primarily of mortgage-backed securities, collateralized mortgage obligations, U.S. Treasury notes, U.S. Government agency bonds, P.R. Government obligations, and money market instruments. Mortgage-backed securities, the largest component, consist principally of pools of residential mortgage loans that are made to consumers and then resold in the form of certificates in the secondary market, the payment of interest and principal of which is guaranteed by GNMA, FNMA or FHLMC. For more information, see Note 3 to the accompanying consolidated financial statements.

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

Securities Brokerage and Investment Banking Activities

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

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

OFSC also manages and participates in public offerings and private placements of debt and equity securities in Puerto Rico. Investment banking revenue from such activities, include gains, losses, and fees, net of syndicate expenses,

arising from securities offerings in which OFSC acts as an underwriter or agent. Investment banking revenue also includes fees earned from providing merger-and-acquisition and financial restructuring advisory services. Investment banking management fees are recorded on the offering date, sales concessions on settlement date, and underwriting fees at the time the underwriting is completed and the income is reasonably determinable.

In January 2005, OFSC was selected for the third time to serve as Senior Manager, through 2007, for the Commonwealth of Puerto Rico's bond syndicate in partnership with Banc of America Securities LLC. In

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connection therewith, OFSC has entered into an Agreement to Seek Municipal Securities Business with Banc of America Securities LLC. OFSC also participates as underwriter or selling group member in certain bond issues of Puerto Rico government instrumentalities.

Other Activities

Oriental Financial (PR) Statutory Trust I (Statutory Trust I) and Oriental Financial (PR) Statutory Trust II (Statutory Trust II) are special purpose entities of the Group that were formed for the purpose of issuing trust redeemable preferred securities. Such entities have each issued \$35.0 million of trust redeemable preferred securities as part of pooled underwriting transactions. Pooled underwriting involves participating with other bank holding companies in issuing the securities through a special purpose pooling vehicle created by the underwriters.

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

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

The Group is a legal entity separate and distinct from the Bank, OFSC, the Statutory Trusts, CPC and Oriental Insurance. There are various legal limitations governing the extent to which the Bank may extend credit, pay dividends or otherwise supply funds to, or engage in transactions with the Group or its other subsidiaries.

Market Area and Competition

Puerto Rico, where the banking market is highly competitive, is the main geographic business and service area of the Group. As of December 31, 2005, Puerto Rico had 10 commercial banking institutions with a total of approximately \$103.0 billion in assets according to industry statistics published by the FDIC. The Group ranked 8th based on total assets at December 31, 2005. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States of America.

The Group competes with brokerage firms with retail operations, credit unions, savings and loan cooperatives, small loan companies, insurance agencies and mortgage banks in Puerto Rico. The Group encounters intense competition in attracting and retaining deposits and in its consumer and commercial lending activities. Management believes that the Group has been able to compete effectively for deposits and loans by offering a variety of transaction account products and loans with competitive terms, by emphasizing the quality of its service, by pricing its products at competitive interest rates and by offering convenient branch locations. The Group's ability to originate loans depends primarily on the service it provides to its borrowers in making prompt credit decisions and on the rates and fees that it charges.

Segment Disclosure

The Group has three reportable segments: Banking, Treasury, and Financial Services. Management established the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Group's organizational structure, nature of products, distribution channels and economic characteristics of the products were also considered in the determination of the reportable segments. The

Group measures the performance of these reportable segments based on pre-established goals of different financial parameters such as net income, interest spread, loan production and fees generated.

For detailed information regarding performance of the Group's operating segments, please refer to Note 18 to the Group's accompanying consolidated financial statements.

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Regulation and Supervision

General

The Group is a bank holding company subject to supervision and regulation by the Federal Reserve Board under the BHC Act. Under the BHC Act, prior to the adoption of the Gramm-Leach-Bliley Act in 1999, the activities of bank holding companies and their banking and non-banking subsidiaries were limited to the business of banking and activities closely related to banking, and no bank holding company could directly or indirectly acquire ownership or control of more than 5% of any class of voting shares or substantially all of the assets of any company in the United States, including a bank, without the prior approval of the Federal Reserve Board. In addition, bank holding companies generally have been prohibited under the BHC Act from engaging in non-banking activities, unless they were found by the Federal Reserve Board to be closely related to banking. The Gramm-Leach-Bliley Act authorized bank holding companies that qualify as financial holding companies to engage in a substantially broader range of non-banking activities, subject to certain conditions. The qualification requirements and the process for a bank holding company that elects to be treated as a financial holding company requires that all of the subsidiary banks controlled by the bank holding company at the time of election must be and remain at all times well capitalized and well managed.

The Gramm-Leach-Bliley Act further requires that, in the event that the bank holding company elects to become a financial holding company, the election must be made by filing a written declaration with the appropriate Federal Reserve Bank that: (i) states that the bank holding company elects to become a financial holding company; (ii) provides the name and head office address of the bank holding company and each depository institution controlled by the bank holding company; (iii) certifies that each depository institution controlled by the bank holding company is well capitalized as of the date the bank holding company submits its declaration; (iv) provides the capital ratios for all relevant capital measures as of the close of the previous quarter for each depository institution controlled by the bank holding company on the date the bank holding company submits its declaration; and (v) certifies that each depository institution controlled by the bank holding company is well managed as of the date the bank holding company submits its declaration. The bank holding company must have also achieved at least a rating of satisfactory record of meeting community credit needs under the Community Reinvestment Act during the institution's most recent examination. The Group elected to be treated as a financial holding company as permitted by the Gramm-Leach-Bliley Act. Under the Gramm-Leach-Bliley Act, if the Group fails to meet the requirements for being a financial holding company and is unable to correct such deficiencies within certain prescribed time periods, the Federal Reserve Board could require the Group to divest control of its depository institution subsidiary or alternatively cease conducting activities that are not permissible for bank holding companies that are not financial holding companies.

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

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

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

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The Bank is regulated by various agencies in the United States and the Commonwealth of Puerto Rico. Its main regulators are the OCFI and the FDIC. The FDIC insures the Bank's deposits up to \$100,000 per depositor, except for certain retirement accounts which are insured up to \$250,000 per depositor. The Bank is further subject to the regulation of the Puerto Rico Finance Board. The Bank is subject to extensive regulation and examination by the OCFI and the FDIC, which insures its deposits to the maximum extent, permitted by law, and is subject to certain Federal Reserve Board regulations of transactions with Bank affiliates. The federal and Puerto Rico laws and regulations which are applicable to the Bank, regulate, among other things, the scope of its business, its investments, its reserves against deposits, the timing of the availability of deposited funds, and the nature and amount of and collateral for certain loans. In addition to the impact of such regulations, commercial banks are affected significantly by the actions of the Federal Reserve Board as it attempts to control the money supply and credit availability in order to control inflation in the economy.

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

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

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

Holding Company Structure

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

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

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

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Under the Federal Deposit Insurance Act (FDIA), a depository institution (which definition includes both banks and savings associations), the deposits of which are insured by the FDIC, can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with (1) the default of a commonly controlled FDIC-insured depository institution or (2) any assistance provided by the FDIC to any commonly controlled FDIC-insured depository institution in danger of default. Default is defined generally as the appointment of a conservator, receiver or other legal custodian and in danger of default is defined generally as the existence of certain conditions indicating that default is likely to occur in the absence of regulatory assistance. In some circumstances (depending upon the amount of the loss or anticipated loss suffered by the FDIC), cross-guarantee liability may result in the ultimate failure or insolvency of one or more insured depository institutions in a holding company structure. Any obligation or liability owed by a subsidiary bank to its parent company is subordinated to the subsidiary bank's cross-guarantee liability with respect to commonly controlled insured depository institutions.

Dividend Restrictions

The principal source of funds for the Group is the dividends from the Bank. The ability of the Bank to pay dividends on its common stock is restricted by the Puerto Rico Banking Act of 1933, as amended (the Puerto Rico Banking Act), the FDIA and FDIC regulations. In general terms, the Puerto Rico Banking Act provides that when the expenditures of a bank are greater than receipts, the excess of expenditures over receipts shall be charged against the undistributed profits of the bank and the balance, if any, shall be charged against the required reserve fund of the bank. If there is no sufficient reserve fund to cover such balance in whole or in part, the outstanding amount shall be charged against the bank's capital account. The Puerto Rico Banking Act provides that until said capital has been restored to its original amount and the reserve fund to 20% of the original capital, the bank may not declare any dividends. In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding a bank.

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

Federal Home Loan Bank System

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

As a system member, the Bank is entitled to borrow from the FHLB of New York (the FHLB-NY) and is required to own capital stock in the FHLB-NY in an amount equal to the greater of \$500; 1% of the Bank's aggregate unpaid principal of its home mortgage loans, home purchase contracts, and similar obligations; or 5% of the Bank's aggregate amount of outstanding advances by the FHLB-NY. The Bank is in compliance with the stock ownership rules described above with respect to such advances, commitments and letters of credit and home mortgage loans and similar obligations. All loans, advances and other extensions of credit made by the FHLB-NY to the Bank are secured

by a portion of the Bank's mortgage loan portfolio, certain other investments and the capital stock of the FHLB-NY held by the Bank. At no time may the aggregate amount of outstanding advances made by the FHLB-NY to the Bank exceed 20 times the amount paid in by the Bank for capital stock in the FHLB-NY.

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Federal Deposit Insurance Corporation Improvement Act

Under FDICIA, the federal banking regulators must take prompt corrective action in respect to depository institutions that do not meet minimum capital requirements. FDICIA, and the regulations issued thereunder, established five capital tiers: (i) well capitalized, if it has a total risk-based capital ratio of 10.0% or more, has a Tier I risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more, and is not subject to any written capital order or directive; (ii) adequately capitalized, if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well capitalized, (iii) undercapitalized, if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances), (iv) significantly undercapitalized, if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital ratio that is less than 3.0%, and (v) critically undercapitalized, if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. A depository institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives a less than satisfactory examination rating in any of the first four categories. The Bank is a well-capitalized institution.

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

Insurance of Accounts and FDIC Insurance Assessments

The FDIC insures the Bank's deposit accounts up to the applicable limits. The insurance of deposit accounts by the FDIC subjects the Bank to comprehensive regulation, supervision, and examination by the FDIC. If the Bank violates its duties as an insured institution, engages in unsafe and unsound practices, is in an unsound and unsafe condition, or has violated any applicable FDIC requirements, the FDIC may terminate the insurance of depository accounts of the Bank.

Pursuant to FDICIA, the FDIC has adopted a risk-based assessment system, under which the assessment rate for an insured depository institution varies according to the level of risk incurred in its activities. An institution's risk category is based partly upon whether the institution is well capitalized, adequately capitalized or less than adequately capitalized. Each insured institution is also assigned to one of the following supervisory subgroups: A, B, or C. Group A institutions, like the Bank, are financially sound institutions with only a few minor weaknesses; Group B institutions are institutions that demonstrate weaknesses that, if not corrected, could result in significant deterioration; and Group C institutions are institutions with respect to which there is a substantial probability that the FDIC will suffer a loss in connection with the institution unless effective action is taken to correct the areas of weakness. Currently, well capitalized institutions in Group A are not assessed deposit insurance premiums.

The Federal Deposit Insurance Reform Act of 2005 was signed into law on February 8, 2006. This law merged, as of March 31, 2006, the two deposit insurance funds managed by the FDIC, the Bank Insurance Fund and the Savings Association Insurance Fund, into a new Deposit Insurance Fund. It also, among other things, increases to \$250,000 the insurance coverage for retirement accounts, such as traditional and Roth IRA s and self- directed Keogh plans,

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and establishes a method for considering an increase in the insurance limits on all deposit accounts (including retirement accounts) every five years starting in 2011 and based, in part, on inflation.

Regulatory Capital Requirements

The Federal Reserve Board has adopted risk-based capital guidelines for bank holding companies. Under the guidelines, the minimum ratio of qualifying total capital to risk-weighted assets is 8%. At least half of the total capital is to be comprised of common stockholders' equity, qualifying noncumulative perpetual preferred stock (including related surplus), minority interest related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary, and restricted core capital elements (Tier 1 Capital). The remainder (Tier 2 Capital) may consist, subject to certain limitations, of allowance for loan and lease losses; perpetual preferred stock and related surplus; hybrid capital instruments, perpetual debt, and mandatory convertible debt securities; term subordinated debt and intermediate-term preferred stock, including related surplus; and unrealized holding gains on equity securities.

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

In addition, the Federal Reserve Board has established minimum leverage ratio (Tier 1 Capital to quarterly average assets) guidelines for bank holding companies and member banks. These guidelines provide for a minimum leverage ratio of 3% for bank holding companies and member banks that meet certain specified criteria, including that they have the highest regulatory rating. All other bank holding companies and member banks are required to maintain a minimum ratio of Tier 1 Capital to total assets of 4%. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets. Furthermore, the guidelines point out that the Federal Reserve Board will continue to consider a tangible Tier 1 leverage ratio and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet the capital guidelines could subject an institution to a variety of enforcement actions, including the termination of deposit insurance by the FDIC, and to certain restrictions on its business. At December 31, 2005, the Group was in compliance with all capital requirements. For more information, please refer to Note 14 to the accompanying consolidated financial statements.

Safety and Soundness Standards

Section 39 of the FDIA, as amended by FDICIA, requires each federal banking agency to prescribe for all insured depository institutions standards relating to internal control, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, and such other operational and managerial standards as the agency deems appropriate. In addition, each federal banking agency also is required to adopt for all insured depository institutions and their holding companies standards that specify (i) a maximum ratio of classified assets to capital, (ii) minimum earnings sufficient to absorb losses without impairing capital, (iii) to the extent feasible, a minimum ratio of market value to book value for publicly-traded shares of the institution or holding company, and (iv) such other standards relating to asset quality, earnings and valuation as the agency deems appropriate. Finally, each federal banking agency is required to prescribe standards for the employment contracts and other compensation arrangements of executive officers, employees, directors and principal stockholders of insured depository institutions that would prohibit compensation, benefits and other arrangements that are excessive

or that could lead to a material financial loss for the institution. If an insured depository institution or its holding company fails to meet any of the standards described above, it will be required to submit to the appropriate federal banking agency a plan specifying the steps that will be taken to cure the deficiency. If an institution or holding company fails to submit an acceptable plan or fails to implement the plan, the appropriate federal banking agency will require the institution or holding company to correct the deficiency and,

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until it is corrected, may impose other restrictions on the institution or holding company, including any of the restrictions applicable under the prompt corrective action provisions of FDICIA.

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

Activities and Investments of Insured State-Chartered Banks

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

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

Transactions with Affiliates and Related Parties

Transactions between the Bank and any of its affiliates are governed by sections 23A and 23B of the Federal Reserve Act. These sections are important statutory provisions designed to protect a depository institution from transferring to its affiliates the subsidy arising from the institution's access to the Federal safety net. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. Generally, sections 23A and 23B (1) limit the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate to an amount equal to 10% of the bank's capital stock and surplus, and limit such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus, and (2) require that all such transactions be on terms that are consistent with safe and sound banking practices. The term covered transactions includes the making of loans, purchase of or investment in securities issued by the affiliate, purchase of assets, issuance of guarantees and other similar types of transactions. Most loans by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100 to 130 percent of the loan amount, depending on the nature of the collateral. In addition, any covered transaction by a bank with an affiliate and any sale of assets or provision of services to an affiliate must be on terms that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with nonaffiliated companies.

Regulation W of the Federal Reserve Board comprehensively implements sections 23A and 23B. The regulation unified and updated staff interpretations issued over the years prior to its adoption, incorporated several interpretative proposals (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate), and

addressed issues arising as a result of the expanded scope of non-banking activities engaged in by banks and bank holding companies and authorized for financial holding companies under the Gramm-Leach-Bliley Act.

Sections 22(g) and (h) of the Federal Reserve Act place restrictions on loans by a bank to executive officers, directors, and principal shareholders. Regulation O of the Federal Reserve Board implements these provisions. Under Section 22(h) and Regulation O, loans to a director, an executive officer and to a greater than 10%

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

Community Reinvestment Act

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

USA Patriot Act

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

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

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

Privacy Policies

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

Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 (SOX) implemented legislative reforms intended to address corporate and accounting fraud. SOX contains reforms of various business practices and numerous aspects of corporate

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governance. Most of these requirements have been implemented pursuant to regulations issued by the SEC. The following is a summary of certain key provisions of SOX.

In addition to the establishment of an accounting oversight board that enforces auditing, quality control and independence standards and is funded by fees from all registered public accounting firms and publicly traded companies, SOX places restrictions on the scope of services that may be provided by accounting firms to their public company audit clients. Any non-audit services being provided to a public company audit client requires pre-approval by the Audit Committee of the Board of Directors (Audit Committee). In addition, SOX makes certain changes to the requirements for partner rotation after a period of time. SOX requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the SEC, subject to civil and criminal penalties if they knowingly or willingly violate this certification requirement. In addition, counsel is required to report evidence of a material violation of securities laws or a breach of fiduciary duties to the company s chief legal officer or to both the company s chief executive officer and its chief legal officer, and, if any of such officers does not appropriately respond, to report such evidence to the Audit Committee or other similar committee of the board of directors or to the board itself.

Under SOX, longer prison terms apply to corporate executives who violate federal securities laws; the period during which certain types of suits can be brought against a company or its officers is extended; and bonuses issued to top executives prior to restatement of a company s financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from insider trading during retirement plan blackout periods, and loans to company executives (other than loans by financial institutions permitted by federal rules or regulations) are restricted. In addition, the legislation accelerates the time frame for disclosures by public companies, as they must immediately disclose any material changes in their financial condition or operations. Directors and executive officers required to report changes in ownership in a company s securities must now report any such change within two business days of the change.

SOX increases responsibilities and codifies certain requirements relating to audit committees of public companies and how they interact with the company s independent registered public accounting firm. Audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the company. In addition, companies are required to disclose whether at least one member of the committee is a financial expert (as such term is defined by the SEC) and if not, why not. A company s independent registered public accounting firm is prohibited from performing statutorily mandated audit services for a company if the company s chief executive officer, chief financial officer, controller, chief accounting officer or any person serving in equivalent positions had been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date. SOX also prohibits any officer or director of a company or any other person acting under their direction from taking any action to fraudulently influence, coerce, manipulate or mislead any independent public or certified accountant engaged in the audit of the company s financial statements for the purpose of rendering the financial statements materially misleading.

SOX also has provisions relating to inclusion of certain internal control reports and assessments by management in the annual report to stockholders. The law also requires the company s registered public accounting firm that issues the audit report to attest to and report on management s assessment of the company s internal control over financial reporting. The Group is required to include in its annual report on Form 10-K an internal control report containing management s assertions regarding the effectiveness of the Group s internal control structure and procedures over financial reporting. The internal control report must include a statement of management s responsibility for establishing and maintaining adequate internal control over financial reporting for the Group; of management s assessment as to the effectiveness of the Group s internal control over financial reporting based on management s evaluation of it, as of the end of the Group s most recent fiscal year, including disclosure of any material weaknesses therein; of the framework used by management as criteria for evaluating the effectiveness of the Group s internal

control over financial reporting; and a statement that the Group's independent registered public accounting firm that audited its financial statements has issued an attestation report on management's assessment of such internal control over financial reporting.

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Puerto Rico Banking Act

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

The Puerto Rico Banking Act requires that at least 10% of the yearly net income of the Bank be credited annually to a reserve fund. This apportionment shall be done every year until the reserve fund is equal to the total paid-in capital on common and preferred stock. As of December 31, 2005, the Bank's capital reserve fund, which is presented as "Legal surplus" in the accompanying consolidated financial statements, was \$35.9 million.

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

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

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

The Puerto Rico Banking Act generally restricts the amount a bank can lend to a single borrower. The Act prohibits one or more loans to the same person, firm, partnership, corporation or related parties financially dependent, in an aggregate amount that exceeds 15% of the bank's paid-in capital and reserve fund. The regulations issued thereunder by the OCFI expand the above limitation to include 15% of 50% of the bank's retained earnings. This additional lending limit is only allowed to institutions with: (1) a rating of "1" on their last regulatory examination and (2) classification of a "well-capitalized" institution. The 15% limitation is not applicable to loans guaranteed by collateral having a fair value of at least 25% more than the loan amount. It is also not applicable to letters of credit or guarantees and loans guaranteed by bonds, securities and debts of the government of the United States or Puerto Rico or bonds of Puerto Rico governmental agencies, instrumentalities or municipalities. The Group has a lending concentration of \$87.5 million in one mortgage originator in Puerto Rico at December 31, 2005. This mortgage-related transaction is classified as a commercial loan, and is collateralized by mortgages on real estate properties, mainly one-to-four family residences, and is also guaranteed by the parent company of the mortgage originator. This mortgage-related transaction is performing in accordance with its contractual terms. On May 4, 2006, the Group obtained a waiver from the OCFI with respect to the statutory limit for loans to a single borrower (loan to one borrower limit), which allows the Group to retain this credit relationship in its portfolio until it is paid in full.

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

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

International Banking Center Regulatory Act of Puerto Rico

The business and operations of O.B.T. International Bank and Oriental International are subject to supervision and regulation by the OCFI. Under the IBE Act, no sale, encumbrance, assignment, merger, exchange or transfer of shares, interest or participation in the capital of an international banking entity (an IBE) may be initiated without the prior approval of the OCFI, if by such transaction a person would acquire, directly or indirectly, control of 10% or more of any class of stock, interest or participation in the capital of the IBE. The IBE Act and the regulations issued thereunder by the OCFI (the IBE Regulations) limit the business activities that may be carried out by an IBE. Such activities are limited in part to persons and assets/liabilities located outside of Puerto Rico. The IBE Act provides further that every IBE must have not less than \$300,000 of unencumbered assets or acceptable financial guarantees.

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

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

In November 2003, the IBE Act was amended to impose income taxes at normal statutory rates on each IBE that operates as a unit of a bank, such as O.B.T. International Bank, if the IBE's net income generated after December 31, 2003 exceeds 40 percent of the Bank's net income in the taxable year commenced on July 1, 2003 to June 30, 2004, 30 percent of the Bank's net income in the taxable year commencing on July 1, 2004 to June 30, 2005, 20 percent of the Bank's net income in the taxable six-month period commencing on July 1, 2005 to December 31, 2005 and 20 percent of the Bank's net income in the taxable year commencing on January 1, 2006 to December 31, 2006, and thereafter. It does not impose income taxation on an IBE that operates as a subsidiary of a bank, such as Oriental International. As of January 1, 2004, most of the assets and liabilities of O.B.T. International Bank were transferred to Oriental International.

Employees

At December 31, 2005, the Group had 520 employees. None of its employees is represented by a collective bargaining group. The Group considers its employee relations to be good.

Internet access to reports

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

The Group's corporate governance guidelines, code of business conduct and ethics, and the charters of its Audit Committee, Compensation Committee, and Corporate Governance and Nominating Committee are available free of charge on the Group's website at www.orientalonline.com in the investor relations section under the corporate governance link. The Group's code of business conduct and ethic applies to its directors, officers, employees and agents, including its principal executive, financial and accounting officers.

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ITEM 1A. RISK FACTORS

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

Puerto Rico's current economic condition may have an adverse effect in the credit quality of our loan portfolio

During the first two weeks of May 2006, the central government of Puerto Rico experienced a partial shutdown and closed a number of government agencies due to the insufficiency of current budgetary funds necessary to maintain the operations of the government through the end of the current fiscal year, which ends on June 30, 2006. The partial shutdown included the closing of Puerto Rico's public schools and indirectly forced the closing of government offices at certain municipalities. Approximately, 95,000 public employees were placed on unpaid leave until an agreement in principle was reached between the Governor and the Legislature. As a result of the agreement, government officials have been discussing legislation that would provide new sources of tax revenues to the Commonwealth and allow it to repay a loan from the Government Development Bank for Puerto Rico which was authorized to cover the current budgetary deficit. The current economic uncertainty that exists in Puerto Rico caused by the disagreements of the legislative and executive branches of the Puerto Rico government regarding the tax and fiscal reform and the budget approval, coupled with increases in the price of petroleum and other consumer goods, are aggravating concerns over the economic condition of the Commonwealth. The partial shutdown of government offices and public schools, the increase in petroleum prices, along with rising interest rates, may adversely impact employment and economic growth in Puerto Rico. These factors may have an adverse effect in the credit quality of our loan portfolio, as delinquency rates could increase in the short-term, until the economy stabilizes.

Fluctuations in interest rates may hurt our business

Interest rate fluctuations are the primary market risk affecting us. Changes in interest rates affect the following areas, among others, of our business:

- the number of mortgage loans originated;
- the interest income earned on loans and securities;
- the value of securities holdings; and
- gains from sales of loans and securities.

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 borrowings from the Federal Home Loan Bank of New York, and other alternative sources, our business may be significantly dependent upon shorter-term borrowings, such as repurchase agreements.

