POPULAR INC
Form 10-Q
August 11, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2008

Commission File Number: **000-13818**

POPULAR, INC.

(Exact name of registrant as specified in its charter)

Puerto Rico	**66-0667416**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
Popular Center Building 209 Muñoz Rivera Avenue, Hato Rey San Juan, Puerto Rico	**00918**
(Address of principal executive offices)	(Zip code)

(787) 765-9800

(Registrant s telephone number, including area code)

NOT APPLICABLE

(Former name, former address and former fiscal year, if changed since last report)

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.
þ Yes o No

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: Common Stock $6 par value 281,738,612 shares outstanding as of August 5, 2008.

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Forward-Looking Information

The information included in this Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to the Corporation s 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 losses, 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 Corporation 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, could, might, can, may, or similar expressions are generally intended to identify forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, estimates and assumptions by management that are difficult to predict. Various factors, some of which are beyond the Corporation 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, 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; the relative strength or weakness of the consumer and commercial credit sectors and of the real estate markets; the performance of the stock and bond markets; competition in the financial services industry; possible legislative, tax or regulatory changes; and difficulties in combining the operations of acquired entities.

Moreover, the outcome of legal proceedings, as discussed in Part II, Item I. Legal Proceedings, is inherently uncertain and depends on judicial interpretations of law and the findings of regulators, judges and juries.

All forward-looking statements included in this document are based upon information available to the Corporation as of the date of this document, and we assume 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.

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ITEM 1. FINANCIAL STATEMENTS
POPULAR, INC.
CONSOLIDATED STATEMENTS OF CONDITION
(UNAUDITED)

(In thousands, except share information)	June 30, 2008	December 31, 2007	June 30, 2007
ASSETS			
Cash and due from banks	$ 887,619	$ 818,825	$ 762,085
Money market investments:			
Federal funds sold	710,000	737,815	345,400
Securities purchased under agreements to resell	170,497	145,871	212,138
Time deposits with other banks	17,299	123,026	17,449
	897,796	1,006,712	574,987
Investment securities available-for-sale, at fair value:			
Pledged securities with creditors right to repledge	3,418,708	4,249,295	3,421,716
Other investment securities available-for-sale	4,283,619	4,265,840	5,552,752
Investment securities held-to-maturity, at amortized cost (market value as of June 30, 2008 - $231,210; December 31, 2007 - $486,139; June 30, 2007 - $429,536)	232,483	484,466	429,479
Other investment securities, at lower of cost or realizable value (realizable value as of June 30, 2008 - $299,827; December 31, 2007 - $216,819; June 30, 2007 - $160,372)	240,731	216,584	160,150
Trading account securities, at fair value:			
Pledged securities with creditors right to repledge	417,437	673,958	355,484
Other trading securities	82,051	93,997	321,374
Loans held-for-sale measured at lower of cost or market value	337,552	1,889,546	605,990
Loans measured at fair value pursuant to SFAS No. 159:			
Loans measured at fair value pledged with creditors right to repledge	45,758		
Other loans measured at fair value	799,134		
Loans held-in-portfolio:			
Loans held-in-portfolio pledged with creditors right to repledge		149,610	195,661
Other loans	26,636,004	28,053,956	32,274,058
Less Unearned income	186,770	182,110	323,864
Allowance for loan losses	652,730	548,832	564,847
	25,796,504	27,472,624	31,581,008
Premises and equipment, net	633,450	588,163	587,505

Other real estate	102,809	81,410	112,858
Accrued income receivable	163,274	216,114	249,746
Servicing assets (at fair value on June 30, 2008 - $186,155; December 31, 2007 - $191,624; June 30, 2007 - $197,873)	190,778	196,645	201,861
Other assets (See Note 8)	2,455,842	1,456,994	1,297,600
Goodwill	628,826	630,761	668,469
Other intangible assets	64,223	69,503	102,299
	$41,678,594	$ 44,411,437	$46,985,363
LIABILITIES AND STOCKHOLDERS EQUITY			
Liabilities:			
Deposits:			
Non-interest bearing	$ 4,482,287	$ 4,510,789	$ 4,280,195
Interest bearing	22,633,441	23,823,689	21,105,800
	27,115,728	28,334,478	25,385,995
Federal funds purchased and assets sold under agreements to repurchase	4,738,677	5,437,265	5,655,936
Other short-term borrowings	1,337,210	1,501,979	3,384,105
Notes payable at cost	3,750,647	4,621,352	8,068,638
Notes payable at fair value pursuant to SFAS No. 159	173,725		
Other liabilities	856,504	934,372	793,500
	37,972,491	40,829,446	43,288,174
Commitments and contingencies (See Note 16)			
Minority interest in consolidated subsidiaries	109	109	109
Stockholders equity:			
Preferred stock, $25 liquidation value; 30,000,000 shares authorized; 7,475,000 Class A shares issued and outstanding in all periods presented; 16,000,000 Class B shares issued and outstanding at June 30, 2008	586,875	186,875	186,875
Common stock, $6 par value; 470,000,000 shares authorized in all periods presented; 294,620,193 shares issued (December 31, 2007 - 293,651,398; June 30, 2007 - 292,722,761) and 280,983,132 outstanding (December 31, 2007 - 280,029,215; June 30, 2007 - 279,326,816)	1,767,721	1,761,908	1,756,337
Surplus	563,100	568,184	533,152
Retained earnings	1,086,373	1,319,467	1,701,100
Accumulated other comprehensive loss, net of tax of ($22,392) (December 31, 2007 - ($15,438); June 30, 2007 - ($96,065))	(90,448)	(46,812)	(274,817)
Treasury stock at cost, 13,637,061 shares (December 31, 2007 - 13,622,183; June 30, 2007 - 13,395,945)	(207,627)	(207,740)	(205,567)
	3,705,994	3,581,882	3,697,080

	$41,678,594	$ 44,411,437	$46,985,363

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

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POPULAR, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(In thousands, except per share information)	Quarter ended June 30, 2008	Quarter ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
INTEREST INCOME:				
Loans	$497,418	$656,485	$1,058,535	$1,300,599
Money market investments	3,476	5,752	10,204	10,361
Investment securities	83,128	113,063	177,533	228,554
Trading account securities	16,133	9,611	34,826	18,992
	600,155	784,911	1,281,098	1,558,506
INTEREST EXPENSE:				
Deposits	168,045	182,730	362,985	355,832
Short-term borrowings	42,502	119,466	107,647	244,275
Long-term debt	51,723	111,298	115,392	232,000
	262,270	413,494	586,024	832,107
Net interest income	337,885	371,417	695,074	726,399
Provision for loan losses	190,640	115,167	358,862	211,513
Net interest income after provision for loan losses	147,245	256,250	336,212	514,886
Service charges on deposit accounts	51,799	48,392	102,886	96,863
Other service fees (See Note 17)	110,079	89,590	215,546	177,439
Net gain on sale and valuation adjustments of investment securities	27,763	1,175	75,703	82,946
Trading account profit (loss)	16,711	10,377	21,175	(3,787)
Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159	(35,922)		(38,942)	
(Loss) gain on sale of loans and valuation adjustments on loans held-for- sale	(1,453)	28,294	67,292	31,728
Other operating income	24,595	25,547	57,887	70,362
	340,817	459,625	837,759	970,437
OPERATING EXPENSES:				
Personnel costs:				
Salaries	125,423	126,950	262,132	263,429
Pension, profit sharing and other benefits	36,462	37,338	74,932	79,234
	161,885	164,288	337,064	342,663
Net occupancy expenses	26,362	26,501	61,354	58,515
Equipment expenses	30,724	32,245	62,722	64,641

Other taxes	13,879	11,835	27,022	23,682
Professional fees	31,627	38,642	68,252	74,629
Communications	13,145	16,973	28,448	34,035
Business promotion	18,251	30,369	35,467	58,741
Printing and supplies	3,899	4,549	8,174	8,825
Other operating expenses	45,471	32,838	86,763	64,854
Amortization of intangibles	2,490	2,813	4,982	5,796
	347,733	361,053	720,248	736,381
(Loss) income before income tax	(6,916)	98,572	117,511	234,056
Income tax (benefit) expense	(31,166)	23,622	(10,029)	40,459
NET INCOME	$ 24,250	$ 74,950	$ 127,540	$ 193,597
NET INCOME APPLICABLE TO COMMON STOCK	$ 18,247	$ 71,972	$ 118,559	$ 187,641
BASIC EARNINGS PER COMMON SHARE (EPS)	$ 0.06	$ 0.26	$ 0.42	$ 0.67
DILUTED EPS	$ 0.06	$ 0.26	$ 0.42	$ 0.67
DIVIDENDS DECLARED PER COMMON SHARE	$ 0.16	$ 0.16	$ 0.32	$ 0.32

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

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POPULAR, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(UNAUDITED)

(In thousands)	Six months ended June 30, 2008	2007
Preferred stock:		
Balance at beginning of year	$ 186,875	$ 186,875
Issuance of preferred stock	400,000	
Balance at end of period	586,875	186,875
Common stock:		
Balance at beginning of year	1,761,908	1,753,146
Common stock issued under the Dividend Reinvestment Plan	5,813	3,131
Stock options exercised		60
Balance at end of period	1,767,721	1,756,337
Surplus:		
Balance at beginning of year	568,184	526,856
Common stock issued under the Dividend Reinvestment Plan	4,307	5,290
Issuance cost of preferred stock	(9,950)	
Stock options expense on unexercised options, net of forfeitures	559	857
Stock options exercised		149
Balance at end of period	563,100	533,152
Retained earnings:		
Balance at beginning of year	1,319,467	1,594,144
Net income	127,540	193,597
Cumulative effect of accounting change-adoption of SFAS No. 159 in 2008 (2007-SFAS No. 156 and EITF 06-5)	(261,831)	8,667
Cash dividends declared on common stock	(89,822)	(89,352)
Cash dividends declared on preferred stock	(8,981)	(5,956)
Balance at end of period	1,086,373	1,701,100
Accumulated other comprehensive loss:		
Balance at beginning of year	(46,812)	(233,728)
Other comprehensive loss, net of tax	(43,636)	(41,089)
Balance at end of period	(90,448)	(274,817)
Treasury stock at cost:		
Balance at beginning of year	(207,740)	(206,987)
Purchase of common stock	(358)	(352)
Reissuance of common stock	471	1,772

