

ORIENTAL FINANCIAL GROUP INC

Form 10-Q

November 07, 2011

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2011

or

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

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

Commission File Number 001-12647

**Oriental Financial Group Inc.**

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

**Principal Executive Offices:**

**997 San Roberto Street**

**Oriental Center 10th Floor**

**Professional Offices Park**

**San Juan, Puerto Rico 00926**

**Telephone Number: (787) 771-6800**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input checked="" type="checkbox"/>
Non-Accelerated Filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting Company <input type="checkbox"/>

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:**

43,075,786 common shares (\$1.00 par value per share) outstanding as of October 31, 2011

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**FORWARD-LOOKING STATEMENTS**

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

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

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

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

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

a credit default by the U.S. government or a downgrade in the credit ratings of the U.S. government;

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

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

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

the performance of the stock and bond markets;

competition in the financial services industry;

additional Federal Deposit Insurance Corporation ( FDIC ) assessments; and

possible legislative, tax or regulatory changes.

Other possible events or factors that could cause results or performance to differ materially from those expressed in these forward-looking statements include the following: negative economic conditions that adversely affect the general economy, housing prices, the job market, consumer confidence and spending habits which may affect, among other things, the level of non-performing assets, charge-offs and provision

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expense; changes in interest rates and market liquidity which may reduce interest margins, impact funding sources and affect the ability to originate and distribute financial products in the primary and secondary markets; adverse movements and volatility in debt and equity capital markets; changes in market rates and prices which may adversely impact the value of financial assets and liabilities; liabilities resulting from litigation and regulatory investigations; changes in accounting standards, rules and interpretations; increased competition; the Group's ability to grow its core businesses; decisions to downsize, sell or close units or otherwise change the Group's business mix; and management's ability to identify and manage these and other risks.

All forward-looking statements included in this quarterly report on Form 10-Q are based upon information available to the Group as of the date of this report, and other than as required by law, including the requirements of applicable securities laws, the Group assumes no obligation to update or revise any such forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

**Table of Contents****ORIENTAL FINANCIAL GROUP INC.****UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****SEPTEMBER 30, 2011 AND DECEMBER 31, 2010**

	September 30, 2011	December 31, 2010
	(In thousands, except share data)	
<b>ASSETS</b>		
<b>Cash and cash equivalents</b>		
Cash and due from banks	\$ 513,905	\$ 344,067
Money market investments	3,431	104,869
<b>Total cash and cash equivalents</b>	<b>517,336</b>	<b>448,936</b>
<b>Securities purchased under agreements to resell</b>	<b>165,000</b>	
<b>Investments:</b>		
Trading securities, at fair value, with amortized cost of \$343 (December 31, 2010 - \$1,306)	346	1,330
Investment securities available-for-sale, at fair value, with amortized cost of \$3,154,057 (December 31, 2010 - \$3,661,146)	3,226,972	3,700,064
Investment securities held-to-maturity, at amortized cost, with fair value of \$854,633 (December 31, 2010 - \$675,721)	837,920	689,917
Federal Home Loan Bank (FHLB) stock, at cost	23,779	22,496
Other investments	75	150
<b>Total investments</b>	<b>4,089,092</b>	<b>4,413,957</b>
<b>Loans:</b>		
Mortgage loans held-for-sale, at lower of cost or fair value	33,619	33,979
Loans not covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$35,869 (December 31, 2010 - \$31,430)	1,125,769	1,117,889
Loans covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$37,240 (December 31, 2010 - \$49,286)	524,490	620,711
<b>Total loans, net</b>	<b>1,683,878</b>	<b>1,772,579</b>
FDIC shared-loss indemnification asset	392,096	473,629
Foreclosed real estate covered under shared-loss agreements with the FDIC	16,319	14,871
Foreclosed real estate not covered under shared-loss agreements with the FDIC	14,675	11,969
Accrued interest receivable	24,246	28,716
Deferred tax asset, net	33,102	30,732
Premises and equipment, net	22,498	23,941
Derivative assets	6,707	28,315
Other assets	58,339	63,361
<b>Total assets</b>	<b>\$ 7,023,288</b>	<b>\$ 7,311,006</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Deposits:</b>		
Demand deposits	\$ 979,326	\$ 954,554
Savings accounts	256,611	235,690