The funding needed to maintain our growth strategy for our loan and investment portfolios is obtained, in large part, through repurchase agreements (repos) with maturities of one to three months. We have entered into interest rate swap agreements where we pay a fixed rate for a period of two to ten years, and receive a floating rate equal to one or three months LIBOR. These swaps are designed to hedge a portion of our exposure to changes in short-term interest rates on the repurchase agreements; thereby, allowing us to extend the maturity of the repo liability while renewing these agreements for additional terms. We believe the coverage provided by these hedges to be adequate to reduce our exposure to a rise in short-term interest rates.

While 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 the event that

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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, which would have a material adverse effect on our operations and financial condition.

Increases in interest rates reduce demand for new mortgage loan originations and refinancings

Higher interest rates increase the cost of mortgage loans to consumers and reduce demand for mortgage loans, which negatively impacts our profits. Reduced demand for mortgage loans results in reduced loan originations by us, therefore generating lower mortgage origination income and lower gains on sale of loans. In addition, the demand for refinancing is particularly sensitive to increases in interest rates.

Increases in interest rates reduce net interest income

Increases in short-term interest rates reduce net interest income, which is an important part of our earnings. Net interest income is the difference between the interest received by us on our assets and the interest paid on our borrowings. Most of our assets, like mortgage loans and mortgage-backed securities, are long-term assets with fixed interest rates. In contrast, most of our borrowings are short-term, thus putting us in a liability sensitive position in terms of our balance sheet interest rate exposure. When interest rates rise, we must pay more in interest on our borrowings while interest earned on our assets does not rise as quickly, which causes profits to decrease.

Increases in interest rates may reduce the value of mortgage loans and securities holdings

Increases in interest rates may reduce the value of our financial assets and have an adverse impact on our earnings and financial condition. We own a substantial portfolio of mortgage loans, mortgage-backed securities and other debt securities which have both fixed and adjustable interest rates. The fair value of an obligation with a fixed interest rate generally decreases when prevailing interest rates rise, which may have an adverse effect on our earnings and financial condition. In addition, we may suffer losses as we sell loans to reduce future interest rate exposure. The fair value of an obligation with an adjustable interest rate can be adversely affected when interest rates increase due to a lag in the implementation of repricing terms as well as due to interest rate caps, which may limit the amount of increase in the obligation's interest rate. Earnings can be further impacted negatively by a flattening in the slope of the yield curve, which tends to increase interest expense as short-term rates increase, while maintaining long-term rates, which may present favorable terms for our clients to exercise their prepayment options on their mortgage loans.

Declining interest rates could reduce interest income on cash and investments

We make loans and invest in debt generally issued by the federal and Puerto Rico governments. If interest rates decrease, the interest income derived from any new loans or investments which have fixed or variable rates will be less than interest income previously derived when rates were higher. Additionally, if interest rates decrease, our interest income will also decrease during the term of a loan or investment that bears interest at a variable rate. Furthermore, reduced interest rates will result in a decrease in income on our cash and short-term investments. Therefore, a decrease in interest rates may have an adverse effect on our business, results of operations and financial condition.

During periods of declining interest rates, prepayment of debt underlying asset-backed securities can be expected to accelerate. Accordingly, our ability to maintain the yield anticipated from investments in asset-backed securities will be affected by reductions in the principal amount of such securities resulting from such prepayments, and our ability to reinvest the returns of principal at comparable rates is subject to general prevailing interest rates at that time. Prepayments may also result in the realization of capital losses with respect to higher yielding securities that had been bought at a premium or the loss of opportunity to realize capital gains in the future from possible appreciation.

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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. The risk of nonpayment is affected by a number of factors, including:

the duration of the loan;

credit risks of a particular borrower;

changes in economic or industry conditions; and

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

We attempt to maintain an appropriate allowance for loan losses to provide for losses inherent in our loan portfolio. We periodically determine the amount of the allowance based on consideration of several factors. Default frequency, internal risk ratings, expected future cash collections, loss recovery rates and general economic factors, among others, are considered in this evaluation, 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 specific allowances for identified problem loans, allowance by formula and an unallocated allowance.

In the six-month period ended December 31, 2005, we recorded a provision for loan losses of \$1.9 million based on our overall evaluation of the risks of our loan portfolio. Although we believe that our allowance for loan losses is currently sufficient given 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 OCFI may require us to establish additional reserves. Additions to the allowance for loan losses would result in a decrease in our net earnings and capital and hinder our ability to pay dividends.

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

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

Our exposure to overall credit risk will increase as a consequence of the increase in our commercial lending activities

We have increased our emphasis on commercial lending, which is likely to increase our overall credit risk. Banks generally charge higher interest rates on commercial loans than on residential mortgage loans, because larger loan losses are expected in this business line. Generally, commercial loans are considered to be riskier than residential mortgage loans because they have larger balances to a single borrower or group of related borrowers. In addition, the borrower's ability to repay a commercial loan depends on the successful operation of the business or the property securing the loan. If we experience loan losses that are higher than our allowance for loan losses, our profits and

financial condition would be adversely affected.

We are at risk because most of our business is conducted in Puerto Rico

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, including a downturn in real estate values, and natural hazards that affect Puerto Rico. If Puerto Rico's economy experiences an overall decline as a result of these adverse developments or natural hazards, the rates of delinquencies, foreclosures,

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bankruptcies and losses on loan portfolios would probably increase substantially. This would cause our profitability to decrease.

Competition with other financial institutions could adversely affect our profitability

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

Changes in statutes and regulations could adversely affect us

We, as a Puerto Rico-chartered financial holding company, and our various subsidiaries, are each subject to federal and Puerto Rico governmental supervision and regulation. There are laws and regulations which restrict transactions between us and our various subsidiaries. Any change in such regulations, whether by applicable regulators or as a result of legislation subsequently enacted by the Congress of the United States or the Legislature of Puerto Rico, could have a substantial impact on our operations.

Banking regulations may restrict our ability to pay dividends

We may not be able to pay dividends in the future if we do not earn sufficient net income. Federal Reserve Board policy is that a bank holding company should pay dividends only out of its current net income. Federal and Puerto Rico banking regulations may also restrict the ability of Oriental Bank and Trust to make distributions to us. These distributions may be necessary for us to pay dividends on our common and preferred stock.

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.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

The Group leases its main offices located at 997 San Roberto Street, Oriental Center 10th Floor, Professional Offices Park, San Juan, Puerto Rico. The executive office, treasury, trust division, brokerage, investment banking, insurance services, and back-office support departments are maintained at such location.

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

At December 31, 2005, the aggregate future rental commitments under the terms of the leases, exclusive of taxes, insurance and maintenance expenses payable by the Group, was \$26.2 million.

On June 30, 2005, the Group sold the Las Cumbres building, a two-story structure located at 1990 Las Cumbres Avenue, San Juan, Puerto Rico, for the amount of \$3.4 million, to a local investor and his spouse. The local investor (the Buyer) is the brother of the Chairman of the Group s Board of Directors. The building was the principal property owned by the Group for banking operations and other services. The Bank s mortgage banking division and one of the principal branches and financial services office (brokerage and insurance) are located in that building.

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The book value of that property at June 30, 2005, was \$1.3 million. Also, on the same date, the Bank entered into a lease agreement with the new owner for a period of 10 years. In summary, the lease contract provides for an annual rent of \$324,000 or a monthly rent of \$27,000, for 13,200 square feet, including 42 parking spaces. During the lease term, the rental fee will increase by 6% every three years, except for the last year on which the increment will be 2%. This transaction was financed by a loan granted to the Buyer by the Group. The loan was for \$2.0 million (56% loan to value) at 6.50% fixed interest for a period of 10 years, collateralized by the Las Cumbres building and the assignment of the monthly rent. The transaction was accounted for in accordance to the provisions of SFAS 13, as amended by SFAS 98, Accounting for Leases: Sale-leaseback Transactions Involving Real Estate, and accordingly, the lease portion of the transaction was classified as an operating lease and the gain on the sale portion of the transaction was deferred and is being amortized to income over the lease term (10 years) in proportion to the related gross rental expense for the leaseback property each period.

On July 6, 2004, the Group announced plans for its new headquarters, Oriental Center, which will consolidate all corporate offices and support facilities into a building under construction at Professional Offices Park in San Juan, Puerto Rico. The Group is the anchor tenant by leasing 55,336 square feet of office space. The Group's executive offices, the main offices of OFSC, as well as several support facilities of the Group, had been located at two different buildings within the Professional Offices Park facilities, and at the Tres Rios Building located in Guaynabo, Puerto Rico. All these facilities are being relocated to the new building constructed at Professional Offices Park. Occupancy of the new building began in May 2006. The lease term is for 10 years and commenced on the date that the premises were ready for occupancy.

The Group's investment in premises and equipment, exclusive of leasehold improvements, at December 31, 2005, was \$9.5 million.

ITEM 3. *LEGAL PROCEEDINGS*

On August 14, 1998, as a result of a review of its accounts in connection with the admission by a former Group officer of having embezzled funds, and manipulated bank accounts and records, the Group became aware of certain irregularities. The Group notified the appropriate regulatory authorities and commenced an intensive investigation with the assistance of forensic accountants, fraud experts and legal counsel. The investigation determined losses of \$9.6 million, resulting from dishonest and fraudulent acts and omissions involving several former Group employees, which were submitted to the Group's fidelity insurance policy (the Policy) issued by Federal Insurance Company, Inc. (FIC). In the opinion of the Group's management, its legal counsel and experts, the losses determined by the investigation were covered by the Policy. However, FIC denied all claims for such losses. On August 11, 2000, the Group filed a lawsuit in the United States District Court for the District of Puerto Rico against FIC, a stock insurance corporation organized under the laws of the State of Indiana, for breach of insurance contract, breach of covenant of good faith and fair dealing and damages, seeking payment of the Group's \$9.6 million insurance claim loss and the payment of consequential damages of no less than \$13.0 million resulting from FIC capricious, arbitrary fraudulent and without cause denial of the Group's claim. The losses resulting from such dishonest and fraudulent acts and omissions were expensed in prior years. On October 3, 2005, a jury rendered a verdict of \$7.5 million in favor of the Group and against FIC, the defendant. The jury granted the Group \$453,219 for fraud and loss documentation in connection with its Accounts Receivable Returned Checks Account. However, the jury could not reach a decision on the Group's claim for \$3.4 million in connection with fraud in its Cash Accounts, thus forcing a new trial on this issue. The jury denied the Group's claim for \$5.6 million in connection with fraud in the Mortgage Loans Account, but the jury determined that FIC had acted in bad faith and with malice. It, therefore, awarded the Group \$7.1 million in consequential damages. The court decided not to enter a final judgment for the aforementioned awards until a new trial on the fraud in the Cash Accounts claim is held. After a final judgment is entered, the parties would be entitled to exhaust their post-judgment and appellate rights. The Group has not recognized any income on this claim since the appellate rights have not been exhausted and the amount to be collected has not been determined. The Group expects

to request and recover prejudgment interest, costs, fees and expenses related to its prosecution of this case. However, no specific sum can be anticipated as they are subject to the discretion of the court. To date, the court has not scheduled this new trial.

In addition, the Group and its subsidiaries are defendants in a number of legal proceedings incidental to their business. The Group is vigorously contesting such claims. Based upon a review by legal counsel and the

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development of these matters to date, management is of the opinion that the ultimate aggregate liability, if any, resulting from these claims will not have a material adverse effect on the Group's financial condition or results of operations.

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

Not applicable.

PART II

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

The Group's common stock is traded on the New York Stock Exchange (NYSE) under the symbol OFG . Information concerning the range of high and low sales prices for the Group's common stock for each quarter in the previous two fiscal years and six-month period ended December 31, 2005, as well as cash dividends declared for such fiscal years and six-month period are contained in Table 7 (Capital, Dividends and Stock Data) and under the Stockholders' Equity caption in the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A).

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

As of December 31, 2005, the Group had approximately 6,127 holders of record of its common stock, including all directors and officers of the Group, and beneficial owners whose shares are held in street name by securities broker-dealers or other nominees.

On November 20, 2003, the Group declared a ten percent (10%) stock dividend on common stock held by shareholders of record as of December 31, 2003. As a result, 1,798,722 shares of common stock were distributed on January 15, 2004, from the Group's treasury stock account. For purposes of the computation of income per common share, cash dividends and stock price, the stock dividend was retroactively recognized for all periods presented in the accompanying consolidated financial statements. Also, on November 30, 2004, the Group declared a ten percent (10%) stock dividend on common stock held by shareholders of record as of December 31, 2004. As a result, a total of 2,236,152 shares of common stock were distributed on January 17, 2005 (1,993,711 shares of common stock were issued and 242,441 were distributed from the Group's treasury stock account). For purposes of the computation of income per common share, cash dividends and stock price, the stock dividend was retroactively recognized for all periods presented in the accompanying consolidated financial statements.

On February 12, 2004, the Group filed a registration statement with the SEC for an offering of 2,565,000 shares of common stock. The registration statement was amended on February 27, 2004. The offering consisted of 1,700,000 shares offered by the Group, and an aggregate of 865,000 shares offered by three stockholders of the Group. The offering also included an additional 384,750 shares subject to over-allotment options granted by the Group and the selling stockholders to the underwriters. The registration statement, as amended, was declared effective by the SEC on March 3, 2004. On March 20, 2004, the underwriters exercised their options to purchase from the Group and the selling stockholders an aggregate of 384,750 shares of the Group's common stock to cover over-allotments (255,000 of these shares were purchased from the Group and 129,750 from the three selling stockholders of the Group). Following such exercise, the total offering was for 2,949,750 shares at a public offering price of \$28.00 per share, consisting of 1,955,000 shares offered by the Group and an aggregate of 994,750 shares by the three selling stockholders of the Group. Proceeds to the Group from the issuance of common stock were approximately \$51.6 million, net of \$3.2 million of issuance costs.

The Puerto Rico Internal Revenue Code of 1994, as amended, generally imposes a withholding tax on the amount of any dividends paid by Puerto Rico corporations to individuals, whether residents of Puerto Rico or not, trusts, estates, and special partnerships at a special 10% withholding tax rate. Prior to the first dividend distribution for the taxable year, such shareholders may elect to be taxed on the dividends at the regular rates, in which case the special 10% tax will not be withheld from such year's distributions. Dividends distributed by Puerto Rico corporations to

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foreign corporations or partnerships not engaged in trade or business in Puerto Rico are also generally subject to withholding tax at a 10% rate.

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

The Group has three stock options plans: the 1996, 1998 and 2000 Incentive Stock Option Plans, all of which were approved by the Group's stockholders. These plans offer key officers, directors and employees an opportunity to purchase shares of the Group's common stock. The Compensation Committee of the Board of Directors has sole authority and absolute discretion as to the number of stock options to be granted, their vesting rights, and the options exercise price.

The following table shows certain information pertaining to the plans as of December 31, 2005:

Plan Category	(a)	(b)	(c)
	Number of Securities to be Issued Upon Exercise of Outstanding Options		Weighted-Average Exercise Price of Outstanding Options
Equity compensation plans approved by shareholders:			
1996 Plan	536,369	\$ 19.74	
1998 Plan	327,882	10.42	136,656
2000 Plan	82,604	8.17	
Total	946,855	\$ 15.51	136,656

On December 16, 2004, the Financial Accounting Standards Board (FASB) published Statement 123(R) requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces FASB Statement No. 123,

Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. The Group was required to apply Statement 123(R) as of July 1, 2005. The implementation of this statement had no effect on the consolidated financial results of the Group as of July 1, 2005.

On June 30, 2005, the Compensation Committee of the Group's Board of Directors approved the acceleration of the vesting of all unvested options to purchase shares of common stock of OFG that were held by employees, officers and directors as of June 30, 2005. As a result, options to purchase 1,219,333 shares became exercisable. The purpose of the accelerated vesting is to enable the Group to avoid recognizing in its income statement compensation expense associated with these options in future periods, upon adoption of FASB Statement No. 123(R).

Subsequent to the adoption of SFAS 123R, the Group recorded approximately \$11,000 related to compensation expense for options issued during the six-month period ended December 31, 2005.

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

The following table sets forth issuer purchases of equity securities made by the Group during the three-month period ended December 31, 2005:

Month	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c)	(d)
			Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
October 2005	200,000	\$ 11.62	200,000	\$ 10,868,990
November 2005				
December 2005				
Total	200,000	\$ 11.62	200,000	\$ 10,868,990

On August 30, 2005, the Board of Directors of the Group approved a new stock repurchase program for the repurchase of up to \$12.1 million of the Group's outstanding shares of common stock, which replaced the former program. On June 20, 2006, the Board of Directors approved an increase of \$3.0 million to the initial amount, for the repurchase of up to \$15.1 million. During the three-month period ended December 31, 2005, the Group repurchased 200,000 of its shares of common stock in the open market, at a total cost of \$2.3 million, under such program.

For more information, please refer to Notes 1 and 14 to the accompanying consolidated financial statements.

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SELECTED FINANCIAL DATA
SIX-MONTH PERIODS ENDED DECEMBER 31, 2005 AND 2004 AND
FIVE-YEAR FISCAL PERIOD ENDED JUNE 30, 2005

	Six-Month Period Ended December 31,		Fiscal Year Ended June 30,				
	2005	2004	2005	2004	2003	2002	2001
	(As	(As	(As	(As	(As	(As	(As
	Restated)(2)	Restated)(2)	Restated)(2)	Restated)(2)	Restated)(2)	Restated)(2)	Restated)(2)
(In thousands, except per share data)							
EARNINGS:							
Interest income	\$ 105,086	\$ 92,864	\$ 189,312	\$ 164,385	\$ 151,746	\$ 141,695	\$ 120,344
Interest expense	70,706	46,149	102,899	77,174	77,335	82,695	91,281
Net interest income	34,380	46,715	86,413	87,211	74,411	59,000	29,063
Provision for loan losses	1,902	1,805	3,315	4,587	4,190	2,117	2,903
Net interest income after provision for loan losses	32,478	44,910	83,098	82,624	70,221	56,883	26,160
Non-interest income	16,382	22,347	34,885	46,034	39,039	31,250	20,383
Non-interest expenses	31,814	33,921	59,963	63,364	57,405	52,852	41,581
Income before taxes	17,046	33,336	58,020	65,294	51,855	35,281	4,962
Income tax benefit (expense)	(127)	(645)	1,649	(5,577)	(4,284)	(720)	1,318
Income before cumulative effect of change in accounting principle	16,919	32,691	59,669	59,717	47,571	34,561	6,280
Cumulative effect of change in accounting principle, net of tax							(164)
Net Income	16,919	32,691	59,669	59,717	47,571	34,561	6,116
Less: dividends on preferred stock	(2,401)	(2,401)	(4,802)	(4,198)	(2,387)	(2,387)	(2,387)
Income available to common shareholders	\$ 14,518	\$ 30,290	\$ 54,867	\$ 55,519	\$ 45,184	\$ 32,174	\$ 3,729

**PER SHARE AND
DIVIDENDS****DATA(1):**

Basic EPS before cumulative effect of change in accounting principle	\$	0.59	\$	1.24	\$	2.23	\$	2.48	\$	2.15	\$	1.55	\$	0.19
Basic EPS after cumulative effect of change in accounting principle	\$	0.59	\$	1.24	\$	2.23	\$	2.48	\$	2.15	\$	1.55	\$	0.18
Diluted EPS before cumulative effect of change in accounting principle	\$	0.58	\$	1.17	\$	2.14	\$	2.32	\$	1.99	\$	1.46	\$	0.18
Diluted EPS after cumulative effect of change in accounting principle	\$	0.58	\$	1.17	\$	2.14	\$	2.32	\$	1.99	\$	1.46	\$	0.17
Average common shares outstanding		24,777		24,407		24,571		22,394		21,049		20,738		20,867
Average potential common share-options		340		1,546		1,104		1,486		1,643		1,313		625
Average shares and shares equivalents		25,117		25,953		25,675		23,880		22,692		22,051		21,492
Book value per common share	\$	11.14	\$	10.17	\$	10.88	\$	8.82	\$	7.38	\$	6.59	\$	3.93
Market price at end of period	\$	12.36	\$	28.31	\$	15.26	\$	27.07	\$	25.69	\$	25.36	\$	19.00
Cash dividends declared per common share	\$	0.28	\$	0.27	\$	0.55	\$	0.51	\$	0.45	\$	0.38	\$	0.36
Cash dividends declared on common share	\$	6,913	\$	6,582	\$	13,522	\$	11,425	\$	9,415	\$	7,840	\$	7,533

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	December 31, 2005	2004 (As Restated)(2)	2005 (As Restated)(2)	2004 (As Restated)(2)	June 30, 2003 (As Restated)(2)	2002 (As Restated)(2)	2001 (As Restated)(2)
MOD END							
ANCES:							
Assets and loans							
Assets	\$ 3,476,767	\$ 3,300,029	\$ 3,231,580	\$ 2,846,750	\$ 2,232,330	\$ 1,757,435	\$ 1,459,9
Assets and leases							
Outstanding loans							
(For-sale), net	903,308	767,950	903,604	743,456	728,462	576,770	462,5
Assets sold but not							
Delivered	44,009	688	1,034	47,312	1,894	71,750	14,1
	\$ 4,424,084	\$ 4,068,667	\$ 4,136,218	\$ 3,637,518	\$ 2,962,686	\$ 2,405,955	\$ 1,936,6
Liabilities and							
Liabilities							
Liabilities	\$ 1,298,568	\$ 1,065,923	\$ 1,252,897	\$ 1,024,349	\$ 1,044,265	\$ 968,850	\$ 815,5
Lease agreements	2,427,880	2,342,207	2,197,926	1,897,429	1,401,256	998,025	916,9
Borrowings	404,921	387,166	399,476	387,166	181,083	259,283	165,0
Assets and loans							
Leased but not yet							
Delivered	43,354	87	22,772	89,068	152,219	56,195	
	\$ 4,174,723	\$ 3,795,383	\$ 3,873,071	\$ 3,398,012	\$ 2,778,823	\$ 2,282,353	\$ 1,897,4
Shareholders' equity							
Preferred equity	\$ 68,000	\$ 68,000	\$ 68,000	\$ 68,000	\$ 33,500	\$ 33,500	\$ 33,5
Common equity	273,791	250,094	270,755	213,646	157,716	124,762	74,3
	\$ 341,791	\$ 318,094	\$ 338,755	\$ 281,646	\$ 191,216	\$ 158,262	\$ 107,8
Financial ratios							
Return on average capital	10.13%	10.17%	10.59%	10.88%	7.83%	7.47%	6.
Return on risk-based capital	34.70%	38.91%	36.97%	36.77%	23.36%	20.94%	18.
Return on risk-based capital	35.22%	39.60%	37.51%	37.48%	23.88%	21.28%	19.
SELECTED							
FINANCIAL RATIOS							
OTHER							
INFORMATION:							
Return on average assets							
(A)	0.77%	1.65%	1.46%	1.79%	1.75%	1.55%	0.

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Return on average common equity (ROE)	11.54%	24.78%	21.34%	32.35%	28.93%	32.66%	4.00%
Equity-to-assets ratio	7.52%	7.64%	7.98%	7.56%	6.29%	6.37%	5.00%
Liquidity ratio	66.12%	53.24%	51.39%	52.92%	55.77%	61.31%	76.00%
Expense ratio	0.85%	0.89%	0.75%	0.97%	1.13%	1.24%	0.00%
Interest rate spread	1.33%	2.27%	2.00%	2.64%	2.91%	2.59%	1.00%
Number of financial instruments	24	23	24	23	23	21	
Assets managed	\$ 1,875,300	\$ 1,770,938	\$ 1,823,292	\$ 1,670,651	\$ 1,670,437	\$ 1,382,268	\$ 1,444,500
Off-balance sheet assets	1,132,286	1,237,960	1,135,115	1,051,812	962,919	1,118,181	1,002,200
Assets Managed	\$ 3,007,586	\$ 3,008,898	\$ 2,958,407	\$ 2,722,463	\$ 2,633,356	\$ 2,500,449	\$ 2,446,700

(1) Per share related information has been retroactively adjusted to reflect stock splits and stock dividends, when applicable.

(2) Refer to Note 2 to the Group's consolidated financial statements in Item 8 for information about the restatement.