Balance at end of period	(207,627)	(205,567)
Total stockholders equity	$3,705,994	$3,697,080

Disclosure of changes in number of shares:

	June 30, 2008	December 31, 2007	June 30, 2007
Preferred Stock:			
Balance at beginning of year	7,475,000	7,475,000	7,475,000
New shares issued	16,000,000		
Balance at end of period	23,475,000	7,475,000	7,475,000
Common Stock Issued:			
Balance at beginning of year	293,651,398	292,190,924	292,190,924
Issued under the Dividend Reinvestment Plan	968,795	1,450,410	521,773
Stock options exercised		10,064	10,064
Balance at end of period	294,620,193	293,651,398	292,722,761
Treasury stock	(13,637,061)	(13,622,183)	(13,395,945)
Common Stock outstanding	280,983,132	280,029,215	279,326,816

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

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POPULAR, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(UNAUDITED)

	Quarter ended June 30,		Six months ended June 30,	
(In thousands)	2008	2007	2008	2007
Net income	$ 24,250	$ 74,950	$127,540	$193,597
Other comprehensive loss before tax:				
Foreign currency translation adjustment	(1,411)	1,200	(1,192)	2,980
Adjustment of pension and postretirement benefit plans	(37)		(74)	(519)
Unrealized losses on securities available-for-sale arising during the period	(149,927)	(95,452)	(22,437)	(55,969)
Reclassification adjustment for gains included in net income	(27,685)	(1)	(26,373)	(83)
Unrealized net gains (losses) on cash flow hedges	2,963	1,840	(2,107)	948
Reclassification adjustment for losses (gains) included in net income	92	(286)	1,593	(125)
Cumulative effect of accounting change		(243)		(243)
	(176,005)	(92,942)	(50,590)	(53,011)
Income tax benefit	41,838	22,060	6,954	11,922
Total other comprehensive loss, net of tax	(134,167)	(70,882)	(43,636)	(41,089)
Comprehensive (loss) income	($ 109,917)	$ 4,068	$ 83,904	$152,508

Tax Effects Allocated to Each Component of Other Comprehensive Loss:

	Quarter ended June 30,		Six months ended June 30,	
(In thousands)	2008	2007	2008	2007
Underfunding of pension and postretirement benefit plans				$ 180
Unrealized losses on securities available-for-sale arising during the period	$38,943	$22,615	$3,680	12,022
Reclassification adjustment for gains included in net income	4,025		3,124	14
Unrealized net gains (losses) on cash flows hedges	(1,094)	(669)	775	(352)
Reclassification adjustment for (gains) losses included in net income	(36)	114	(625)	58
Income tax benefit	$41,838	$22,060	$6,954	$11,922

Disclosure of accumulated other comprehensive loss:

(In thousands)	June 30, 2008	December 31, 2007	June 30, 2007
Foreign currency translation adjustment	($ 35,780)	($ 34,588)	($ 33,721)
Underfunding of pension and postretirement benefit plans	(51,213)	(51,139)	(69,779)
Tax effect	20,108	20,108	27,214
Net of tax amount	(31,105)	(31,031)	(42,565)
Unrealized (losses) gains on securities available-for-sale	(21,718)	27,092	(268,295)
Tax effect	854	(5,950)	69,182
Net of tax amount	(20,864)	21,142	(199,113)
Unrealized (losses) gains on cash flows hedges	(4,129)	(3,615)	913
Tax effect	1,430	1,280	(331)
Net of tax amount	(2,699)	(2,335)	582
Accumulated other comprehensive loss, net of tax	($ 90,448)	($ 46,812)	($ 274,817)

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

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POPULAR, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months ended June 30,	
(In thousands)	2008	2007
Cash flows from operating activities:		
Net income	$ 127,540	$ 193,597
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	37,318	39,973
Provision for loan losses	358,862	211,513
Amortization of intangibles	4,982	5,796
Amortization and fair value adjustments of servicing assets	25,122	22,606
Net gain on sale and valuation adjustments of investment securities	(75,703)	(82,946)
Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159	38,942	
Net gain on disposition of premises and equipment	(3,111)	(4,851)
Net gain on sale of loans and valuation adjustments on loans held-for-sale	(67,292)	(31,728)
Net amortization of premiums and accretion of discounts on investments	12,656	11,235
Net amortization of premiums and deferred loan origination fees and costs	28,951	47,938
Earnings from investments under the equity method	(6,899)	(16,590)
Stock options expense	559	907
Deferred income taxes	(83,836)	(48,112)
Net disbursements on loans held-for-sale	(1,509,819)	(3,087,103)
Acquisitions of loans held-for-sale	(185,053)	(403,712)
Proceeds from sale of loans held-for-sale	1,006,208	2,833,030
Net decrease in trading securities	732,067	645,680
Net decrease (increase) in accrued income receivable	42,301	(1,506)
Net increase in other assets	(264,170)	(16,261)
Net decrease in interest payable	(53,440)	(14,013)
Net increase in postretirement benefit obligation	203	1,824
Net decrease in other liabilities	(24,429)	(52,071)
Total adjustments	14,419	61,609
Net cash provided by operating activities	141,959	255,206
Cash flows from investing activities:		
Net decrease (increase) in money market investments	108,916	(206,843)
Purchases of investment securities:		
Available-for-sale	(3,427,660)	(65,385)
Held-to-maturity	(3,631,141)	(12,293,611)
Other	(136,775)	(16,935)
Proceeds from calls, paydowns, maturities and redemptions of investment securities:		

Available-for-sale	1,851,899	810,710
Held-to-maturity	3,884,838	11,957,964
Other	112,628	5,445
Proceeds from sale of investment securities available-for-sale	2,406,504	28,981
Proceeds from sale of other investment securities	49,330	246,352
Net disbursements on loans	(596,548)	(362,569)
Proceeds from sale of loans	1,715,330	3,549
Acquisition of loan portfolios	(6,669)	(784)
Assets acquired, net of cash		(1,633)
Mortgage servicing rights purchased	(2,986)	(23,988)
Acquisition of premises and equipment	(98,028)	(49,652)
Proceeds from sale of premises and equipment	19,743	21,951
Proceeds from sale of foreclosed assets	51,684	80,278
Net cash provided by investing activities	2,301,065	133,830
Cash flows from financing activities:		
Net (decrease) increase in deposits	(1,198,512)	936,810
Net decrease in federal funds purchased and assets sold under agreements to repurchase	(698,588)	(106,509)
Net decrease in other short-term borrowings	(164,769)	(650,020)
Payments of notes payable	(1,243,674)	(773,731)
Proceeds from issuance of notes payable	630,186	103,249
Dividends paid	(98,685)	(95,223)
Proceeds from issuance of common stock	10,120	8,667
Proceeds from issuance of preferred stock	390,050	
Treasury stock acquired	(358)	(352)
Net cash used in financing activities	(2,374,230)	(577,109)
Net increase (decrease) in cash and due from banks	68,794	(188,073)
Cash and due from banks at beginning of period	818,825	950,158
Cash and due from banks at end of period	$ 887,619	$ 762,085

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

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Notes to Unaudited Consolidated Financial Statements

Note 1 Nature of Operations and Basis of Presentation

Popular, Inc. (the Corporation or Popular) is a diversified, publicly owned financial holding company subject to the supervision and regulation of the Board of Governors of the Federal Reserve System. The Corporation is a full service financial services provider with operations in Puerto Rico, the United States, the Caribbean and Latin America. As the leading financial institution in Puerto Rico, the Corporation offers retail and commercial banking services through its principal banking subsidiary, Banco Popular de Puerto Rico (BPPR), as well as auto and equipment leasing and financing, mortgage loans, consumer lending, investment banking, broker-dealer and insurance services through specialized subsidiaries. In the United States, the Corporation operates Banco Popular North America (BPNA), including its wholly-owned subsidiary E-LOAN, and Popular Financial Holdings (PFH). BPNA is a community bank providing a broad range of financial services and products to the communities it serves. BPNA operates branches in New York, California, Illinois, New Jersey, Florida and Texas. E-LOAN offers online consumer direct lending and provides an online platform to raise deposits for BPNA. As described in Note 19 to the consolidated financial statements, E-LOAN restructured its business operations during the fourth quarter of 2007 and the beginning of 2008. PFH, after certain restructuring events discussed also in Note 19 to the consolidated financial statements, exited the branch network loan origination business during the first quarter of 2008, but continues to operate a mortgage loan servicing unit, a small scale origination / refinancing unit and to carry a maturing loan portfolio. The Corporation, through its transaction processing company, EVERTEC, continues to use its expertise in technology as a competitive advantage in its expansion throughout the United States, the Caribbean and Latin America, as well as internally servicing many of its subsidiaries system infrastructures and transactional processing businesses. Note 24 to the consolidated financial statements presents further information about the Corporation s business segments.

The unaudited consolidated financial statements include the accounts of Popular, Inc. and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. These unaudited statements are, in the opinion of management, a fair statement of the results for the periods reported and include all necessary adjustments, all of a normal recurring nature, for a fair statement of such results. Certain reclassifications have been made to the prior period consolidated financial statements to conform to the 2008 presentation.

