

ORIENTAL FINANCIAL GROUP INC

Form 10-Q

August 08, 2007

Table of Contents

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

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2007

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

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

Incorporated in the Commonwealth of Puerto Rico.

IRS Employer Identification No. 66-0538893

Principal Executive Offices:

997 San Roberto Street

Oriental Center 10th Floor

Professional Offices Park

San Juan, Puerto Rico 00926

Telephone Number: (787) 771-6800

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

Yes No

Indicate by check mark whether the registrant 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

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

24,512,042 common shares (\$1.00 par value per share)

outstanding as of July 31, 2007

TABLE OF CONTENTS

	Page
<u>Part I FINANCIAL INFORMATION:</u>	
<u>Item 1 Financial Statements</u>	
<u>Unaudited consolidated statements of financial condition at June 30, 2007 and December 31, 2006</u>	1
<u>Unaudited consolidated statements of income for the quarters and six-month periods ended June 30, 2007 and 2006</u>	2
<u>Unaudited consolidated statements of changes in stockholders' equity for the six-month periods ended June 30, 2007 and 2006</u>	3
<u>Unaudited consolidated statements of comprehensive income for the quarters and six-month periods ended June 30, 2007 and 2006</u>	3
<u>Unaudited consolidated statements of cash flows for the six-month periods ended June 30, 2007 and 2006</u>	4
<u>Notes to unaudited consolidated financial statements</u>	5
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	35
<u>Item 4 Controls and Procedures</u>	37
<u>PART II OTHER INFORMATION:</u>	
<u>Item 1 Legal Proceedings</u>	38
<u>Item 1A Risk Factors</u>	38
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	38
<u>Item 3 Defaults Upon Senior Securities</u>	39
<u>Item 4 Submissions of Matters to a Vote of Security Holders</u>	39
<u>Item 5 Other Information</u>	39
<u>Item 6 Exhibits</u>	39
<u>Signatures</u>	40
<u>Certifications</u>	41
<u>EX-31.1 SECTION 302 CERTIFICATION OF THE CEO</u>	

EX-31.2 SECTION 302 CERTIFICATION OF THE CFO

EX-32.1 SECTION 906 CERTIFICATION OF THE CEO

EX-32.2 SECTION 906 CERTIFICATION OF THE CFO

Table of Contents

FORWARD-LOOKING STATEMENTS

When used in this Form 10-Q 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 local, 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.

Table of Contents**PART I FINANCIAL INFORMATION****ITEM I FINANCIAL STATEMENTS****UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****JUNE 30, 2007 AND DECEMBER 31, 2006***(In thousands, except share data)*

	June 30, 2007	December 31, 2006
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	\$ 21,727	\$ 15,341
Money market investments	48,480	18,729
Total cash and cash equivalents	70,207	34,070
Investments:		
Securities purchased under agreements to resell	16,200	
Time deposits with other banks	5,000	5,000
Trading securities, at fair value with amortized cost of \$548 (December 31, 2006 - \$246)	548	243
Investment securities available-for-sale, at fair value with amortized cost of \$1,940,707 (December 31, 2006 - \$984,060)		
Securities pledged that can be repledged	1,846,450	947,880
Other investment securities	59,878	27,080
Total investment securities available-for-sale	1,906,328	974,960
Investment securities held-to-maturity, at amortized cost with fair value of \$1,714,608 (December 31, 2006 - \$1,931,720)		
Securities pledged that can be repledged	1,620,932	1,814,746
Other investment securities	143,653	152,731
Total investment securities held-to-maturity	1,764,585	1,967,477
Other Investments	31,770	30,949
Federal Home Loan Bank (FHLB) stock, at cost	13,909	13,607
Total investments	3,738,340	2,992,236
Securities sold but not yet delivered	46,461	6,430

Loans:		
Mortgage loans held-for-sale, at lower of cost or market	66,032	10,603
Loans receivable, net of allowance for loan losses of \$8,432 (December 31, 2006 - \$8,016)	1,206,145	1,201,767
Total loans, net	1,272,177	1,212,370
Accrued interest receivable	45,807	27,940
Premises and equipment, net	19,390	20,153
Deferred tax asset, net	18,005	14,150
Foreclosed real estate	4,971	4,864
Other assets	75,291	61,477
Total assets	\$ 5,290,649	\$ 4,373,690

LIABILITIES AND STOCKHOLDERS EQUITY

Deposits:		
Demand deposits	\$ 111,686	\$ 132,434
Savings accounts	326,124	266,184
Certificates of deposit	891,852	834,370
Total deposits	1,329,662	1,232,988
Borrowings:		
Federal funds purchased and other short term borrowings	24,641	13,568
Securities sold under agreements to repurchase	3,283,796	2,535,923
Advances from FHLB	180,000	181,900
Term notes		15,000
Subordinated capital notes	36,083	36,083
Total borrowings	3,524,520	2,782,474
Securities purchased but not yet received	100,067	
Accrued expenses and other liabilities	22,925	21,802
Total liabilities	4,977,174	4,037,264
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
	25,543	25,431

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Common stock, \$1 par value; 40,000,000 shares authorized; 25,542,960 shares issued (December 31, 2006 - 25,430,929 shares)		
Additional paid-in capital	209,860	209,033
Legal surplus	38,312	36,245
Retained earnings	32,883	26,772
Treasury stock, at cost 1,022,600 shares (December 31, 2006 - 989,405 shares)	(13,311)	(12,956)
Accumulated other comprehensive loss, net of tax of \$4,030 (December 31, 2006 - \$290)	(47,812)	(16,099)
Total stockholders' equity	313,475	336,426
Total liabilities and stockholders' equity	\$ 5,290,649	\$ 4,373,690

See notes to unaudited consolidated financial statements.

- 1 -

Table of Contents**UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2007 AND 2006***(In thousands, except per share data)*

	Quarter ended June 30,		Six-Month Period Ended June 30,	
	2007	2006	2007	2006
Interest income:				
Loans	\$ 22,315	\$ 18,311	\$ 44,163	\$ 34,564
Mortgage-backed securities	25,268	23,887	50,766	48,387
Investment securities and other	23,218	14,696	37,371	29,935
Total interest income	70,801	56,894	132,300	112,886
Interest expense:				
Deposits	13,601	11,146	25,849	21,644
Securities sold under agreements to repurchase	36,546	31,128	69,334	57,491
Advances from FHLB, term notes and other borrowings	2,198	2,568	4,515	5,190
Subordinated capital notes	766	1,344	1,524	2,641
Total interest expense	53,111	46,186	101,222	86,966
Net interest income	17,690	10,708	31,078	25,920
Provision for loan losses	1,375	947	2,450	2,048
Net interest income after provision for loan losses	16,315	9,761	28,628	23,872
Non-interest income:				
Financial service revenues	4,049	4,066	8,892	7,317
Banking service revenues	2,265	2,511	4,139	4,687
Investment banking revenues		852		2,561
Mortgage banking activities	170	634	232	1,070
Net gain (loss) on:				
Securities available-for-sale	10		369	19
Derivatives	88	(23)	8,384	859
Trading securities	2	(8)	2	21
Income (loss) from other investments	1,159	(574)	777	(270)
Other	53	63	132	210
Total non-interest income, net	7,796	7,521	22,927	16,474
Non-interest expenses:				
Compensation and employees benefits	6,916	5,627	13,661	11,801

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Occupancy and equipment	3,343	2,793	6,337	5,682
Professional and service fees	1,984	1,546	3,522	2,902
Advertising and business promotion	1,118	1,077	1,911	2,014
Directors and investor relations	769	295	1,300	708
Loan servicing expenses	540	509	1,063	964
Taxes, other than payroll and income taxes	489	573	937	1,173
Electronic banking charges	457	494	916	962
Clearing and wrap fees expenses	310	393	675	789
Communication	308	395	646	843
Insurance	211	219	427	432
Foreclosure expenses	338	131	405	232
Printing, postage, stationery and supplies	189	359	391	544
Other	505	373	1,113	621
Total non-interest expenses	17,477	14,784	33,304	29,667
Income before income taxes	6,634	2,498	18,251	10,679
Income tax expense (benefit)	187	(21)	811	110
Net income	6,447	2,519	17,440	10,569
Less: Dividends on preferred stock	(1,201)	(1,201)	(2,401)	(2,401)
Income available to common shareholders	\$ 5,246	\$ 1,318	\$ 15,039	\$ 8,168
Income per common share:				
Basic	\$ 0.21	\$ 0.05	\$ 0.61	\$ 0.33
Diluted	\$ 0.21	\$ 0.05	\$ 0.61	\$ 0.33
Average common shares outstanding	24,488	24,599	24,480	24,608
Average potential common shares-options	75	106	97	128
	24,563	24,705	24,577	24,736
Cash dividends per share of common stock	\$ 0.14	\$ 0.14	\$ 0.28	\$ 0.28

See notes to unaudited consolidated financial statements.