The ratios shown below demonstrate the Group's ability to generate sufficient earnings to pay the fixed charges or expenses of its debt and preferred stock dividends. The Group's consolidated ratios of earnings to combined fixed charges and preferred stock dividends were computed by dividing earnings by combined fixed charges and

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preferred stock dividends, as specified below, using two different assumptions, one excluding interest on deposits and the second including interest on deposits:

Consolidated Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends:	Six-Month Period Ended December 31,		Fiscal Year Ended June 30,				
	2005	2004	2005	2004	2003	2002	2001
Excluding Interest on Deposits	1.27x	1.84x	1.66x	2.11x	2.00x	1.61x	1.05x
Including Interest on Deposits	1.20x	1.62x	1.48x	1.72x	1.60x	1.38x	1.03x

For purposes of computing the consolidated ratios of earnings to combined fixed charges and preferred stock dividends, earnings consist of pre-tax income from continuing operations plus fixed charges and amortization of capitalized interest, less interest capitalized. Fixed charges consist of interest expensed and capitalized, amortization of debt issuance costs, and the Group's estimate of the interest component of rental expense. The term "preferred stock dividends" is the amount of pre-tax earnings that is required to pay dividends on the Group's outstanding preferred stock. As of December 31, 2005 and 2004, and June 30, 2005 and 2004, the Group had noncumulative preferred stock issued and outstanding amounting to \$68.0 million as follows: (1) Series A amounting to \$33.5 million or 1,340,000 shares at a \$25 liquidation value; and (2) Series B amounting to \$34.5 million or 1,380,000 shares at a \$25 liquidation value. As of June 30, 2003, 2002, and 2001, the Group had noncumulative preferred stock, Series A, issued and outstanding amounting to \$33.5 million or 1,340,000 shares at a \$25 liquidation value.

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

OVERVIEW OF FINANCIAL PERFORMANCE

The following discussion of our financial condition and results of operations should be read in conjunction with Item 6, "Selected Financial Data," and our consolidated financial statements and related notes in Item 8. This discussion and analysis contains forward-looking statements. Please see "Forward Looking Statements" and "Risk Factors" for discussions of the uncertainties, risks and assumptions associated with these statements.

On August 30, 2005, the Group's Board of Directors amended Section 1 of Article IX of the Group's bylaws to change its fiscal year-end from June 30 to December 31. As a result of the change in fiscal year end, the following comparative periods are presented for purposes of discussion of results of operations:

Six-month period ended December 31, 2005 compared to six-month period ended December 31, 2004;

Fiscal year ended June 30, 2005 compared to fiscal year ended June 30, 2004; and

Fiscal year ended June 30, 2004 compared to fiscal year ended June 30, 2003.

All financial information presented in this discussion has been derived from the Group's audited consolidated financial statements for the six-month period ended December 31, 2005 and the years ended June 30, 2005, 2004, 2003, 2002 and 2001, as well as its unaudited consolidated financial statements for the six-month period ended December 31, 2004. In the opinion of management, all adjustments, if any, considered necessary for a fair presentation have been included and are of a normal, recurring nature.

The following management's discussion and analysis of financial condition and results of operations gives effect to the restatement, please see Note 2 – Restatement of Previously Issued Financial Statements – to the Group's consolidated financial statements in Item 8 for a summary of the significant effects of the restatement as of June 30, 2005 and 2004, for the six-month period ended December 31, 2004, and for the fiscal years ended June 30, 2005, 2004 and 2003.

Comparison of the six-month periods ended December 31, 2005 and December 31, 2004:

The Group's diversified mix of businesses and products generates both the interest income traditionally associated with a banking institution and non-interest income traditionally associated with a financial services institution (generated by such businesses as securities brokerage, fiduciary services, investment banking, insurance and

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pension administration). Although all of these businesses, to varying degrees, are affected by interest rate and financial markets fluctuations and other external factors, the Group's commitment is to continue producing a balanced and growing revenue stream.

During the six-month period ended December 31, 2005, the Group continued expanding its executive management team and strengthened its banking and financial service franchise. The Group continued with The Oriental Way program to deliver world-class products and services, targeting the personal and commercial needs of Puerto Rico's professionals and owners of small and mid-sized businesses. The results of these efforts reflected continued growth in commercial loans and tight control over non-interest expenses.

For the six-month period ended December 31, 2005, net income was \$14.5 million, a decrease of 52.1% compared with \$30.3 million reported in the same period of 2004. Earnings per diluted share decreased 50.4% to \$0.58, compared to \$1.17 per share reported for the same period of 2004. Net income for the quarter ended December 31, 2005, was \$7.3 million, a decrease of 49.2% compared with net income of \$14.4 million reported in the quarter ended December 31, 2004. Earnings per diluted share decreased 47.3% to \$0.29, compared to \$0.55 for the same quarter of 2004.

Return on common equity (ROE) and return on assets (ROA) for the six-month period ended December 31, 2005 were 11.54% and 0.77%, respectively, which represent a decrease of 53.4% in ROE, from 24.78% in the same period of 2004, and a decrease of 53.4% in ROA, from 1.65% in the same period of 2004.

Net interest income represented approximately 68% of the Group's total revenues (defined as net interest income plus non interest income) in the six-month period ended December 31, 2005. During such six-month period, net interest income was \$34.4 million, a decrease of 26.4% from the \$46.7 million recorded for the same period of 2004. For the quarter ended December 31, 2005, net interest income decreased 26.1% to \$17.1 million, compared with \$23.1 million recorded in the quarter ended December 31, 2004. Higher interest income on increased investment securities volume was offset by lower average yields on such investments and higher interest rates on borrowings. Interest rate spread for the six-month period ended December 31, 2005 was 1.33% compared to 2.27% in the same period of 2004. Investment yields declined as the Group continued to reposition the portfolio, shifting into shorter-term government securities and away from longer-term, mortgage-backed securities. At December 31, 2005, interest earning assets increased 8.7% to \$4.424 billion, compared to \$4.069 billion at December 31, 2004, reflecting a 5.4% increase in investments from \$3.300 billion to \$3.477 billion, which consisted mainly of AAA-rated mortgage-backed securities and U.S. government and agency obligations.

The provision for loan losses for the six-month period ended December 31, 2005 increased 5.4% to \$1.9 million from \$1.8 million for the same period of 2004, reflecting higher allowance requirements related to the increase of commercial and consumer loan business in that period. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for loan losses for the year ended December 31, 2005 was adequate in order to maintain the allowance for loan losses at an appropriate level.

Non-interest income represented approximately 32.3% of the Group's total revenues in the six-month period ended December 31, 2005. For such six-month period, non-interest income decreased 26.7% to \$16.4 million from \$22.3 million for the same period of 2004. Performance in such period of 2005 reflects decreases in revenues from financial services, investment banking activities, as well as mortgage banking and securities activities, partially offset by an increase in banking service revenues.

Total non-interest banking and financial services revenues decreased 19.4% to \$13.7 million in the six-month period ended December 31, 2005, compared to \$17.0 million for the same period of 2004. Banking service revenues increased 16.5% to \$4.5 million compared to \$3.9 million for the comparable period of 2004. Financial service

revenues (commissions and fees from securities brokerage, investment banking, insurance and fiduciary activities) decreased 1.4% to \$7.5 million compared to \$7.6 million for the same period of 2004.

For the six-month period ended December 31, 2005, mortgage-banking revenues were \$1.7 million, reflecting a decrease of 69.2% when compared with \$5.5 million for the same period of 2004. Such decrease in mortgage revenues resulted from reduced sales of whole-loans in the open market, which resulted in lower gains on such transactions.

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Non-interest expenses for the six-month period ended December 31, 2005 decreased 6.2% to \$31.8 million, compared to \$33.9 million for the same period of 2004, reflecting tight cost controls. The decrease was mainly due to reductions in compensation and employee benefits, as well as in advertising and business promotion and electronic banking charges. Professional and service fees increased 11.6% for such period of 2005, compared to the corresponding 2004 period, in part due to the impact of the compliance requirements of the Sarbanes-Oxley Act. The Group's efficiency ratio in the six-month period ended December 31, 2005 was 66.12%, compared to 53.24% for the same six-month period of 2004. The Group computes its efficiency ratio by dividing operating expenses by the sum of net interest income and recurring non-interest income, but excluding gains on sale of investment securities.

Total Group financial assets (including assets managed by the trust department, the retirement plan administration subsidiary, and securities broker-dealer subsidiary) increased 5.3% to \$7.554 billion as of December 31, 2005, compared to \$7.173 billion as of December 31, 2004. Assets managed by the Group's trust department, the retirement plan administration subsidiary, and the securities broker-dealer subsidiary decreased to \$3.008 billion from \$3.009 billion as of December 31, 2004. The Group's assets owned reached \$4.547 billion as of December 31, 2005, an increase of 9.2%, compared to \$4.164 billion as of December 31, 2004. Major contributors to this increase were the investment securities portfolio, which increased by 5.4% or \$176.7 million, along with the loan portfolio, which increased by \$135.4 million or 17.6%.

On the liability side, total deposits increased by 21.8%, from \$1.066 billion at December 31, 2004, to \$1.299 billion at December 31, 2005. This performance reflects the Group's strategy of attracting longer-term checking and savings deposits from consumer, professional and commercial customers, based on the Group's total capabilities to serve their needs. Total borrowings increased 3.8%, from \$2.729 billion at December 31, 2004, to \$2.833 billion at December 31, 2005. The increase in borrowings was concentrated in larger balances of repurchase agreements and federal funds purchased during 2005. The increase in borrowed funds was used primarily to fund the Group's investment and loan portfolio growth.

The Group continued strengthening its capital base during 2005. Stockholders' equity as of December 31, 2005 was \$341.8 million, an increase of 7.4% from \$318.1 million as of December 31, 2004. This increase reflects the impact of earnings retention.

Comparison of the fiscal years ended June 30, 2005 and 2004:

For fiscal 2005, net income was \$54.9 million, a decrease of 1.2% compared with \$55.5 million reported for fiscal 2004. Earnings per diluted share decreased 7.8% to \$2.14 for fiscal 2005, compared to \$2.32 per diluted share for the same fiscal period of 2004.

ROE and ROA for the fiscal year ended June 30, 2005 were 21.34% and 1.46%, respectively, which represent a decrease of 34.0% in ROE, from 32.35% in the same fiscal period of 2004, and a decrease of 18.4% in ROA, from 1.79% in the fiscal year ended June 30, 2004.

Net interest income represented approximately 71% of the Group's total revenues during the fiscal year ended June 30, 2005 and amounted to \$86.4 million, a decrease of 0.9% from the \$87.2 million recorded for the fiscal year ended June 30, 2004. Higher interest income on increased investment securities volume was offset by lower average yields on such investments and higher interest rates on borrowings. Interest rate spread for the fiscal year ended June 30, 2005 was 2.00% compared to 2.64% in the corresponding 2004 period, reflecting the margin reduction provoked by increases in market interest rates combined with the Group's liability sensitive position in its balance sheet. Investment yields declined as the Group continued to reposition the portfolio, shifting into shorter-term government securities and away from longer-term, mortgage-backed securities. As of June 30, 2005, interest earning assets increased 13.7% to \$4.136 billion compared to June 30, 2004, primarily driven by a 13.5% increase in investments to \$3.232 billion,

which consisted mainly of AAA-rated mortgage-backed securities and U.S. government and agency obligations.

The provision for loan losses for the fiscal year ended June 30, 2005 decreased 27.7% to \$3.3 million from \$4.6 million for the same period of 2004, reflecting lower allowance requirements related to the stabilization of commercial and consumer loan business in the fiscal year ended June 30, 2005. Based on an analysis of the credit

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quality and the composition of the Group's loan portfolio, management determined that the provision for the fiscal year ended June 30, 2005 was adequate in order to maintain the allowance for loan losses at an appropriate level, even though the loan portfolio increased from \$743.5 million as of June 30, 2004 to \$903.6 million as of June 30, 2005 (a 21.5% increase) and there was an increase in the net credit losses from \$2.1 million for the fiscal year ended June 30, 2004 to \$4.4 million for the fiscal year ended June 30, 2005 (an increase of 111.8%). The main reason for the decrease in the provision is that during the fiscal year ended June 30, 2004, management charged against earnings the provision for the possible losses on certain nonperforming loans which were in the process of evaluation. During the fiscal year ended June 30, 2005, these loans or portions thereof were charged-off against the allowance established in the previous fiscal year since such loans or the portions thereof were determined to be uncollectible. The increase in the loan portfolio is mainly related to new high quality and well collateralized loans which do not require large amounts of allowance for loan losses.

Non-interest income represented approximately 28.8% of the Group's total revenues in the fiscal year ended June 30, 2005. For such fiscal period, non-interest income decreased 24.2% to \$34.9 million from \$46.0 million from the fiscal year ended June 30, 2004. Performance in the fiscal year ended June 30, 2005 reflects increases in banking service revenues, totally offset by decreases in revenues from financial services, investment banking activities, and securities, derivatives and trading activities.

Total non-interest banking and financial services revenues decreased 8.0% to \$29.9 million in the fiscal year ended June 30, 2005, compared to \$32.5 million in the corresponding fiscal period of 2004. Banking service revenues increased 8.2% to \$7.8 million, compared to \$7.2 million in the fiscal year ended June 30, 2004. Financial service revenues (commissions and fees from securities brokerage, investment banking, insurance and fiduciary activities) decreased 18.4% to \$14.4 million compared to \$17.6 million in the fiscal year ended June 30, 2004.

For the fiscal year ended June 30, 2005, mortgage-banking revenues were \$7.8 million, reflecting an increase of 0.7% when compared with \$7.7 million for the previous fiscal year. Such increase in mortgage revenues resulted from higher gains on the sale of whole-loans in the open market.

Non-interest expenses for the fiscal year ended June 30, 2005 decreased 5.4% to \$60.0 million, compared to \$63.4 million in the previous fiscal year. The reduction was mainly due to lower compensation and employee benefits for the fiscal year ended June 30, 2005 in the amount of \$4.9 million, compared to the fiscal year ended June 30, 2004. This \$4.9 million decrease was mainly due to a decrease in fair value of the Group's common stock from one period to the other which resulted in a credit to compensation expense of \$3.1 million as a result of the application of the variable accounting to outstanding options granted to certain employees. With respect to the other categories of non-interest expenses, the Group reflected increases in professional and service fees, in part due to the impact of the compliance requirements of the Sarbanes-Oxley Act, and in electronic banking charges. The Group's efficiency ratio in the fiscal year ended June 30, 2005 was 51.39%, compared to 52.92% a year earlier. The Group computes its efficiency ratio by dividing operating expenses by the sum of net interest income and recurring non-interest income, but excluding gains on sale of investment securities.

Total Group financial assets (including assets managed by the trust department, the retirement plan administration subsidiary, and the securities broker-dealer subsidiary) increased 11.7% to \$7.205 billion as of June 30, 2005, compared to \$6.448 billion as of June 30, 2004. Assets managed by the Group's trust department, the retirement plan administration subsidiary, and the securities broker-dealer subsidiary increased 8.7%, year-over-year, to \$2.958 billion from \$2.722 billion as of June 30, 2004. This increase was primarily due to the equity market recovery impact on assets gathered by the Group's securities broker-dealer subsidiary as well as the development of new business and trust relationships throughout the year. The Group's bank assets reached \$4.247 billion as of June 30, 2005, an increase of 14.0%, compared to \$3.726 billion as of June 30, 2004. Major contributors to this increase were the investment securities portfolio, which increased by 13.5% or \$384.8 million, along with the loan portfolio, which increased by

\$160.1 million or 21.5%.

On the liability side, total deposits increased by 22.3% from \$1.024 billion at June 30, 2004, to \$1.253 billion at June 30, 2005. This performance reflects the Group's strategy of attracting longer-term checking and savings deposits from consumer, professional and commercial customers, based on the Group's total capabilities to serve their needs. Total borrowings increased 13.7% from \$2.285 billion at June 30, 2004, to \$2.597 billion at June 30, 2005. The increase in borrowings was concentrated in larger balances of repurchase agreements and federal funds

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purchased during the fiscal year ended June 30, 2005. The increase in borrowed funds was used primarily to fund the Group's investment and loan portfolio growth.

The Group strengthened its capital base during the fiscal year ended June 30, 2005. Stockholders' equity as of June 30, 2005 was \$338.8 million, an increase of 20.3% from \$281.6 million as of June 30, 2004. This increase reflects the impact of earnings retention.

Comparison of the fiscal years ended June 30, 2004 and 2003:

For the fiscal year ended June 30, 2004, net income was \$55.5 million, an increase of 22.9% compared with \$45.2 million reported in the comparable fiscal period of 2003. Earnings per diluted share increased 16.6% to \$2.32, compared to \$1.99 per diluted share for the fiscal year ended June 30, 2003.

Earnings per share for the fiscal year ended June 30, 2004 were affected by more average shares outstanding, as a result of the Group's March 2004 secondary offering of 1,955,000 common shares, which raised \$51.6 million (net of expenses), and dividends paid on the Series B Preferred Stock issued in September 2003, which raised \$33.1 million (net of expenses). Excluding the effect of the new common shares and the Series B Preferred Stock dividend, earnings per share would have been higher by an additional \$0.14 for the year ended June 30, 2004.

ROE and ROA for the fiscal year ended June 30, 2004 were 32.35% and 1.79%, respectively, which represent an increase of 11.8% in ROE, from 28.93% in the fiscal year ended June 30, 2003, and an increase of 2.3% in ROA, from 1.75% in fiscal 2003.

Net interest income represented approximately 65% of the Group's total revenues (defined as net interest income plus non interest income) in the fiscal year ended June 30, 2004. For such period, net interest income was \$87.2 million, an increase of 17.2% from the \$74.4 million recorded for the corresponding fiscal period of 2003. Results benefited from a larger volume of interest earning assets (investment and loans) partially offset by lower average yields. Interest rate spread equaled 2.64% for the fiscal year ended June 30, 2004. At June 30, 2004, interest earning assets increased 22.8% to \$3.638 billion compared to June 30, 2003, reflecting a 27.5% increase in investments to \$2.847 billion, which consisted mainly of AAA-rated mortgage-backed securities and Puerto Rico government agency obligations.

The provision for loan losses for the fiscal year ended June 30, 2004 increased 9.5% to \$4.6 million from \$4.2 million for the corresponding fiscal period of 2003 reflecting higher allowance requirements related to the expanded commercial and consumer loan business in the fiscal year ended June 30, 2004.

Non-interest income represented approximately 34.5% of the Group's total revenues in the fiscal year ended June 30, 2004. For such period, non-interest income grew by 17.9% to \$46.0 million from \$39.0 million a year earlier. Key factors for such increase included the success of the Group's product and service marketing programs, the result of general improvement in equity markets, increased underwriting activities, higher revenues from fiduciary service fees, and income generated by CPC which was acquired in January 2003.

Total non-interest banking and financial services revenues increased 14.2% to \$32.5 million in the fiscal year ended June 30, 2004 compared to \$28.5 million in the corresponding fiscal period of 2003. Banking service revenues increased 20.1% to \$7.2 million compared to \$6.0 million in the fiscal year ended June 30, 2003. Financial service revenues (commissions and fees from broker, insurance and fiduciary activities) increased 21.7% to \$17.6 million compared to \$14.5 million in the fiscal year ended June 30, 2003.

For the fiscal year ended June 30, 2004, mortgage-banking activity revenue was \$7.7 million reflecting a decrease of 3.8% when compared with \$8.0 million for the previous fiscal year. Such decrease in mortgage production was

primarily due to the Group's decision to temporarily moderate loan activity based on fourth quarter market conditions, which also resulted in lower mortgage banking revenue.

Non-interest expenses for the fiscal year ended June 30, 2004 increased 10.4% to \$63.4 million, compared to \$57.4 million in the previous fiscal year. The increase was mainly due to higher compensation and employee benefits for the fiscal year ended June 30, 2004 in the amount of \$4.2 million, compared to the fiscal year ended June 30, 2003. This \$4.2 million increase was mainly due to increases in fair value of the Group's common stock from one period to the other which resulted in additional compensation expense of \$3.9 million as a result of the

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application of the variable accounting to outstanding options granted to certain employees. However, the Group's efficiency ratio in the fiscal year ended June 30, 2004 improved to 52.92%, compared to 55.77% a year earlier.

Total Group financial assets (including assets managed by the trust department, the retirement plan administration subsidiary, and securities broker-dealer subsidiary) increased 13.6% to \$6.448 billion as of June 30, 2004, compared to \$5.674 billion as of June 30, 2003. Assets managed by the Group's trust department, the retirement plan administration subsidiary, and the securities broker-dealer subsidiary increased 3.4%, year-over-year, to \$2.722 billion from \$2.633 billion as of June 30, 2003. This increase was primarily due to the equity market recovery impact on assets gathered by the Group's securities broker-dealer subsidiary. The Group's bank assets reached \$3.726 billion as of June 30, 2004, an increase of 22.5%, compared to \$3.041 billion as of June 30, 2003. Major contributors to this increase were the investment securities portfolio, which increased by 27.5% or \$614.4 million, along with the loan portfolio, which increased by \$15.0 million or 2.1%.

On the liability side, total deposits decreased by 1.9% from \$1.044 billion at June 30, 2003, to \$1.024 billion at June 30, 2004. The decrease in deposits primarily reflects the Group's decision to cut back on certificates of deposit in favor of other lower-cost funding sources. Total borrowings increased 44.4% from \$1.582 billion at June 30, 2003, to \$2.285 billion at June 30, 2004. The increase in borrowings was concentrated in larger balances of repurchase agreements, FHLB-NY advances and subordinated capital notes. The increase in borrowed funds was used primarily to fund the Group's investment and loan portfolio growth.

The Group continued strengthening its capital base during fiscal 2004. Stockholders' equity as of June 30, 2004 was \$281.6 million, an increase of 47.3% from \$191.2 million as of June 30, 2003. This increase reflects the improvement in net income, net proceeds of \$33.1 million from the issuance of the Series B Preferred Stock in the first quarter of fiscal 2004 and \$51.6 million, net of related expenses, from the issuance of 1,955,000 shares of common stock in the third quarter of fiscal 2004, partially offset by the increase in the accumulated other comprehensive loss of \$45.1 million, mostly associated with an increase in unrealized losses on the securities available-for-sale portfolio from fiscal 2003 to fiscal 2004.

Table of Contents**TABLE 1A ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE:***For the Six-Month Periods Ended December 31, 2005 and 2004*

	Interest Six-Month Period		Average Rate Six-Month Period Ended		Average Balance Six-Month Period	
	Ended December 31, 2005	2004	December 31, 2005	2004	Ended December 31, 2005	2004
(Dollars in thousands)						
A TAX EQUIVALENT SPREAD						
Interest-earning assets	\$ 105,086	\$ 92,864	4.91%	4.89%	\$ 4,276,515	\$ 3,795,805
Tax equivalent adjustment	23,912	21,167	1.12%	1.12%		
Interest-earning assets tax equivalent	128,998	114,031	6.03%	6.01%	4,276,515	3,795,805
Interest-bearing liabilities	70,706	46,149	3.58%	2.62%	3,953,452	3,526,701
Tax equivalent net interest income/spread	\$ 58,292	\$ 67,882	2.45%	3.39%	\$ 323,063	\$ 269,104
Tax equivalent interest rate margin			2.72%	3.58%		
B NORMAL SPREAD						
Interest-earning assets:						
Investments:						
Investment securities	\$ 73,540	\$ 67,039	4.46%	4.53%	\$ 3,300,864	\$ 2,962,126
Investment management fees	(824)	(958)	(0.05)%	(0.06)%		
Total investment securities	72,716	66,081	4.41%	4.47%	3,300,864	2,962,126
Trading securities	4	2	3.31%	0.41%	242	975
Money market investments	1,465	171	5.17%	1.65%	56,691	20,788
	74,185	66,254	4.42%	4.44%	3,357,797	2,983,889
Loans(1):						
Mortgage(2)	24,617	22,558	6.50%	6.50%	757,207	694,529
Commercial	4,602	3,002	7.11%	6.24%	129,506	96,264
Consumer	1,682	1,050	10.51%	9.94%	32,005	21,123
	30,901	26,610	6.73%	6.55%	918,718	811,916
	105,086	92,864	4.91%	4.89%	4,276,515	3,795,805
Interest-bearing liabilities:						

Deposits:

Non-interest bearing deposits					60,334	50,728
Now accounts	445	438	1.05%	1.06%	84,809	82,931
Savings	440	472	1.02%	1.02%	86,135	92,623
Certificates of deposits	19,396	12,513	3.70%	3.16%	1,049,495	793,112
	20,281	13,423	3.17%	2.63%	1,280,773	1,019,394

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	Interest Six-Month Period		Average Rate Six-Month Period		Average Balance Six-Month Period	
	Ended December 31, 2005	2004	December 31, 2005	2004	Ended December 31, 2005	2004
	(Dollars in thousands)					
Borrowings:						
Repurchase agreements	43,807	18,856	3.86%	1.79%	2,270,145	2,109,690
Interest rate risk management	(1,255)	7,388	(0.11)%	0.70%		
Financing fees	357	311	0.03%	0.03%		
Total repurchase agreements	42,909	26,555	3.78%	2.52%	2,270,145	2,109,690
FHLB advances	4,595	4,002	3.01%	2.58%	305,430	310,451
Subordinated capital notes	2,470	2,046	6.85%	5.67%	72,166	72,166
Term notes	261	123	3.48%	1.64%	15,000	15,000
Other borrowings	190		3.82%		9,938	
	50,425	32,726	3.77%	2.61%	2,672,679	2,507,307
	70,706	46,149	3.58%	2.62%	3,953,452	3,526,701
Net interest income/spread	\$ 34,380	\$ 46,715	1.33%	2.27%		
Interest rate margin			1.61%	2.46%		
Excess of interest-earning assets over interest-bearing liabilities					\$ 323,063	\$ 269,104
Interest-earning assets over interest-bearing liabilities ratio					108.17%	107.63%

	December 31, 2005 versus December 31, 2004		
	Volume	Rate	Total
C. CHANGES IN NET INTEREST INCOME DUE TO(3):			
Interest Income:			
Loans(1)	\$ 3,615	\$ 676	\$ 4,291
Investments	8,262	(331)	7,931
	11,877	345	12,222

Interest Expense:

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Deposits	6,762	96	6,858
Repurchase agreements	1,838	14,515	16,353
Other borrowings	75	1,271	1,346
	8,675	15,882	24,557
Net Interest Income	\$ 3,202	\$ (15,537)	\$ (12,335)

- (1) Loan fees amounted to \$880 and \$1,352 for the six-month periods ended December 31, 2005 and 2004, respectively.
- (2) Real estate loans averages include loans held-for-sale.
- (3) The changes that are not due solely to volume or rate are allocated on the proportion of the change in each category.