The statement of condition data as of December 31, 2007 was derived from audited financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted from the statements presented as of June 30, 2008, December 31, 2007 and June 30, 2007 pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, these financial statements should be read in conjunction with the audited consolidated financial statements of the Corporation for the year ended December 31, 2007, included in the Corporation s 2007 Annual Report. The Corporation s Form 10-K filed on February 29, 2008 incorporates by reference the 2007 Annual Report.

Note 2 Recent Accounting Developments

SFAS No. 157 Fair Value Measurements

SFAS No. 157, issued in September 2006, defines fair value, establishes a framework of measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets carried at fair value will be classified and disclosed in one of the three categories in accordance with the hierarchy. The three levels of the fair value hierarchy are (1) quoted market prices for identical assets or liabilities in active markets, (2) observable market-based inputs or unobservable inputs that are corroborated by market data, and (3) unobservable inputs that are not corroborated by market data. SFAS No. 157 was effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the Financial Accounting Standards Board (FASB) issued financial staff position FSP FAS No. 157-2 which defers for one year the effective date for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value on a nonrecurring basis.

The staff position also amends SFAS No. 157 to exclude SFAS No. 13 Accounting for Leases and its related interpretive accounting pronouncements that address leasing transactions. The Corporation adopted the provisions of SFAS No. 157 that were not deferred by FSP FAS No. 157-2, commencing in the first quarter of 2008. The provisions of SFAS No. 157 are to be applied prospectively. Refer to Note 12 to these consolidated financial statements for the disclosures required for the quarter and six months ended June 30, 2008. The adoption of SFAS No. 157 in January 1, 2008 did not have an impact in beginning retained earnings.

SFAS No. 159 The Fair Value Option for Financial Assets and Liabilities Including an Amendment of FASB Statement No. 115

In February 2007, the FASB issued SFAS No. 159, which provided companies with an option to report selected financial assets and liabilities at fair value. The election to measure a financial asset or liability at fair value can be made on an instrument-by-instrument basis and is irrevocable. The difference between the carrying amount and the fair value at the election date is recorded as a transition adjustment to beginning retained earnings. Subsequent changes in fair value are recognized in earnings. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The Corporation adopted the provisions of SFAS No. 159 in January 2008.

The Corporation elected the fair value option for approximately $1.2 billion of whole loans held-in-portfolio by PFH. Additionally, management adopted the fair value option for approximately $287 million of loans and $287 million of bond certificates associated with PFH s on-balance sheet securitizations that were outstanding as of December 31, 2007. These loans serve as collateral for the bond certificates.

Refer to Note 11 to these consolidated financial statements for the impact of the initial adoption of SFAS No. 159 to beginning retained earnings as of January 1, 2008 and additional disclosures as of June 30, 2008.

FSP FIN No. 39-1 Amendment of FASB Interpretation No. 39

In April 2007, the FASB issued Staff Position FSP FIN No. 39-1, which defines right of setoff and specifies what conditions must be met for a derivative contract to qualify for this right of setoff. It also addresses the applicability of a right of setoff to derivative instruments and clarifies the circumstances in which it is appropriate to offset amounts recognized for those instruments in the statement of condition. In addition, this FSP permits the offsetting of fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments. The adoption of FSP FIN No. 39-1 in January 2008 did not have a material impact on the Corporation s consolidated financial statements and disclosures. The Corporation s policy is not to offset the fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement nor to offset the fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments.

SFAS No. 141-R Statement of Financial Accounting Standards No. 141(R), Business Combinations (a revision of SFAS No. 141)

SFAS No. 141(R), issued in December 2007, will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Corporation will account for business combinations under this statement include the following: the acquisition date will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date at fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS No. 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. The Corporation will be required to prospectively apply SFAS No. 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS No. 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes in those amounts to be recorded in earnings. Management will be evaluating the effects that SFAS No. 141(R) will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented on the consolidated financial statements.

SFAS No. 160 Statement of Financial Accounting Standards No. 160, Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51

In December 2007, the FASB issued SFAS No. 160, which amends ARB No. 51, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 will require entities to classify noncontrolling interests as a component of stockholders equity on the consolidated financial statements and will require subsequent changes in ownership interests in a subsidiary to be accounted for as an equity transaction. Additionally, SFAS No. 160 will require entities to recognize a gain or loss upon the loss of control of a subsidiary and to remeasure any ownership interest retained at fair value on that date. This statement also requires expanded disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective on a prospective basis for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, except for the presentation and disclosure requirements, which are required to be applied retrospectively. Early adoption is not permitted. Management will be evaluating the effects, if any, that the adoption of this statement will have on its consolidated financial statements.

SFAS No. 161 Disclosures about Derivative Instruments and Hedging Activities

In March 2008, the FASB issued SFAS No. 161, an amendment of SFAS No. 133. The standard requires enhanced disclosures about derivative instruments and hedged items that are accounted for under SFAS No. 133 and related interpretations. The standard will be effective for all of the Corporation s interim and annual financial statements for periods beginning after November 15, 2008, with early adoption permitted. The standard expands the disclosure requirements for derivatives and hedged items and has no impact on how the Corporation accounts for these instruments. Management will be evaluating the enhanced disclosure requirements.

SFAS No. 162 The Hierarchy of Generally Accepted Accounting Principles

SFAS No. 162, issued by the FASB in May 2008, identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This statement is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. Management does not expect SFAS No. 162 to have a material impact on the Corporation s consolidated financial statements. The Board does not expect that this statement will result in a change in current accounting practice. However, transition provisions have been provided in the unusual circumstance that the application of the provisions of this statement results in a change in accounting practice.

Staff Accounting Bulletin No. 109 (SAB 109) Written Loan Commitments Recorded at Fair Value through Earnings

On November 5, 2007, the SEC issued Staff SAB 109, which requires that the fair value of a written loan commitment that is marked-to-market through earnings should include the future cash flows related to the loan s servicing rights. However, the fair value measurement of a written loan commitment still must exclude the expected net cash flows related to internally developed intangible assets (such as customer relationship intangible assets). SAB 109 applies to two types of loan commitments: (1) written mortgage loan commitments for loans that will be held-for-sale when funded that are marked-to-market as derivatives under SFAS No. 133 (derivative loan commitments); and (2) other written loan commitments that are accounted for at fair value through earnings under SFAS No. 159 s fair-value election.

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SAB 109 supersedes SAB 105, which applied only to derivative loan commitments and allowed the expected future cash flows related to the associated servicing of the loan to be recognized only after the servicing asset had been contractually separated from the underlying loan by sale or securitization of the loan with servicing retained. SAB 109 will be applied prospectively to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The implementation of SAB 109 did not have a material impact to the Corporation s consolidated financial statements, including disclosures, for the six months ended June 30, 2008.

FASB Staff Position (FSP) FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions

The objective of FSP FAS 140-3, issued by the FASB in February 2008, is to provide implementation guidance on whether the security transfer and contemporaneous repurchase financing involving the transferred financial asset must be evaluated as one linked transaction or two separate de-linked transactions.

Current practice records the transfer as a sale and the repurchase agreement as a financing. The FSP FAS 140-3 requires the recognition of the transfer and the repurchase agreement as one linked transaction, unless all of the following criteria are met: (1) the initial transfer and the repurchase financing are not contractually contingent on one another; (2) the initial transferor has full recourse upon default, and the repurchase agreement s price is fixed and not at fair value; (3) the financial asset is readily obtainable in the marketplace and the transfer and repurchase financing are executed at market rates; and (4) the maturity of the repurchase financing is before the maturity of the financial asset. The scope of this FSP is limited to transfers and subsequent repurchase financings that are entered into contemporaneously or in contemplation of one another.

FSP FAS 140-3 will be effective for the Corporation on January 1, 2009. Early adoption is prohibited. The Corporation will be evaluating the potential impact of adopting this FSP.

FASB Staff Position (FSP) FAS 142-3, Determination of the Useful Life of Intangible Assets

FSP FAS 142-3, issued by the FASB in April 2008, amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142 Goodwill and Other Intangible Assets . In developing these assumptions, an entity should consider its own historical experience in renewing or extending similar arrangements adjusted for entity specific factors or, in the absence of that experience, the assumptions that market participants would use about renewals or extensions adjusted for the entity specific factors.

FSP FAS 142-3 shall be applied prospectively to intangible assets acquired after the effective date. This FSP will be effective for the Corporation on January 1, 2009. Early adoption is prohibited. The Corporation will be evaluating the potential impact of adopting this FSP.

Note 3 Restrictions on Cash and Due from Banks and Highly-Liquid Securities

The Corporation s subsidiary banks are required by federal and state regulatory agencies to maintain average reserve balances with the Federal Reserve Bank or other banks. Those required average reserve balances were $665 million as of June 30, 2008 (December 31, 2007 $678 million; June 30, 2007 $603 million). Cash and due from banks as well as other short-term, highly-liquid securities are used to cover the required average reserve balances.

In compliance with rules and regulations of the Securities and Exchange Commission, at June 30, 2008, the Corporation had securities with a market value of $274 thousand (December 31, 2007 - securities with a market value of $273 thousand; June 30, 2007 securities with a market value of $445 thousand); segregated in a special reserve bank account for the benefit of brokerage customers of its broker-dealer subsidiary. These securities were classified in the consolidated statement of condition within the other trading securities category.

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As required by the Puerto Rico International Banking Center Regulatory Act, as of June 30, 2008, December 31, 2007, and June 30, 2007, the Corporation maintained separately for its two international banking entities (IBEs), $600 thousand in time deposits, equally divided for the two IBEs, which were considered restricted assets.