- 2 -

Table of Contents**UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
FOR THE SIX-MONTH PERIODS ENDED ENDED JUNE 30, 2007 AND 2006***(In thousands)*

	Six-Month Period Ended June 30,	
	2007	2006
CHANGES IN STOCKHOLDERS EQUITY:		
Preferred stock:		
Balance at beginning and end of period	\$ 68,000	\$ 68,000
Common stock:		
Balance at beginning of period	25,431	25,350
Stock options exercised	112	20
Balance at end of period	25,543	25,370
Additional paid-in capital:		
Balance at beginning of period	209,033	208,454
Stock-based compensation expense	12	16
Stock options exercised	815	150
Balance at end of period	209,860	208,620
Legal surplus:		
Balance at beginning of period	36,245	35,863
Transfer from retained earnings	2,067	1,251
Balance at end of period	38,312	37,114
Retained earnings:		
Balance at beginning of period	26,772	52,340
Net income	17,440	10,569
Cash dividends declared on common stock	(6,861)	(6,889)
Cash dividends declared on preferred stock	(2,401)	(2,401)
Transfer to legal surplus	(2,067)	(1,251)
Balance at end of period	32,883	52,368
Treasury stock:		
Balance at beginning of period	(12,956)	(10,332)
Stock used to match defined contribution plan 1165(e)	175	135
Stock purchased	(530)	(582)

Balance at end of period	(13,311)	(10,779)
Accumulated other comprehensive loss, net of tax:		
Balance at beginning of period	(16,099)	(37,884)
Other comprehensive loss, net of tax	(31,713)	(2,526)
Balance at end of period	(47,812)	(40,410)
Total stockholders equity	\$ 313,475	\$ 340,283

**UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED ENDED JUNE 30, 2007 AND 2006**
(In thousands)

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
COMPREHENSIVE INCOME	2007	2006	2007	2006
Net income	\$ 6,447	\$ 2,519	\$ 17,440	\$ 10,569
Other comprehensive income (loss), net of tax:				
Unrealized loss on securities available-for-sale	(31,286)	(9,807)	(26,086)	(21,351)
Realized gain on investment securities available-for-sale included in net income	(10)		(369)	(19)
Unrealized gain on derivatives designated as cash flows hedges arising during the period		8,106		18,022
Gains on derivatives designated as cash flow hedges included in net income			(773)	(749)
Gain from termination of cash flow hedging			(8,225)	
Income tax effect related to unrealized loss on securities available-for-sale	4,381	992	3,740	1,571
Other comprehensive loss for the period	(26,915)	(709)	(31,713)	(2,526)
Comprehensive income (loss)	\$ (20,468)	\$ 1,810	\$ (14,273)	\$ 8,043

See notes to unaudited consolidated financial statements.

Table of Contents**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2007 AND 2006***(In thousands)*

	Six-Month Period Ended June	
	30,	
	2007	2006
Cash flows from operating activities:		
Net income	\$ 17,440	\$ 10,569
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of deferred loan origination fees, net of costs	(771)	(760)
Amortization of premiums, net of accretion of discounts	4,143	1,045
Depreciation and amortization of premises and equipment	2,916	2,672
Deferred income tax benefit	(116)	(1,068)
Equity in (earnings) losses of investment in limited liability partnership	(75)	271
Provision for loan losses	2,450	2,048
Common stock used to match defined contribution plan 1165(e)	175	135
Stock-based compensation	12	16
Gain on:		
Sale of securities available-for-sale	(369)	(19)
Mortgage banking activities	(232)	(1,070)
Derivatives	(8,898)	(859)
Sale of foreclosed real estate	(67)	(115)
Sale of premises and equipment	(20)	(8)
Originations of loans held-for-sale	(80,420)	(33,830)
Proceeds from sale of loans held-for-sale	25,223	13,525
Net decrease in:		
Trading securities	(305)	(222)
Accrued interest receivable	(17,867)	(2,246)
Other assets	(4,597)	(7,375)
Net increase (decrease) in:		
Accrued interest on deposits and borrowings	(4,216)	(2,492)
Other liabilities	1,015	(2,030)
Net cash used in operating activities	(64,579)	(21,813)
Cash flows from investing activities:		
Net decrease in time deposits with other banks		30,000
Net increase in securities purchased under agreements to resell	(16,200)	
Purchases of:		
Investment securities available-for-sale	(1,053,377)	(278,566)
Investment securities held-to-maturity	(10,772)	(6,500)
Other Investments	(701)	
Equity options	(9,504)	(9,733)
FHLB stock	(17,162)	
Maturities and redemptions of:		
Investment securities available-for-sale	70,857	73,173

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Investment securities held-to-maturity	273,663	108,975
FHLB stock	16,860	11,466
Proceeds from sales of:		
Investment securities available-for-sale	23,043	57,130
Foreclosed real estate	1,414	2,142
Loan production:		
Origination and purchase of loans, excluding loans held-for-sale	(85,230)	(321,068)
Principal repayment of loans	77,719	68,474
Additions to premises and equipment, net	(2,133)	(5,194)
Net cash used in investing activities	(731,523)	(269,701)
Cash flows from financing activities:		
Net increase (decrease) in:		
Deposits	96,770	(85,449)
Securities sold under agreements to repurchase	750,161	425,516
Federal funds purchased and other short term borrowings	11,073	12,643
Proceeds from:		
Advances from FHLB	2,463,370	1,322,995
Exercise of stock options	927	170
Repayments of advances from FHLB	(2,465,270)	(1,350,795)
Repurchase of treasury stocks	(530)	(582)
Maturity of term note	(15,000)	
Dividend paid in common and preferred stock	(9,262)	(9,294)
Net cash provided by financing activities	832,239	315,204
Net change in cash and cash equivalents	36,137	23,690
Cash and cash equivalents at beginning of period	34,070	17,269
Cash and cash equivalents at end of period	\$ 70,207	\$ 40,959
Supplemental Cash Flow Disclosure and Schedule of Noncash Activities:		
Interest paid	\$ 96,790	\$ 90,826
Mortgage loans securitized into mortgage-backed securities	\$	\$ 20,447
Securities sold but not yet delivered	\$ 46,461	\$ 710
Securities and loans purchased but not yet received	\$ 100,067	\$ 6,539
Transfer from loans to foreclosed real estate	\$ 1,454	\$ 1,604

See notes to unaudited consolidated financial statements.

- 4 -

Table of Contents**ORIENTAL FINANCIAL GROUP INC.****Notes to Unaudited Consolidated Financial Statements****NOTE 1 BASIS OF PRESENTATION:**

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

The unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In the opinion of management, these consolidated financial statements include all adjustments necessary, all of which are of normal recurring nature, to present fairly the consolidated statement of financial condition as of June 30, 2007 and December 31, 2006, and the consolidated results of operations and cash flows for the six-month periods ended June 30, 2007 and 2006. All significant intercompany balances and transactions have been eliminated in the accompanying unaudited consolidated financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such SEC rules and regulations. Management believes that the disclosures made are adequate to make the information presented not misleading. The results of operations and cash flows for the six-month periods ended June 30, 2007 and 2006 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2006, included in the Group's 2006 annual report on Form 10-K.

Nature of Operations

The Group is a diversified, publicly-owned financial holding company incorporated on June 14, 1996 under the laws of the Commonwealth of Puerto Rico. It has four wholly-owned subsidiaries, Oriental Bank and Trust (the Bank), Oriental Financial Services Corp. (Oriental Financial Services), Oriental Insurance, Inc. (Oriental Insurance), and Caribbean Pension Consultants, Inc. (located in Boca Raton, Florida). The Group also has two special purpose entities, Oriental Financial (PR) Statutory Trust I (the Statutory Trust I) and Oriental Financial (PR) Statutory Trust II (the Statutory Trust II). Through these subsidiaries and its divisions, the Group provides comprehensive financial services to its clients through a complete range of banking and financial solutions, including mortgage, commercial and consumer lending, financial planning, insurance sales, money management and investment banking and brokerage services, as well as corporate and individual trust services. Note 9 to the unaudited consolidated financial statements present further information about the operations of the Group's business segments.