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	June 30, 2005	Interest June 30, 2004	June 30, 2003	June 30, 2005	Average Rate June 30, 2004 (Dollars in thousands)	June 30, 2003	June 30, 2005	Average Balance June 30, 2004	
EQUIVALENT									
ing assets	\$ 189,312	\$ 164,385	\$ 151,746	4.81%	5.19%	6.09%	\$ 3,932,822	\$ 3,168,832	\$
t adjustment	42,411	35,223	52,895	1.08%	1.11%	2.12%			
ing assets tax	231,723	199,608	204,641	5.89%	6.30%	8.21%	3,932,822	3,168,832	
g liabilities	102,899	77,174	77,335	2.81%	2.55%	3.18%	3,659,858	3,026,876	
nt net interest d	\$ 128,824	\$ 122,434	\$ 127,306	3.08%	3.75%	5.03%	\$ 272,964	\$ 141,956	\$
nt interest rate				3.27%	3.86%	5.11%			
L SPREAD									
ing assets:									
curities	\$ 135,710	\$ 113,732	\$ 100,905	4.41%	4.70%	5.61%	\$ 3,074,679	\$ 2,419,264	\$
management fees	(1,898)	(1,685)	(1,443)	(0.06)%	(0.07)%	(0.08)%			
ent securities	133,812	112,047	99,462	4.35%	4.63%	5.53%	3,074,679	2,419,264	
ties	8	44	502	1.21%	3.26%	4.86%	662	1,350	
e investments	526	164	296	2.00%	1.53%	1.93%	26,242	10,714	
	134,346	112,255	100,260	4.33%	4.62%	5.49%	3,101,583	2,431,328	
	45,943	46,467	45,848	6.57%	7.01%	7.54%	699,027	662,590	
	6,674	3,336	2,958	6.14%	5.85%	7.31%	108,636	57,047	
	2,349	2,327	2,680	9.96%	13.02%	13.69%	23,576	17,867	
	54,966	52,130	51,486	6.61%	7.07%	7.70%	831,239	737,504	
	189,312	164,385	151,746	4.81%	5.19%	6.09%	3,932,822	3,168,832	
ing liabilities:									
earing deposits							54,986	51,906	
	900	818	1,054	1.05%	1.08%	1.69%	85,756	75,495	

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	941	1,079	1,319	1.01%	1.22%	1.55%	93,218	88,568
deposits	27,903	28,115	31,284	3.27%	3.38%	3.83%	854,337	831,167
	29,744	30,012	33,657	2.73%	2.87%	3.30%	1,088,297	1,047,136
agreements	49,746	17,805	17,362	2.29%	1.12%	1.50%	2,174,312	1,595,717
risk management	10,131	17,744	16,141	0.47%	1.11%	1.39%		
s	647	469	331	0.03%	0.03%	0.03%		
use agreements	60,524	36,018	33,834	2.78%	2.26%	2.92%	2,174,312	1,595,717
es	7,962	8,011	7,709	2.58%	2.63%	3.83%	308,930	304,547
capital notes	4,318	2,986	1,926	5.98%	4.63%	5.34%	72,166	64,476
	317	147	209	2.11%	0.98%	1.39%	15,000	15,000
ings	34			2.95%			1,153	
	73,155	47,162	43,678	2.84%	2.38%	3.10%	2,571,561	1,979,740
	102,899	77,174	77,335	2.81%	2.55%	3.18%	3,659,858	3,026,876
income/spread	\$ 86,413	\$ 87,211	\$ 74,411	2.00%	2.64%	2.91%		
margin				2.19%	2.75%	2.99%		
rest-earning								
interest-bearing							\$ 272,964	\$ 141,956
								\$
ing assets over								
ng liabilities							107.46%	104.69%

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	Fiscal 2005 versus 2004			Fiscal 2004 versus 2003		
	Volume	Rate	Total	Volume	Rate	Total
C. CHANGES IN NET INTEREST INCOME DUE TO(3):						
Interest Income:						
Loans(1)	\$ 6,342	\$ (3,506)	\$ 2,836	\$ 5,089	\$ (4,445)	\$ 644
Investments	29,383	(7,292)	22,091	29,710	(17,715)	11,995
	35,725	(10,798)	24,927	34,799	(22,160)	12,639
Interest Expense:						
Deposits	1,154	(1,422)	(268)	883	(4,528)	(3,645)
Repurchase agreements	21,598	2,908	24,506	14,581	(12,397)	2,184
Other borrowings	363	1,124	1,487	4,250	(2,950)	1,300
	23,115	2,610	25,725	19,714	(19,875)	(161)
Net Interest Income	\$ 12,610	\$ (13,408)	\$ (798)	\$ 15,085	\$ (2,285)	\$ 12,800

- (1) Loan fees amounted to \$880, \$1,352, \$2,430, \$2,923 and \$2,333 for the six months period ended December 31, 2005 and 2004 and in fiscal 2005, 2004 and 2003, respectively.
- (2) Real estate loans averages include loans held-for-sale.
- (3) The changes that are not due solely to volume or rate are allocated on the proportion of the change in each category.

Net Interest Income**Comparison of the six-month periods ended December 31, 2005 and 2004:**

Net interest income is affected by the difference between rates earned on the Group's interest-earning assets and rates paid on its interest-bearing liabilities (interest rate spread) and the relative amounts of its interest-earning assets and interest-bearing liabilities (interest rate margin). As further discussed in the Risk Management section of this report, the Group monitors the composition and repricing of its assets and liabilities to maintain its net interest income at adequate levels. Table 1A shows the major categories of interest-earning assets and interest-bearing liabilities, their respective interest income, expenses, yields and costs, and their impact on net interest income due to changes in volume and rates for the six-month periods ended December 31, 2005 and 2004.

Net interest income decreased 26.4% to \$34.4 million in the six-month period ended December 31, 2005, from \$46.7 million in the same six-month period of 2004. This decrease was due to a positive volume variance of \$3.2 million, offset by a negative rate variance of \$15.5 million, as average interest earning assets increased 12.7% to \$4.277 billion as of December 31, 2005, from \$3.796 billion as of December 31, 2004, while the interest rate margin declined 85 basis points to 1.61% for the same period of 2005, from 2.46% for the same period of 2004. The interest

rate spread declined 94 basis points to 1.33% for the six-month period ended December 31, 2005, from 2.27% for the same period of 2004, due to a 2 basis point increase in the average yield of interest earning assets to 4.91% from 4.89%, in addition to a 96 basis point increase in the average cost of funds to 3.58% from 2.62%. The increase in the average yield of interest earning assets was primarily due to the purchase of securities with lower rates, reflecting market conditions, prepayments of higher rate mortgage loans and mortgage-backed securities, and the repricing of adjustable and floating interest rate commercial loans. The increase in the average cost of funds was primarily due to higher rates paid on repurchase agreements and other borrowings due to the impact of the increases in short-term borrowing rates.

Interest income increased 13.2% to \$105.1 million for the six-month period ended December 31, 2005, as compared to \$92.9 million for the same six-month period of 2004, reflecting a 12.7% increase in the average balance of interest earning assets, which grew to \$4.277 billion in the 2005 six-month period ended December 31, 2005, from \$3.796 billion for the same period of 2004, with an increase in yield to 4.91% from 4.89%. Interest income is

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generated by investment securities, which accounted for 70.6% of total interest income, and from loans, which accounted for 29.4% of total interest income. Interest income from investments increased 12.0% to \$74.2 million, due to a 12.5% increase in the average balance of investments, which grew to \$3.358 billion, partially offset by a 2 basis point decline in yield from 4.44% to 4.42%. The increase in investments reflects a 21.5% increase in U.S. government and agency obligations, which grew to \$1.251 billion as of December 31, 2005, from \$819.0 million as of December 31, 2004. Interest income from loans increased 16.1% to \$30.9 million, mainly due to a 13.2% increase in the average balance of loans, which grew to \$918.7 million, in addition to an 18 basis point increase in yield from 6.55% to 6.73%. Total loans remained approximately at the same level comparing December 31, 2005 to June 30, 2005 at \$903 million. Over 90% of the commercial loans are secured by mortgages.

Interest expense increased 53.2%, to \$70.7 million for the six-month period ended December 31, 2005, from \$46.1 million for the same period of 2004, due to a 96 basis point increase in the average cost of retail and wholesale funds, to 3.58% for the 2005 six-month period, from 2.62% for the same period of 2004. The increase is also due to the expansion of the average interest-bearing liabilities to \$3.953 billion, from \$3.527 billion, in order to fund the growth of the Group's investment and loan portfolios. The average cost of retail deposits increased 54 basis points, to 3.17% for the six-month period ended December 31, 2005, from 2.63% for the same period of 2004, and the average cost of wholesale funding sources increased 116 basis points, to 3.77%, from 2.61%, substantially reflected in repurchase agreements, which increased 126 basis points, to 3.78% and subordinated capital notes which increased 118 basis points.

Comparison of the fiscal years ended June 30, 2005 and 2004:

Net interest income decreased 0.9%, to \$86.4 million in the fiscal year ended June 30, 2005, from \$87.2 million in the corresponding fiscal period of 2004. This decrease was due to a positive volume variance of \$12.6 million, offset by a negative rate variance of \$13.4 million, as average interest earning assets increased 24.1%, to \$3.933 billion as of June 30, 2005, from \$3.169 billion as of June 30, 2004, while the interest rate margin declined 56 basis points, to 2.19% for the fiscal year ended June 30, 2005, from 2.75% for fiscal period of 2004. The interest rate spread declined 64 basis points, to 2.00% in the fiscal year ended June 30, 2005, from 2.64% in the prior fiscal period of 2004, due to a 38 basis point decline in the average yield of interest earning assets to 4.81%, from 5.19%, in addition to a 26 basis point increase in the average cost of funds to 2.81%, from 2.55%. The decline in the average yield of interest earning assets was primarily due to the purchase of securities with lower rates, reflecting market conditions, prepayments of higher rate mortgage loans, and the repricing of adjustable and floating interest rate commercial loans. The increase in the average cost of funds was primarily due to higher rates paid on repurchase agreements and other borrowings due to the impact of the increases in short-term borrowing rates.

Interest income increased 15.2%, to \$189.3 million for the fiscal year ended June 30, 2005, as compared to \$164.4 million for fiscal 2004, reflecting a 24.1% increase in the average balance of interest earning assets, to \$3.933 billion in the fiscal year ended June 30, 2005, from \$3.169 billion in the fiscal period of 2004, partially offset by the decline in yield to 4.81%, from 5.19%. Interest income is generated by investment securities, which accounted for 70.9% of total interest income, and from loans, which accounted for 29.1% of total interest income. Interest income from investments increased 19.7%, to \$134.3 million, due to a 27.6% increase in the average balance of investments, to \$3.102 billion, partially offset by a 29 basis points decline in yield, to 4.33%, from 4.62%. The increase in investments reflects a 397.6% increase in U.S. government and agency obligations, to \$1.030 billion as of June 30, 2005, from \$207.0 million as of June 30, 2004, partially offset by a 20.6% decrease in mortgage-backed securities, to \$1.960 billion as of June 30, 2005, from \$2.467 billion as of June 30, 2004. Interest income from loans increased 5.4%, to \$55.0 million, due to a 12.7% increase in the average balance of loans, to \$831.2 million, partially offset by a 46 basis points decline in yield, to 6.61%, from 7.07%. The increase in loans reflects a 1.1% decrease in residential, non residential and home equity mortgage loans, to \$643.4 million in the fiscal period of 2005, from \$650.8 million in the same fiscal period of 2004, and a 189.8% increase in commercial loans, reflecting the continued

expansion of that business, to \$236.4 million in the fiscal year ended June 30, 2005, from \$81.6 million in the fiscal period of 2004. Also, the increase is due to the purchase of real estate mortgage loans classified as commercial loans with an outstanding balance of \$106.7 million as of June 30, 2005. Over 90% of the commercial loans are secured by commercial real estate properties.

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Interest expense increased 33.3%, to \$102.9 million in the fiscal year ended June 30, 2005, from \$77.2 million in the same fiscal period of 2004, due to a 26 basis point increase in the average cost of retail and wholesale funds, to 2.81% in the fiscal year ended June 30, 2005, from 2.55% in the fiscal year ended June 30, 2004. The increase is also due to the expansion of the average interest-bearing liabilities to \$3.660 billion, from \$3.027 billion, in order to fund the growth of the Group's investment and loan portfolios. The average cost of retail deposits declined 14 basis points, to 2.73% in the fiscal period of 2005, from 2.87% in the same fiscal period of 2004, and the average cost of wholesale funding sources increased 46 basis points, to 2.84%, from 2.38%, substantially reflected in repurchase agreements, which increased 52 basis points, to 2.78% and subordinated capital notes which increased 135 basis points.

Comparison of the fiscal years ended June 30, 2004 and 2003:

Net interest income increased 17.2%, to \$87.2 million in the fiscal year ended June 30, 2004, from \$74.4 million in the corresponding fiscal period of 2003. This increase was due to a positive volume variance of \$15.1 million, partially offset by a negative rate variance of \$2.3 million, as average interest earning assets increased 27.1%, to \$3.169 billion as of June 30, 2004, from \$2.493 billion as of June 30, 2003, while the interest rate margin declined 24 basis points, to 2.75% in the fiscal period of 2004, from 2.99% in the same fiscal period of 2003. The interest rate spread declined 27 basis points, to 2.64% in the fiscal year ended June 30, 2004, from 2.91% in the fiscal year ended June 30, 2003, due to a 90 basis point decline in the average yield of interest earning assets to 5.19%, from 6.09%, partially offset by a 63 basis point decline in the average cost of funds to 2.55%, from 3.18%. The decline in the average yield of interest earning assets was primarily due to the purchase of securities with lower rates, reflecting market conditions, prepayments of higher rate mortgage loans, and the re-pricing of adjustable and floating rate commercial loans. The decline in the average cost of funds was primarily due to reductions in rates paid on retail deposits, reflecting the prevailing lower interest rate scenario during such period, and to management's decision to reduce the use of higher-cost, retail certificates of deposit in favor of lower-cost, wholesale funding sources.

Interest income increased 8.3%, to \$164.4 million in the fiscal year ended June 30, 2004, as compared to \$151.7 million in the corresponding fiscal period of 2003, reflecting a 27.1% increase in the average balance of interest earnings assets, to \$3.169 billion in the fiscal period of 2004, from \$2.493 billion in the same fiscal period of 2003, partially offset by the decline in yield to 5.19%, from 6.09%. Interest income is generated by investment securities, which accounted for 68.3%, and from loans, which accounted for 31.7%. Interest income from investments increased 12.0%, to \$112.3 million, due to a 33.2% increase in the average balance of investments, to \$2.431 billion, partially offset by an 87 basis points decline in yield, to 4.62%, from 5.49%. The increase in investments reflects a 17.9% increase in mortgage-backed securities, to \$2.467 billion as of June 30, 2004, from \$2.093 billion as of June 30, 2003, and a 209.8% increase in P.R. and U.S. government and agency obligations, to \$322.3 million as of June 30, 2004, from \$104.0 million as of June 30, 2003. Interest income from loans increased 1.3%, to \$52.1 million, due to a 10.4% increase in the average balance of loans, to \$737.5 million, partially offset by a 63 basis points decline in yield, to 7.07%, from 7.70%. The increase in loans reflects an 2.8% decrease in mortgage loans, to \$650.8 million in fiscal 2004, from \$670.1 million in fiscal 2003, and a 87.2% increase in commercial loans, reflecting the initial expansion of that business, to \$81.6 million in the fiscal year ended June 30, 2004, from \$43.6 million in the same fiscal period of 2003. Over 90% of the commercial loans are secured by commercial real estate properties.

Interest expense declined 0.21%, to \$77.2 million in the fiscal year ended June 30, 2004, from \$77.3 million in the corresponding fiscal period of 2003, due to a 63 basis point reduction in the average cost of retail and wholesale funds, to 2.55% for the fiscal period of 2004, from 3.18% for the same fiscal period of 2003. This decline more than offset the cost of expanding interest-bearing liabilities, to \$3.027 billion, from \$2.430 billion, in order to fund the growth of the Group's investment and loan portfolios. The average cost of retail deposits declined 43 basis points, to 2.87% in the fiscal year ended June 30, 2004, from 3.30% in the fiscal year ended June 30, 2003, and the average cost of wholesale funding sources declined 72 basis points, to 2.38%, from 3.10%, with the largest average cost reductions occurring in Federal Home Loan Bank of New York advances, which dropped 120 basis points, to 2.63%, and in

repurchase agreements, which dropped 66 basis points, to 2.26%.

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TABLE 2 NON-INTEREST INCOME SUMMARY
FOR THE SIX-MONTH PERIODS ENDED DECEMBER 31, 2005 AND 2004, AND THE FISCAL YEARS
ENDED JUNE 30, 2005, 2004 AND 2003

	Six-Month Period Ended December 31,			Fiscal Year Ended June 30,		
	2005	2004	Variance %	2005	2004	2003
	(Dollars in thousands)					
Mortgage banking activities	\$ 1,702	\$ 5,532	(69.2)%	\$ 7,774	\$ 7,719	\$ 8,026
Financial services revenues	7,506	7,612	(1.4)%	14,371	17,617	14,472
Non-banking service revenues	9,208	13,144	(30.0)%	22,145	25,336	22,498
Fees on deposit accounts	3,025	2,466	22.7%	4,858	4,887	4,075
Bank service charges and commissions	1,324	1,150	15.1%	2,079	2,037	1,625
Other operating revenues	146	243	(39.9)%	815	241	268
Banking service revenues	4,495	3,859	16.5%	7,752	7,165	5,968
Securities net activity	650	5,642	(88.5)%	7,446	13,414	14,223
Derivatives net gain (loss)	1,256	(322)	490.1%	(2,811)	11	(4,061)
Trading net gain (loss)	5	(33)	115.2%	(15)	21	571
Securities, derivatives and trading activities	1,911	5,287	(63.9)%	4,620	13,446	10,733
Investment in limited liability partnership	838		100%	246		
Other income (loss)	(70)	57	(222.8)%	122	87	(160)
Other non-interest income	768	57	1247.4%	368	87	(160)
Total non-interest income	\$ 16,382	\$ 22,347	(26.7)%	\$ 34,885	\$ 46,034	\$ 39,039

Non-Interest IncomeComparison of the six-month periods ended December 31, 2005 and 2004:

Non-interest income is affected by the amount of securities and trading transactions, the level of trust assets under management, transactions generated by the gathering of financial assets and investment activities by the securities broker-dealer subsidiary, the level of mortgage banking activities, deposit accounts and insurance products. As shown in Table 2, non-interest income for the six-month period ended December 31, 2005 decreased 26.7%, from \$22.3 million to \$16.4 million, when compared to the same period in 2004.

One of the main components of non-interest income is mortgage-banking activities. Income generated from such activities decreased 69.2% in the six-month period ended December 31, 2005, from \$5.5 million in the six-month period ended December 31, 2004, to \$1.7 million in the same period of 2005. The decline reflects the Group's strategy subsequent to the December 2004 quarter of retaining a higher amount of mortgages, as well as profitable investment securities, to obtain recurring interest income. This strategy is further reflected by the increase of 21.5% in residential mortgage loan production, including the purchase of loans from third-party investors, from \$111.4 million in the six-month period ended December 31, 2004 to \$135.3 million for the same period of 2005.

Financial services revenues, which consist of commissions and fees from fiduciary activities, and commissions and fees from securities brokerage, investment banking and insurance activities, decreased 0.3% and 2.7%, respectively, to \$4.1 million and \$3.4 million in the six-month period ended December 31, 2005, from \$4.1 million and \$3.5 million in the same period of 2004. Decrease for the period reflected temporarily reduced market for public finance activities in Puerto Rico which affects revenues from brokerage and investment banking activities in the local retail public finance market.

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Banking service revenues, which consist primarily of fees generated by deposit accounts, electronic banking and customer services, continued with an increase of 16.5% to \$4.5 million in the six-month period ended December 31, 2005, from \$3.9 million in the same period of 2004, mainly driven by the strategy of strengthening the Group's banking franchise by expanding our ability to attract deposits and build relationships with individual, professional and commercial customers through aggressive marketing and the expansion of the Group's sales force.

Revenues from securities, derivatives and trading activities decreased 63.9% in the six-month period ended December 31, 2005 due to a net gain of \$1.9 million in the 2005 six-month period from a net gain of \$5.3 in the same period of 2004. The reduction in securities net activity, which was principally due to the Group's strategy of retaining a higher amount of profitable investment securities to obtain recurring interest income, offset the positive results in derivatives activity, which reflected a net gain of \$1.3 million during the six-month period ended December 31, 2005, compared to a \$322,000 net loss in the same period of 2004. This fluctuation is related to the mark-to-market of derivative instruments which are expected to continue improving as interest rates increase.

Comparison of the fiscal years ended June 30, 2005 and 2004:

Income from mortgage banking activities increased 0.7% in the fiscal year ended June 30, 2005, from \$7.7 million in the fiscal year ended June 30, 2004 to \$7.8 million in the fiscal period of 2005. This source of revenues showed relative stability, despite a reduction of 12.9% in residential mortgage loan production, from \$332.5 million in the fiscal year ended June 30, 2004 to \$289.7 million in the fiscal year ended June 30, 2005.

Financial services revenues consist of commissions and fees from fiduciary activities, and commissions and fees from securities brokerage, investment banking and insurance activities, decreased 11.5% and 25.1%, respectively, to \$7.7 million and \$6.7 million in the fiscal year ended June 30, 2005, from \$8.6 million and \$9.0 million in the corresponding fiscal period of 2004. Decrease for the year reflected temporarily reduced market for public finance activities in Puerto Rico which affects revenues from brokerage and investment banking activities in the local retail public finance market.

Banking service revenues, which consist primarily of fees generated by deposit accounts, electronic banking and customer services, continued with an increase of 8.2% to \$7.8 million in the fiscal year ended June 30, 2005, from \$7.2 million in the fiscal year ended June 30, 2004 mainly driven by the strategy of strengthening the Group's banking franchise by expanding our ability to attract deposits and build relationships with individual, professional and commercial customers through aggressive marketing and the expansion of the Group's sales force.

Securities, derivatives and trading activities decreased 65.6% in the fiscal year ended June 30, 2005, to a net gain of \$4.6 million in the 2005 fiscal period from a net gain of \$13.4 in the fiscal year ended June 30, 2004, mainly affected by negative results in derivative activity which reflected a loss during the fiscal year ended June 30, 2005 of \$2.8 million, compared to \$11,000 net gain in the corresponding fiscal period of 2004. The fluctuations are related to the mark-to-market of derivative instruments which we expect to improve as interest rates go up.

Securities net activities showed a 44.5% decrease from a net gain of \$13.4 million in the fiscal year ended June 30, 2004, to a net gain of \$7.4 million in the fiscal year ended June 30, 2005, while trading net activities revenues showed a decrease of 171.4% to a net loss of \$15,000 in the fiscal year ended June 30, 2005, compared to a net gain of \$21,000 in the fiscal year ended June 30, 2004. As in the previous fiscal period of 2004, this decrease in trading net activities revenues is mainly due to the unfavorable conditions of the secondary market due to the higher short term rates.

Comparison of the fiscal years ended June 30, 2004 and 2003:

Non-interest income for the fiscal year ended June 30, 2004 increased 17.9%, from \$39.0 million in fiscal 2003 to \$46.0 million in fiscal 2004.