As part of a line of credit facility with a financial institution, as of June 30, 2008, the Corporation maintained restricted cash of $1.9 million as collateral (December 31, 2007 $1.9 million; June 30, 2007 $1.9 million). The cash is being held in certificates of deposits which mature in less than 90 days. The line of credit is used to support letters of credit.

As of June 30, 2008, the Corporation had restricted cash of $3.5 million (December 31, 2007 $3.5 million) to support a letter of credit related to a service settlement agreement.

Note 4 Pledged Assets

Certain securities and loans were pledged to secure public and trust deposits, assets sold under agreements to repurchase, other borrowings and credit facilities available. The classification and carrying amount of the Corporation s pledged assets, in which the secured parties are not permitted to sell or repledge the collateral, were as follows:

(In thousands)	June 30, 2008	December 31, 2007	June 30, 2007
Investment securities available-for-sale, at fair value	$ 2,716,718	$ 2,944,643	$ 3,264,299
Investment securities held-to-maturity, at amortized cost		339	501
Loans held-for-sale measured at lower of cost or market value	36,613	42,428	
Loans measured at fair value pursuant to SFAS No. 159	167,646		
Loans held-in-portfolio	7,727,951	8,489,814	9,062,900
	$10,648,928	$11,477,224	$12,327,700

Pledged securities and loans in which the creditor has the right by custom or contract to repledge are presented separately in the consolidated statements of condition.

Note 5 Investment Securities Available-For-Sale

The amortized cost, gross unrealized gains and losses and approximate market value (or fair value for certain investment securities where no market quotations are available) of investment securities available-for-sale as of June 30, 2008, December 31, 2007 and June 30, 2007 were as follows:

	AS OF JUNE 30, 2008			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 461,404	$ 542	$ 1,195	$ 460,751
Obligations of U.S. Government sponsored entities	4,588,854	27,677	10,781	4,605,750
Obligations of Puerto Rico, States and political subdivisions	126,775	243	1,836	125,182
Collateralized mortgage obligations	1,626,202	3,487	21,079	1,608,610
Mortgage-backed securities	889,613	5,743	11,318	884,038
Equity securities	28,607	441	13,642	15,406

Others	2,590			2,590
	$7,724,045	$38,133	$59,851	$7,702,327

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(In thousands)	AS OF DECEMBER 31, 2007 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 476,104	$ 3	$ 5,011	$ 471,096
Obligations of U.S. Government sponsored entities	5,450,028	52,971	5,885	5,497,114
Obligations of Puerto Rico, States and political subdivisions	103,206	470	2,184	101,492
Collateralized mortgage obligations	1,403,292	3,754	10,506	1,396,540
Mortgage-backed securities	1,017,302	4,690	11,864	1,010,128
Equity securities	33,299	690	36	33,953
Others	4,812			4,812
	$8,488,043	$62,578	$35,486	$8,515,135

(In thousands)	AS OF JUNE 30, 2007 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 500,193		$ 37,616	$ 462,577
Obligations of U.S. Government sponsored entities	6,016,206		174,448	5,841,758
Obligations of Puerto Rico, States and political subdivisions	117,372	$ 170	3,754	113,788
Collateralized mortgage obligations	1,544,362	6,122	18,435	1,532,049
Mortgage-backed securities	991,440	1,529	32,771	960,198
Equity securities	55,250	1,173	11,074	45,349
Others	17,940	809		18,749
	$9,242,763	$9,803	$278,098	$8,974,468

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The table below shows the Corporation s amortized cost, gross unrealized losses and market value of investment securities available-for-sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of June 30, 2008, December 31, 2007 and June 30, 2007.

	AS OF JUNE 30, 2008		
	Less than 12 months		
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 277,645	$ 1,195	$ 276,450
Obligations of U.S. Government sponsored entities	2,104,165	10,781	2,093,384
Obligations of Puerto Rico, States and political subdivisions	31,745	112	31,633
Collateralized mortgage obligations	923,625	10,626	912,999
Mortgage-backed securities	277,464	3,388	274,076
Equity securities	27,268	13,634	13,634
	$3,641,912	$39,736	$3,602,176

	12 months or more		
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
Obligations of Puerto Rico, States and political subdivisions	$ 49,012	$ 1,724	$ 47,288
Collateralized mortgage obligations	218,656	10,453	208,203
Mortgage-backed securities	276,775	7,930	268,845
Equity securities	29	8	21
	$544,472	$20,115	$524,357

	Total		
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 277,645	$ 1,195	$ 276,450
Obligations of U.S. Government sponsored entities	2,104,165	10,781	2,093,384
Obligations of Puerto Rico, States and political subdivisions	80,757	1,836	78,921
Collateralized mortgage obligations	1,142,281	21,079	1,121,202
Mortgage-backed securities	554,239	11,318	542,921
Equity securities	27,297	13,642	13,655
	$4,186,384	$59,851	$4,126,533

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(In thousands)	AS OF DECEMBER 31, 2007 Less than 12 months Amortized Cost	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$ 67,107	$ 185	$ 66,922
Obligations of Puerto Rico, States and political subdivisions	2,600	2	2,598
Collateralized mortgage obligations	349,084	2,453	346,631
Mortgage-backed securities	99,328	667	98,661
Equity securities	28	10	18
	$518,147	$3,317	$514,830

(In thousands)	12 months or more Amortized Cost	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 466,111	$ 5,011	$ 461,100
Obligations of U.S. Government sponsored entities	1,807,457	5,700	1,801,757
Obligations of Puerto Rico, States and political subdivisions	65,642	2,182	63,460
Collateralized mortgage obligations	430,034	8,053	421,981
Mortgage-backed securities	656,879	11,197	645,682
Equity securities	300	26	274
	$3,426,423	$32,169	$3,394,254

(In thousands)	Total Amortized Cost	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 466,111	$ 5,011	$ 461,100
Obligations of U.S. Government sponsored entities	1,874,564	5,885	1,868,679
Obligations of Puerto Rico, States and political subdivisions	68,242	2,184	66,058
Collateralized mortgage obligations	779,118	10,506	768,612
Mortgage-backed securities	756,207	11,864	744,343
Equity securities	328	36	292
	$3,944,570	$35,486	$3,909,084

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(In thousands)	AS OF JUNE 30, 2007 Less than 12 months Amortized Cost	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$475,542	$13,283	$462,259
Obligations of Puerto Rico, States and political subdivisions	21,652	473	21,179
Collateralized mortgage obligations	189,570	2,077	187,493
Mortgage-backed securities	39,132	873	38,259
Equity securities	53,683	11,047	42,636
	$779,579	$27,753	$751,826

(In thousands)	12 months or more Amortized Cost	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 500,193	$ 37,616	$ 462,577
Obligations of U.S. Government sponsored entities	5,540,664	161,165	5,379,499
Obligations of Puerto Rico, States and political subdivisions	69,136	3,281	65,855
Collateralized mortgage obligations	647,337	16,358	630,979
Mortgage-backed securities	869,343	31,898	837,445
Equity securities	310	27	283
	$7,626,983	$250,345	$7,376,638

(In thousands)	Total Amortized Cost	Gross Unrealized Losses	Market Value
U.S. Treasury securities	$ 500,193	$ 37,616	$ 462,577
Obligations of U.S. Government sponsored entities	6,016,206	174,448	5,841,758
Obligations of Puerto Rico, States and political subdivisions	90,788	3,754	87,034
Collateralized mortgage obligations	836,907	18,435	818,472
Mortgage-backed securities	908,475	32,771	875,704
Equity securities	53,993	11,074	42,919
	$8,406,562	$278,098	$8,128,464

As of June 30, 2008, Obligations of Puerto Rico, States and political subdivisions include approximately $55 million in Commonwealth of Puerto Rico Appropriation Bonds (Appropriation Bonds) in the Corporation s available-for-sale and held-to-maturity securities portfolios. The rating on these bonds by Moody s Investors Service (Moody s) is Ba1, one notch below investment grade, while Standard & Poor s (S&P) rates them as investment grade. As of June 30, 2008, these Appropriation Bonds represented approximately $1.6 million in net unrealized losses in the Corporation s investment securities available-for-sale portfolio. The Corporation is closely monitoring the political and economic situation of the Island as part of its evaluation of its available-for-sale portfolio for any declines in value that management may consider being other-than-temporary. 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.

The unrealized loss positions of available-for-sale securities as of June 30, 2008, except for the obligations of the Puerto Rico government described above and certain equity securities which have recently declined in value during 2008, are primarily associated with U.S. Agency and government sponsored-issued mortgage-backed securities and

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collateralized mortgage obligations. The vast majority of these securities are rated the equivalent of AAA by the major rating agencies. The investment portfolio is structured primarily with highly-liquid securities, which possess a large and efficient secondary market. Management believes that the unrealized losses in these available-for-sale securities as of June 30, 2008 are temporary and are substantially related to market interest rate fluctuations and not to the 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.

During the six months ended June 30, 2008, the Corporation recognized through earnings approximately $2.9 million in losses considered other-than-temporary on residual interests classified as available-for-sale. During the six months ended June 30, 2007, the Corporation recognized through earnings approximately $30.7 million in losses in residual interests classified as available-for-sale and $7.6 million in losses in equity securities that management considered to be other-than-temporarily impaired.

The following table states the names of issuers and the aggregate amortized cost and market value of the securities of such issuer (includes available-for-sale and held-to-maturity securities), when the aggregate amortized cost of such securities exceeds 10% of stockholders equity. This information excludes securities of the U.S. Government agencies and corporations. Investments in obligations issued by a state of the U.S. and its political subdivisions and agencies, which are payable and secured by the same source of revenue or taxing authority, other than the U.S. Government, are considered securities of a single issuer.