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Certificates of deposit	1,142,428	1,398,644
<b>Total deposits</b>	<b>2,378,365</b>	<b>2,588,888</b>
<b>Borrowings:</b>		
Short-term borrowings	46,619	42,460
Securities sold under agreements to repurchase	3,356,322	3,456,781
Advances from FHLB	281,753	281,753
FDIC-guaranteed term notes	105,112	105,834
Subordinated capital notes	36,083	36,083
<b>Total borrowings</b>	<b>3,825,889</b>	<b>3,922,911</b>
FDIC net settlement payable	41	22,954
Derivative liabilities	48,146	64
Accrued expenses and other liabilities	42,931	43,858
<b>Total liabilities</b>	<b>6,295,372</b>	<b>6,578,675</b>
<b>Stockholders equity:</b>		
Preferred stock, \$1 par value; 10,000,000 shares authorized; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding, \$25 liquidation value.	68,000	68,000
Common stock, \$1 par value; 100,000,000 shares authorized; 47,808,284 shares issued; 44,014,791 shares outstanding (December 31, 2010 - 47,807,734; 46,348,667)	47,808	47,808
Additional paid-in capital	498,875	498,435
Legal surplus	51,274	46,331
Retained earnings	82,616	51,502
Treasury stock, at cost, 3,793,493 shares (December 31, 2010 - 1,459,067 shares)	(45,376)	(16,732)
Accumulated other comprehensive income, net of tax of \$249 (December 31, 2010 - \$2,107)	24,719	36,987
<b>Total stockholders equity</b>	<b>727,916</b>	<b>732,331</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 7,023,288</b>	<b>\$ 7,311,006</b>

See notes to unaudited consolidated financial statements

**Table of Contents****ORIENTAL FINANCIAL GROUP INC.****UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS****FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010**

Quarter Ended September 30, Nine-Month Period Ended September 30,  
2011                      2010                      2011                      2010  
(In thousands, except per share data)

<b>Interest income:</b>				
Loans				
Loans not covered under shared-loss agreements with the FDIC	\$ 17,287	\$ 17,700	\$ 51,095	\$ 53,150
Loans covered under shared-loss agreements with the FDIC	18,222	16,647	45,507	28,232
Mortgage-backed securities	33,515	40,429	128,275	125,542
Investment securities and other	2,638	6,445	6,895	24,476
<b>Total interest income</b>	<b>71,662</b>	<b>81,221</b>	<b>231,772</b>	<b>231,400</b>
<b>Interest expense:</b>				
Deposits				
Securities sold under agreements to repurchase	11,558	12,680	35,360	35,874
Advances from FHLB and other borrowings	23,206	25,128	70,878	75,900
Note payable to the FDIC	3,121	3,082	9,231	9,147
FDIC-guaranteed term notes		823		1,887
Subordinated capital notes	1,021	1,021	3,063	3,063
	305	327	916	930
<b>Total interest expense</b>	<b>39,211</b>	<b>43,061</b>	<b>119,448</b>	<b>126,801</b>
<b>Net interest income</b>	<b>32,451</b>	<b>38,160</b>	<b>112,324</b>	<b>104,599</b>
Provision for non-covered loan and lease losses	3,800	4,100	11,400	12,214
Recapture of covered loan and lease losses, net	(1,936)		(1,387)	
<b>Total provision for loan and lease losses, net</b>	<b>1,864</b>	<b>4,100</b>	<b>10,013</b>	<b>12,214</b>
<b>Net interest income after provision for loan and lease losses</b>	<b>30,587</b>	<b>34,060</b>	<b>102,311</b>	<b>92,385</b>
<b>Non-interest income:</b>				
Wealth management revenues				
Banking service revenues	5,387	4,613	14,641	13,250
Mortgage banking activities	3,261	3,442	10,404	8,105
	2,623	3,418	7,017	7,555
<b>Total banking and wealth management revenues</b>	<b>11,271</b>	<b>11,473</b>	<b>32,062</b>	<b>28,910</b>
Total loss on other-than-temporarily impaired securities		(14,739)		(39,674)
Portion of loss on securities recognized in other comprehensive income				22,508
Other-than-temporary impairments on securities		(14,739)		(17,166)
Net (amortization) accretion of FDIC loss-share indemnification asset	(2,422)	1,600	(191)	2,914
Fair value adjustment on FDIC equity appreciation instrument				909
Net gain (loss) on:				
Sale of securities	13,971	13,954	23,102	37,807



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Derivatives	(564)	(22,580)	(8,135)	(59,832)
Early extinguishment of repurchase agreement	(4,790)		(4,790)	
Trading securities	14	4	(23)	2
Foreclosed real estate	(199)	(140)	(334)	(283)
Other	(93)	(35)	(113)	(18)
<b>Total non-interest income (loss), net</b>	<b>17,188</b>	<b>(10,463)</b>	<b>41,578</b>	<b>(6,757)</b>

See notes to unaudited consolidated financial statements.