Financial services revenues consist of commissions and fees from fiduciary activities and commissions and fees from securities brokerage, investment banking and insurance activities, two of the main components of non-interest income, increased 25.3% and 18.5%, respectively, to \$8.6 million and \$9.0 million in the fiscal year ended June 30, 2004, from \$6.9 million and \$7.6 million in the fiscal year ended June 30, 2003. Growth for the year reflected the

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general improvement in equity markets, increased underwriting activities, higher service fees in fiduciary activities, and income generated by CPC, the retirement plan administration subsidiary, which was acquired in January 2003.

Another component of non-interest income is mortgage-banking activities. Such income decreased 3.8% in the fiscal year ended June 30, 2004, from \$8.0 million in the fiscal year ended June 30, 2003, to \$7.7 million in the corresponding fiscal period of 2004, in relation to a decrease of 8.0% in residential mortgage loan production from \$357.0 million in the fiscal year ended June 30, 2003, to \$332.5 million in the fiscal year ended June 30, 2004. Such decrease in mortgage production was primarily due to the Group's decision to temporarily moderate home loan activity based on fourth quarter market conditions, which also resulted in lower mortgage banking revenues.

Banking service revenues, which consist primarily of fees generated by deposit accounts, electronic banking and customer services, increased 20.1%, to \$7.2 million in the fiscal year ended June 30, 2004, from \$6.0 million in the fiscal year ended June 30, 2003, mainly due to a 19.9% increase in fees on deposit accounts, from \$4.1 million for the fiscal year ended June 30, 2003, to \$4.9 million in the fiscal year ended June 30, 2004. This increase in bank service revenues was mainly driven by an increase in the fees on deposit accounts, mostly overdraft fees related to the bank overdraft privilege program attached to consumer deposit accounts, and the success of the Group's product and service marketing programs. Bank service charges and commissions increased 25.4% to \$2.0 million in the fiscal year ended June 30, 2004 from \$1.6 million in the corresponding fiscal period of 2003. Most of this increase was related to higher transactional volume in the Bank's debit and credit cards.

Securities, derivatives and trading activities increased 25.3% in the fiscal year ended June 30, 2004 to a net gain of \$13.4 million in the fiscal year ended June 30, 2004 from a net gain of \$10.7 million in the fiscal year ended June 30, 2003, mainly driven by a positive results in derivatives activity which carried a substantial loss during the fiscal year ended June 30, 2003 from \$4.1 million net loss in the fiscal year ended June 30, 2003, to \$11,000 net gains in the corresponding fiscal period of 2004. Securities and trading net activity decreased when compared to the previous fiscal year ended June 30, 2003.

Securities net activities showed a 5.7% decrease from a net gain of \$14.2 million in the fiscal year ended June 30, 2003 to a net gain of \$13.4 million in the fiscal year ended June 30, 2004, while trading net activities revenues showed a decrease of 96.3% to a net gain of \$21,000 in the fiscal year ended June 30, 2004, compared to a net gain of \$571,000 in the fiscal year ended June 30, 2003. As in the fiscal period of 2003, this decrease in trading net activities revenues is mainly due to a substantial decrease in the average volume of trading portfolio. The average trading portfolio dropped from \$10.3 million in the fiscal year ended June 30, 2003 to an average of \$1.4 million in the corresponding fiscal period of 2004.

Table of Contents**TABLE 3 NON-INTEREST EXPENSES SUMMARY**
FOR THE SIX-MONTH PERIODS ENDED DECEMBER 31, 2005 AND 2004, AND FISCAL YEARS ENDED JUNE 30, 2005, 2004 AND 2003

	Six-Month Period Ended December 31,		Variance % (Dollars in thousands)	Fiscal Year Ended June 30,		
	2005	2004		2005	2004	2003
Compensation and employees benefits	\$ 12,714	\$ 15,910	(20.1)%	\$ 23,606	\$ 28,511	\$ 24,312
Occupancy and equipment	5,798	5,050	14.8%	10,583	9,639	9,079
Advertising and business promotion	3,187	3,599	(11.5)%	6,506	7,466	7,052
Professional and service fees	3,771	3,380	11.6%	6,994	5,631	6,467
Communication	837	843	(0.7)%	1,630	1,849	1,671
Loan servicing expenses	911	896	1.7%	1,727	1,853	1,775
Taxes, other than payroll and income taxes	1,195	902	32.5%	1,836	1,754	1,556
Electronic banking charges	854	1,015	(15.9)%	2,075	1,679	1,244
Printing, postage, stationery and supplies	528	474	11.4%	891	1,121	1,038
Insurance	374	392	(4.6)%	767	791	736
Other operating expenses	1,645	1,460	12.7%	3,348	3,070	2,475
Total non-interest expenses	\$ 31,814	\$ 33,921	(6.2)%	\$ 59,963	\$ 63,364	\$ 57,405
Relevant ratios and data:						
Non-interest income to Non-interest expenses ratio	51.49%	65.88%		58.18%	72.65%	68.01%
Efficiency ratio	66.12%	53.24%		51.39%	52.92%	55.77%
Expense ratio	0.85%	0.89%		0.75%	0.97%	1.13%
Compensation and benefits to non-interest expenses	40.0%	46.9%		39.4%	45.0%	42.4%
Compensation to total assets	0.56%	0.76%		0.56%	0.77%	0.80%
Average compensation per employee (annualized)	\$ 48.8	\$ 60.6		\$ 44.6	\$ 52.3	\$ 48.0
Average number of employees	521	525		529	545	506

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Bank assets per employee	\$ 8,723	\$ 7,932	\$ 8,028	\$ 6,836	\$ 6,009
Total workforce:					
Banking operations	417	453	426	454	423
Trust operations	52	59	52	52	57
Brokerage and Insurance operations	51	42	42	20	33
Total workforce	520	554	520	526	513

Non-Interest Expenses

Comparison of the six-month periods ended December 31, 2005 and 2004:

Non-interest expenses in the six-month period ended December 31, 2005 decreased 6.2%, from \$33.9 million in the six-month period ended December 31, 2004 to \$31.8 million in the same period of 2005. The decrease in non-interest expenses was mainly the result of a 20.1% reduction in compensation and employee benefits expense from

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the six-month period ended December 31, 2004 to the comparative 2005 period, from \$15.9 million to \$12.7 million, respectively. The reduction was mainly due to the recording of compensation expense for the six-month period ended December 31, 2004 of \$3.2 million as a result of the application of the variable accounting to outstanding options granted to certain employees. No such expense was recorded on the six-month period ended December 31, 2005, since it is not required under the provisions of SFAS 123R, which came in effect on July, 1, 2005.

The increment in other non-interest expenses, other than in compensation and employees' benefits, during the comparative six-month periods reflects the Group's continued spending on The Oriental Way program, specifically for the expansion and improvement of the Group's sales capabilities, including additional experienced lenders, marketing, enhancing branch distribution and support risk management processes. Also, these results include expenses for new technology for the implementation of PeopleSoft enterprise software to increase efficiencies, and cost of documentation and testing required by SOX regarding management's assessment of internal control over financial reporting. Consequently, expenses have been pared in other areas, consistent with management's goal of limiting expense growth to those areas that directly contribute to increase the efficiency, service quality and profitability of the Group.

Occupancy and equipment expenses increased 14.8%, from \$5.1 million in the six-month period ended December 31, 2004 to \$5.8 million in the six-month period ended December 31, 2005, due to higher depreciation resulting from upgrading technology, infrastructure in our financial centers in order to improve efficiency and the acceleration of leasehold improvements amortization due to the move to new facilities beginning in May of 2006.

During the six-month period ended December 31, 2005, the cost of advertising and business promotions decreased 11.5% to \$3.2 million versus \$3.6 million in the six-month period ended December 31, 2004. Such activity was mainly due to management's strategy of redistributing the marketing expenses for the 2005 six-month period ended December 31, as the Group continued its selective promotional campaign to enhance the market recognition of new and existing products, to increase fee-based revenues and to strengthen the banking and financial services franchise.

In the six-month period ended December 31, 2005, professional and service fees increased 11.6%, from \$3.4 million in the six-month period ended December 31, 2004 to \$3.8 million in the 2005 six-month period. The increase in the period was due to the effect of reviews performed by advisors in specific operational areas to improve financial and operational performance and expenses associated with SOX implementation.

The aggregate decrease in communication, electronic banking charges and insurance is principally due to effective cost controls without affecting the general growth in the Group's business activities, products and services.

The rise in taxes other than payroll and income taxes, and other operating expenses is principally due to the general growth in the Group's business activities, products and services offered.

Comparison of the fiscal years ended June 30, 2005 and 2004:

Non-interest expenses in the fiscal year ended June 30, 2005 decreased 5.4%, from \$63.4 million in the fiscal year ended June 30, 2004 to \$60.0 million in the fiscal year ended June 30, 2005. The reduction was mainly due to lower compensation and employee benefits for the fiscal year ended June 30, 2005 in the amount of \$4.9 million, compared to the fiscal year ended June 30, 2004. This \$4.9 million decrease was mainly due to a decrease in fair value of the Group's common stock from one period to the other which resulted in a credit to compensation expense of \$3.1 million as a result of the application of the variable accounting to outstanding options granted to certain employees. Increases in other non-interest expense categories in the year reflect the Group's spending on The Oriental Way program, specifically for the expansion and improvement of the Group's sales capabilities, including additional experienced lenders, marketing, enhancing branch distribution and support risk management processes. Also, these results include

expenses for new technology for the implementation of PeopleSoft enterprise software to increase efficiencies, and also include the cost of documentation and testing required by SOX regarding management's assessment of internal control over financial reporting. Consequently, expenses have been pared in other areas, consistent with management's goal of limiting expense growth to those areas that directly contribute to increase the efficiency, service quality and profitability of the Group.

Occupancy and equipment expenses increased 9.8%, from \$9.6 million in the fiscal year ended June 30, 2004 to \$10.6 million in the fiscal year ended June 30, 2005, due to higher depreciation resulting from upgrading

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technology, infrastructure in our financial centers in order to improve efficiency and the acceleration of leasehold improvements amortization due to the move to new facilities during the second quarter of 2006.

During the fiscal year ended June 30, 2005, the cost of advertising and business promotions decreased 12.9% to \$6.5 million versus \$7.5 million in the fiscal year ended June 30, 2004. Such activity was mainly due to management's strategy of redistributing the marketing expenses for the 2005 fiscal year as the Group continued its selective promotional campaign to enhance the market recognition of new and existing products, to increase fee-based revenues and to strengthen the banking and financial services franchise.

In the fiscal year ended June 30, 2005, professional and service fees increased 24.2%, from \$5.6 million in the fiscal year ended June 30, 2004 to \$7.0 million in the corresponding fiscal period of 2005. The increase in the period was due to the effect of reviews performed by advisors in specific operational areas to improve financial and operational performance and expenses associated with the implementation of SOX.

The aggregate decrease in communication, insurance and printing, postage, stationery and supplies expenses is principally due to effective cost controls without affecting the general growth in the Group's business activities, products and services.

The rise in electronic banking charges, taxes other than payroll and income taxes, and other operating expenses is principally due to the general growth in the Group's business activities, products and services offered.

Comparison of the fiscal years ended June 30, 2004 and 2003:

In the fiscal year ended June 30, 2004, non-interest expenses increased 10.4%, from \$57.4 million in the fiscal year ended June 30, 2003 to \$63.4 million in the fiscal year ended June 30, 2004, reflecting the impact of the Group's expansion strategy. The Group incurred higher outlays for human resources, technology and marketing, among others, during the first quarter of the fiscal year ended June 30, 2004, as it continued its growth program. Thereafter, the Group was able to realign costs, with expenses trending lower in the last three quarters of the fiscal year ended June 30, 2004.

Compensation and employee's benefits is the Group's largest non-interest expense category. In the fiscal year ended June 30, 2004, compensation and benefit expense increased 17.3% to \$28.5 million versus \$24.3 million in the fiscal year ended June 30, 2003, reflecting an expansion of the Group's work force as part of its growth program which includes the improvement of the sales force through the addition of experienced lenders and the expansion of the executive team.

Occupancy and equipment expenses increased 6.2%, from \$9.1 million in the fiscal year ended June 30, 2003 to \$9.6 million in the fiscal year ended June 30, 2004, due to higher depreciation resulting from upgrades to technology and infrastructure in the Group's financial centers in order to improve efficiency.

During the fiscal year ended June 30, 2004, advertising and business promotions increased 5.9% to \$7.5 million versus \$7.1 million in the fiscal year ended June 30, 2003. The Group focused on marketing campaigns that expanded the awareness of new and existing products and contributed to the 17.9% increase in fee-based revenues, compared to the fiscal year ended June 30, 2003.

In the fiscal year ended June 30, 2004, professional and service fees decreased 12.9%, from \$6.5 million in the fiscal year ended June 30, 2003 to \$5.6 million in the corresponding fiscal period of 2004. The decrease was due to specific cost control initiatives effectively implemented by management.

The rise in electronic banking charges, communication, taxes other than payroll and income taxes, insurance, printing, postage, stationery and supply, and other operating expenses are principally due to the general growth in the Group's business activities, products and services offered.

Provision for Loan Losses

Comparison of the six-month periods ended December 31, 2005 and 2004:

The provision for loan losses for the six-month period ended December 31, 2005 totaled \$1.9 million, a 5.4% increase from the \$1.8 million reported for the six-month period ended December 31, 2004. Based on an analysis of

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the credit quality and the composition of the Group's loan portfolio, management determined that the provision for the period December 31, 2005 was adequate in order to maintain the allowance for loan losses at an appropriate level.

The reduction in net credit losses of 1.5% during the six-month period ended December 31, 2005 was primarily due to a \$568,000 decrease in net credit losses from mortgage loans. Recoveries decreased from \$438,000 for the six-month period ended December 31, 2004 to \$314,000 for the corresponding 2005 six-month period. As result, the recoveries to charge-offs ratio decreased from 19.6% in the six-month period ended December 31, 2004 to 15.1% in the corresponding 2005 six-month period.

Mortgage loan charge-offs in the six-month period ended December 31, 2005 were \$774,000 as compared to \$1.2 million in the same period of 2004. Commercial loans net credit losses increased to \$164,000 in the 2005 six-month period, when compared to \$25,000 in the same period of 2004. Almost all the commercial lending that the Group originates is collateralized by mortgages.

Net credit losses on consumer loans increased when compared with the 2004 period. In the six-month period ended December 31, 2005, net credit losses on consumer loans were \$974,000, an increase of 70.4% when compared with the same period of 2004 in which the Group had net credit losses of \$571,000.

The Group evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. At December 31, 2005, the total investment in impaired commercial loans was \$3.6 million. Impaired commercial loans are measured based on the fair value of collateral. The Group determined that no specific impairment allowance was required for such loans. The average investment in impaired commercial loans for the year ended December 31, 2005 amounted to \$3.2 million compared to \$2.3 million for the year ended June 30, 2005.

Please refer to the Allowance for Loan Losses and Non-performing assets section on Table 8 through Table 12 for a more detailed analysis of the allowances for loan losses, net credit losses and credit quality statistics.

Comparison of the fiscal years ended June 30, 2005 and 2004:

The provision for loan losses for the year ended June 30, 2005 totaled \$3.3 million, a 27.7% decrease from the \$4.6 million reported for the year ended June 30, 2004. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for the year ended June 30, 2005 was adequate in order to maintain the allowance for loan losses at an appropriate level, even though the loan portfolio increased from \$745.2 million as of June 30, 2004 to \$892.1 million as of June 30, 2005 (a 19.7% increase) and there was an increase in the net credit losses from \$2.1 million for the year ended June 30, 2004 to \$4.4 million for the year ended June 30, 2005 (an increase of 111.8%). The main reason for the decrease in the provision is that during the year ended June 30, 2004 Management charged against earnings the provision for the possible losses on certain nonperforming loans which were in the process of evaluation. During the year ended June 30, 2005, these loans or portions thereof were charged-off against the allowance established in the previous fiscal year since such loans or the portions thereof were determined to be uncollectible. The increase in the loan portfolio is mainly related to new high quality and well collateralized loans which do not require large amounts of allowance for loan losses.

Net credit losses increased 111.8%, from \$2.1 million in the fiscal year ended June 30, 2004 to \$4.4 million in the fiscal year ended June 30, 2005. The increase was primarily due to \$2.5 million increment in net credit losses from mortgage loans. Total loss recoveries decreased from \$1.1 million as of June 30, 2004 to \$721,000 as of June 30, 2005. As result, the recoveries to charge-offs ratio decreased from 35.6% in the fiscal year ended June 30, 2004 to 14.2% for the corresponding fiscal period of 2005.

Residential mortgage loans net credit losses in the fiscal year ended June 30, 2005 were \$2.9 million as compared to \$378,000 in the prior fiscal year. Commercial loans net credit losses increased to \$496,000 in the fiscal year ended June 30, 2005, when compared to \$110,000 in the previous fiscal year. Almost all the commercial lending that the Group is originating is collateralized by mortgages.

Net credit losses on consumer loans decreased when compared with the prior fiscal year. In the fiscal year ended June 30, 2005, net credit losses on consumer loans were \$1.0 million, a decrease of 41.2% when compared with the fiscal year ended June 30, 2004 in which the Group had net credit losses of \$1.7 million.

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The Group evaluates all loans, some individually and others as homogeneous groups, for purposes of determining impairment. At June 30, 2005, the total investment in impaired commercial loans was \$3.2 million. Impaired commercial loans are measured based on the fair value of collateral. The Group determined that no specific impairment allowance was required for such loans. The average investment in impaired commercial loans for the fiscal year ended June 30, 2005 amounted to \$2.3 million compared to \$2.1 million for the fiscal year ended June 30, 2004.

Please refer to the Allowance for Loan Losses and Non-performing assets section on Table 8 through Table 12 for a more detailed analysis of the allowances for loan losses, net credit losses and credit quality statistics.

Comparison of the fiscal years ended June 30, 2004 and 2003:

The provision for loan losses for the fiscal year ended June 30, 2004, totaled \$4.6 million, a 9.5% increase from the \$4.2 million reported for the previous fiscal year ended June 30, 2003. The increase in the provision for loan losses reflects the required provisions needed to cover any loss exposure in commercial and mortgage non-performing loans as of June 30, 2004 and the expected increase in the consumer loans portfolio as the Group revitalized such lending activity during the fourth quarter of fiscal 2004. Non-performing loans increased 6.9%, from \$28.9 million as of June 30, 2003, to \$30.9 million as of June 30, 2004. The increase in non-performing loans came from the residential mortgage and commercial loan portfolios. The commercial and residential mortgage portfolios are well collateralized and the Group does not expect any major losses on such portfolios.

During the last two quarters of the fiscal year ended June 30, 2004, no major increases in net credit losses were experienced, but the actual level of credit losses support the provision for the period to maintain an adequate reserve for possible loan losses. Net credit losses for the fiscal year decreased 6.1%, from \$2.2 million in the fiscal year ended June 30, 2003 to \$2.1 million in the fiscal year ended June 30, 2004. Such decrease was mainly due to an increase experienced in total loss recoveries. Total loss recoveries increased from \$897,000 as of June 30, 2003 to \$1.1 million as of June 30, 2004. As result, the recoveries to charge-offs ratio improved from 29.0% in the fiscal year ended June 30, 2003 to 35.6% in the corresponding fiscal period of 2004.

Residential real state loans net credit losses in the fiscal year ended June 30, 2004 were \$378,000 as compared with \$5,000 in the prior fiscal year. The amount for the fiscal year ended June 30, 2004 represents charge-offs on two mortgage loans. Commercial loans net credit losses increased to \$110,000 in the fiscal year ended June 30, 2004, when compared with a net recovery of \$39,000 in the previous fiscal year. Management performed a review of the entire commercial loan portfolio and determined to recognize as losses during the second quarter of the fiscal year ended June 30, 2004 certain loans considered uncollectible or of such little value that their continuance as bankable assets was not warranted. This review reflects the Group's strategy to expand its commercial loan portfolio, primarily collateralized by mortgages.

Net credit losses on consumer loans decreased when compared with the prior fiscal year. In the fiscal year ended June 30, 2004, net credit losses on consumer loans were \$1.7 million, a decrease of 25.5% when compared with the fiscal year ended June 30, 2003 in which the Group had net credit losses of \$2.3 million.

Please refer to the Allowance for Loan Losses and Non-performing assets section on Table 8 through Table 12 for a more detailed analysis of the allowances for loan losses, net credit losses and credit quality statistics.

Income Taxes

The income tax expense was \$127,000 for the six-month period ended December 31, 2005, as compared with \$645,000 for the corresponding period of 2004.

The Group recorded an income tax benefit of \$1.6 million for the fiscal year ended June 30, 2005, as compared with an income tax expense of \$5.6 million for the fiscal year ended June 30, 2004. The tax benefit for the fiscal year ended June 30, 2005 takes into account, among other things, the expiration of certain tax contingencies. Also, the effective income tax rate was lower than the statutory tax rate for the Group, which was 39% as of June 30, 2005, due to the high level of tax-advantaged interest income earned on certain investments and loans, net of the disallowance of related expenses attributable to the exempt income. Exempt interest relates principally to interest

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earned on obligations of the United States and Puerto Rico governments and certain mortgage-backed securities, including securities held by the Group's international banking entities.

The Group recognized an income tax expense of \$5.6 million in the fiscal year ended June 30, 2004, compared with a provision of \$4.3 million in the previous fiscal year. The main reason for the increase of the fiscal year ended June 30, 2004 tax expense was the increase in income before income taxes of 25.9% when compared to fiscal 2003 results.

On August 1, 2005 the Puerto Rico Legislature approved Law No. 41 - Law of the Educational Future of the Puerto Rican Children. This law imposes an additional tax of 2.5% on taxable net income exceeding \$20,000. This law is applicable to all corporations and partnerships with a taxable net income over \$20,000, according to part (a) of Section 1015 of the Puerto Rico Internal Revenue Code of 1994. The law is effective for tax years beginning after December 31, 2004 and ending on or before December 31, 2006. Although the effectiveness of this law is subject to the final approval of the Joint Resolution of the Legislature Number 445, concerning the General Budget for the 2005-2006 fiscal year, it is the position of the Puerto Rico Treasury Department that it is in effect notwithstanding the Governor's veto of Joint Resolution of the Legislature Number 445. This additional tax imposition did not have a material effect on the Group's consolidated operational results for the six-month period ended December 31, 2005 due to the tax exempt composition of the Group's investments.

FINANCIAL CONDITION

Assets Owned

At December 31, 2005, the Group's total assets amounted to \$4.547 billion, an increase of 7.1% when compared to \$4.247 billion at June 30, 2005. At the same date, interest-earning assets, excluding securities sold but not yet delivered, reached \$4.380 billion, up 5.9%, versus \$4.135 billion at June 30, 2005.

As detailed in Table 4, investments are the Group's largest interest-earning assets component. Investments principally consist of money market instruments, U.S. government and agency bonds, mortgage-backed securities, CMO's and Puerto Rico government and agency bonds. At December 31, 2005, the investment portfolio increased 7.6%, to \$3.477 billion, from \$3.232 billion as of June 30, 2005.

Growth in U.S. government securities drove the investment portfolio's expansion of \$245.2 million from June 30, 2005, to December 31, 2005. U.S. government securities increased 21.5% from \$1.030 billion as of June 30, 2005 to \$1.251 billion as of December 31, 2005, as the Group continued its asset liability management strategies of rebalancing its asset mix through sound and lesser-risk asset acquisitions. Mortgage-backed securities increased 0.1% to \$1.961 billion (56.4% of the total investment portfolio) from \$1.960 billion (60.6% of the total investment portfolio) in the year before. These activities are in line with the Group's strategy in a rising interest rate environment of investing in fixed and variable rate, short-term and medium-term government securities, and the sale of longer-term mortgage-backed securities.