	June 30, 2008		December 31, 2007		June 30, 2007	
(In thousands)	Amortized Cost	Market Value	Amortized Cost	Market Value	Amortized Cost	Market Value
FNMA	$1,137,288	$1,131,842	$1,132,834	$1,128,544	$1,261,541	$1,238,499
FHLB	4,506,509	4,521,314	5,649,729	5,693,170	6,069,496	5,897,748
Freddie Mac	816,570	810,182	918,976	913,609	1,011,125	996,046

Note 6 Investment Securities Held-to-Maturity

The amortized cost, gross unrealized gains and losses and approximate market value (or fair value for certain investment securities where no market quotations are available) of investment securities held-to-maturity as of June 30, 2008, December 31, 2007 and June 30, 2007 were as follows:

	AS OF JUNE 30, 2008			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$ 34,084		$ 8	$ 34,076
Obligations of Puerto Rico, States and political subdivisions	185,852	$280	1,566	184,566
Collateralized mortgage obligations	267		15	252
Others	12,280	38	2	12,316
	$232,483	$318	$1,591	$231,210

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	AS OF DECEMBER 31, 2007			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$395,974	$ 15	$1,497	$394,492
Obligations of Puerto Rico, States and political subdivisions	76,464	3,108	26	79,546
Collateralized mortgage obligations	310		17	293
Others	11,718	94	4	11,808
	$484,466	$3,217	$ 1,544	$486,139

	AS OF JUNE 30, 2007			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$340,323	$ 13	$ 36	$340,300
Obligations of Puerto Rico, States and political subdivisions	72,406	441	374	72,473
Collateralized mortgage obligations	354		19	335
Others	16,396	39	7	16,428
	$429,479	$493	$436	$429,536

The following table shows the Corporation s amortized cost, gross unrealized losses and fair value of investment securities held-to-maturity, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2008, December 31, 2007 and June 30, 2007:

	AS OF JUNE 30, 2008 Less than 12 months		
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$34,085	$ 8	$34,077
Obligations of Puerto Rico, States and political subdivisions	41,694	1,566	40,128
	$75,779	$1,574	$74,205

	12 months or more		
	Amortized	Gross Unrealized	Market

(In thousands)	Cost	Losses	Value
Collateralized mortgage obligations	$ 267	$ 15	$ 252
Others	1,000	2	998
	$1,267	$ 17	$1,250

(In thousands)	Amortized Cost	Total Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$34,085	$ 8	$34,077
Obligations of Puerto Rico, States and political subdivisions	41,694	1,566	40,128
Collateralized mortgage obligations	267	15	252
Others	1,000	2	998
	$77,046	$1,591	$75,455

	AS OF DECEMBER 31, 2007		
	Less than 12 months		
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$196,129	$1,497	$194,632
Obligations of Puerto Rico, States and political subdivisions	1,883	26	1,857
Others	1,250	1	1,249
	$199,262	$1,524	$197,738

	12 months or more		
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
Collateralized mortgage obligations	$ 310	$ 17	$ 293
Others	1,250	3	1,247
	$1,560	$ 20	$1,540

(In thousands)	Amortized Cost	Total Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$196,129	$1,497	$194,632
Obligations of Puerto Rico, States and political subdivisions	1,883	26	1,857
Collateralized mortgage obligations	310	17	293
Others	2,500	4	2,496
	$200,822	$1,544	$199,278

	AS OF JUNE 30, 2007		
	Less than 12 months		
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$240,336	$ 36	$240,300
Obligations of Puerto Rico, States and political subdivisions	20,995	223	20,772
Others	250	2	248
	$261,581	$261	$261,320

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	12 months or more		
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
Obligations of Puerto Rico, States and political subdivisions	$24,545	$151	$24,394
Collateralized mortgage obligations	354	19	335
Others	1,250	5	1,245
	$26,149	$175	$25,974

		Total	
(In thousands)	Amortized Cost	Gross Unrealized Losses	Market Value
Obligations of U.S. Government sponsored entities	$240,336	$ 36	$240,300
Obligations of Puerto Rico, States and political subdivisions	45,540	374	45,166
Collateralized mortgage obligations	354	19	335
Others	1,500	7	1,493
	$287,730	$436	$287,294

Management believes that the unrealized losses in the held-to-maturity portfolio as of June 30, 2008 are temporary and are substantially related to market interest rate fluctuations and not to deterioration in the creditworthiness of the issuers. Management has the intent and ability to hold these investments until maturity.

Note 7 Mortgage Servicing Rights and Residual Interests on Transfers of Mortgage Loans

The Corporation recognizes as assets the rights to service loans for others, whether these rights are purchased or result from asset transfers (sales and securitizations).

Effective January 1, 2007, under SFAS No. 156, the Corporation identified servicing rights related to residential mortgage loans as a class of servicing rights and elected to apply fair value accounting to these mortgage servicing rights (MSRs). These MSRs are segregated between loans serviced by PFH and by the Corporation s banking subsidiaries. Fair value determination is performed on a subsidiary basis, with assumptions varying in accordance with the types of assets or markets served.

Classes of mortgage servicing rights were determined based on the different markets or types of assets served. Under the fair value accounting method of SFAS No. 156, purchased MSRs and MSRs resulting from asset transfers are capitalized and carried at fair value.

Effective January 1, 2007, upon the remeasurement of the MSRs at fair value in accordance with SFAS No. 156, the Corporation recorded a cumulative effect adjustment to increase the 2007 beginning balance of MSRs by $15.3 million, which resulted in a $9.6 million, net of tax, increase in the retained earnings account of stockholders equity in 2007.

At the end of each quarter, the Corporation uses a discounted cash flow model to estimate the fair value of MSRs. The discounted cash flow model incorporates assumptions that market participants would use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, prepayment and late fees, among other considerations. Prepayment speeds are adjusted for the Corporation s loan characteristics and portfolio behavior.

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The changes in MSRs measured using the fair value method for the six months ended June 30, 2008 and June 30, 2007 were:

	Residential MSRs		
(In thousands)	Banking subsidiaries	PFH	Total
Fair value at January 1, 2008	$110,612	$ 81,012	$191,624
Purchases	2,986		2,986
Servicing from securitizations or asset transfers	15,521		15,521
Changes due to payments on loans (1)	(5,618)	(13,180)	(18,798)
Changes in fair value due to changes in valuation model inputs or assumptions	6,390	(11,568)	(5,178)
Fair value as of June 30, 2008	$129,891	$ 56,264	$186,155

(1) Represents changes due to collection / realization of expected cash flows over time.

	Residential MSRs		
(In thousands)	Banking subsidiaries	PFH	Total
Fair value at January 1, 2007	$ 91,431	$ 84,038	$175,469
Purchases	2,030	21,958	23,988
Servicing from securitizations or asset transfers	11,968	8,040	20,008
Changes due to payments on loans (1)	(4,561)	(16,837)	(21,398)
Changes in fair value due to changes in valuation model inputs or assumptions	3,887	(4,015)	(128)
Other changes		(66)	(66)
Fair value as of June 30, 2007	$104,755	$ 93,118	$197,873

(1) Represents changes due to collection / realization of expected cash flows over time.

Residential mortgage loans serviced for others were $20.4 billion as of June 30, 2008 (December 31, 2007 $20.5 billion; June 30, 2007 $15.4 billion).

Net mortgage servicing fees, a component of other service fees in the consolidated statements of operations, include the changes from period to period in the fair value of the MSRs, which may result from changes in the valuation model inputs or assumptions (principally reflecting changes in discount rates and prepayment speed assumptions) and other changes, representing changes due to collection / realization of expected cash flows.

The section below includes information on assumptions used in the valuation model of the MSRs, originated and purchased, as well as information on the residual interests derived from securitizations.

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Popular Financial Holdings

Key economic assumptions used to estimate the fair value of residual interests and MSRs derived from PFH s securitization transactions and the sensitivity of residual cash flows to immediate changes in those assumptions as of period end were as follows:

(In thousands)	June 30, 2008 Residual Interests	June 30, 2008 Originated MSRs Fixed-rate loans	June 30, 2008 Originated MSRs ARM loans	December 31, 2007 Residual Interests	December 31, 2007 Originated MSRs Fixed-rate loans	December 31, 2007 Originated MSRs ARM loans
Carrying amount of retained interests (fair value)	$37,490	$41,109	$2,080	$45,009	$47,243	$11,335
Weighted average life of collateral	7.8 years	5.4 years	3.4 years	7.6 years	4.3 years	2.6 years
Weighted average prepayment speed (annual rate)	16.6% (Fixed-rate loans) 24.0% (ARM loans)	16.6%	24.0%	20.7% (Fixed-rate loans) 30.0% (ARM loans)	20.7%	30.0%
Impact on fair value of 10% adverse change	$ 3,428	($ 723)	$ 240	$ 5,031	($ 192)	$ 272
Impact on fair value of 20% adverse change	$ 6,820	($ 1,831)	$ 467	$ 6,766	($ 886)	$ 688
Weighted average discount rate (annual rate)	40.0%	17.0%	17.0%	40.0%	17.0%	17.0%
Impact on fair value of 10% adverse change	($ 2,756)	($ 1,452)	($ 18)	($ 2,884)	($ 1,466)	($ 225)
Impact on fair value of 20% adverse change	($ 5,159)	($ 2,808)	($ 36)	($ 5,427)	($ 2,846)	($ 441)
Cumulative credit losses	5.62% to 16.29%			3.35% to 11.03%		
Impact on fair value of 10% adverse change	($ 7,527)			($ 8,829)		
Impact on fair value of 20% adverse change	($14,359)			($15,950)		

PFH, as servicer, collects prepayment penalties on a substantial portion of the underlying serviced loans. As such, an adverse change in the prepayment assumptions with respect to the MSRs could be partially offset by the benefit derived from the prepayment penalties estimated to be collected.