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

The Bank operates through twenty-four branches located throughout Puerto Rico and is subject to the supervision, examination and regulation of the Office of the Commissioner of Financial Institutions of Puerto Rico (OCIF) and the Federal Deposit Insurance Corporation (FDIC). The Bank offers banking services such as commercial and consumer lending, saving and time deposit products, financial planning, and corporate and individual trust services, and capitalizes on its commercial banking network to provide mortgage lending products to its clients. The Bank operates one international banking entity (IBE) pursuant to the International Banking Center Regulatory Act of Puerto Rico, as amended (the IBE Act): Oriental International Bank Inc., which is a wholly-owned subsidiary of the Bank. The IBE offers the Bank certain Puerto Rico tax advantages and its services are limited under Puerto Rico law to persons and assets/liabilities located outside of Puerto Rico. The Group previously had another IBE, which was liquidated on May 31, 2007, after obtaining all the corresponding regulatory approvals.

Oriental Financial Services is subject to the supervision, examination and regulation of the National Association of Securities Dealers, Inc. (now the Financial Industry Regulatory Authority), the SEC, and the OCIF. Oriental Insurance is subject to the supervision, examination and regulation of the Office of the Commissioner of Insurance of Puerto Rico.

The Group's mortgage banking activities are conducted through 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 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

- 5 -

Table of Contents

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. In 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 continues to outsource the servicing of the GNMA, FNMA and FHLMC pools that it issues and of its mortgage loan portfolio.

Significant Accounting Policies

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

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses based on probable losses that are estimated to occur. Loan losses are charged against the allowance when 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.

Included in the review of individual loans are those that are impaired, as provided in the Statement of Financial Accounting Standards (SFAS) No. 114, Accounting by Creditors for Impairment of a Loan. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or as a practical expedient, at the observable market price of the loan or the fair value of the collateral, if the loan is collateral dependent. Loans are individually evaluated for impairment, except large groups of small balance homogeneous loans that are collectively evaluated for impairment under the provisions of SFAS No. 5, Accounting for Contingencies, as amended, and 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 mortgage and consumer loans are considered homogeneous, and are evaluated collectively for impairment.

The Group, using a rating system, applies an overall allowance percentage to each 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: the overall historical loss trends and other information including underwriting standards and economic trends.

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

changes to the allowance.

Financial Instruments

Certain financial instruments including derivatives, hedged items, trading securities and investment securities available-for-sale are recorded at fair value and unrealized gains and losses are recorded in other comprehensive income or as part of non-interest income, as appropriate. Fair values are based on listed market prices, if available. If listed market prices are not available, fair value is determined based on other relevant

- 6 -

Table of Contents

factors, including price quotations for similar instruments. The fair values of certain derivative contracts are derived from pricing models that consider current market and contractual prices for the underlying financial instruments as well as time value and yield curve or volatility factors underlying the positions.

Impairment of Investment Securities

The Group evaluates its securities available-for-sale and held-to-maturity for impairment. An impairment charge in the consolidated statements of income is recognized when the decline in the fair value of investments below their cost basis is judged to be other-than-temporary. The Group considers various factors in determining whether it should recognize an impairment charge, including, but not limited to the length of time and extent to which the fair value has been less than its cost basis, and the Group's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value. For debt securities, the Group also considers, among other factors, the investors repayment ability on its debt obligations and its cash and capital generation ability.

Income Taxes

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

The Group maintained an effective tax rate lower than the maximum marginal statutory rate of 39% and 43.5% as of June 30, 2007 and 2006, respectively, mainly due to the interest income arising from investments exempt from Puerto Rico income taxes, net of expenses attributable to the exempt income. Exempt interest relates mostly to interest earned on obligations of the United States and Puerto Rico governments and certain mortgage-backed securities, including securities held by the Bank's international banking entity.

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of the Group's net deferred tax assets assumes that the Group will be able to generate sufficient future taxable income based on estimates and assumptions. If these estimates and related assumptions change in the future, the Group may be required to record valuation allowances against its deferred tax assets resulting in additional income tax expense in the consolidated statements of income. Management evaluates the realizability of the deferred tax assets on a regular basis and assesses the need for a valuation allowance. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in valuation allowance from period to period are included in the Group's tax provision in the period of change. As of June 30, 2007, a valuation allowance of approximately \$3.9 million was recorded to offset deferred tax assets from loss carry forwards that the Group considers it may not realize in future periods.

Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the projections of future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Group will realize the benefits of these deductible differences, net of the existing valuation allowances at June 30, 2007. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward period are reduced.

Effective at the beginning of the first quarter of 2007, the Group adopted the provisions of Financial Accounting Standard Board (FASB) Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax

positions accounted for in accordance with SFAS No. 109, Accounting for Income Taxes. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.

- 7 -

Table of Contents

The total amount of gross unrecognized tax benefits as of the date of adoption that would affect the effective tax rate was \$5.7 million. The Group classifies unrecognized tax benefits in income taxes payable. No adjustments resulted by the implementation of FIN 48. These gross unrecognized tax benefits would affect the effective tax rate if realized.

The Group's policy to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the consolidated condensed statements of income did not change as a result of implementing the provisions of FIN 48. As of the date of adoption of FIN 48, the Group had accrued \$1.3 million for the payment of interest and penalties relating to unrecognized tax benefits. The Group does not anticipate significant changes in unrecognized tax benefits during 2007.

Equity Compensation Plans

On April 25, 2007, the Board of Directors (the "Board") formally adopted the Oriental Financial Group Inc. 2007 Omnibus Performance Incentive Plan (the "Omnibus Plan"), which was subsequently approved at the annual meeting of stockholders held on June 27, 2007. The Omnibus Plan provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units and dividend equivalents, as well as equity-based performance awards.

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

The Compensation Committee of the the Group's Board, or such other committee as the Board may designate (the "Committee"), has full authority to interpret and administer the Omnibus Plan in order to carry out its provisions and purposes. The Committee has the authority to determine those persons eligible to receive an Award and to establish the terms and conditions of any Award. The Committee may delegate, subject to such terms or conditions or guidelines as it shall determine, to any employee or group of employees any portion of its authority and powers under the Omnibus Plan with respect to participants who are not directors or executive officers subject to the reporting requirements under Section 16(a) of the Securities Exchange Act of 1934. Only the Committee may exercise authority in respect of Awards granted to such participants. Awards vest upon completion of specified years of service. The Omnibus Plan replaced and superseded the Oriental Financial Group Inc. 1996, 1998 and 2000 Incentive Stock Option Plans (the "Stock Option Plans"). All outstanding stock options under the Stock Option Plans continue in full force and effect, subject to their original terms.

Effective July 1, 2005, the Group adopted Statement of Financial Accounting Standards (SFAS) No. 123R Share-Based Payment (SFAS 123R), an amendment of SFAS 123 Accounting for Stock-Based Compensation using the modified prospective transition method. SFAS 123R requires measurement of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award with the cost to be recognized over the service period. SFAS 123R is effective for financial statements as of the beginning of the first interim or annual reporting period of the first fiscal year that began after June 15, 2005. SFAS No. 123R applies to all awards unvested and granted after this effective date and awards modified, repurchased, or cancelled after that date.

The Group recorded approximately \$12,000 and \$16,000 during the six-month periods ended June 30, 2007 and 2006, respectively, related to compensation expense for options issued subsequent to the adoption of SFAS 123R. The remaining unrecognized compensation cost related to unvested awards as of June 30, 2007, was approximately \$450,000 and the weighted average period of time over which this cost will be recognized is approximately 7 years. The average fair value of each option granted during the six-month periods ended June 30, 2007 and 2006 was \$2.16 and \$4.05, respectively. The average fair value of each option granted was estimated at the date of the grant using the Black-Scholes option pricing model. The Black-Scholes option-pricing model was developed for use in estimating the

fair value of traded options that have no restrictions and are fully transferable and negotiable in a free trading market. Black-Scholes does not consider the employment, transfer or vesting restrictions that are inherent in the Group's employee options. Use of an option valuation model, as required by GAAP, includes highly

- 8 -

Table of Contents

subjective assumptions based on long-term predictions, including the expected stock price volatility and average life of each option grant.