Table of Contents**TABLE 4 ASSETS SUMMARY AND COMPOSITION**
AS OF DECEMBER 31, 2005, JUNE 30, 2005 and 2004

	December 31, 2005	June 30, 2005 (Dollars in thousands)	Variance %	June 30, 2004
Investments:				
Mortgage-backed securities	\$ 1,961,285	\$ 1,959,760	0.1%	\$ 2,467,384
U.S. Government and agency obligations	1,251,058	1,029,980	21.5%	206,977
P.R. Government and agency obligations	90,333	108,968	(16.9)%	115,846
Other investment securities	90,609	66,023	37.2%	20,636
Short-term investments	63,480	39,791	59.5%	7,747
FHLB stock	20,002	27,058	(26.1)%	28,160
	3,476,767	3,231,580	7.6%	2,846,750
Loans:				
Loans receivable	900,992	892,136	1.0%	745,195
Allowance for loan losses	(6,630)	(6,495)	2.1%	(7,553)
Loans receivable, net	894,362	885,641	1.0%	737,642
Mortgage loans held for sale	8,946	17,963	(50.2)%	5,814
Total loans	903,308	903,604	0.0%	743,456
Securities sold but not yet delivered	44,009	1,034	4156.2%	47,312
Total securities and loans	4,424,084	4,136,218	7.0%	3,637,518
Other assets:				
Cash and due from banks	13,789	14,892	(7.4)%	9,284
Accrued interest receivable	29,067	23,735	22.5%	19,127
Premises and equipment, net	14,828	15,269	(2.9)%	18,552
Deferred tax asset, net	12,222	6,191	97.4%	7,337
Foreclosed real estate	4,802	4,186	14.7%	888
Other assets	48,157	46,374	3.8%	32,989
Total other assets	122,865	110,647	11.0%	88,177
Total assets	\$ 4,546,949	\$ 4,246,865	7.1%	\$ 3,725,695
Investments portfolio composition:				
Mortgage-backed securities	56.4%	60.6%		86.7%
U.S. Government and agency obligations	36.0%	31.9%		7.3%
P.R. Government and agency obligations	2.6%	3.4%		4.1%
FHLB stock, short term investments and other investment securities	5.0%	4.1%		1.9%

100.0%

100.0%

100.0%

Refer to Note 3 of the accompanying consolidated financial statements for information related to the carrying amount of available-for-sale and held to maturity investment securities at December 31, 2005, by contractual maturity.

At December 31, 2005, the Group's loan portfolio, the second largest category of the Group's interest-earning assets, amounted to \$903.3 million, approximately at the same level when compared to the \$903.6 million at June 30, 2005. The Group's loan portfolio is mainly comprised of residential loans, home equity loans, and commercial loans collateralized by mortgages. As shown in Table 5, the mortgage loan portfolio amounted to

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\$637.3 million or 71.0% of the loan portfolio as of December 31, 2005, compared to \$625.5 million or 70.7% of the loan portfolio at June 30, 2005. Mortgage production of \$134.7 million for the six-month period ended December 31, 2005 increased 22.1%, from \$110.3 million, when compared to the corresponding six-month period of 2004.

The second largest component of the Group's loan portfolio are commercial loans, most of which are collateralized by commercial real estate properties. At December 31, 2005, the commercial loan portfolio totaled \$227.8 million (25.0% of the Group's total loan portfolio), in comparison to \$236.4 million at June 30, 2005 (26.0% of the Group's total loan portfolio). Production of commercial loans decreased 72.2%, from \$118.1 million for the six-month period ended December 31, 2004, to \$32.9 million for the same period of 2005.

The consumer loan portfolio totaled \$35.8 million (4.0% of total loan portfolio at December 31, 2005), an 18.3% increase when compared to the June 30, 2005 portfolio of \$30.3 million (3.3% total loan portfolio at such date). Consumer loan production reflected the Group's expansion of the business, which resulted in a 34.1% increase in production for the six-month period ended December 31, 2005 when compared to the same period of 2004, from \$10.5 million for the 2004 period to \$14.1 million for the 2005 period.

The following table summarizes the remaining contractual maturities of the Group's total loans segmented to reflect cash flows as of December 31, 2005. Contractual maturities do not necessarily reflect the actual term of a loan, considering prepayments.

	Balance		Maturities			
	Outstanding		After One Year to Five			
	at		Years		After Five Years	
	December 31,	One Year	Fixed	Variable	Fixed	Variable
	2005	or Less	Interest	Interest	Interest	Interest
			Rates	Rates	Rates	Rates
	(In thousands)					
Mortgage, mainly residential	\$ 646,264	\$ 1,432	\$ 41,686	\$	\$ 603,146	\$
Commercial, mainly real estate	227,846	29,929	18,484	82,792	4,374	92,267
Consumer	35,828	13,178	20,743		1,907	
Total	\$ 909,938	\$ 44,539	\$ 80,913	\$ 82,792	\$ 609,427	\$ 92,267

At June 30, 2005, the Group's total assets amounted to \$4.247 billion, an increase of 14.0% when compared to \$3.726 billion at June 30, 2004. Interest-earning assets, excluding securities sold but not yet delivered, reached \$4.135 billion at June 30, 2005, an increase of 15.2%, versus \$3.590 billion at June 30, 2004.

As detailed in Table 4, investments are the Group's largest interest-earning assets component. Investments principally consist of money market instruments, U.S. government and agency bonds, mortgage-backed securities, CMO's and Puerto Rico government and agency bonds. At June 30, 2005, the investment portfolio increased 13.5%, to \$3.232 billion, from \$2.847 billion as of June 30, 2004.

At June 30, 2005, the Group's loan portfolio, the second largest category of the Group's interest-earning assets, amounted to \$903.6 million, 21.5% higher than the \$743.5 million at June 30, 2004. The Group's loan portfolio is

mainly comprised of residential loans, home equity loans, and commercial loans collateralized by real estate. As shown in Table 5, the mortgage loan portfolio amounted to \$625.5 million or 70.7% of the loan portfolio as of June 30, 2005, compared to \$645.0 million or 86.8% of the loan portfolio at June 30, 2004. Mortgage production of \$250.8 million for the fiscal year ended June 30, 2005, declined 24.3% when compared to the prior fiscal year. The Group sold/converted residential mortgage loans in the secondary market totaled \$188 million in fiscal 2005 compared to \$228 million sold/converted in fiscal 2004.

The second largest component of the Group's loan portfolio are commercial loans, most of which are collateralized by commercial real estate properties. At June 30, 2005, the commercial loan portfolio totaled \$236.4 million (26.0% of the Group's total loan portfolio), a substantial growth of 189.8% when compared to \$81.6 million at June 30, 2004 (10.9% of the Group's total loan portfolio). Production of commercial loans for the fiscal year ended June 30, 2005 increased 61.3%, to \$90.9 million compared to \$56.4 million in the prior fiscal year ended June 30, 2004. The increase reflected the Group's expansion of its commercial business with professionals and small and mid-sized businesses, and participations in commercial real estate properties. Commercial loan production for the fiscal year

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ended June 30, 2005 in the amount of \$90.9 million excludes transactions involving purchases of commercial loans secured by one-to-four family residential properties. Such transactions totaled \$114.9 million during the fiscal year ended June 30, 2005.

The consumer loan portfolio totaled \$30.3 million (3.3% of total loan portfolio at June 30, 2005), a 62.3% increase when compared to the June 30, 2004 portfolio of \$18.7 million, or 2.4% of the total loan portfolio as of such date. Consumer loan production reflected the expansion of the business during the fiscal year ended June 30, 2005 as compared to the fiscal year ended June 30, 2004.

TABLE 5 LOANS RECEIVABLE COMPOSITION:**Selected Financial Data**

As of December 31, 2005 and June 30, 2005 and 2004

	December 31, 2005	June 30, 2005	2004
	(Dollars in thousands)		
Mortgage, mainly residential	\$ 637,318	\$ 625,481	\$ 644,964
Commercial, mainly real estate	227,846	236,373	81,572
Consumer	35,828	30,282	18,659
Loans receivable	900,992	892,136	745,195
Allowance for loan losses	(6,630)	(6,495)	(7,553)
Loans receivable, net	894,362	885,641	737,642
Mortgage loans held for sale	8,946	17,963	5,814
Total loans, net	\$ 903,308	\$ 903,604	\$ 743,456
Loans portfolio composition percentages:			
Mortgage, mainly residential	71.0%	70.7%	86.7%
Commercial, mainly real estate	25.0%	26.0%	10.9%
Consumer	4.0%	3.3%	2.4%
Total loans	100.0%	100.0%	100.0%

Liabilities and Funding Sources

As shown in Table 6, at December 31, 2005, the Group's total liabilities reached \$4.205 billion, 7.6% higher than the \$3.908 billion reported at June 30, 2005. Interest-bearing liabilities, the Group's funding sources, amounted to \$4.175 billion at December 31, 2005 versus \$3.873 billion at June 30, 2005, a 7.8% increase, mainly driven by the increased use of repurchase agreements to fund the increase in the investment securities portfolio.

Borrowings are the Group's largest interest-bearing liability component. Borrowings consist mainly of diversified funding sources through the use of FHLB advances and borrowings, repurchase agreements, term notes, subordinated capital notes, other borrowings and lines of credit. At December 31, 2005, borrowings amounted to \$2.833 billion,

9.1% higher than the \$2.597 billion at June 30, 2005. The increase, mainly in repurchase agreements, reflects the funding needed to maintain the Group's growth strategy for its loan and investment portfolios. Repurchase agreements as of December 31, 2005 amounted to \$2.428 billion, a 10.5% increase when compared to \$2.198 billion as of June 30, 2005.

The FHLB system functions as a source of credit for financial institutions that are members of a regional Federal Home Loan Bank. As a member of the FHLB, the Group can obtain advances from the FHLB, secured by the FHLB stock owned by the Group, as well as by certain of the Group's mortgage loans and investment securities. FHLB funding amounted to \$313.3 million at December 31, 2005, versus \$300.0 million at June 30, 2005. All of these advances mature between January 2006 and August 2008. Table 6 presents the composition of the Group's other borrowings at the end of the periods analyzed. However, the Group has the capacity to expand such source of funding up to a maximum of \$17.2 million based on the \$20.0 million of capital contribution that the Group has allocated with FHLB.

Table of Contents**TABLE 6 LIABILITIES SUMMARY AND COMPOSITION
AS OF DECEMBER 31, 2005 and JUNE 30, 2005 and 2004**

	December 31, 2005	June 30, 2005 (Dollars in thousands)	Variance %	June 30, 2004
Deposits:				
Non-interest bearing deposits	\$ 61,473	\$ 62,205	(1.2)%	\$ 44,622
Now accounts	85,119	89,930	(5.3)%	81,644
Savings accounts	82,640	93,920	(12.0)%	88,459
Certificates of deposit	1,061,401	1,002,908	5.8%	807,783
	1,290,633	1,248,963	3.3%	1,022,508
Accrued interest payable	7,935	3,934	101.7%	1,841
	1,298,568	1,252,897	3.6%	1,024,349
Borrowings:				
Short term borrowings	1,930		100.0%	
Repurchase agreements	2,427,880	2,197,926	10.5%	1,897,429
Advances from FHLB	313,300	300,000	4.4%	300,000
Subordinated capital notes	72,166	72,166	0.0%	72,166
Term notes	15,000	15,000	0.0%	15,000
Federal funds purchased	2,525	12,310	(79.5)%	
	2,832,801	2,597,402	9.1%	2,284,595
Securities and loans purchased but not yet received	43,354	22,772	90.4%	89,068
Total deposits and borrowings	4,174,723	3,873,071	7.8%	3,398,012
Other liabilities	30,435	35,039	(13.1)%	46,037
Total liabilities	\$ 4,205,158	\$ 3,908,110	7.6%	\$ 3,444,049
Deposits portfolio composition percentages:				
Non-interest bearing deposits	4.8%	5.0%		4.4%
Now accounts	6.6%	7.2%		8.0%
Savings accounts	6.4%	7.5%		8.6%
Certificates of deposit	82.2%	80.3%		79.0%
	100.0%	100.0%		100.0%
Borrowings portfolio composition percentages:				
Short term borrowings	0.1%			
Repurchase agreements	85.7%	84.6%		83.0%

Advances from FHLB	11.1%	11.6%	13.1%
Subordinated capital notes	2.5%	2.8%	3.2%
Term notes	0.5%	0.6%	0.7%
Federal funds purchased	0.1%	0.4%	
	100.0%	100.0%	100.0%

Securities sold under agreements to repurchase

Amount outstanding at year-end	\$ 2,427,880	\$ 2,197,926	\$ 1,897,429
Daily average outstanding balance	\$ 2,270,145	\$ 2,174,312	\$ 1,595,717
Maximum outstanding balance at any month-end	\$ 2,417,570	\$ 2,398,861	\$ 1,895,865
Weighted average interest rate:			
For the period	3.78%	2.78%	2.26%
At period end	4.29%	3.07%	1.23%

At December 31, 2005, deposits, the second largest category of the Group's interest-bearing liabilities reached \$1.299 billion, up 3.6% from \$1.253 billion at June 30, 2005. Deposits reflected a 5.8% growth in certificates of

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deposits, to \$1.069 billion, primarily due to increase in one-year CDs. Such increases are due in part to the Group's success in opening accounts as part of its expanded commercial and consumer lending businesses and as that of the Oriental Preferred program of bank services and accounts, as well as brokered deposits.

At December 31, 2005, the scheduled maturities of time deposits and individual retirement accounts (IRA) of \$100,000 or more were as follows:

	(In thousands)
3 months or less	\$ 329,896
Over 3 months through 6 months	137,472
Over 6 months through 12 months	105,680
Over 12 months	36,926
Total	\$ 609,974

At June 30, 2005, the Group's total liabilities reached \$3.908 billion, 13.5% higher than the \$3.444 billion reported a year earlier. Interest-bearing liabilities, the Group's funding sources, amounted to \$3.873 billion at the end of fiscal 2005 versus \$3.398 billion the year before, a 14.0% increase. The rise in deposits, other borrowings and repurchase agreements drove this growth.

At June 30, 2005, borrowings amounted to \$2.597 billion, 13.7% higher than the \$2.285 billion at June 30, 2004. The increase, mainly in repurchase agreements, reflects the funding needed to maintain the Group's growth strategy for loans and investment portfolios. Repurchase agreements as of June 30, 2005 amounted to \$2.198 billion, a 15.9% increase when compared to \$1.897 billion as of June 30, 2004.

At June 30, 2005, deposits reached \$1.253 billion, up 22.4% from \$1.024 billion at June 30, 2004. Deposits reflected a 24.2% growth in certificates of deposits, to \$1.003 billion primarily due to an increase in one-year CDs. Such increases are due in part to the Group's success in opening accounts as part of its expanded commercial and consumer lending businesses and as that of the Oriental Preferred program of bank services and accounts, as well as brokered deposits.

Stockholders' Equity

At December 31, 2005, the Group's total stockholders' equity was \$341.8 million, a 0.9% increase, when compared to \$338.8 million at June 30, 2005. This increase was due to the net effect of earnings retention from operations, net of dividends paid, and to a reduction pursuant to the repurchase of stocks as part of the repurchase program entered into in August 2005. As of December 31, 2005, accumulated other comprehensive loss amounted to \$37.9 million, a decrease of \$499,000, when compared to the \$38.4 million loss recorded as of June 30, 2005. Net accumulated other comprehensive loss consists of the unrealized loss on derivatives designated as cash flow hedges and the unrealized gain or loss on investment securities available-for-sale, net of deferred tax.

At December 31, 2005, accumulated unrealized gain, net of tax, on derivatives designated as cash flow hedges was \$3.9 million, a \$12.7 million increase, when compared to an accumulated unrealized loss of \$8.8 million at June 30, 2005. Accumulated unrealized loss, net of tax, on investment securities available-for-sale amounted to \$41.8 million at December 31, 2005, after a \$12.2 million increase, when compared with an accumulated unrealized loss of \$29.6 million at June 30, 2005. Accumulated unrealized loss, net of tax, on investment securities available-for-sale at

December 31, 2005 includes an unrealized loss amounting to \$21.6 million related to securities transferred to the held-to-maturity category, mostly during fiscal 2004. This unrealized loss is amortized over the remaining life of the securities as a yield adjustment.

On November 30, 2004, the Group declared \$3.5 million in cash dividends, a 25.0% increase when compared to \$2.8 million declared for the same period a year ago. The Group also declared a 10% stock dividend paid to holders of record as of December 31, 2004. During each quarterly period of the fiscal year ended June 30, 2005 and for the two quarters in the six-month period ended December 31, 2005, the Group declared regular quarterly cash dividends of \$0.14 per common share.

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The Group's common stock is traded on the New York Stock Exchange (NYSE) under the symbol OFG. At December 31, 2005, the Group's market capitalization for its outstanding common stock was \$303.8 million (\$12.36 per share).

The Bank is considered well-capitalized under the regulatory framework for prompt corrective action if it meets or exceeds a Tier I risk-based capital ratio of 6%, a total risk-based capital ratio of 10% and a leverage capital ratio of 5%. In addition, the Group and the Bank meet the following minimum capital requirements: a Tier I risk-based capital ratio of 4%, a total risk-based capital ratio of 8% and a leverage capital ratio of 4%. As shown in Table 7 and in Note 14 to the consolidated financial statements, the Group and the Bank comfortably exceed these benchmarks due to the high level of capital and the quality and conservative nature of its assets.

TABLE 7 CAPITAL, DIVIDENDS AND STOCK DATA
AS OF DECEMBER 31, 2005 and JUNE 30, 2005 and 2004

	December 31, 2005	June 30, 2005	Variance %	June 30, 2004
	(In thousands, except for per share data)			
Capital data:				
Stockholders' equity	\$ 341,791	\$ 338,755	0.9%	\$ 281,646
Regulatory Capital Ratios data:				
Leverage Capital Ratio	10.13%	10.59%	(4.3)%	10.88%
Minimum Leverage Capital Ratio Required	4.00%	4.00%		4.00%
Actual Tier 1 Capital	\$ 447,669	\$ 445,131	0.6%	\$ 394,985
Minimum Tier 1 Capital Required	\$ 176,790	\$ 168,080	5.2%	\$ 145,209
Tier 1 Risk-Based Capital Ratio	34.70%	36.97%	(6.1)%	36.77%
Minimum Tier 1 Risk-Based Capital Ratio Required	4.00%	4.00%		4.00%
Actual Tier 1 Risk-Based Capital	\$ 447,669	\$ 445,131	0.6%	\$ 394,985
Minimum Tier 1 Risk-Based Capital Required	\$ 51,602	\$ 48,163	7.1%	\$ 42,966
Total Risk-Based Capital Ratio	35.22%	37.51%	(6.1)%	37.48%
Minimum Total Risk-Based Capital Ratio Required	8.00%	8.00%		8.00%
Actual Total Risk-Based Capital	\$ 454,299	\$ 451,626	0.6%	\$ 402,538
Minimum Total Risk-Based Capital Required	\$ 103,204	\$ 96,327	7.1%	\$ 85,932

Stock data:

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Outstanding common shares, net of treasury(1)	24,580	24,876	(1.2)%	22,007
Book value(1)	\$ 11.14	\$ 10.88	2.4%	\$ 8.82
Market Price at end of period	\$ 12.36	\$ 15.26	(19.0)%	\$ 24.61
Market capitalization	\$ 303,809	\$ 379,608	(20.0)%	\$ 541,592
Common dividend data:				
Cash dividends declared	\$ 6,913	\$ 13,522	(48.9)%	\$ 11,425
Cash dividends declared per share(1)	\$ 0.28	\$ 0.55	(49.1)%	\$ 0.51
Payout ratio	47.61%	24.65%	93.1%	20.58%
Dividend yield	4.34%	2.46%	76.4%	2.36%

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

	Price High	Low	Cash Dividend per Share
December 31, 2005			
December 31, 2005	\$ 13.12	\$ 10.16	\$ 0.14
September 30, 2005	\$ 15.98	\$ 11.91	\$ 0.14
June 30, 2005			
June 30, 2005	\$ 23.47	\$ 13.66	\$ 0.14
March 31, 2005	\$ 28.94	\$ 22.97	\$ 0.14
December 31, 2004	\$ 28.41	\$ 24.37	\$ 0.14
September 30, 2004(1)	\$ 26.64	\$ 22.76	\$ 0.13
June 30, 2004(1)			
June 30, 2004	\$ 29.77	\$ 23.26	\$ 0.13
March 31, 2004	\$ 29.55	\$ 22.45	\$ 0.13
December 31, 2003	\$ 23.77	\$ 19.87	\$ 0.13
September 30, 2003	\$ 22.30	\$ 19.28	\$ 0.12

(1) Adjusted to give retroactive effect to the 10% stock dividends declared on the Group's common stock on November 30, 2004.

Group's Financial Assets

The Group's total financial assets include the Group's assets and the assets managed by the Group's trust division, the retirement plan administration subsidiary, and the securities broker-dealer subsidiary. At December 31, 2005, such assets reached \$7.555 billion up 4.9% from \$7.205 billion at June 30, 2005. The increase was mainly due to an increase of 7.1% in the Group's assets owned, when compared to June 30, 2005, and to a decrease of 0.2% in the equity value of broker-dealer assets gathered, when compared to June 30, 2005. The principal component of the Group's financial assets is the assets owned by the Group, of which about 98% are owned by the Group's banking subsidiary. At June 30, 2005, the Group's total financial assets reached \$7.205 billion, up 11.8% from \$6.448 billion at June 30, 2004.

Another component of financial assets are the assets managed by the Group's trust division and the retirement plan administration subsidiary. The Group's trust division offers various types of IRA products and manages 401(K) and Keogh retirement plans, custodian and corporate trust accounts, while the retirement plan administration subsidiary manages private pension plans. As of December 31, 2005, total assets managed by the Group's trust division amounted to \$1.875 billion, an increase of 2.9% over the \$1.823 billion at June 30, 2005, which increased by 9.16% over the \$1.670 billion at June 30, 2004.

The other financial asset component is the assets gathered by the Group's securities broker-dealer subsidiary. The Group's broker-dealer subsidiary offers a wide array of investment alternatives to its client base, such as tax-advantaged fixed income securities, mutual funds, stocks and bonds. At December 31, 2005, total assets gathered by the broker-dealer from its customer investment accounts decreased 0.3%, to \$1.132 billion as of December 31, 2005, from \$1.135 billion as of June 30, 2005. At June 30, 2005, total assets gathered by the broker-dealer from its customer investment accounts reached \$1.135 billion, up 7.9% from \$1.052 million at June 30, 2004.

Table of Contents**Allowance for loan losses and Non-Performing Assets**

The Group maintains an allowance for loan losses at a level that management considers adequate to provide for probable losses based upon an evaluation of known and inherent risks. The Group's allowance for loan losses policy provides for a detailed quarterly analysis of probable losses. Refer to details of the methodology in this section for more information. Tables 8 through 12 set forth an analysis of activity in the allowance for loan losses and present selected loan loss statistics. In addition, refer to Table 5 for the composition (mix) of the loan portfolio.

At December 31, 2005, the Group's allowance for loan losses amounted to \$6.6 million or 0.73% of total loans versus \$6.5 million or 0.71% of total loans at June 30, 2005. Commercial loans allowances increased 0.5% by \$9,000 while the allowance for residential mortgage loans increased 0.6% or \$18,000, when compared with balances recorded at June 30, 2005. The consumer loans allowance increased by 6.1% or \$82,000, when compared to \$1.3 million recorded at June 30, 2005.

The provision for loan losses for the six-month period ended December 31, 2005 totaled \$1.9 million, a 5.4% increase from the \$1.8 million reported for the six-month period ended December 31, 2004. Based on an analysis of the credit quality and the composition of the Group's loan portfolio, management determined that the provision for the period ended December 31, 2005 was adequate in order to maintain the allowance for loan losses at an appropriate level.

The Group follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan losses. This methodology consists of several key elements. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

TABLE 8 ALLOWANCE FOR LOAN LOSSES SUMMARY:

Six-Month Periods Ended December 31, 2005 and 2004

Fiscal Years Ended June 30, 2005, 2004, 2003, 2002 and 2001

	Six-Month Period Ended December 31,		Fiscal Year Ended June 30,				
	2005	2004	2005	2004	2003	2002	2001
	(Dollars in thousands)						
Balance at beginning of period	\$ 6,495	\$ 7,553	\$ 7,553	\$ 5,031	\$ 3,039	\$ 2,856	\$ 6,837
Provision for loan losses	1,902	1,805	3,315	4,587	4,190	2,117	2,903
Net credit losses see Table 10	(1,767)	(1,793)	(4,373)	(2,065)	(2,198)	(1,934)	(6,884)
Balance at end of period	\$ 6,630	\$ 7,565	\$ 6,495	\$ 7,553	\$ 5,031	\$ 3,039	\$ 2,856

Table of Contents**TABLE 9 ALLOWANCE FOR LOAN LOSSES BREAKDOWN:****Six-Month Periods Ended December 31, 2005 and 2004****Fiscal Years Ended June 30, 2005, 2004, 2003, 2002 and 2001**

	Six-Month Period Ended December 31,		Fiscal Year Ended June 30,				
	2005	2004	2005	2004	2003	2002	2001
	(Dollars in thousands)						
Mortgage	\$ 3,185	\$ 3,200	\$ 3,167	\$ 3,861	\$ 1,749	\$ 1,178	\$ 816
Commercial	1,723	2,027	1,714	1,317	433	284	419
Consumer	1,417	1,775	1,335	1,462	1,289	1,486	1,318
Financing leases(1)					10	73	303
Unallocated allowance	305	563	279	913	1,550	18	
	\$ 6,630	\$ 7,565	\$ 6,495	\$ 7,553	\$ 5,031	\$ 3,039	\$ 2,856
Allowance composition:							
Mortgage	48.0%	42.3%	48.8%	51.1%	34.8%	38.8%	28.6%
Commercial	26.0%	26.8%	26.4%	17.4%	8.6%	9.3%	14.7%
Consumer	21.4%	23.5%	20.6%	19.4%	25.6%	48.9%	46.1%
Financing leases	0.0%	0.0%	0.0%	0.0%	0.2%	2.4%	10.6%
Unallocated allowance	4.6%	7.4%	4.2%	12.1%	30.8%	0.6%	0.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Allowance coverage ratio at end of period							
Applicable to:							
Mortgage	0.50%	0.50%	0.51%	0.60%	0.26%	0.23%	0.20%
Commercial	0.76%	1.86%	0.73%	1.61%	0.99%	0.69%	1.62%
Consumer	3.96%	7.23%	4.41%	7.84%	6.50%	6.73%	5.80%
Financing leases	0.00%	0.00%	0.00%	0.00%	23.81%	24.75%	36.64%
Unallocated allowance to total loans	0.03%	0.07%	0.03%	0.12%	0.21%	0.00%	0.00%
Total allowance to total loans	0.73%	0.98%	0.71%	1.01%	0.69%	0.52%	0.61%
Other selected data and ratios:							
Recoveries to charge-off's	15.1%	19.6%	14.2%	35.6%	29.0%	31.9%	23.8%
Allowance coverage ratio to:							
Non-performing loans	23.3%	25.1%	21.1%	24.4%	17.4%	15.1%	16.9%

Non-real estate non-performing loans	135.4%	184.7%	139.0%	229.8%	217.3%	256.2%	103.4%
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(1) Discontinued in June 2000.