PFH also owns servicing rights purchased from other institutions. The fair value of purchased MSRs, their related valuation assumptions and the sensitivity to immediate changes in those assumptions as of period end were as follows:

	Purchased MSRs			
	June 30, 2008		December 31, 2007	
(In thousands)	Fixed-rate loans	ARM loans	Fixed-rate loans	ARM loans
Carrying amount of retained interests (fair value)	$9,416	$3,659	$7,808	$14,626
Weighted average life of collateral	6.6 years	3.5 years	4.7 years	3.4 years
Weighted average prepayment speed (annual rate)	14.1%	20.6%	18.3%	25.2%

Impact on fair value of 10% adverse change	($ 415)	($ 208)	($ 329)	($ 719)
Impact on fair value of 20% adverse change	($ 817)	($ 402)	($ 631)	($ 1,377)
Weighted average discount rate (annual rate)	17.0%	17.0%	17.0%	17.0%
Impact on fair value of 10% adverse change	($ 522)	($ 136)	($ 330)	($ 509)
Impact on fair value of 20% adverse change	($ 994)	($ 262)	($ 633)	($ 981)

Another key assumption used to estimate the fair value of PFH s MSRs was the default/delinquency rate which varies by the delinquency bucket in which the particular loans are categorized. The sensitivity to changes in the default curve as of June 30, 2008 was as follows:

	Originated MSRs		Purchased MSRs	
(In thousands)	Fixed-rate loans	ARM loans	Fixed-rate loans	ARM loans
Fair value	$41,109	$2,080	$9,416	$3,659
Impact on fair value of 10% adverse change	($ 1,235)	($1,408)	($ 315)	($1,978)
Impact on fair value of 20% adverse change	($ 2,471)	($2,795)	($ 630)	($3,935)

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Banking subsidiaries

The Corporation s banking subsidiaries retain servicing responsibilities on the sale of wholesale mortgage loans and under pooling / selling arrangements of mortgage loans into mortgage-backed securities, primarily GNMA and FNMA securities. Substantially all mortgage loans securitized by the banking subsidiaries have fixed rates. Under these servicing agreements, the banking subsidiaries do not earn significant prepayment penalty fees on the underlying loans serviced.

Key economic assumptions used in measuring the servicing rights retained at the date of the residential mortgage loan securitizations and whole loan sales by the banking subsidiaries during the quarter ended June 30, 2008 and year ended December 31, 2007 were:

	June 30, 2008	December 31, 2007
Prepayment speed	12.8%	9.5%
Weighted average life	7.8 years	10.6 years
Discount rate (annual rate)	11.5%	10.7%

Key economic assumptions used to estimate the fair value of MSRs derived from sales and securitizations of mortgage loans performed by the banking subsidiaries and the sensitivity of residual cash flows to immediate changes in those assumptions were as follows:

	Originated MSRs	
(In thousands)	June 30, 2008	December 31, 2007
Fair value of retained interests	$ 105,235	$ 86,453
Weighted average life (in years)	12.4 years	12.5 years
Weighted average prepayment speed (annual rate)	8.1%	8.0%
Impact on fair value of 10% adverse change	($ 4,126)	($ 1,983)
Impact on fair value of 20% adverse change	($ 7,154)	($ 3,902)
Weighted average discount rate (annual rate)	11.49%	10.83%
Impact on fair value of 10% adverse change	($ 5,524)	($ 2,980)
Impact on fair value of 20% adverse change	($ 9,757)	($ 5,795)

The banking subsidiaries also own servicing rights purchased from other financial institutions. The fair value of purchased MSRs, their related valuation assumptions and the sensitivity to immediate changes in those assumptions as of period end were as follows:

	Purchased MSRs	
(In thousands)	June 30, 2008	December 31, 2007
Fair value of retained interests	$ 24,656	$ 24,159
Weighted average life of collateral	12.3 years	12.4 years
Weighted average prepayment speed (annual rate)	8.2%	8.0%
Impact on fair value of 10% adverse change	($ 1,204)	($ 719)
Impact on fair value of 20% adverse change	($ 1,943)	($ 1,407)
Weighted average discount rate (annual rate)	13.1%	10.8%
Impact on fair value of 10% adverse change	($ 1,560)	($ 956)
Impact on fair value of 20% adverse change	($ 2,597)	($ 1,846)

The sensitivity analyses presented in the tables above for residual interests and servicing rights of PFH and the banking subsidiaries are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 and 20 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in the sensitivity

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tables included herein, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

Note 8 Other Assets

The caption of other assets in the consolidated statements of condition consists of the following major categories:

(In thousands)	June 30, 2008	December 31, 2007	June 30, 2007
Net deferred tax assets	$ 807,884	$ 525,369	$ 419,611
Trade receivables from brokers and counterparties	515,273	1,160	19,685
Securitization advances and related assets	299,519	168,599	106,123
Bank-owned life insurance program	219,867	215,171	210,333
Prepaid expenses	198,286	188,237	200,307
Investments under the equity method	108,008	89,870	82,620
Derivative assets	50,121	76,958	77,484
Others	256,884	191,630	181,437
Total	$2,455,842	$1,456,994	$1,297,600

Note 9 Derivative Instruments and Hedging

Refer to Note 30 to the consolidated financial statements included in the 2007 Annual Report for a complete description of the Corporation s derivative activities. The following represents the major changes that occurred in the Corporation s derivative activities during the second quarter of 2008.

Cash Flow Hedges

Derivative financial instruments designated as cash flow hedges outstanding as of June 30, 2008 and December 31, 2007 were as follows:

	As of June 30, 2008				
(In thousands)	Notional amount	Derivative assets	Derivative liabilities	Equity OCI	Ineffectiveness
Asset Hedges					
Forward commitments	$ 180,900	$ 742	$ 354	$ 237	
Liability Hedges					
Interest rate swaps	$ 200,000		$ 4,517	($2,936)	

	As of December 31, 2007				
(In thousands)	Notional amount	Derivative assets	Derivative liabilities	Equity OCI	Ineffectiveness
Asset Hedges					
Forward commitments	$ 142,700	$ 169	$ 509	($ 207)	
Liability Hedges					
Interest rate swaps	$ 200,000		$ 3,179	($2,066)	

The Corporation utilizes forward contracts to hedge the sale of mortgage-backed securities with duration terms over one month. Interest rate forward contracts are contracts for the delayed delivery of securities which the seller agrees to deliver on a specified future date at a specified price or yield. These forward contracts are used to hedge a forecasted transaction and thus qualify for cash flow hedge accounting in accordance with SFAS No. 133, as amended. Changes in the fair value of the derivatives are recorded in other comprehensive income. The amount included in accumulated other comprehensive income corresponding to these forward contracts is expected to be reclassified to earnings in the next twelve months. The contracts outstanding as of June 30, 2008 have a maximum remaining maturity of 84 days.

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The Corporation also has designated as cash flow hedges, interest rate swap contracts that convert floating rate debt into fixed rate debt by minimizing the exposure to changes in cash flows due to higher interest rates. These interest rate swap contracts have a maximum remaining maturity of 9.3 months.

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Non-Hedging Activities

Financial instruments designated as non-hedging derivatives outstanding as of June 30, 2008 and December 31, 2007 were as follows:

As of June 30, 2008

		Fair Values	
(In thousands)	Notional amount	Derivative assets	Derivative liabilities
Forward contracts	$ 379,115	$ 1,383	$ 987
Interest rate swaps associated with:			
- bond certificates offered in an on-balance sheet securitization	67,985		2,557
- swaps with corporate clients	963,773		23,969
- swaps offsetting position of corporate client swaps	963,773	23,969	
Foreign currency and exchange rate commitments w/ clients	28		
Foreign currency and exchange rate commitments w/ counterparty	28		
Interest rate caps	214,500	803	
Interest rate caps for benefit of corporate clients	114,500		802
Indexed options on deposits	198,307	21,156	
Indexed options on S&P Notes	31,152	2,286	
Bifurcated embedded options	214,766		24,784
Mortgage rate lock commitments	98,139	122	812
Total	$3,246,066	$49,719	$ 53,911

As of December 31, 2007

		Fair Values	
(In thousands)	Notional amount	Derivative assets	Derivative liabilities
Forward contracts	$ 693,096	$ 74	$ 3,232
Interest rate swaps associated with:			
- short-term borrowings	200,000		1,129
- bond certificates offered in an on-balance sheet securitization	185,315		2,918
- swaps with corporate clients	802,008		24,593
- swaps offsetting position of corporate client swaps	802,008	24,593	
Credit default swap	33,463		
Foreign currency and exchange rate commitments w/ clients	146		1
Foreign currency and exchange rate commitments w/ counterparty	146	2	
Interest rate caps	150,000	27	
Interest rate caps for benefit of corporate clients	50,000		18
Indexed options on deposits	211,267	45,954	

Indexed options on S&P Notes	31,152	5,962	
Bifurcated embedded options	218,327		50,227
Mortgage rate lock commitments	148,501	258	386
Total	$3,525,429	$76,870	$ 82,504

Interest Rates Swaps

The Corporation has an interest rate swap outstanding with a notional amount of $68 million to economically hedge the payments of certificates issued as part of a securitization. This swap is marked-to-market quarterly and recognized as part of interest expense. The Corporation recognized gains of $2.4 million for the second quarter and $0.4 million for the six months ended June 30, 2008 due to changes in the fair value of this swap. The Corporation recognized gains of $1.7 million for the second quarter and $1.9 million for the six months ended June 30, 2007 due to changes in its fair value.