The following assumptions were used in estimating the fair value of the options granted:

	Six-Month Period Ended	
	June 30,	
	2007	2006
Weighted Average Assumptions:		
Dividend yield	4.54%	3.87%
Expected volatility	33.34%	34.26%
Risk-free interest rate	4.65%	4.19%
Expected life (in years)	8.5	8.5

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

NOTE 2 INVESTMENT SECURITIES:

The amortized cost, gross unrealized gains and losses, fair value, and weighted average yield of the investment securities as of June 30, 2007 and December 31, 2006, were as follows:

	June 30, 2007 (In thousands)				Weighted Average Yield
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	
Available-for-sale					
Obligations of US Government sponsored agencies	\$ 950,000	\$	\$ 18,211	\$ 931,789	5.88%
Puerto Rico Government and agency obligations	20,292	64	1,095	19,261	5.68%
Corporate bonds and other	26,108		130	25,978	5.68%
Total investment securities	996,400	64	19,436	977,028	
FNMA and FHLMC certificates	238,809		5,103	233,706	5.68%
GNMA certificates	39,284	175	873	38,586	5.61%
Collateralized mortgage obligations (CMO's)	666,214	46	9,252	657,008	5.48%
Total mortgage-backed-securities and CMO's	944,307	221	15,228	929,300	
Total securities available-for-sale	1,940,707	285	34,664	1,906,328	5.71%
Held-to-maturity					
Obligations of US Government sponsored agencies	668,500	4	13,189	655,315	3.84%
Puerto Rico Government and agency obligations	55,239		4,701	50,538	5.29%
Corporate bonds and other	60,000			60,000	6.99%

Total investment securities	783,739	4	17,890	765,853	
FNMA and FHLMC certificates	663,310		24,153	639,157	5.05%
GNMA certificates	170,883		5,610	165,273	5.35%
Collateralized mortgage obligations	146,653		2,328	144,325	5.14%
Total mortgage-backed-securities and CMO s	980,846		32,091	948,755	
Total securities held-to-maturity	1,764,585	4	49,981	1,714,608	4.70%
Total	\$ 3,705,292	\$ 289	\$ 84,645	\$ 3,620,936	5.23%

- 9 -

Table of Contents

	December 31, 2006 (In thousands)				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Available-for-sale					
Puerto Rico Government and agency obligations	\$ 20,254	\$ 64	\$ 872	\$ 19,446	5.68%
Corporate bonds and other	50,598	520	2,347	48,771	6.11%
Total investment securities	70,852	584	3,219	68,217	
FNMA and FHLMC certificates	150,099		1,506	148,593	5.45%
GNMA certificates	40,690	408	235	40,863	5.61%
Collateralized mortgage obligations (CMOs)	722,419	7	5,139	717,287	5.48%
Total mortgage-backed-securities and CMO s	913,208	415	6,880	906,743	
Total securities available-for-sale	984,060	999	10,099	974,960	5.52%
Held-to-maturity					
US Treasury securities	15,022		127	14,895	2.71%
Obligations of US Government sponsored agencies	848,400	7	17,529	830,878	3.85%
Puerto Rico Government and agency obligations	55,262		3,961	51,301	5.29%
Total investment securities	918,684	7	21,617	897,074	
FNMA and FHLMC certificates	713,171	628	11,529	702,270	5.04%
GNMA certificates	182,874	215	2,176	180,913	5.35%
Collateralized mortgage obligations	152,748	18	1,303	151,463	5.13%
Total mortgage-backed-securities and CMO s	1,048,793	861	15,008	1,034,646	
Total securities held-to-maturity	1,967,477	868	36,625	1,931,720	4.55%
Total	\$ 2,951,537	\$ 1,867	\$ 46,724	\$ 2,906,680	4.87%

The amortized cost and fair value of the Group's investment securities available-for-sale and held-to-maturity at June 30, 2007, by contractual maturity, are shown in the next table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(In thousands)

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investment securities				
Due within 1 year	\$ 2,000	\$ 2,001	\$ 124,993	\$ 124,443
Due after 1 to 5 years			187,386	182,837
Due after 5 to 10 years	903,380	885,264	256,269	252,120
Due after 10 years	91,020	89,763	215,091	206,453
	996,400	977,028	783,739	765,853
Mortgage-backed securities				
Due after 1 to 5 years	1,014	1,051		
Due after 10 years	943,293	928,249	980,846	948,755
	944,307	929,300	980,846	948,755
	\$1,940,707	\$1,906,328	\$1,764,585	\$1,714,608

Securities not due on a single contractual maturity date, such as collateralized mortgage obligations, are classified in the period of final contractual maturity. The expected maturities of collateralized mortgage obligations and certain other securities may differ from their contractual maturities because they may be subject to prepayments or may be called by the issuer.

Proceeds from the sale of investment securities available-for-sale during the six-month periods ended June 30, 2007 and 2006 totaled \$23.0 million and \$57.1 million, respectively. Realized gains on those sales during the six-month periods ended June 30, 2007 and 2006 were \$369,000 and \$19,000, respectively. There were no losses in either period. The following table shows the Group's gross unrealized losses and fair value of investment securities available-for-sale and held-to-maturity, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2007.

- 10 -

Table of Contents**Available-for-sale
(In thousands)**

	Less than 12 months		Fair Value
	Amortized Cost	Unrealized Loss	
Obligations of U.S. government entities	\$ 950,000	\$ 18,211	\$ 931,789
Puerto Rico Government and agency obligations	2,376	341	2,035
Mortgage-backed securities and CMO s	926,821	14,878	911,943
Corporate bonds and other	26,000	130	25,870
	1,905,197	33,560	1,871,637

	12 months or more		Fair Value
	Amortized Cost	Unrealized Loss	
Puerto Rico Government and agency obligations	14,119	754	13,365
Mortgage-backed securities and CMO s	8,543	350	8,193
	22,662	1,104	21,558

	Total		Fair Value
	Amortized Cost	Unrealized Loss	
Obligations of U.S. government entities	\$ 950,000	\$ 18,211	\$ 931,789
Puerto Rico Government and agency obligations	16,495	1,095	15,400
Mortgage-backed securities and CMO s	935,364	15,228	920,136
Corporate bonds and other	26,000	130	25,870
	\$1,927,859	\$34,664	\$1,893,195

**Held-to-maturity
(In thousands)**

	Less than 12 months		Fair Value
	Amortized Cost	Unrealized Loss	
Obligations of U.S government sponsored entities	\$ 56,499	\$ 2,183	\$ 54,316
Puerto Rico Government and agency obligations	4,272	36	4,236
Mortgage-backed securities and CMO s	527,726	12,935	514,791
	588,497	15,154	573,343

	12 months or more		Fair Value
	Amortized Cost	Unrealized Loss	

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Obligations of U.S government sponsored entities	512,231	11,006	501,225
Puerto Rico Government and agency obligations	50,968	4,665	46,303
Mortgage-backed securities and CMO s	453,120	19,156	433,964
	1,016,319	34,827	981,492

	Amortized Cost	Total Unrealized Loss	Fair Value
Obligations of U.S government sponsored entities	568,730	13,189	555,541
Puerto Rico Government and agency obligations	55,240	4,701	50,539
Mortgage-backed securities and CMO s	980,846	32,091	948,755
	\$1,604,816	\$49,981	\$1,554,835

Securities in an unrealized loss position at June 30, 2007 are mainly composed of securities issued or backed by U.S. government agencies and U.S. government sponsored agencies. The vast majority of these securities are rated the equivalent of AAA by nationally recognized rating organizations. The investment portfolio is structured primarily with highly liquid securities that have a large and efficient secondary market. Valuations are performed on a monthly basis using a third party provider and dealer quotes. Management believes that the unrealized losses in the investment portfolio at June 30, 2007 are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuers. Also, Management has the intent and ability to hold these investments for a reasonable period of time for a forecasted recovery of fair value up to (or beyond) the cost of these investments.

Table of Contents**NOTE 3 LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES:****Loans Receivable**

The Group's credit activities are mainly with customers located in Puerto Rico. The Group's loan transactions are encompassed within three main categories: mortgage, commercial and consumer. The composition of the Group's loan portfolio at June 30, 2007, and December 31, 2006, was as follows:

	(In thousands)	
	June 30, 2007	December 31, 2006
Residential mortgage loans	\$ 922,865	\$ 899,162
Home equity loans and secured personal loans	31,232	36,270
Commercial loans, mainly secured by real estate	232,164	241,702
Personal consumer loans and lines of credit	30,905	35,772
Loans receivable, gross	1,217,166	1,212,906
Less: deferred loan fees, net	(2,589)	(3,123)
Loans receivable	1,214,577	1,209,783
Allowance for loan losses	(8,432)	(8,016)
Loans receivable, net	1,206,145	1,201,767
Mortgage loans held-for-sale	66,032	10,603
Total loans, net	\$ 1,272,177	\$ 1,212,370

Allowance for Loan Losses

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. The analysis includes a review of historical loan loss experience, value of underlying collateral, current economic conditions, financial condition of borrowers and other pertinent factors.