Table of Contents**TABLE 10 NET CREDIT LOSSES STATISTICS:****Six-Month Periods Ended December 31, 2005 and 2004****Fiscal Years Ended June 30, 2005, 2004, 2003, 2002 and 2001**

	Six-Month Period Ended December 31,		Fiscal Year Ended June 30,					
	2005	2004	2005	2004	2003	2002	2001	
	(Dollars in thousands)							
Mortgage								
Charge-offs	\$ (774)	\$ (1,198)	\$ (2,861)	\$ (378)	\$ (5)	\$ (30)	\$ (77)	
Recoveries	145							
	(629)	(1,198)	(2,861)	(378)	(5)	(30)	(77)	
Commercial								
Charge-offs	(180)	(129)	(614)	(249)	(24)		(222)	
Recoveries	16	105	119	139	63	42	58	
	(164)	(24)	(495)	(110)	39	42	(164)	
Consumer								
Charge-offs	(1,127)	(904)	(1,619)	(2,563)	(2,928)	(2,389)	(3,289)	
Recoveries	153	333	602	832	606	566	1,352	
	(974)	(571)	(1,017)	(1,731)	(2,322)	(1,823)	(1,937)	
Financing leases(1)								
Charge-offs				(17)	(138)	(420)	(5,442)	
Recoveries				171	228	297	736	
				154	90	(123)	(4,706)	
Net credit losses								
Total charge-offs	(2,081)	(2,231)	(5,094)	(3,207)	(3,095)	(2,839)	(9,030)	
Total recoveries	314	438	721	1,142	897	905	2,146	
	\$ (1,767)	\$ (1,793)	\$ (4,373)	\$ (2,065)	\$ (2,198)	\$ (1,934)	\$ (6,884)	
Net credit losses (recoveries) to average loans:								
Mortgage	0.17%	0.34%	0.41%	0.06%	0.00%	0.01%	0.02%	
Commercial	0.25%	0.05%	0.46%	0.19%	(0.10)%	(0.13)%	0.72%	
Consumer	6.08%	5.41%	4.31%	9.70%	11.97%	8.46%	9.92%	

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Financing leases	0.00%	0.00%	0.00%	1100.00%	(50.85)%	22.20%	95.90%
Total	0.38%	0.44%	0.53%	0.28%	0.33%	0.35%	1.53%
Average loans:							
Mortgage	\$ 757,207	\$ 694,529	\$ 699,027	\$ 662,590	\$ 608,189	\$ 495,631	\$ 401,916
Commercial	129,506	96,264	108,636	57,047	40,477	31,345	22,926
Consumer	32,005	21,123	23,576	17,853	19,404	21,549	19,517
Financing leases				14	177	554	4,907
Total	\$ 918,718	\$ 811,916	\$ 831,239	\$ 737,504	\$ 668,247	\$ 549,079	\$ 449,266

(1) Discontinued in June 2000.

Table of Contents**TABLE 11 NON-PERFORMING ASSETS:****As of December 31, 2005 and June 30, 2005, 2004, 2003, 2002 and 2001**

	December 31, 2005	2005	Fiscal Year Ended June 30, 2004 2003 2002 2001 (Dollars in thousands)			
Non-performing assets:						
Non-performing loans						
Non-accruing loans	\$ 18,986	\$ 21,859	\$ 23,714	\$ 10,350	\$ 10,196	\$ 6,537
Accruing loans over 90 days past due	9,447	8,997	7,224	18,532	9,920	10,366
Total non-performing loans (see Table 12 below)	28,433	30,856	30,938	28,882	20,116	16,903
Foreclosed real estate	4,802	4,186	888	536	476	847
Reposessed autos and equipment						107
Total non-performing assets	\$ 33,235	\$ 35,042	\$ 31,826	\$ 29,418	\$ 20,592	\$ 17,857
Non-performing assets to total assets						
	0.73%	0.83%	0.85%	0.97%	0.83%	0.88%
Interest that would have been recorded in the period if the loans had not been classified as non-accruing loans						
	\$ 1,403	\$ 2,164	\$ 843	\$ 648	\$ 724	\$ 664

TABLE 12 NON-PERFORMING LOANS:**As of December 31, 2005, June 30, 2005 and 2004**

	December 31, 2005	June 30, 2005	2004
(Dollars in thousands)			
Non-performing loans:			
Mortgage	\$ 23,535	\$ 26,184	\$ 27,651
Commercial, mainly real estate	4,600	4,549	2,954
Consumer	298	123	333
Total	\$ 28,433	\$ 30,856	\$ 30,938
Non-performing loans composition percentages:			
Mortgage	82.8%	84.9%	89.4%
Commercial, mainly real estate	16.2%	14.7%	9.6%

Consumer	1.0%	0.4%	1.0%
Total	100.0%	100.0%	100.0%
Non-performing loans to:			
Total loans	3.12%	3.39%	4.12%
Total assets	0.63%	0.73%	0.83%
Total capital	8.32%	9.11%	10.98%

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

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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 for loans that are recorded at fair value or at the lower of cost or market. The Group measures for impairment all commercial loans over \$250,000. The portfolios of residential mortgages and consumer loans are considered homogeneous and are evaluated collectively for impairment.

For loans that are not individually graded, the Group uses a methodology that follows a loan credit risk rating process that involves dividing loans into risk categories. The following are the credit risk categories (established by the FDIC Interagency Policy Statement of 1993) used:

1. Pass loans considered highly collectible due to their repayment history or current status (to be in this category a loan cannot be more than 90 days past due).
2. Special Mention loans with potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects of the loan.
3. Substandard loans inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.
4. Doubtful loans that have all the weaknesses inherent in substandard, with the added characteristic that collection or liquidation in full is highly questionable and improbable.
5. Loss loans considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

The Group, using an aged-based rating system, applies an overall allowance percentage to each loan portfolio category based on historical credit losses adjusted for current conditions and trends. This delinquency-based calculation is the starting point for management's determination of the required level of the allowance for loan losses. Other data considered in this determination includes:

1. Overall historical loss trends; and
2. Other information, including underwriting standards, economic trends and unusual events.

Loan loss ratios and credit risk categories, are updated quarterly and are applied in the context of GAAP and the Joint Interagency Guidance on the importance of depository institutions having prudent, conservative, but not excessive loan allowances that fall within an acceptable range of estimated losses. While management uses available information in estimating possible loan losses, future changes to the allowance may be necessary based on factors beyond the Group's control, such as factors affecting general economic conditions.

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

these conditions involves a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments.

During the six-month period ended December 31, 2005, net credit losses amounted to \$1.77 million, a 1.5% decrease when compared to \$1.79 million reported for the same period of 2004. The decrease was primarily due to a \$568,000 reduction in net credit losses for mortgage loans. Total loss recoveries decreased from \$438,000 for the six months ended December 31, 2004 to \$314,000 for the six months period ended December 31, 2005. As result, the recoveries to charge-offs ratio decreased from 19.6% for the six months ended December 31, 2004 to 15.1% for the six months ended December 31, 2005.

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The Group's non-performing assets include non-performing loans, foreclosed real estate and other repossessed assets (see Tables 11 and 12). At December 31, 2005, the Group's non-performing assets totaled \$33.2 million (0.73% of total assets) versus \$35.0 million (0.83% of total assets) at June 30, 2005. At June 30, 2004 and 2003, non-performing assets amounted to \$31.8 million and \$29.4 million, respectively (0.85% and 0.97%, respectively, of total assets).

At December 31, 2005, the allowance for loan losses to non-performing loans coverage ratio was 23.3% (25.1% at December 31, 2004). Excluding the lesser-risk mortgage loans, the ratio is much higher, 135.4% (184.7% at December 31, 2004).

Detailed information concerning each of the items that comprise non-performing assets follows:

Mortgage loans Well collateralized residential mortgage loans are placed in non-accrual status when they become 365 days or more past due, or earlier if other factors indicate that the collection of principal and interest is doubtful, and are written down, if necessary, based on the specific evaluation of the collateral underlying the loan. At December 31, 2005, the Group's non-performing mortgage loans totaled \$23.5 million or 82.8% of the Group's non-performing loans, compared to \$26.2 million or 84.9% at June 30, 2005, and to \$27.7 million or 89.4% at June 30, 2004. Non-performing loans in this category are primarily residential mortgage loans. Based on the value of the underlying collateral and the loan-to-value ratios, management considers that no significant losses will be incurred on this portfolio.

Commercial business loans are placed in non-accrual status when they become 90 days or more past due and are charged-off based on the specific evaluation of the underlying collateral. At December 31, 2005, the Group's non-performing commercial business loans amounted to \$4.6 million or 16.2% of the Group's non-performing loans, compared to \$4.5 million or 14.7% at June 30, 2005, and \$3.0 million or 9.6% at June 30, 2004. Most of this portfolio is also collateralized by real estate and no significant losses are expected.

Consumer loans are placed in non-accrual status when they become 90 days past due and charged-off when payments are delinquent 120 days. At December 31, 2005, the Group's non-performing consumer loans amounted to \$298,000 or 1.0% of the Group's total non-performing loans, compared to \$123,000 or 0.4% at June 30, 2005, and \$333,000 or 1.0% at June 30, 2004.

Foreclosed real estate is initially recorded at the lower of the related loan balance or fair value at the date of foreclosure. Any excess of the loan balance over the fair value of the property is charged against the allowance for loan losses. Subsequently, any excess of the carrying value over the estimated fair value less selling costs is charged to operations. Management is actively seeking prospective buyers for these foreclosed properties. Foreclosed real estate amounted to \$4.8 million at December 31, 2005, \$4.2 million at June 30, 2005, \$888,000 at June 30, 2004, \$536,000 at June 30, 2003 and \$476,000 at June 30, 2002.

Table of Contents***Contractual Obligations and Commercial Commitments***

As disclosed in the notes to the Group's consolidated financial statements, the Group has certain obligations and commitments to make future payments under contracts. At December 31, 2005, the aggregate contractual obligations and commercial commitments are:

		Payments Due by Period			
	Total	Less Than 1 Year	1 3 Years	3 5 Years	After 5 Years
		(Dollars in thousands)			
CONTRACTUAL OBLIGATIONS:					
Federal funds purchased	\$ 2,525	\$ 2,525	\$	\$	\$
Short term borrowings	1,930	1,930			
Securities sold under agreements to repurchase	2,427,880	2,427,880			
Advances from FHLB	313,300	238,300	75,000		
Term notes	15,000		15,000		
Subordinated capital notes	72,166				72,166
Annual rental commitments under noncancelable operating leases	26,243	3,274	5,867	5,591	11,511
Total	\$ 2,859,044	\$ 2,673,909	\$ 95,867	\$ 5,591	\$ 83,677
OTHER COMMERCIAL COMMITMENTS:					
Lines of credit	\$ 16,386	\$ 16,386	\$	\$	\$
Commitments to extend credit	39,093	39,093			
Total	\$ 55,479	\$ 55,479	\$	\$	\$

Such commitments will be funded in the normal course of business from the Bank's principal sources of funds. At December 31, 2005 the Bank had \$807.5 million in time deposits and IRA accounts that mature during the following twelve months. The Bank does not anticipate any difficulty in retaining such deposits.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with U.S. generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature.

As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as

the prices of goods and services since such prices are affected by inflation.

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The following is a summary of the unaudited quarterly results of operations:

TABLE 13A SELECTED QUARTERLY FINANCIAL DATA:

Six-Month Period Ended December 31, 2005	September 30, December 31, (In thousands, except for per share data)	
Interest income	\$ 50,813	\$ 54,273
Interest expense	33,485	37,221
Net interest income	17,328	17,052
Provision for loan losses	951	951
Net interest income after provision for loan losses	16,377	16,101
Total non-interest income	7,825	8,557
Total non-interest expenses	15,390	16,424
Income before taxes	8,812	8,234
Income tax expense	(391)	264
Net income	8,421	8,498
Less: Dividends on preferred stock	(1,200)	(1,201)
Income available to common shareholders	\$ 7,221	\$ 7,297
Per share data:		
Basic	\$ 0.29	\$ 0.30
Diluted	\$ 0.29	\$ 0.29

TABLE 13B SELECTED QUARTERLY FINANCIAL DATA:

Year Ended June 30, 2005	September 30,		December 31,		March 31,		June 30,	
	As		As		As		As	
	Previously Reported	As Restated(1)	Previously Reported	As Restated(1)	Previously Reported	As Restated(1)	Previously Reported	As Restated(1)
(In thousands, except for per share data)								
Interest income	\$ 44,947	\$ 44,947	\$ 47,917	\$ 47,917	\$ 47,572	\$ 47,572	\$ 48,876	\$ 48,876
Interest expense	21,294	21,294	24,855	24,855	27,162	27,162	29,588	29,588
Net interest income	23,653	23,653	23,062	23,062	20,410	20,410	19,288	19,288
Provision for loan losses	700	700	1,105	1,105	660	660	850	850

Net interest income after provision for loan losses	22,953	22,953	21,957	21,957	19,750	19,750	18,438	18,438
Total non-interest income	10,404	10,404	11,943	11,943	6,101	6,101	6,437	6,437
Total non-interest expenses	15,183	15,461	15,508	18,460	15,472	12,148	16,857	13,894
Income before taxes	18,174	17,896	18,392	15,440	10,379	13,703	8,018	10,981
Income tax expense	(768)	(768)	123	123	2,671	2,671	(377)	(377)
Net income	17,406	17,128	18,515	15,563	13,050	16,374	7,641	10,604
Less: Dividends on preferred stock	(1,200)	(1,200)	(1,201)	(1,201)	(1,200)	(1,200)	(1,201)	(1,201)
Income available to common shareholders	\$ 16,206	\$ 15,928	\$ 17,314	\$ 14,362	\$ 11,850	\$ 15,174	\$ 6,440	\$ 9,403
Per share data:								
Basic	\$ 0.67	\$ 0.66	\$ 0.71	\$ 0.59	\$ 0.48	\$ 0.62	\$ 0.26	\$ 0.38
Diluted	\$ 0.64	\$ 0.61	\$ 0.68	\$ 0.55	\$ 0.46	\$ 0.58	\$ 0.26	\$ 0.37

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Year Ended June 30, 2004	September 30,		December 31,		March 31,		June 30,	
	As		As		As		As	
	Previously Reported	As Restated(1)	Previously Reported	As Restated(1)	Previously Reported	As Restated(1)	Previously Reported	As Restated(1)
Interest income	\$ 37,365	\$ 37,365	\$ 42,085	\$ 42,085	\$ 42,447	\$ 42,447	\$ 42,488	\$ 42,488
Interest expense	18,467	18,467	19,139	19,139	19,691	19,691	19,877	19,877
Net interest income	18,898	18,898	22,946	22,946	22,756	22,756	22,611	22,611
Provision for loan losses	1,340	1,340	1,014	1,014	1,050	1,050	1,183	1,183
Net interest income after provision for loan losses	17,558	17,558	21,932	21,932	21,706	21,706	21,428	21,428
Total non-interest income	12,942	12,942	9,357	9,357	11,199	11,199	12,536	12,536
Total non-interest expenses	15,381	14,823	14,603	15,984	14,997	20,922	14,451	11,635
Income before taxes	15,119	15,677	16,686	15,305	17,908	11,983	19,513	22,329
Income tax expense	(1,560)	(1,560)	(998)	(998)	(1,585)	(1,585)	(1,434)	(1,434)
Net income	13,559	14,117	15,688	14,307	16,323	10,398	18,079	20,895
Less: Dividends on preferred stock	(597)	(597)	(1,200)	(1,200)	(1,200)	(1,200)	(1,201)	(1,201)
Income available to common shareholders	\$ 12,962	\$ 13,520	\$ 14,488	\$ 13,107	\$ 15,123	\$ 9,198	\$ 16,878	\$ 19,694
Per share data:								
Basic	\$ 0.61	\$ 0.63	\$ 0.67	\$ 0.60	\$ 0.68	\$ 0.41	\$ 0.70	\$ 0.81
Diluted	\$ 0.56	\$ 0.59	\$ 0.63	\$ 0.57	\$ 0.64	\$ 0.39	\$ 0.66	\$ 0.77

(1) Refer to Note 2 to the Group's consolidated financial statements in Item 8 for information about the restatement.

Critical Accounting Policies***Transfers and Servicing of Financial Assets and Extinguishments of Liabilities***

A transfer of financial assets is accounted for as a sale when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the transferor, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the transferor does not maintain effective control over the transferred assets through an agreement to repurchase them before maturity. As such, the Group recognizes the financial assets and servicing assets it controls and the liabilities it has incurred. At the same time, it ceases to recognize financial assets when control has been surrendered and liabilities when they are extinguished.

Derivative Financial Instruments

As part of the Group's asset and liability management, the Group uses interest-rate contracts, which include interest-rate swaps to hedge various exposures or to modify interest rate characteristics of various statement of financial condition accounts.

The Group follows Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The statement requires that all derivative instruments be recognized as assets and liabilities at fair value. If certain conditions are met, the derivative may qualify for hedge accounting treatment and be designated as one of the following types of hedges: (a) hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (fair value hedge); (b) a hedge of the exposure to variability of cash flows of a recognized asset, liability or forecasted transaction (cash flow hedge) or (c) a hedge of foreign currency exposure (foreign currency hedge).

In the case of a qualifying fair value hedge, changes in the value of the derivative instruments that have been highly effective are recognized in current period earnings along with the change in value of the designated hedged item. In the case of a qualifying cash flow hedge, changes in the value of the derivative instruments that have been highly effective are recognized in other comprehensive income, until such time as those earnings are affected by the

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variability of the cash flows of the underlying hedged item. In either a fair value hedge or a cash flow hedge, net earnings may be impacted to the extent the changes in the fair value of the derivative instruments do not perfectly offset changes in the fair value or cash flows of the hedged items. If the derivative is not designated as a hedging instrument, the changes in fair value of the derivative are recorded in earnings.

Certain contracts 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 uses several 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 to derive the fair value of certain derivatives contracts.

Off-Balance Sheet Instruments

In the ordinary course of business, the Group enters into off-balance sheet instruments consisting of commitments to extend credit and commitments under credit card arrangements. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The Group periodically evaluates the credit risks inherent in these commitments, and establishes loss allowances for such risks if and when these are deemed necessary.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The Group follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan losses. This methodology consists of several key elements. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

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.

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 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. The Group's effective tax rate

includes the impact of tax contingency accruals and changes to such accruals, including related interest and penalties, as considered appropriate by management. When particular matters arise, a number of years may elapse before such matters are audited and finally resolved. Favorable resolution of such matters could be recognized as a reduction to the Group's effective rate in the year of resolution. Unfavorable settlement of any particular issue could increase the effective rate and may require the use of cash in the year of resolution.

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New Accounting Pronouncements

SFAS Statement No. 123(R) Share Based Payment

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), an amendment of SFAS Statement No. 123, Accounting for Stock-Based Compensation (SFAS 123). This Statement requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. SFAS 123R requires measurement of fair value of employee stock options using an option pricing model that takes into account the awarded options' unique characteristics.

SFAS 123R requires charging the recognized cost to expense over the period the employee provides services to earn the award, generally its vesting period. SFAS 123R's measurement requirements for employee stock options are similar to those under the fair value method of SFAS 123. However, SFAS 123R requires:

initial and ongoing estimates of the amount of shares that will vest while SFAS 123 provided entities the option of assuming that all shares would vest and then trueing up compensation cost and expense as shares were forfeited;

different measurements of awards that contain performance or market conditions; and

distinguishment of awards between equity and liabilities based on guidance in Statement of Financial Accounting Standards No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity .

SFAS 123R also provides for the use of alternative models to determine compensation cost related to stock option grants. The model the Group is using to value its employee stock-based compensation is the Black-Scholes option pricing model. The Group adopted SFAS 123R on July 1, 2005. Subsequent to the adoption of SFAS 123R, the Group recorded approximately \$11,000 related to the expensing of new grants issued during the six-month period ended December 31, 2005.

SFAS No. 153 Exchanges of Nonmonetary Assets

In December 2004, FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions. This statement amends the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged and more broadly provides for exceptions regarding exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The entity's future cash flows are expected to significantly change if either of the following criteria is met: (a) the configuration (risk, timing, and amount) of the future cash flows of the asset(s) received differs significantly from the configuration of the future cash flows of the asset(s) transferred, or (b) the entity-specific value of the asset(s) received differs from the entity-specific value of the asset(s) transferred, and the difference is significant in relation to the fair values of the assets exchanged. A qualitative assessment will, in some cases, be conclusive in determining that the estimated cash flows of the entity are expected to significantly change as a result of the exchange. SFAS No. 153 was effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS 153 did not affect the results of operations presented in the Group's consolidated financial statements.

SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140

In February 2006, FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. This statement amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 155 resolves issues addressed in Statement 133

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Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS No. 155:

Permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation;

Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133;

Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation;

Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives;

Amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The fair value election provided for in paragraph 4(c) of SFAS 155 may also be applied upon adoption of this statement for hybrid financial instruments that had been bifurcated under paragraph 12 of SFAS No. 133 prior to the adoption of SFAS No. 155. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including financial statements for any interim period for that fiscal year. Provisions of this statement may be applied to instruments that an entity holds at the date of adoption on an instrument-by-instrument basis.

At adoption, any difference between the total carrying amount of the individual components of the existing bifurcated hybrid financial instrument and the fair value of the combined hybrid financial instrument should be recognized as a cumulative-effect adjustment to beginning retained earnings. An entity should separately disclose the gross gains and losses that make up the cumulative-effect adjustment, determined on an instrument-by-instrument basis. Prior periods should not be restated.

The Group is evaluating the impact that this recently issued accounting pronouncement may have on its financial condition and results of operations.

SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statements No. 133 and 140

In March 2006, FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment to SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, to (1) require the recognition of a servicing asset or servicing liability under specified circumstances, (2) require that, if practicable, all separately recognized servicing assets and liabilities be initially measured at fair value, (3) create a choice for subsequent measurement of each class of servicing assets or liabilities by applying either the amortization method or the fair value method, and (4) permit the one-time reclassification of securities identified as offsetting exposure to changes in fair value of servicing assets or liabilities from available-for-sale securities to trading securities under SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. In addition, SFAS No. 156 amends SFAS No. 140 to require significantly greater disclosure concerning recognized servicing assets and liabilities. SFAS No. 156 is effective for all separately recognized servicing assets and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006, with early adoption permitted.

The adoption of SFAS No. 156 is not expected to have a material effect on the Group's consolidated financial position or results of operations.

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FIN No. 47, Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143

In March 2005, FASB issued interpretation (FIN) No. 47, Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143 . This Interpretation clarifies the term conditional asset retirement obligation as used in SFAS No. 143 and requires a liability to be recorded if the fair value of the obligation can be reasonably estimated. The types of asset retirement obligations that are covered by this Interpretation are those for which an entity has a legal obligation to perform an asset retirement activity. However, the timing and/or method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This Interpretation is effective for fiscal years ending after December 15, 2005. The adoption of this statement did not have a material impact on the Corporation's financial condition, results of operations, or cash flows.

FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 (FSP 109-2). The American Jobs Creation Act of 2004 (the Act) provides for a special one-time deduction of 85 percent of certain foreign earnings repatriated to electing 10% corporate U.S. shareholders from non-U.S. subsidiaries through September 30, 2006. To date, the Group has not provided for income taxes on unremitted earnings generated by the non-U.S. subsidiary given the Corporation's intent to permanently reinvest those earnings.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk and Asset/Liability Management

The Group's interest rate risk and asset and liability management is the responsibility of the Asset and Liability Management Committee (ALCO), which reports to the Board of Directors and is composed of members of the Group's senior management. The principal objective of ALCO is to enhance profitability while maintaining appropriate levels of interest rate and liquidity risks. ALCO is also involved in formulating economic projections and strategies used by the Group in its planning and budgeting process. It oversees the Group's sources, uses and pricing of funds.

Interest rate risk can be defined as the exposure of the Group's operating results or financial position to adverse movements in market interest rates, which mainly occurs when assets and liabilities reprice at different times and at different rates. This difference is commonly referred to as a maturity mismatch or gap . The Group employs various techniques to assess the degree of interest rate risk.

The Group is liability sensitive due to its fixed rate and medium to long-term asset composition being funded with shorter-term repricing liabilities. As a result, the Group utilizes various derivative instruments for hedging purposes, such as interest rate swap agreements. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations and payments are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. The actual risk of loss is the cost of replacing, at market, these contracts in the event of default by the counterparties. The Group controls the credit risk of its derivative financial instrument agreements through credit approvals, limits, monitoring procedures and collateral, when considered necessary.

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

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The Group's swaps (excluding those used to manage exposure to the stock market at December 31, 2005 and June 30, 2005 and 2004) are set forth in the table below:

Swaps:	December 31, 2005	June 30, 2005	2004
	(Dollars in thousands)		
Pay fixed swaps notional amount	\$ 1,275,000	\$ 885,000	\$ 900,000
Weighted average pay rate fixed	3.90%	3.44%	3.47%
Weighted average receive rate floating	4.39%	3.27%	1.25%
Maturity in months	1 to 60	4 to 64	3 to 76
Floating rate as a percent of LIBOR	100%	100%	100%

The Group offers its customers certificates of deposit with an option tied to the performance of the Standard & Poor's 500 stock market index. At the end of five years, the depositor will receive a specified percentage of the average increase of the month-end value of the stock index. If the index decreases, the depositor receives the principal without any interest. The Group uses option agreements with major money center banks and major broker-dealer companies to manage its exposure to changes in those indexes. Under the terms of the option agreements, the Group will receive the average increase in the month-end value of the corresponding index in exchange for a fixed premium. The changes in fair value of the options purchased and the options embedded in the certificates of deposit are recorded in earnings.

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

During fiscal year 2005, the Group bought put and call option contracts for the purpose of economically hedging \$100,000,000 in US Treasury Notes. The objective of the hedges was to protect the fair value of the US Treasury Notes classified as available-for-sale. The net effect of these transactions was to reduce earnings by \$719,000. There were no put or call options at June 30, 2005.

Derivatives designated as a hedge consist of interest rate swaps primarily used to hedge securities sold under agreements to repurchase with notional amounts of \$1.240 billion, \$885.0 million and \$900.0 million as of December 31, 2005 and June 30, 2005 and 2004, respectively. Derivatives not designated as a hedge consist of purchased options used to manage the exposure to the stock market on stock indexed deposits with notional amounts of \$173,280, \$186,010, and \$227,260 as of December 31, 2005 and June 30 2005 and 2004, respectively; embedded options on stock indexed deposits with notional amounts of \$164,651, \$178,478, and \$218,884, as of December 31, 2005 and June 30 2005 and 2004, respectively; and interest rate swaps with notional amounts of \$35.0 million as of December 31, 2005.

At December 31, 2005, the contractual maturities of interest rate swaps and equity indexed options, by fiscal year were as follows:

Year Ending December 31,	Interest Rate Swaps	Equity Indexed Options Purchased	Equity Indexed	Total
		and Swaps	Options Sold	

(In thousands)

2006	\$	460,000	\$	63,165	\$	60,126	\$	583,291
2007		175,000		43,285		39,537		257,822
2008				35,700		34,726		70,426
2009				22,085		21,419		43,504
2010		640,000		9,045		8,843		657,888
	\$	1,275,000	\$	173,280	\$	164,651	\$	1,612,931

Gains (losses) credited (charged) to earnings and reflected as Derivatives in the consolidated statements of income for the six months ended December 31, 2005 and 2004 and for the fiscal years ended June 30, 2005, 2004 and 2003 amounted to \$1.1 million, (\$322,000), (\$2.8 million), \$11,000 and (\$4.1 million) respectively. An

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unrealized loss of \$6.4 million and an unrealized gain of \$11.1 million, on derivatives designated as cash flow hedges were included in other comprehensive income for the fiscal years ended June 30, 2005 and 2004, respectively. Ineffectiveness of \$1.1 million was credited to earnings during fiscal 2005. No ineffectiveness was charged to earnings during fiscal 2004.

At December 31, 2005 and June 30, 2005 and 2004, the fair value of derivatives was recognized as either assets or liabilities in the consolidated statements of financial condition as follows: (i) the fair value of the interest rate swaps used to manage the exposure to the stock market on stock indexed deposits and fix the cost of short-term borrowings represented a liability of \$844,000, \$11.1 million and \$13.8 million, respectively, in accrued expenses and other liabilities; (ii) the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of \$22.1 million, \$19.0 million and \$16.5 million, respectively; and (iii) the options sold to customers embedded in the certificates of deposit represented a liability of \$21.1 million, \$18.2 million and \$16.2 million, respectively, recorded in deposits.

The Group is exposed to a reduction in the level of net interest income (NII) in a rising interest rate environment. NII will fluctuate with changes in the levels of interest rates, affecting interest-sensitive assets and liabilities. The hypothetical rate scenarios as of December 31, 2005 consider a gradual change of plus 200 and minus 100 basis points during a forecasted twelve-month period. The hypothetical rate scenarios as of June 30, 2005 consider a gradual change of plus 200 and minus 50 basis points during a forecasted twelve-month period. If (1) the rates in effect at year-end remain constant, or increase or decrease on instantaneous and sustained changes in the amounts presented for each forecasted period, and (2) all scheduled repricing, reinvestments and estimated prepayments, and reissuances are constant, or increase or decrease accordingly; NII will fluctuate as shown on the following table:

Change in Interest Rate	Expected NII	Amount Change	Percent Change
	(Dollars in thousands)		
December 31, 2005:			
Base Scenario			
Flat	\$ 56,798	\$	0.00%
+ 200 Basis points	\$ 38,043	\$ (18,755)	(33.02)%
– 100 Basis points	\$ 65,168	\$ 8,370	14.74%
June 30, 2005:			
Base Scenario			
Flat	\$ 78,855	\$	0.00%
+ 200 Basis points	\$ 50,236	\$ (28,619)	(36.29)%
– 50 Basis points	\$ 84,867	\$ 6,012	7.62%

Liquidity Risk Management

The objective of the Group's asset and liability management function is to maintain consistent growth in net interest income within the Group's policy limits. This objective is accomplished through management of the Group's balance

sheet composition, liquidity, and interest rate risk exposure arising from changing economic conditions, interest rates and customer preferences.

The goal of liquidity management is to provide adequate funds to meet changes in loan demand or unexpected deposit withdrawals. This is accomplished by maintaining liquid assets in the form of investment securities, maintaining sufficient unused borrowing capacity in the national money markets and delivering consistent growth in core deposits. As of December 31, 2005, the Group had approximately \$916.6 million in investments available to cover liquidity needs. Additional asset-driven liquidity is provided by securitizable loan assets. These sources, in addition to the Group's 10.1% average equity capital base, provide a stable funding base.

In addition to core deposit funding, the Group also accesses a variety of other short-term and long-term funding sources. Short-term funding sources mainly include securities sold under agreements to repurchase. Borrowing funding source limits are determined annually by each counterparty and depend on the Bank's financial condition

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and delivery of acceptable collateral securities. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. The Group also uses the FHLB as a funding source, issuing notes payable, such as advances, through its FHLB member subsidiary, the Bank. This funding source requires the Bank to maintain a minimum amount of qualifying collateral with a fair value of at least 110% of the outstanding advances. At December 31, 2005, the Group has an additional borrowing capacity with the FHLB of \$17.2 million.

In addition, the Bank utilizes the National Certificate of Deposit (CD) Market as a source of cost effective deposit funding in addition to local market deposit inflows. Depositors in this market consist of credit unions, banking institutions, CD brokers and some private corporations or non-profit organizations. The Bank's ability to acquire brokered deposits can be restricted if it becomes in the future less than well capitalized. An adequately-capitalized bank, by regulation, may not accept deposits from brokers unless it applies for and receives a waiver from the FDIC.

As of December 31, 2005, the Bank had line of credit agreements with other financial institutions permitting the Bank to borrow a maximum aggregate amount of \$40.0 million (no borrowings were made during the six-month period ended December 31, 2005 under such lines of credit). The agreements provide for unsecured advances to be used by the Group on an overnight basis. Interest rates are negotiated at the time of the transaction. The credit agreements are renewable annually.

The Group's liquidity targets are reviewed monthly by ALCO and are based on the Group's commitment to make loans and investments and its ability to generate funds.

The principal source of funds for the Group is dividends from the Bank. The ability of the Bank to pay dividends is restricted by regulatory authorities (see Dividend Restrictions under Regulation and Supervision in Item 1). Primarily, through such dividends the Group meets its cash obligations and pays dividends to its common and preferred stockholders. Management believes that the Group will continue to meet its cash obligations as they become due and pay dividends as they are declared.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
Oriental Financial Group Inc.:

We have audited the accompanying consolidated statement of financial condition of Oriental Financial Group Inc. and subsidiaries (the Group) as of December 31, 2005, and the related consolidated statements of income, changes in stockholders' equity, comprehensive income, and cash flows for the six-month period then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oriental Financial Group Inc. and subsidiaries as of December 31, 2005, and the results of their operations and their cash flows for the six-month period then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in note 1, effective July 1, 2005, the Group changed its method of accounting for share-based payments in accordance with Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Oriental Financial Group Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated June 9, 2006 expressed an unqualified opinion on management's assessment of, and an adverse opinion on the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

San Juan, Puerto Rico
June 9, 2006

Stamp No. 2102943 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Oriental Financial Group Inc.
San Juan, Puerto Rico

We have audited the accompanying consolidated statements of financial condition of Oriental Financial Group Inc. and its subsidiaries (the Group) as of June 30, 2005 and 2004, and the related consolidated statements of income, changes in stockholders' equity, comprehensive income, and cash flows for each of the three years in the period ended June 30, 2005. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Oriental Financial Group Inc. and its subsidiaries as of June 30, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2005 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, the consolidated financial statements referred to above have been restated.

/s/ DELOITTE & TOUCHE LLP

*San Juan, Puerto Rico
September 9, 2005 (June 9, 2006 as
to the effects of the restatement
discussed in Note 2)*

*Stamp No. 2166488
affixed to original.*

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
Oriental Financial Group Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Oriental Financial Group Inc. and subsidiaries (the Group) did not maintain effective internal control over financial reporting as of December 31, 2005, because of the effects of the material weaknesses identified in management's assessment, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Group's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Group's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that result in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment:

The Group did not maintain effective internal control over accounting for employee stock option awards. Specifically, the Group had inadequate review procedures to identify non-standard terms in stock option awards and equity-related contracts. This deficiency resulted in material errors, in the Group's previously issued consolidated financial statements. As a result, the Group restated its consolidated financial statements for each of the years in the three-year period ending June 30, 2005 and for each of the quarters from July 1, 2003 through September 30, 2005, in order to record non-cash adjustments to previously reported other liabilities, stockholders' equity, net income, earnings per share and total average shares and equivalents.

The Group also had inadequate review procedures over review of loan acquisition documents in order to identify and consider all relevant terms and conditions for the proper application of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This deficiency resulted in material errors, in the Group's previously issued consolidated financial statements, related to presentation of certain mortgage-related transactions with another institution as purchases

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of residential mortgage loans secured by first mortgage liens, which should have been recorded as commercial loans secured by such first lien mortgages. As a result, the Group restated its annual consolidated financial statements for the year ended June 30, 2005 and for each of the quarters from July 1, 2004 through September 30, 2005.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of Oriental Financial Group Inc. and subsidiaries as of December 31, 2005, and the related consolidated statements of income, changes in stockholders' equity, comprehensive income, and cash flows for the six-month period then ended, these material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the December 31, 2005 consolidated financial statements, and this report does not affect our report dated June 9, 2006, which expressed an unqualified opinion on those consolidated financial statements.

In our opinion, management's assessment that Oriental Financial Group Inc. did not maintain effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, Oriental Financial Group Inc. has not maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ KPMG LLP

San Juan, Puerto Rico
June 9, 2006

Stamp No. 2102945 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

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Oriental Financial Group Inc.

Management's Report on Internal Control Over Financial Reporting

To the Board of Directors and Stockholders of Oriental Financial Group Inc.:

The management of Oriental Financial Group Inc. (the Group) is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, and for the assessment of internal control over financial reporting. The Group's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

The Group's internal control over financial reporting includes those policies and procedures that:

- (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Group;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Group are being made only in accordance with authorization of management and directors of the Group; and
- (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Group's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As called for by Section 404 of the Sarbanes-Oxley Act of 2002, management has assessed the effectiveness of the Group's internal control over financial reporting as of December 31, 2005. Management made its assessment using the criteria set forth in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Criteria).

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Management's assessment of the Group's internal control over financial reporting led it to conclude that the Group did not maintain effective internal control over financial reporting as of December 31, 2005 due to the following identified material weaknesses:

The Group did not maintain effective internal control over accounting for employee stock option awards. Specifically, the Group had inadequate review procedures to identify non-standard terms in stock option awards and equity-related contracts. This deficiency resulted in material errors, in the Group's previously issued financial statements. As a result, the Group restated its financial statements for each of the years in the three-year period ending June 30, 2005 and for each of the quarters from July 1, 2003 through September 30,

2005, in order to record non-cash adjustments to previously reported other liabilities, stockholders' equity, net income, earnings per share and total average shares and equivalents.

The Group also had inadequate review procedures over review of loan acquisition documents in order to identify and consider all relevant terms and conditions for the proper application of statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This deficiency resulted in material errors, in the Group's previously issued financial statements, related to presentation of certain mortgage-related transactions with another institution as purchases of residential mortgage loans secured by first mortgage liens, which should have been recorded as commercial loans secured by such first lien mortgages. As a result, the Group restated its annual financial

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statements for the year ended June 30, 2005 and for each of the quarters from July 1, 2004 through September 30, 2005.

Using the COSO Criteria, management has determined that the material weakness found identified above result in more than a remote likelihood that a material misstatement of its annual or interim consolidated financial statements could occur and not be detected by management before the financial statements are published.

The Group's management assessment of the effectiveness of its internal control over financial reporting as of December 31, 2005, has been audited by KPMG LLP, the Group's independent registered public accounting firm, as stated in their report dated June 9, 2006.

By:
/s/ José Rafael Fernández

José Rafael Fernández
President and Chief Executive Officer

Date: June 9, 2006

By:
/s/ Héctor Méndez

Héctor Méndez
Senior Executive Vice President,
Treasurer and Chief Financial Officer

Date: June 9, 2006

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CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2005 AND JUNE 30, 2005 AND 2004

	December 31, 2005	June 30, 2005 (As Restated - See Note 2)	June 30, 2004 (As Restated - See Note 2)
	(In thousands, except share data)		
ASSETS			
Cash and due from banks	\$ 13,789	\$ 14,892	\$ 9,284
Investments:			
Time deposits with other banks	60,000	30,000	
Money market investments	3,480	9,791	7,747
Short term investments	63,480	39,791	7,747
Trading securities, at fair value with amortized cost of \$144 (June 30, 2005 \$259, June 30, 2004 \$561)	146	265	574
Investment securities available-for-sale, at fair value with amortized cost of \$1,069,649 (June 30, 2005 \$1,036,153, June 30, 2004 \$1,533,145)			
Securities pledged that can be replighted	558,719	409,556	986,165
Other investment securities	488,165	620,164	541,242
Total investment securities available-for-sale	1,046,884	1,029,720	1,527,407
Investment securities held-to-maturity, at amortized cost with fair value of \$2,312,832 (June 30, 2005 \$2,142,708, June 30, 2004 \$1,275,534)			
Securities pledged that can be replighted	1,917,805	1,802,596	1,002,041
Other investment securities	428,450	332,150	280,821
Total investment securities held-to-maturity	2,346,255	2,134,746	1,282,862
Federal Home Loan Bank (FHLB) stock, at cost	20,002	27,058	28,160
Total investments	3,476,767	3,231,580	2,846,750
Securities sold but not yet delivered	44,009	1,034	47,312
Loans:			
Mortgage loans held-for-sale, at lower of cost or market	8,946	17,963	5,814
Loans receivable, net of allowance for loan losses of \$6,630 (June 30, 2005 \$6,495, June 30, 2004 \$7,553)	894,362	885,641	737,642

Total loans, net	903,308	903,604	743,456
Accrued interest receivable	29,067	23,735	19,127
Premises and equipment, net	14,828	15,269	18,552
Deferred tax asset, net	12,222	6,191	7,337
Foreclosed real estate	4,802	4,186	888
Other assets	48,157	46,374	32,989
Total assets	\$ 4,546,949	\$ 4,246,865	\$ 3,725,695

LIABILITIES AND STOCKHOLDERS EQUITY

Deposits:

Demand deposits	\$ 146,623	\$ 152,165	\$ 126,296
Savings accounts	82,641	93,925	88,463
Certificates of deposit	1,069,304	1,006,807	809,590
Total deposits	1,298,568	1,252,897	1,024,349

Borrowings:

Federal funds purchased and other short term borrowings	4,455	12,310	
Securities sold under agreements to repurchase	2,427,880	2,191,756	1,895,865
Advances from FHLB	313,300	300,000	300,000
Term notes	15,000	15,000	15,000
Subordinated capital notes	72,166	72,166	72,166
Total borrowings	2,832,801	2,591,232	2,283,031

Securities and loans purchased but not yet received	43,354	22,772	89,068
Accrued expenses and other liabilities	30,435	41,209	47,601

Total liabilities	4,205,158	3,908,110	3,444,049
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Commitments and Contingencies

Stockholders equity:

Preferred stock, \$1 par value; 5,000,000 shares authorized; \$25 liquidation value; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding	68,000	68,000	68,000
Common stock, \$1 par value; 40,000,000 shares authorized; 25,350,125 shares issued (June 30, 2005 25,103,636 shares, June 30, 2004 22,253,084 shares)	25,350	25,104	22,253
Additional paid-in capital	208,454	206,804	137,156
Legal surplus	35,863	33,893	27,425
Retained earnings	52,340	46,705	76,752
Treasury stock, at cost 770,472 shares (June 30, 2005 228,000 shares and June 30, 2004 246,441 shares)	(10,332)	(3,368)	(4,578)
Accumulated other comprehensive loss, net of tax of \$1,810 (June 30, 2005 \$311, June 30, 2004 \$474)	(37,884)	(38,383)	(45,362)
Total stockholders equity	341,791	338,755	281,646

Total liabilities and stockholders equity	\$ 4,546,949	\$ 4,246,865	\$ 3,725,695
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The accompanying notes are an integral part of these consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME
FOR THE SIX-MONTH PERIODS ENDED DECEMBER 31, 2005 AND 2004
FOR THE FISCAL YEARS ENDED JUNE 30, 2005, 2004 AND 2003

	Six-Month Period Ended December 31,		Fiscal Year Ended June 30,		
	2005	2004	2005	2004	2003
	(As	(As	(As	(As	(As
	Restated -	Restated -	Restated -	Restated -	Restated -
	See Note 2)	See Note 2)	See Note 2)	See Note 2)	See Note 2)
	(In thousands, except per share data)				
	(Unaudited for the six-month period ended December 31, 2004)				
Interest income:					
Loans	\$ 30,901	\$ 26,610	\$ 54,966	\$ 52,130	\$ 51,486
Mortgage-backed securities	45,251	56,024	103,425	104,779	96,225
Investment securities	27,469	10,059	30,395	7,312	3,739
Short term investments	1,465	171	526	164	296
Total interest income	105,086	92,864	189,312	164,385	151,746
Interest expense:					
Deposits	20,281	13,423	29,744	30,012	33,657
Securities sold under agreements to repurchase	42,909	26,555	60,524	36,018	33,834
Advances from FHLB, term notes and other borrowings	5,046	4,125	8,313	8,158	7,918
Subordinated capital notes	2,470	2,046	4,318	2,986	1,926
Total interest expense	70,706	46,149	102,899	77,174	77,335
Net interest income	34,380	46,715	86,413	87,211	74,411
Provision for loan losses	1,902	1,805	3,315	4,587	4,190
Net interest income after provision for loan losses	32,478	44,910	83,098	82,624	70,221
Non-interest income (expense):					
Financial service revenues	7,506	7,612	14,371	17,617	14,472
Banking service revenues	4,495	3,859	7,752	7,165	5,968
Net gain (loss) on:					
Mortgage banking activities	1,702	5,532	7,774	7,719	8,026
Securities available-for-sale	650	5,642	7,446	13,414	14,223
Derivatives	1,256	(322)	(2,811)	11	(4,061)
Trading securities	5	(33)	(15)	21	571
Premises and equipment	36				(219)
Other	732	57	368	87	59

Total non-interest income, net	16,382	22,347	34,885	46,034	39,039
Non-interest expenses:					
Compensation and employees' benefits	12,714	15,910	23,606	28,511	24,312
Occupancy and equipment	5,798	5,050	10,583	9,639	9,079
Advertising and business promotion	3,187	3,599	6,506	7,466	7,052
Professional and service fees	3,771	3,380	6,994	5,631	6,467
Communication	837	843	1,630	1,849	1,671
Loan servicing expenses	911	896	1,727	1,853	1,775
Taxes, other than payroll and income taxes	1,195	902	1,836	1,754	1,556
Electronic banking charges	854	1,015	2,075	1,679	1,244
Printing, postage, stationery and supplies	528	474	891	1,121	1,038
Insurance	374	392	767	791	736
Other	1,645	1,460	3,348	3,070	2,475
Total non-interest expenses	31,814	33,921	59,963	63,364	57,405
Income before income taxes	17,046	33,336	58,020	65,294	51,855
Income tax expense (benefit)	127	645	(1,649)	5,577	4,284
Net income	16,919	32,691	59,669	59,717	47,571
Less: Dividends on preferred stock	(2,401)	(2,401)	(4,802)	(4,198)	(2,387)
Income available to common shareholders	\$ 14,518	\$ 30,290	\$ 54,867	\$ 55,519	\$ 45,184
Income per common share:					
Basic	\$ 0.59	\$ 1.24	\$ 2.23	\$ 2.48	\$ 2.15
Diluted	\$ 0.58	\$ 1.17	\$ 2.14	\$ 2.32	\$ 1.99
Average common shares outstanding	24,777	24,407	24,571	22,394	21,049
Average potential common shares-options	340	1,546	1,104	1,486	1,643
	25,117	25,953	25,675	23,880	22,692
Cash dividends per share of common stock	\$ 0.28	\$ 0.27	\$ 0.55	\$ 0.51	\$ 0.45

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

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**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE SIX-MONTH PERIODS ENDED DECEMBER 31, 2005 AND 2004
FOR THE FISCAL YEARS ENDED JUNE 30, 2005, 2004 AND 2003**

Changes in Stockholders' Equity:	Six-Month Period Ended December 31,		Fiscal Year Ended June 30,		
	2005	2004	2005	2004	2003
	(As Restated - See Note 2)	(As Restated - See Note 2)	(As Restated - See Note 2)	(As Restated - See Note 2)	(As Restated - See Note 2)
(In thousands)					
(Unaudited for the six-month period ended December 31, 2004)					
Preferred stock:					
Balance at beginning of period	\$ 68,000	\$ 68,000	\$ 68,000	\$ 33,500	\$ 33,500
Issuance of preferred stock				34,500	
Balance at end of period	68,000	68,000	68,000	68,000	33,500
Common stock:					
Balance at beginning of period	25,104	22,253	22,253	19,684	15,300
Issuance of common stock				1,955	
Stock options exercised	246	354	857	614	520
Stock dividend and stock split effected in the form of a dividend		1,994	1,994		3,864
Balance at end of period	25,350	24,601	25,104	22,253	19,684
Additional paid-in capital:					
Balance at beginning of period as previously reported					52,670
Prior period adjustment (See Note 2)					9,126
Balance at beginning of period as restated	206,804	137,156	137,156	67,813	61,796
Issuance of common stock				52,785	
Stock-based compensation expense		1,292	7,552	1,373	1,451
Stock options exercised	1,650	2,573	3,650	5,282	4,566