In addition, the Corporation also utilizes interest rate swaps in its capacity as an intermediary on behalf of its customers. The Corporation minimizes its market risk and credit risk by taking offsetting positions under the same terms and conditions with credit limit approvals and monitoring procedures.

Interest Rate Caps

The Corporation has interest rate caps to economically hedge the exposure to rising interest rates of certain short-term borrowings. Additionally, the Corporation enters into interest rate caps as an intermediary on behalf of its customers and simultaneously takes offsetting positions with creditworthy counterparts under the same terms and conditions thus minimizing its market and credit risks.

Forward Contracts

The Corporation has loan sales commitments to economically hedge the changes in fair value of mortgage loans held-for-sale associated with interest rate lock commitments through both mandatory and best efforts forward sales agreements. These contracts are entered into in order to optimize the gain on sales of loans. These contracts are recognized at fair market value with changes directly reported in income as part of gain on sale of loans. For the quarter and six months ended June 30, 2008, gains of $1.1 million and $2.2 million, respectively, were recognized due to changes in fair value of these forward sales commitments. For the quarter and six months ended June 30, 2007, gains of $2.3 million and $1.6 million, respectively, were recognized due to changes in fair value of these forward sales commitments. Additionally, the Corporation has forward commitments to hedge the changes in fair value of certain MBS securities classified as trading securities. For the quarter and six months ended June 30, 2008, the Corporation recognized gains of $611 thousand and $1.4 million, respectively, due to changes in the fair value of these forward commitments, which were recognized as part of trading gains and losses. For the quarter and six months ended June 30, 2007, gains of $428 thousand and $259 thousand, respectively, were recognized due to changes in fair value of these forward commitments.

Mortgage Rate Lock Commitments

The Corporation has mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed for a specified period of time. The mortgage rate lock commitments are accounted as derivatives pursuant to SFAS No. 133. These contracts are recognized at fair value with changes directly reported in income as part of gain on sale of loans. For the quarter and six months ended June 30, 2008, losses of $639 thousand and $562 thousand, respectively, were recognized due to changes in fair value of these commitments. For the quarter and six months ended June 30, 2007, the Corporation recognized losses of $2.3 million and $1.5 million, respectively, related to these commitments.

Note 10 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the six months ended June 30, 2008 and 2007, allocated by reportable segments, were as follows (refer to Note 24 for the definition of the Corporation s reportable segments):

	2008				
(In thousands)	Balance at January 1, 2008	Goodwill acquired	Purchase accounting adjustments	Other	Balance at June 30, 2008
Banco Popular de Puerto Rico:					
Commercial Banking	$ 35,371		($ 115)		$ 35,256
Consumer and Retail Banking	136,407		(562)		135,845
Other Financial Services	8,621	$ 153		$ 3	8,777
Banco Popular North America:					
Banco Popular North America	404,237				404,237
E-LOAN					
Popular Financial Holdings					
EVERTEC	46,125	1,000		(2,414)	44,711
Total Popular, Inc.	$630,761	$1,153	($ 677)	($ 2,411)	$628,826

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(In thousands)	2007 Balance at January 1, 2007	Goodwill acquired	Other	Balance at June 30, 2007
Banco Popular de Puerto Rico:				
Commercial Banking	$ 14,674			$ 14,674
Consumer and Retail Banking	34,999			34,999
Other Financial Services	4,391	$ 24		4,415
Banco Popular North America:				
Banco Popular North America	404,237			404,237
E-LOAN	164,410			164,410
Popular Financial Holdings				
EVERTEC	45,142	775	($183)	45,734
Total Popular, Inc.	$ 667,853	$799	($183)	$668,469

Purchase accounting adjustments consist of adjustments to the value of the assets acquired and liabilities assumed resulting from the completion of appraisals or other valuations, adjustments to initial estimates recorded for transaction costs, if any, and contingent consideration paid during a contractual contingency period. The purchase accounting adjustments during the six months ended June 30, 2008 at the BPPR reportable segment were mostly related to the acquisition of Citibank s retail branches in Puerto Rico (acquisition completed in December 2007). The reduction in goodwill in the EVERTEC reportable segment during the six months ended June 30, 2008 was the result of the sale of substantially all assets of EVERTEC s health processing division during the second quarter of 2008.

As of June 30, 2008, other than goodwill, the Corporation had $17 million of identifiable intangibles with indefinite useful lives (December 31, 2007 $17 million; June 30, 2007 $65 million).

The following table reflects the components of other intangible assets subject to amortization:

(In thousands)	June 30, 2008 Gross Amount	June 30, 2008 Accumulated Amortization	December 31, 2007 Gross Amount	December 31, 2007 Accumulated Amortization	June 30, 2007 Gross Amount	June 30, 2007 Accumulated Amortization
Core deposits	$66,040	$26,141	$66,381	$23,171	$71,629	$46,982
Other customer relationships	9,852	4,803	10,375	4,131	11,543	3,113
Other intangibles	8,219	6,150	8,164	5,385	9,146	4,534
Total	$84,111	$37,094	$84,920	$32,687	$92,318	$54,629

Certain core deposit intangibles with a gross amount of $699 thousand became fully amortized or written off during the six months ended June 30, 2008 and, as such, their gross amount and accumulated amortization were eliminated from the tabular disclosure presented above.

During the quarter and six months ended June 30, 2008, the Corporation recognized $2.5 million and $5.0 million, respectively, in amortization expense related to other intangible assets with definite lives (June 30, 2007 - $2.8 million and $5.8 million in the quarter and six months ended June 30, 2007, respectively).

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The following table presents the estimated aggregate annual amortization expense of the intangible assets with definite lives for each of the following fiscal years:

	(In thousands)
2008	$4,717
2009	8,332
2010	7,479
2011	6,125
2012	5,105

No significant events or circumstances have occurred during the quarter ended June 30, 2008 that would reduce the fair value of any reporting unit below its carrying amount.

Note 11 Fair Value Option

As indicated in Note 2 to the consolidated financial statements, the Corporation elected to measure at fair value certain loans and borrowings outstanding at January 1, 2008 pursuant to the fair value option provided by SFAS No. 159. These financial instruments, all of which pertained to the operations of Popular Financial Holdings that are running off, were as follows:

Approximately $1.2 billion of whole loans held-in-portfolio by PFH that were outstanding as of December 31, 2007. These whole loans consist principally of first lien residential mortgage loans and closed-end second lien loans that were originated through the exited origination channels of PFH (e.g. asset acquisition, broker and retail channels), and home equity lines of credit that had been originated by E-LOAN, but sold to PFH as part of the Corporation s 2007 U.S. reorganization whereby E-LOAN became a subsidiary of BPNA. Also, to a lesser extent, the loan portfolio included mixed-use / multi-family loans (small commercial category) and manufactured housing loans.

Management believes that accounting for these loans at fair value provides a more relevant and transparent measurement of the realizable value of the assets and differentiates the PFH portfolio from the loan portfolios that the Corporation will continue to originate through channels other than PFH.

Approximately $287 million of owned-in-trust loans and $287 million of bond certificates associated with PFH securitization activities that were outstanding as of December 31, 2007. The owned-in-trust loans are pledged as collateral for the bond certificates as a financing vehicle through on-balance sheet securitization transactions. These loan securitizations conducted by the Corporation did not meet the sale criteria under SFAS No. 140; accordingly, the transactions are treated as on-balance sheet securitizations for accounting purposes. Due to the terms of the transactions, particularly the existence of an interest rate swap agreement and to a lesser extent clean up calls, the Corporation was unable to recharacterize these loan securitizations as sales for accounting purposes in 2007. The owned-in-trust loans include first lien residential mortgage loans, closed-end second lien loans, mixed-use / multi-family loans (small commercial category) and manufactured housing loans. The majority of the portfolio is comprised of first lien residential mortgage loans.

These owned-in-trust loans do not pose the same magnitude of risk to the Corporation as those loans owned outright because certain of the potential losses related to owned-in-trust loans are born by the bondholders and not the Corporation. Upon the adoption of SFAS No. 159, the loans and related bonds are both measured at fair value, thus their net position better portrays the credit risk born by the Corporation.

Excluding the PFH loans elected for the fair value option as described above, PFH s reportable segment held approximately $1.8 billion of additional loans at the time of fair value option election on January 1, 2008. Of these remaining loans, $1.4 billion were classified as loans held-for-sale and were not subject to the fair value option as the loans were intended to be sold to an institutional buyer during the first quarter of 2008. These loans were sold in March 2008. The remaining $0.4 billion in other loans held-in-portfolio at PFH as of that same date consisted principally of a small portfolio of auto loans that was acquired from E-LOAN, warehousing revolving lines of credit

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with monthly advances and pay-downs, and construction credit agreements in which permanent financing will be with a lender other than PFH. Although these businesses are running off, PFH must contractually continue to fund the revolving credit arrangements.

There were no other assets or liabilities elected for the fair value option after January 1, 2008.

Upon adoption of SFAS No. 159 the Corporation recognized a $262 million negative after-tax adjustment ($409 million before tax) to beginning retained earnings due to the transitional adjustment for electing the fair value option, as detailed in the following table.

(In thousands)	January 1, 2008 (Carrying value prior to adoption)	Cumulative effect adjustment to January 1, 2008 retained earnings- Gain (Loss)	January 1, 2008 fair value (Carrying value after adoption)
Loans	$1,481,297	($ 494,180)	$987,117
Notes payable (bond certificates)	($ 286,611)	$ 85,625	($200,986)
Pre-tax cumulative effect of adopting fair value option accounting		($ 408,555)	
Net increase in deferred tax asset		146,724	
After-tax cumulative effect of adopting fair value option accounting		($ 261,831)	

As of January 1, 2008, the Corporation eliminated $37 million in allowance for loan losses associated to the loan portfolio elected for fair value option accounting and recognized it as part of the cumulative effect adjustment.