While management uses available information in estimating probable loan losses, future additions to the allowance may be required based on factors beyond the Group's control. Refer to Table 4 of the Management's Discussion and Analysis of Financial Condition and Results of Operations for additional details related to the changes in the allowance for loan losses for the quarters and six-month periods ended June 30, 2007 and 2006.

The Group evaluates all loans, some individually, and others as homogeneous groups, for purposes of determining impairment. At June 30, 2007 and December 31, 2006, the total investment in impaired loans was \$1.7 million and \$2.0 million, respectively. The impaired loans were measured based on the fair value of collateral. The Group determined that no specific impairment allowance was required for such loans.

NOTE 4 PLEDGED ASSETS

At June 30, 2007, residential mortgage loans amounting to \$580.0 million were pledged to secure advances and borrowings from the FHLB. Investment securities with fair values totaling \$3.368 billion, \$91.1 million, and \$8.0 million at June 30, 2007, were pledged to secure securities sold under agreements to repurchase, public fund deposits and other funds, respectively. Also, investment securities with fair value totaling \$119,100 at June 30, 2007, were pledged to the Puerto Rico Treasury Department.

As of June 30, 2007, investment securities available-for-sale and held-to-maturity not pledged amounted to \$59.9 million and \$93.7 million, respectively. As of June 30, 2007, mortgage loans not pledged amounted to \$395.3 million.

Table of Contents**NOTE 5 OTHER ASSETS**

Other assets at June 30, 2007 and December 31, 2006 include the following:

	(In thousands)	
	June 30, 2007	December 31, 2006
Investment in equity indexed options	\$ 43,358	\$ 34,216
Investment in limited partnership	11,988	11,913
Deferred charges	944	1,037
Prepaid expenses	3,504	2,152
Investment in Statutory Trusts	1,086	1,086
Goodwill	2,006	2,006
Servicing asset	1,419	1,507
Accounts receivable and other assets	10,986	7,560
	\$ 75,291	\$ 61,477

NOTE 6 SUBORDINATED CAPITAL NOTES

Subordinated capital notes amounted to \$36,083,000 at June 30, 2007 and December 31, 2006.

In October 2001 and August 2003, the Statutory Trust I and the Statutory Trust II, respectively, special purpose entities of the Group, were formed for the purpose of issuing trust redeemable preferred securities. In December 2001 and September 2003, \$35.0 million of trust redeemable preferred securities were issued by each of the Statutory Trust I and the Statutory Trust II, respectively, as part of pooled underwriting transactions. Pooled underwriting involves participating with other bank holding companies in issuing the securities through a special purpose pooling vehicle created by the underwriters.

The proceeds from these issuances were used by the Statutory Trust I and the Statutory Trust II to purchase a like amount of floating rate junior subordinated deferrable interest debentures (subordinated capital notes) issued by the Group. The call provision of the subordinated capital note purchased by the Statutory Trust I was exercised by the Group in December 2006 and the Group recorded a \$915,000 loss related to the write-off of unamortized issuance cost of the note. The other subordinated capital note has a par value of \$36.1 million, bears interest based on 3-month LIBOR plus 295 basis points (8.31% at June 30, 2007 and December 31, 2006), payable quarterly, and matures on September 17, 2033. The subordinated capital note purchased by the Statutory Trust II may be called at par after five years (September 2008). The trust redeemable preferred securities have the same maturity and call provisions as the subordinated capital notes. The subordinated deferrable interest debentures issued by the Group are accounted for as a liability denominated as subordinated capital notes on the unaudited consolidated statements of financial condition. The subordinated capital notes are treated as Tier 1 capital for regulatory purposes. Under Federal Reserve Board rules, restricted core capital elements, which are qualifying trust preferred securities, qualifying cumulative perpetual preferred stock (and related surplus) and certain minority interests in consolidated subsidiaries, are limited in the aggregate to no more than 25% of a bank holding company's core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability.

NOTE 7 OTHER BORROWINGS

At June 30, 2007, securities underlying agreements to repurchase were delivered to, and are being held by, the counterparties with whom the repurchase agreements were transacted. The counterparties have agreed to resell to the Group the same or similar securities at the maturity of the agreements.

Securities sold under agreements to repurchase and their respective accrued interest at June 30, 2007 mature as follows:

Table of Contents

	(In thousands)
	Balance
Due within 30 days	\$ 125,328
Due after 30 to 60 days	2,195
Due after 60 to 90 days	6,273
Due after 3 to 5 years	1,250,000
Due after 5 to 10 years	1,900,000
	\$ 3,283,796

At June 30, 2007, the advances from the FHLB mature as follows:

	(In thousands)
	Balance
Due within 30 days	\$ 25,000
Due after 1 to 3 years	50,000
Due after 3 to 5 years	50,000
Due after 5 to 10 years	55,000
	\$ 180,000

NOTE 8 DERIVATIVES ACTIVITIES

The Group utilizes various derivative instruments as part of its asset and liability management. These transactions involve both credit and market risks. The notional amounts are amounts on which calculations, payments, and the value of the derivatives 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 entered into 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 paid a fixed monthly or quarterly cost and received a floating thirty or ninety-day payment based on LIBOR. Floating rate payments received from the swap counterparties partially offset the interest payments to be made on the forecasted rollover of short-term borrowings. The Group decided to unwind all of its outstanding interest rate swaps with aggregate notional amounts of \$1.1 billion in two separate transactions in July and December 2006.

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 depositors receive a return equal to the greater of 15% of the principal in the account or 150% of the average increase in the month-end value of the index. The Group uses option agreements with major broker-dealer companies to manage its exposure to changes in this index. Under the terms of the option agreements, the Group receives the average increase in the month-end value of the index in exchange for a fixed premium. The changes in fair value of the option agreements used to manage the exposure in the stock market in the certificates of deposit are recorded in earnings in accordance with SFAS No. 133, as amended.

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

There were no derivatives designated as a hedge as of June 30, 2007 and December 31, 2006. Other derivatives consist of purchased options used to manage the exposure to the stock market on stock indexed deposits with notional amounts of \$145,975,000 and \$131,530,000 as of June 30, 2007 and December 31, 2006, respectively; embedded options on stock indexed deposits with notional amounts of \$139,721,000 and \$122,924,000 as of June 30, 2007 and December 31, 2006, respectively.

During the six-month periods ended June 30, 2007 and 2006, gains of \$8.4 million and \$859,000, respectively, were recognized as earnings and reflected as Derivatives Activities in the unaudited consolidated statements of income, mainly due to the \$8.2 million gain recognized in the first quarter of 2007 because of the elimination of the forecasted transactions on the cash flow hedges of the swaps previously terminated, which gains were

- 14 -

Table of Contents

previously included in other comprehensive income. During the six-month period ended June 30, 2006, unrealized gains of \$18.0 million on derivatives designated as cash flow hedges were included in other comprehensive income (loss). There are no such unrealized gains or losses at June 30, 2007.

At June 30, 2007 and December 31, 2006, the fair value of derivatives was recognized as either assets or liabilities in the unaudited consolidated statements of financial condition as follows: the purchased options used to manage the exposure to the stock market on stock indexed deposits represented an asset of \$43.4 million and \$34.2 million, respectively, presented in other assets; the options sold to customers embedded in the certificates of deposit represented a liability of \$41.4 million and \$32.2 million, respectively, recorded in deposits.

NOTE 9 SEGMENT REPORTING:

The Group segregates its businesses into the following major 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 organization, 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, net interest income, loan production and fees generated.

Banking includes the Bank's branches and mortgage banking, with traditional banking products such as deposits and mortgage, commercial and consumer loans. Mortgage banking activities are carried out by the Bank's mortgage banking division, whose principal activity is to originate mortgage loans for the Group's own portfolio. From time to time, if conditions so warrant, the Group may sell loans directly into the secondary market or securitize conforming loans into mortgage-backed securities certificates. The Group outsourced the servicing of mortgages included in the resulting mortgage-backed securities pools, as well as loans maintained in portfolio.

The Treasury segment encompasses all of the Group's asset and liability management activities such as: purchases and sales of investment securities, interest rate risk management, derivatives, and borrowings, as well as investment banking revenues on public offerings and private placements of debt and equity securities.