**Table of Contents****ORIENTAL FINANCIAL GROUP INC.****UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS****FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010**

	Quarter Ended September 30, 2011		Nine-Month Period Ended September 30, 2010	
	2011	2010	2011	2010
	(In thousands, except per share data)			
<b>Non-interest expenses:</b>				
Compensation and employee benefits	\$ 11,593	\$ 11,686	\$ 34,511	\$ 30,369
Professional and service fees	5,305	5,480	16,506	11,552
Occupancy and equipment	4,369	5,486	12,988	13,484
Insurance	1,302	1,651	4,933	5,218
Electronic banking charges	1,375	1,322	3,984	3,112
Taxes, other than payroll and income taxes	1,184	1,641	3,422	3,759
Advertising, business promotion, and strategic initiatives	1,686	1,275	4,386	3,339
Loan servicing and clearing expenses	975	1,022	3,072	2,538
Foreclosure and repossession expenses	813	694	2,303	1,520
Communication	391	826	1,212	1,905
Director and investor relations	352	396	977	1,098
Printing, postage, stationery and supplies	292	299	937	795
Other	770	927	2,661	2,261
<b>Total non-interest expenses</b>	<b>30,407</b>	<b>32,705</b>	<b>91,892</b>	<b>80,950</b>
<b>Income (loss) before income taxes</b>	<b>17,368</b>	<b>(9,108)</b>	<b>51,997</b>	<b>4,678</b>
Income tax expense (benefit)	580	(1,287)	5,661	(82)
<b>Net income (loss)</b>	<b>16,788</b>	<b>(7,821)</b>	<b>46,336</b>	<b>4,760</b>
Less: Dividends on preferred stock	(1,201)	(1,200)	(3,602)	(4,134)
Less: Deemed dividend on preferred stock beneficial conversion feature		(22,711)		(22,711)
<b>Income available (loss) to common shareholders</b>	<b>\$ 15,587</b>	<b>\$ (31,732)</b>	<b>\$ 42,734</b>	<b>\$ (22,085)</b>
<b>Income (loss) per common share:</b>				
Basic	\$ 0.35	\$ (0.75)	\$ 0.95	\$ (0.66)
Diluted	\$ 0.35	\$ (0.75)	\$ 0.95	\$ (0.66)
Average common shares outstanding and equivalents	44,105	42,288	45,141	33,645
Cash dividends per share of common stock	\$ 0.05	\$ 0.04	\$ 0.15	\$ 0.12

See notes to unaudited consolidated financial statements.

**Table of Contents****ORIENTAL FINANCIAL GROUP INC.****UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010**

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
<b>Net income (loss)</b>	<b>\$ 16,788</b>	<b>\$ (7,821)</b>	<b>\$ 46,336</b>	<b>\$ 4,760</b>
<b>Other comprehensive income (loss):</b>				
Unrealized gain (loss) on securities available-for-sale	35,470	(15,072)	57,097	124,302
Realized gain on investment securities included in net income (loss)	(13,971)	(14,224)	(23,102)	(38,077)
Total loss on other- than-temporarily impaired securities		14,739		39,674
Portion of loss on securities recognized in other comprehensive income				(22,508)
Unrealized losses on cash flow hedges	(34,204)		(48,122)	
Income tax effect	2,550	2,274	1,859	(7,573)
<b>Other comprehensive income (loss) for the period</b>	<b>(10,155)</b>	<b>(12,283)</b>	<b>(12,268)</b>	<b>95,818</b>
<b>Comprehensive income (loss)</b>	<b>\$ 6,633</b>	<b>\$ (20,104)</b>	<b>\$ 34,068</b>	<b>\$ 100,578</b>

See notes to unaudited consolidated financial statements.

**Table of Contents****ORIENTAL FINANCIAL GROUP INC.****UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY****FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010**

	Nine-Month Period Ended September 30,	
	2011	2010
	(In thousands)	
<b>Preferred stock:</b>		
Balance at beginning of period	\$ 68,000	\$ 68,000
Issuance of preferred stock		177,289
Conversion of preferred stock to common stock		(177,289)
<b>Balance at end of period</b>	<b>68,000</b>	<b>68,000</b>
<b>Additional paid-in capital from beneficial conversion feature</b>		
Balance at beginning of period		
Issuance of preferred stock - beneficial conversion feature		22,711
Conversion of preferred stock - beneficial conversion feature		(22,711)
<b>Balance at end of period</b>		
<b>Common stock:</b>		
Balance at beginning of period	47,808	25,739
Issuance of common stock		8,740
Conversion of preferred stock to common stock		13,320
Exercised stock options		9
<b>Balance at end of period</b>	<b>47,808</b>	<b>47,808</b>
<b>Additional paid-in capital:</b>		
Balance at beginning of period	498,435	213,445
Issuance of common stock		90,896
Conversion of preferred stock to common stock		186,680
Deemed dividend on preferred stock beneficial conversion feature		22,711
Exercised stock options		64
Stock-based compensation expense	1,001	865