The following table presents the differences as of June 30, 2008 between the aggregate fair value, including accrued interest, and aggregate unpaid principal balance (UPB) of those loans / notes payable for which the fair value option has been elected. Also, the table presents information of non-accruing loans accounted under the fair value option.

(In thousands)	Aggregate fair value as of June 30, 2008	Aggregate UPB as of June 30, 2008	Unrealized (loss) gain
Loans	$844,892	$1,345,573	($ 500,681)
Loans past due 90 days or more	$110,433	$ 194,767	($84,334)
Non-accrual loans (1)	$110,433	$ 194,767	($84,334)
Notes payable (bond certificates)	($173,725)	($ 253,541)	$ 79,816

(1)

It is the Corporation s policy to recognize interest income separately from other changes in fair value. Interest income is included as part of net interest income in the consolidated statement of operations and is based on the note s contractual rate. Interest income is reversed, if necessary, in accordance with the Corporation s non-accruing policy for each particular loan type.

During the quarter and six-months ended June 30, 2008, the Corporation recognized $31.0 million and $32.7 million, respectively, in estimated net losses attributable to changes in the fair value of loans, including net losses attributable to changes in instrument-specific credit spreads. These estimated net losses were included in the caption Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159 in the consolidated statement of operations. The change in fair value included estimated losses of $6.9 million for the quarter and $43.5 million for the six months ended June 30, 2008 that were attributable to changes in instrument-specific credit spreads. Instrument-specific credit spreads were determined by excluding the non-credit components of gains and losses, such as those due to changes in interest rates.

During the quarter and six months ended June 30, 2008, the Corporation recognized $4.9 million and $6.2 million, respectively, in estimated net losses attributable to changes in the fair value of notes payable (bond certificates), including changes in instrument-specific credit spreads. The estimated net losses were included in the caption Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159 in the consolidated statement of operations. The change in fair value included estimated losses of $5.3 million for the quarter and $10.0 million for the six months ended June 30, 2008 that were attributable to changes in instrument-specific credit spreads.

As indicated in Note 12 to the consolidated financial statements, these assets and liabilities are categorized as Level 3 under the requirements of SFAS No. 157.

Note 12 Fair Value Measurement

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2008, the Corporation adopted SFAS No. 157, which provides a framework for measuring fair value under accounting principles generally accepted. Under SFAS No. 157, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability.

SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels in order to increase consistency and comparability in fair value measurements and disclosures. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for the fair value measurement are observable or unobservable. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect the Corporation s estimates about assumptions that market participants would use in pricing the asset or liability based on the best information available. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1- Unadjusted quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date. Valuation on these instruments does not necessitate a significant degree of judgment since valuations are based on quoted prices that are readily available in an active market.

Level 2- Quoted prices other than those included in Level 1 that are observable either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or that can be corroborated by observable market data for substantially the full term of the financial instrument.

Level 3- Inputs are unobservable and significant to the fair value measurement. Unobservable inputs reflect the Corporation s own assumptions about assumptions that market participants would use in pricing the asset or liability.

The Corporation maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available. Fair value is based upon quoted market prices when available. If listed price or quotes are not available, the Corporation employs internally-developed models that primarily use market-based inputs including yield curves, interest rates, volatilities, and credit curves, among others. Valuation adjustments are limited to those necessary to ensure that the financial instrument s fair value is adequately representative of the price that would be received or paid in the marketplace. These adjustments include amounts that reflect counterparty credit quality, the Corporation s credit standing, constraints on liquidity and unobservable parameters that are applied consistently.

The estimated fair value may be subjective in nature and may involve uncertainties and matters of significant judgment for certain financial instruments. Changes in the underlying assumptions used in calculating fair value could significantly affect the results. In addition, the fair value estimates are based on outstanding balances without attempting to estimate the value of anticipated future business. Therefore, the estimated fair value may materially differ from the value that could actually be realized on a sale.

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Fair Value on a Recurring Basis

The following fair value hierarchy table presents information about the Corporation s assets and liabilities measured at fair value on a recurring basis at June 30, 2008:

	At June 30, 2008			
(In millions)	Quoted prices in active markets for identical assets or liabilities Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3	Balance as of June 30, 2008
Assets				
Investment securities available-for-sale	$ 10	$ 7,651	$ 41	$ 7,702
Trading account securities		154	345	499
Loans measured at fair value (SFAS No. 159)			845	845
Derivatives		51		51
Mortgage servicing rights			186	186
Total	$ 10	$ 7,856	$ 1,417	$ 9,283
Liabilities				
Notes payable measured at fair value (SFAS No. 159)			($ 174)	($ 174)
Derivatives		($ 59)		(59)
Total		($ 59)	($ 174)	($ 233)

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the quarter and six months ended June 30, 2008:

	Quarter ended June 30, 2008			
	Increase (decrease)	Purchases, sales, issuances, settlements,		Changes in unrealized gains (losses) included in earnings related to assets and

(In millions)	Balance as of March 31, 2008	Gains (losses) included in earnings	Gains (losses) included in other comprehensive income	in accrued interest receivable / payable	paydowns and maturities (net)	Balance as of June 30, 2008	liabilities still held as of June 30, 2008
Assets							
Investment securities available-for-sale (e)	$ 42				($ 1)	$ 41	(a)
Trading account securities	280	$ 2			63	345	($ 1)(b)
Loans measured at fair value (SFAS No. 159)	927	(31)		($ 1)	(50)	845	(9)(c)
Mortgage servicing rights	184	(9)			11	186	(1)(d)
Total	$1,433	($ 38)		($ 1)	$ 23	$1,417	($ 11)
Liabilities							
Notes payable measured at fair value (SFAS No. 159)	($ 186)	($ 5)			$ 17	($ 174)	($ 5)(c)
Total	($ 186)	($ 5)			$ 17	($ 174)	($ 5)

(a) Gains (losses) are included in Net (loss) gain on sale and valuation adjustments of investment securities in the statement of operations.

(b) Gains (losses) are included in Trading account profit (loss) in the statement of operations.

(c) Gains (losses) are included in Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159 in the statement of operations.

(d) Gains (losses) are included in Other service fees in the statement of operations.

(e) Other-than-temporary impairment on residual interests classified as available-for-sale amounted to $0.6 million and is classified as realized losses.

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Six months ended June 30, 2008

(In millions)	Balance as of January 1, 2008	Gains (losses) included in earnings	Gains (losses) included in other comprehensive income	Increase (decrease) in accrued interest receivable / payable	Purchases, sales, issuances, settlements, paydowns and maturities (net)	Balance as of June 30, 2008	Changes in unrealized gains (losses) included in earnings related to assets and liabilities still held as of June 30, 2008
Assets							
Investment securities available-for-sale (e)	$ 43	$ (2)	$ 1		$ (1)	$ 41	(a)
Trading account securities	273				72	345	$ (7)(b)
Loans measured at fair value (SFAS No. 159)	987	(33)		$ (2)	(107)	845	15(c)
Mortgage servicing rights	192	(24)			18	186	(5)(d)
Total	$1,495	$(59)	$ 1	$ (2)	$ (18)	$1,417	$ 3
Liabilities							
Notes payable measured at fair value (SFAS No. 159)	$ (201)	$ (6)			$ 33	$ (174)	$ (6)(c)
Total	$ (201)	$ (6)			$ 33	$ (174)	$ (6)

(a) Gains (losses) are included in Net (loss) gain on sale and valuation adjustments of investment securities in the statement of operations.

(b) Gains (losses) are included in Trading account profit (loss) in the statement of operations.

(c) Gains (losses) are included in Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159 in the statement of operations.

(d) Gains (losses) are included in Other service fees in the statement of operations.

(e) Other-than-temporary impairment on residual interests classified as available-for-sale amounted to $2.9 million and is classified as realized losses.

There were no transfers in and / or out of Level 3 for financial instruments measured at fair value on a recurring basis during the quarter and six months ended June 30, 2008.

Gains and losses (realized and unrealized) included in earnings for the quarter and six months ended June 30, 2008 for Level 3 assets and liabilities included in the previous tables are reported in the consolidated statement of operations as follows:

	Quarter ended June 30, 2008	
(In millions)	Total gains (losses) included in	Change in unrealized gains or losses relating to assets / liabilities still held at reporting date

	earnings	
Interest income	$ 4	
Other service fees	(9)	$ (1)
Net loss on sale and valuation adjustments of investment securities	(1)	
Trading account loss	(1)	(1)
Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159	(36)	(14)
Total	$ (43)	$ (16)

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	Six months ended June 30, 2008	
(In millions)	Total gains (losses) included in earnings	Change in unrealized gains or losses relating to assets / liabilities still held at reporting date
Interest income	$ 9	
Other service fees	(24)	($5)
Net loss on sale and valuation adjustments of investment securities	(3)	
Trading account loss	(8)	(7)
Losses from changes in fair value related to instruments measured at fair value pursuant to SFAS No. 159	(39)	9
Total	$ (65)	($3)

Additionally, the Corporation may be required to measure certain assets at fair value on a nonrecurring basis in accordance with accounting principles generally accepted. The adjustments to fair value usually result from the application of lower of cost or market accounting, identification of impaired loans requiring specific reserves under SFAS No. 114, or write-downs of individual assets. The following table presents those financial assets that were subject to a fair value measurement on a non-recurring basis during the six months ended June 30, 2008 and which are still included in the consolidated statement of condition as of June 30, 2008. The amounts disclosed represent the aggregate of the fair value measurements of those assets as of the end of the reporting period.

	Quoted prices in active markets	Significant other	Significant