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

Inter-segment sales and transfers, if any, are accounted for as if the sales or transfers were to third parties, that is, at current market prices. The accounting policies of the segments are the same followed by the Group, which are described in the Summary of Significant Accounting Policies included in the Group's annual report on Form 10-K. Following are the results of operations and the selected financial information by operating segment for the quarters and six-month periods ended June 30, 2007 and 2006:

- 15 -

Table of Contents**Unaudited Quarters Ended June 30,**

<i>(In thousands)</i>	Banking	Treasury	Financial Services	Total Segments	Eliminations	Consolidated Total
June 30, 2007						
Interest income	\$ 22,666	\$ 48,078	\$ 57	\$ 70,801	\$	\$ 70,801
Interest expense	(8,001)	(44,878)	(232)	(53,111)		(53,111)
Net interest income	14,665	3,200	(175)	17,690		17,690
Non-interest income	1,747	2,194	3,855	7,796		7,796
Non-interest expenses	(13,683)	(848)	(2,946)	(17,477)		(17,477)
Intersegment revenue	928			928	(928)	
Intersegment expense		(152)	(776)	(928)	928	
Provision for loan losses	(1,375)			(1,375)		(1,375)
Income (loss) before income taxes	\$ 2,282	\$ 4,394	\$ (42)	\$ 6,634	\$	\$ 6,634
Total Assets as of June 30, 2007	\$ 1,748,466	\$ 3,829,549	\$ 12,077	\$ 5,590,092	\$ (299,443)	\$ 5,290,649
June 30, 2006						
Interest income	\$ 18,653	\$ 38,191	\$ 50	\$ 56,894	\$	\$ 56,894
Interest expense	(6,831)	(39,355)		(46,186)		(46,186)
Net interest income	11,822	(1,164)	50	10,708		10,708
Non-interest income	4,111	112	3,298	7,521		7,521
Non-interest expenses	(12,082)	(314)	(2,388)	(14,784)		(14,784)
Intersegment revenue	576			576	(576)	
Intersegment expense		(240)	(336)	(576)	576	
Provision for loan losses	(947)			(947)		(947)
Income (loss) before income taxes	\$ 3,480	\$ (1,606)	\$ 624	\$ 2,498	\$	\$ 2,498
Total Assets as of June 30, 2006	\$ 1,583,909	\$ 3,667,383	\$ 12,265	\$ 5,263,557	\$ (430,895)	\$ 4,832,662

Unaudited Six-Month Periods Ended June 30,

<i>(In thousands)</i>	Banking	Treasury	Financial Services	Total Segments	Eliminations	Consolidated Total
June 30, 2007						
Interest income	\$ 45,009	\$ 87,161	\$ 130	\$ 132,300	\$	\$ 132,300

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Interest expense	(14,972)	(85,809)	(441)	(101,222)		(101,222)
Net interest income	30,037	1,352	(311)	31,078		31,078
Non-interest income	3,024	11,146	8,757	22,927		22,927
Non-interest expenses	(25,734)	(1,579)	(5,991)	(33,304)		(33,304)
Intersegment revenue	1,876			1,876	(1,876)	
Intersegment expense		(298)	(1,578)	(1,876)	1,876	
Provision for loan losses	(2,450)			(2,450)		(2,450)
Income before income taxes	\$ 6,753	\$ 10,621	\$ 877	\$ 18,251	\$	\$ 18,251

Total Assets as of June 30, 2007	\$ 1,748,467	\$ 3,829,602	\$ 12,023	\$ 5,590,092	\$ (299,443)	\$ 5,290,649
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June 30, 2006

Interest income	\$ 35,253	\$ 77,547	\$ 86	\$ 112,886	\$	\$ 112,886
Interest expense	(12,833)	(74,133)		(86,966)		(86,966)
Net interest income	22,420	3,414	86	25,920		25,920
Non-interest income	7,544	3,062	5,868	16,474		16,474
Non-interest expenses	(24,247)	(697)	(4,723)	(29,667)		(29,667)
Intersegment revenue	1,189			1,189	(1,189)	
Intersegment expense		(407)	(782)	(1,189)	1,189	
Provision for loan losses	(2,048)			(2,048)		(2,048)
Income before income taxes	\$ 4,858	\$ 5,372	\$ 449	\$ 10,679	\$	\$ 10,679

Total Assets as of June 30, 2006	\$ 1,583,909	\$ 3,667,383	\$ 12,265	\$ 5,263,557	\$ (430,895)	\$ 4,832,662
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Table of Contents**NOTE 10 RECENT ACCOUNTING DEVELOPMENTS:*****SFAS No. 157, Fair Value Measurements***

In September 2006, FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. The changes to current practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements.

This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. Management is evaluating the impact that this accounting standard may have on the Group's consolidated financial statements.

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115

On February 15, 2007, the FASB issued SFAS 159, The Fair Value Option for Financial assets and Financial Liabilities, Including an amendment of FASB Statement No. 115. SFAS 159 provides an alternative measurement treatment for certain financial assets and financial liabilities, under an instrument-by-instrument election, that permits fair value to be used for both initial and subsequent measurement, with changes in fair value recognized in earnings. While SFAS 159 is effective for the Group beginning January 1, 2008, earlier adoption is permitted as of January 1, 2007, provided that the entity also adopts all of the requirements of SFAS 157. Management decided not to pursue early adoption and is evaluating the impact that this accounting standard may have on the Group's Consolidated Financial Statements.

FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes, (FIN 48). On January 1, 2007, the Group adopted FIN 48. FIN 48 establishes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Pursuant to FIN 48, the effects of a tax position are recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination by the taxing authority. Conversely, previously recognized tax positions are derecognized when it is no longer more likely than not that the tax position would be sustained upon examination. FIN 48 also requires certain disclosures regarding unrecognized tax benefits and the amounts and classification of the related interest and penalties.

As of January 1, 2007, the Company's unrecognized tax benefit totaled \$7.0 million, of which \$1.3 million related to interest and penalties. No adjustment resulted from the implementation of FIN 48. In accordance with the Group's policy, any tax-related interest and/or penalties are classified as a component of income taxes in the consolidated statements of financial position and results of operations. The tax periods ended June 30, 2003, 2004, and 2005, and December 31, 2005 and 2006 remain subject to examination by the Puerto Rico Department of Treasury.

NOTE 11 SUBSEQUENT EVENT:

On July 27, 2007, the Board of Directors approved a new stock repurchase program pursuant to which the Group is authorized to purchase in the open market up to \$15.0 million of its outstanding share of common stocks. The shares of common stock so repurchased are to be held by the Group as Treasury shares. The new program will substitute the Group stock repurchase program adopted on August 30, 2005. The new program effectively doubles the funds available to repurchase shares under the previous program.

Table of Contents

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
SELECTED FINANCIAL DATA
FOR THE QUARTERS AND SIX-MONTH PERIODS ENDED JUNE 30, 2007 AND 2006
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	Quarter ended			Six months ended		
	June 30,			June 30,		
EARNINGS PER SHARE AND DIVIDENDS DATA:	2007	2006	Variance	2007	2006	Variance
Interest income	\$ 70,801	\$ 56,894	24.4%	\$ 132,300	\$ 112,886	17.2%
Interest expense	53,111	46,186	15.0%	101,222	86,966	16.4%
Net interest income	17,690	10,708	65.2%	31,078	25,920	19.9%
Provision for loan losses	1,375	947	45.2%	2,450	2,048	19.6%
Net interest income after provision for loan losses	16,315	9,761	67.1%	28,628	23,872	19.9%
Non-interest income	7,796	7,521	3.7%	22,927	16,474	39.2%
Non-interest expenses	17,477	14,784	18.2%	33,304	29,667	12.3%
Income before taxes	6,634	2,498	165.6%	18,251	10,679	70.9%
Income tax expense (benefit)	187	(21)	990.5%	811	110	637.3%
Net Income	6,447	2,519	155.9%	17,440	10,569	65.0%
Less: dividends on preferred stock	(1,201)	(1,201)	%	(2,401)	(2,401)	%
Income available to common shareholders	\$ 5,246	\$ 1,318	298.0%	\$ 15,039	\$ 8,168	84.1%
PER SHARE DATA:						
Basic	\$ 0.21	\$ 0.05	320.0%	\$ 0.61	\$ 0.33	84.8%
Diluted	\$ 0.21	\$ 0.05	320.0%	\$ 0.61	\$ 0.33	84.8%
Average common shares outstanding	24,488	24,599	-0.5%	24,480	24,608	-0.5%
Average potential common share-options	75	106	-29.3%	97	128	-24.2%
Total average shares outstanding and equivalents	24,563	24,705	-0.6%	24,577	24,736	-0.6%
PERFORMANCE RATIOS:						
Return on average assets (ROA)	0.49%	0.22%	122.7%	0.70%	0.92%	-23.9%
Return on average common equity (ROE)	7.87%	1.94%	305.7%	11.22%	7.93%	41.5%
Equity-to-assets ratio	5.93%	7.69%	-22.9%	5.93%	7.69%	-22.9%
Efficiency ratio	68.99%	78.76%	-12.4%	73.81%	71.39%	3.4%

Expense ratio	0.78%	0.60%	30.0%	0.81%	0.63%	28.6%
Interest rate spread	1.17%	0.70%	67.1%	1.04%	0.89%	16.9%
Interest rate margin	1.40%	0.96%	45.8%	1.30%	1.16%	12.1%
Number of financial centers	24	24	%	24	24	%

	June 30, 2007	December 31, 2006	Variance
PERIOD END BALANCES AND CAPITAL RATIOS:			
Investments and loans			
Investments securities	\$ 3,738,339	\$ 2,992,236	24.9%
Loans (including loans held-for-sale), net	1,272,177	1,212,370	4.9%
Securities and loans sold but not yet delivered	46,461	6,430	622.6%
	\$ 5,056,977	\$ 4,211,036	20.1%
Deposits and Borrowings			
Deposits	\$ 1,329,662	\$ 1,232,988	7.8%
Repurchase agreements	3,283,796	2,535,923	29.5%
Other borrowings	240,724	246,551	-2.4%
Securities and loans purchased but not yet received	100,067		100.0%
	\$ 4,954,249	\$ 4,015,462	23.4%
Stockholders equity			
Preferred equity	\$ 68,000	\$ 68,000	%
Common equity	245,475	268,426	-8.6%
	\$ 313,475	\$ 336,426	-6.8%
Capital ratios			
Leverage capital	7.23%	8.42%	-14.1%
Tier 1 risk-based capital	19.32%	21.57%	-10.4%
Total risk-based capital	19.75%	22.04%	-10.4%
Trust assets managed	\$ 1,881,043	\$ 1,848,596	1.8%
Broker-dealer assets gathered	1,088,336	1,143,668	-4.8%
Assets managed	2,969,379	2,992,264	-0.8%
Assets owned	5,290,649	4,373,690	21.0%

Total financial assets managed and owned	\$ 8,260,028	\$ 7,365,954	12.1%
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- 18 -

Table of Contents**OVERVIEW OF FINANCIAL PERFORMANCE****Introduction**

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 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 quarter and six-month period ended June 30, 2007, the Group continued targeting the personal and commercial needs of mid and high net worth individuals and families, including professionals and owners of small and mid-size businesses, primarily in Puerto Rico.

During the fourth quarter of 2006, the Group completed a review of its available-for-sale (AFS) investment portfolio in light of asset/liability management considerations and changing market conditions, and strategically repositioned this portfolio. The repositioning involved open market sales of approximately \$865 million of securities with a weighted average yield of 4.60% at a loss of approximately \$16.0 million which was included as non-interest income in the accompanying consolidated financials statements. Following the sale, \$860 million of triple-A securities at a weighted average yield of 5.55% were purchased and classified as AFS. As part of this repositioning, the Group entered into a \$900 million, 5-year structured repurchase agreement (\$450 million non-put 1-year and \$450 million non-put 2-years) with a weighted average rate paid of 4.52%. Proceeds were used to repay repurchase agreements with a weighted average rate paid of 5.25%. In February 2007, the Group continued its strategic repositioning of the repurchase agreements portfolio, restructuring an additional \$1 billion of short-term borrowings, with a weighted average rate being paid of approximately 5.35%, into 10-year, non-put 2-year structured repurchased agreements, priced at 95 basis points under 90-day LIBOR (for a current rate of 4.40%). These strategic actions are expected to significantly improve the Group's net interest income position for 2007. Separately, the Group purchased in February 2007 approximately \$900 million in U.S. government agency securities for the AFS portfolio which were funded with a net spread of approximately 150 basis points, locked in for two years on \$750 million and one year on \$150 million. These securities are intended to replenish scheduled repayments and maturities of securities that occurred in 2006 and are expected to occur in 2007. Most of the actions the Group took to reposition the AFS portfolio and its funding in December 2006 did not take effect until January 2007, and the transactions undertaken to further restructure the Group's funding in February 2007 did not take effect until March 2007. These changes were reflected in the June 2007 quarter, as evidenced in the increase in interest rate spread from 0.89% in the March 2007 quarter to 1.17% in the June 2007 quarter, and also in interest rate margin, from 1.18% to 1.40% for the same comparable periods.

Income Available to Common Shareholders

For the quarter and six-month period ended June 30, 2007, the Group's income available to common shareholders totaled \$5.2 million and \$15.0 million, respectively, compared to \$1.3 million and \$8.2 million, respectively, in the comparable year ago quarter and six-month period. Earnings per basic and fully diluted common share was \$0.21 compared to \$0.05 in the year-ago quarter, and \$0.61 for the six-month period ended June 30, 2007 compared to \$0.33 in the year ago period.

Return on Average Assets and Common Equity

Return on average common equity (ROE) for the quarter and six-month period ended June 30, 2007 was 7.87% and 11.22%, respectively, from 1.94% and 7.93%, for the quarter and six-months ended June 30, 2006, respectively. Return on average assets (ROA) for the quarter and six-month period ended June 30, 2007 was 0.49% and 0.70%, respectively.

Net Interest Income after Provision for Loan Losses

Net interest income after provision for loan losses increased 67.1% and 19.9% for the quarter and six-month period ended June 30, 2007, totaling \$16.3 million and \$28.6 million, respectively, compared with \$9.8 million and \$23.9 million, respectively, for the same periods in the previous year. Net interest income after provision for loan losses also improved as compared to the last three preceding quarters due to the favorable effects of the

aforementioned repositioning of the AFS investment portfolio and restructuring of the funding portfolio. Increases of 24.4% and 17.2% in interest income for the quarter and six-month period ended June 30, 2007, respectively, as compared to same periods last year was mainly due to higher loan volume and higher average yields on interest earning assets. These increases were partially offset by higher interest rates and increased borrowings. Net interest margin for the June 30, 2007 quarter and six-month period was 1.40% and 1.30%,

- 19 -

Table of Contents

respectively, compared to 0.96% and 1.16%, for the corresponding year-ago periods, and 1.18% and 0.72% for the quarters ended March 31, 2007 and December 31, 2006, respectively.

Non-Interest Income

Total non-interest income was \$7.8 million and \$22.9 million for the quarter and six-month period ended June 30, 2007, respectively, an increase of 3.7% and 39.2% over the same quarter and six-month period a year ago. These results reflect year-over-year growth in commissions and fees from brokerage activities, trust activities, securities net gain and derivatives net gain, which more than offset declines in banking service revenues and mortgage banking activities, and the absence of investment banking revenues. Commission and fees from brokerage and insurance activities remained flat at \$4.1 million quarter over quarter, and increased 21.5% to \$8.9 million for the six-month period ended June 30, 2007 as compared to \$7.3 million for the year-ago period, reflecting growth strategies at work in those businesses. Net gains of \$88,000 and \$8.4 million in derivatives activities for the quarter and six-month period ended June 30, 2007, compared to a \$23,000 loss and a \$859,000 gain in the year ago periods. The increase for the six-month period ended June 30, 2007, reflects the recognition in the March 2007 quarter of the remaining net gain from the July 2006 unwinding of interest rate swaps that had been used to hedge rising interest costs of short-term repurchase agreements, which had previously been included in other comprehensive income.

Non-Interest Expenses

Non-interest expenses totaled \$17.5 million and \$33.3 million, respectively, for the quarter and six-month period ended June 30, 2007, compared to \$14.8 million and \$29.7 million, respectively, in the year ago periods reflecting higher advertising expenses, professional fees, severance costs and foreclosure expenses.

Income Tax Expense

The income tax expense was \$187,000 and \$811,000, respectively, for the quarter and six-month period ended June 30, 2007, compared to a benefit of \$21,000 and an expense of \$110,000 for the respective periods ended June 30, 2006. The current income tax provision is lower than the provision based on the statutory tax rate for the Group, which is 39.0%, 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 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 entity.

Group's Financial Assets

The Group's total financial assets include owned assets and the assets managed by the trust division, the securities broker-dealer subsidiary, and the private pension plan administration subsidiary. At June 30, 2007, total financial assets reached \$8.260 billion compared to \$7.366 billion at December 31, 2006, a 12.1% increase. There was 21.0% increase in assets owned when compared to December 31, 2006, while assets managed by the trust division remained flat at \$3.0 billion. Owned assets are approximately 98% owned by the Group's banking subsidiary.

The Group's trust division offers various types of individual retirement accounts (IRA) and manages 401(K) and Keogh retirement plans and custodian and corporate trust accounts, while Caribbean Pension Consultants, Inc. (CPC) manages the administration of private pension plans. At June 30, 2007, total assets managed by the Group's trust division and CPC amounted to \$1.881 billion, compared to the \$1.849 billion reported at December 31, 2006. The Group's securities broker-dealer subsidiary offers a wide array of investment alternatives to its client base such as tax-advantaged fixed income securities, mutual funds, stocks, bonds and money management wrap-fee programs. At June 30, 2007, total assets gathered by the securities broker-dealer from its customer investment accounts, decreased to \$1.088 billion compared to \$1.144 billion as of December 31, 2006.

Table of Contents

Interest Earning Assets

The investment portfolio amounted to \$3.738 billion as of June 30, 2007, a 24.9% increase compared to \$2.992 billion as of December 31, 2006, while the loan portfolio increased 4.9% to \$1.272 billion as of June 30, 2007, compared to \$1.212 billion as of December 31, 2006. The increase in investment securities relates to the \$900 million purchase of U.S. Government agency securities in the March 2007 quarter for the AFS portfolio. That transaction was intended to replenish scheduled repayments and maturities expected for 2007, and provide a new source of interest income in accordance with the Group's strategy in light of current market conditions.

The mortgage loan portfolio totaled \$1.017 billion as of June 30, 2007, a 7.9% increase from \$942.9 million at December 31, 2006, and a 13.8% increase from \$894.2 million a year ago. Mortgage loan production for the six-month period ended June 30, 2007 totaled \$86.3 million, a 35.6% decrease compared to the year ago period, excluding purchases from third party originators. Mortgage loans purchased amounted to \$48.7 million for the six-month period ended June 30, 2007, compared to \$181.8 million for the corresponding year ago period.

Interest Bearing Liabilities

Total deposits amounted to \$1.330 billion at June 30, 2007, an increase of 7.8% compared to December 31, 2006, due to the continued success of the Oriental Money savings account product. Borrowings at June 30, 2007 totaled \$3.525 billion, an increase of 26.7% from December 31, 2006, primarily due to the increased use of repurchase agreements, specifically related to the \$900 million increase in investments securities.

Stockholders Equity

Stockholders' equity as of June 30, 2007, was \$313.5 million, compared to \$336.4 million as of December 31, 2006. The Group continues to be well-capitalized, with ratios significantly above regulatory capital adequacy guidelines. At June 30, 2007, Tier 1 Leverage Capital Ratio was 7.23% (1.8 times the minimum of 4.00%), Tier 1 Risk-Based Capital Ratio was 19.32% (4.8 times the minimum of 4.00%), and Total Risk-Based Capital Ratio was 19.75% (2.5 times the minimum of 8.00%).

Table of Contents**TABLE 1 QUARTERLY ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE****FOR THE QUARTERS ENDED JUNE 30, 2007 AND 2006****(Dollars in thousands)**

	Interest			Average rate			Average balance		
	2007	2006	Variance in %	2007	2006	Variance in BP	2007	2006	Variance in %
A TAX EQUIVALENT SPREAD									
Interest-earning assets	\$70,801	\$56,894	24.4%	5.61%	5.08%	53	\$5,046,726	\$4,480,608	12.6%
Tax equivalent adjustment	14,668	13,051	12.4%	1.16%	1.17%	(1)			
Interest-earning assets tax equivalent	85,469	69,945	22.2%	6.77%	6.25%	52	5,046,726	4,480,608	12.6%
Interest-bearing liabilities	53,111	46,186	15.0%	4.44%	4.38%	6	4,781,105	4,215,139	13.4%
Tax equivalent net interest income / spread	\$32,358	\$23,759	36.2%	2.33%	1.87%	46	\$ 265,621	\$ 265,469	0.1%
Tax equivalent interest rate margin				2.56%	2.13%	43			
B NORMAL SPREAD									
Interest-earning assets:									
Investments:									
Investment securities	\$47,595	\$38,251	24.4%	5.11%	4.44%	67	\$3,727,268	\$3,443,554	8.2%
Investment management fees		(395)	-100.0%	0.00%	-0.05%	5			
Total investment securities	47,595	37,856	25.7%	5.11%	4.40%	71	3,727,268	3,443,554	8.2%
Trading securities	3	4	-25.0%	6.45%	7.34%	(89)	186	218	-14.9%
	888	723	22.8%	5.73%	4.72%	101	61,965	61,269	1.1%

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Money market
investments

	48,486	38,583	25.7%	5.12%	4.40%	72	3,789,419	3,505,041	8.1%
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Loans:

Mortgage	16,888	13,003	29.9%	6.78%	7.28%	(50)	995,669	714,649	39.3%
Commercial	4,554	4,202	8.4%	7.93%	7.55%	38	229,750	222,574	3.2%
Consumer	873	1,106	-21.1%	10.95%	11.54%	(59)	31,889	38,344	-16.8%

	22,315	18,311	21.9%	7.10%	7.51%	(41)	1,257,308	975,567	28.9%
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	70,801	56,894	24.4%	5.61%	5.08%	53	5,046,727	4,480,608	12.6%
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**Interest-bearing
liabilities:**

Deposits:

Non-interest bearing deposits							35,827	39,897	-10.2%
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Now accounts	206	214	-3.7%	1.19%	1.07%	12	69,131	80,077	-13.7%
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Savings	3,351	1,014	230.5%	4.27%	2.87%	140	314,151	141,139	122.6%
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Certificates of deposit	10,044	9,918	1.3%	4.66%	4.12%	54	861,244	961,794	-10.5%
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	13,601	11,146	22.0%	4.25%	3.65%	60	1,280,353	1,222,907	4.7%
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Borrowings:

Repurchase agreements	36,542	32,932	11.0%	4.46%	5.04%	(58)	3,274,576	2,616,058	25.2%
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Interest rate risk management		(1,930)	-100.0%	0.00%	-0.30%	30			
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Financing fees	(25)	126	-119.8%	0.00%	0.02%	(2)			
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Total repurchase agreements	36,517	31,128	17.3%	4.46%	4.76%	(30)	3,274,576	2,616,058	25.2%
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FHLB advances	1,981	2,248	-11.9%	4.57%	3.22%	135	173,419	279,497	-38.0%
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Subordinated capital notes	766	1,344	-43.0%	8.75%	7.45%	130	35,000	72,166	-51.5%
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Term notes	6	159	-96.2%	2.19%	4.24%	(205)	1,108	15,000	-92.6%
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Other borrowings	240	161	49.3%	5.77%	6.77%	(100)	16,650	9,511	75.1%
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	39,510	35,040	12.8%	4.51%	4.68%	(17)	3,500,753	2,992,232	17.0%
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	53,111	46,186	15.0%	4.44%	4.38%	6	4,781,106	4,215,139	13.4%
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	\$17,690	\$10,708	65.2%	1.17%	0.70%	47			
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**Net interest
income / spread****Interest rate
margin**

1.40% 0.96% 44

**Excess of average interest-earning assets over
average interest-bearing liabilities**

\$ 265,621 \$ 265,469 0.1%

**Average interest-earning assets over average
interest-bearing liabilities ratio**

105.56% 106.30%

C CHANGES IN NET INTEREST INCOME DUE TO:

	Volume	Rate	Total
Interest Income:			
Investments	\$ 2,623	7,280	9,903
Loans	5,046	(1,042)	4,004
	7,669	6,238	13,907
Interest Expense:			
Deposits	\$ 489	1,966	2,455
Repurchase agreements	7,442	(2,054)	5,388
Other borrowings	(1,812)	894	(918)
	6,119	806	6,925
Net Interest Income	\$ 1,550	\$ 5,432	\$ 6,982

- 22 -

Table of Contents

TABLE 1A YEAR-TO-DATE ANALYSIS OF NET INTEREST INCOME AND CHANGES DUE TO VOLUME/RATE FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2007 AND 2006
 (Dollars in thousands)

	Interest		Average rate			Average balance	
	2006	Variance	2007	2006	Variance	2007	Variance
2007		in %			in BP		