

# **Popular Securities, Inc.**

(a wholly-owned subsidiary of Popular, Inc.)

**Unaudited Statement of Financial Condition**

**June 30, 2009**

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*(dollars in thousands, except share data)*

<b>Assets</b>	
Cash	\$ 575
Securities purchased under agreements to resell	225,730
Securities owned, at fair value	
Pledged securities with creditors' rights to repledge	71,985
Other securities owned	43,753
Held in segregation	-
Receivables from broker-dealers and counterparties, net	11,341
Accrued interest receivable	687
Fixed assets, net of accumulated depreciation and amortization of \$2,624	1,872
Deferred tax asset, net	1,558
Goodwill and other intangible	3,894
Other assets	5,713
	<u>367,108</u>
Total assets	<u>\$ 367,108</u>
 <b>Liabilities and Stockholder's Equity</b>	
Securities sold under agreements to repurchase	\$ 300,135
Payables to broker-dealers and counterparties	747
Accrued interest payable	104
Accounts payable to affiliates	225
Accrued employee compensation and benefits	1,759
Income Tax Payable	507
Deferred compensation	2,326
Other liabilities	1,301
	<u>307,104</u>
Total liabilities	<u>307,104</u>
Commitments (Note 14)	
Stockholder's equity	
Capital stock, \$25 stated value; 10,000 shares authorized; 1,000 shares issued and outstanding	25
Treasury stock, at cost	-
Additional paid-in capital	15,713
Retained earnings	44,266
	<u>60,004</u>
Total stockholder's equity	<u>60,004</u>
Total liabilities and stockholder's equity	<u>\$ 367,108</u>

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

# Popular Securities, Inc.

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## Notes to the Unaudited Statement of Financial Condition

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### 1. Nature of Business and Summary of Significant Accounting Policies

Popular Securities, Inc. (the "Company") is engaged in investment banking, brokerage and financial advisory services and is a member of the Financial Industry Regulatory Authority (FINRA). The Company operates principally in the Commonwealth of Puerto Rico and is a wholly-owned subsidiary of Popular, Inc. ("Parent Company").

The Company is a registered broker-dealer pursuant to section 15(b) of the Securities Exchange Act of 1934. In addition, the Company is licensed by the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico as a registered broker-dealer and as an eligible similar institution under Regulation 5105.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (GAAP) and industry practices. Following is a description of the more significant accounting policies followed by the Company:

#### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management believes that these estimates are adequate. Actual results could differ from those estimates.

#### Income Recognition

Securities owned transactions are recorded on the trade date, as if they had settled. Customers' securities transactions are recorded on a settlement-date basis with related commission income and expenses recorded on a trade-date basis for the institutional division and on a settlement-date basis for the retail division. The difference between the settlement date basis used for the retail division and the trade date basis required by GAAP is not material. Investment banking revenue is recorded as follows: 1) underwriting fees at the time the underwriting is completed and income is reasonably determinable, 2) corporate finance advisory fees as earned, according to the terms of the specific contracts and 3) sales concessions on a trade-date basis.

#### Securities Owned

Financial instruments owned and financial instruments sold but not yet purchased are recorded on a trade date basis and are carried at fair value. Unrealized gains and losses on securities, forward, future and option contracts, if any, are reflected in the Statement of Income.

The Company self clears its proprietary transactions. Non-proprietary transactions are cleared by its clearing broker.

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a consistent framework for measurement of fair value. Additionally, SFAS 157 eliminates the requirement to defer calculated profit or loss on transaction values that include unobservable inputs "Day 1 profit or loss" and eliminates the use of block discounts for securities traded in an active market. See Note 2 for further discussions of fair value disclosures.

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### Securities Purchased/Sold Under Agreements to Resell/Repurchase

Repurchase and resale agreements are treated as collateralized financing transactions and are carried at the amounts at which the securities will be reacquired or resold as specified in the respective agreements. Interest income and expense related to these agreements is recorded on the accrual basis.

It is the Company's policy to take possession of securities purchased under resale agreements and such collateral is not reflected in the financial statements. The Company monitors the market value of the securities received as collateral under the resale agreements as compared to the related receivable, including accrued interest, and requests additional collateral when deemed appropriate.

The Company maintains control over the securities sold under repurchase agreements. The securities pledged as collateral under such agreements are included in the financial statements.

### Receivables and Payables to Broker-Dealers and Counterparties

At June 30, 2009, receivables and payables to broker dealers and counterparties consist of the following:

#### Receivables

Clearing broker	\$	4,215
Investment banking fees		203
Securities failed to deliver		815
Net Unsettled Transactions		5,510
Other		1,014
		<u>11,757</u>
Allowance for doubtful accounts		416
	\$	<u>11,341</u>

#### Payables

Securities failed to receive	\$	702
Other		45
	\$	<u>747</u>

### Allowance for Doubtful Accounts

The Company provides an allowance for doubtful accounts based on the estimated uncollectible amounts on unsecured counterparty balances receivable. The Company's estimate is primarily based on a review of the current status of specified accounts receivable. Provisions made to this allowance are charged to operations.

### Fixed Assets

Fixed assets are composed of furniture, equipment and leasehold improvements. Furniture and equipment, are initially recorded at cost and depreciated using the straight-line method over the estimated useful life of the related assets (between 3 and 10 years). Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the term of the lease.

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### Other Assets

Included in Other Assets are forgivable loans made to financial consultants, typically in connection with their recruitment. These loans are forgivable based on continued employment and are amortized over the terms specified in each agreement, which is generally four to nine years, using the straight-line method. Total forgivable loans as of June 30, 2009 amounted to approximately \$5,253. At June 30, 2009 the Company has a reserve for uncollectible loans amounting to \$56.

### Income Taxes

A deferred tax asset or liability is recognized for the estimated future tax effects attributable to temporary differences. A related valuation allowance is recognized when it is more likely than not that the deferred tax asset will not be realized. A temporary difference is the difference between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled.

Temporary differences giving rise to deferred tax assets and liabilities are attributable to deferred compensation, and other revenues and expenses which are reported for tax purposes in different years than for financial reporting purposes.

### Goodwill and Other Intangibles

Goodwill represents the excess of the purchase price and related costs over the value assigned to net assets acquired. Other intangible assets are recognized separately from goodwill when they arise from contractual or other legal rights or are separable and their fair value can be measured reliably. Goodwill will not be amortized but rather will be tested at least annually for impairment. Other intangible assets that have a finite useful life are amortized over a period based on the expected useful life.

## 2. Fair Value Measurements

As discussed in Note 1 to the financial statements, effective January 1, 2008, the Company 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:

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- *Level 1*- Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. Valuation on these instruments does not need 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 Company 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 Company 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 Company'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.

Following is a description of the Company's valuation methodologies used for assets measured at fair value.

- **U.S. Treasury securities:** The fair value of U.S. Treasury securities is based on yields that are interpolated from the constant maturity treasury curve. These securities are classified as Level 2.
- **Obligations of U.S. Government sponsored entities:** The Obligations of U.S. Government sponsored entities include U.S agency securities. The fair value of U.S. agency securities, except for structured notes, is based on an active exchange market and is based on quoted market prices for similar securities. The U.S. agency securities are classified as Level 2. U.S. agency structured notes are priced based on a bond's theoretical value from similar bonds defined by credit quality and market sector and for which the fair value incorporates an option adjusted spread in deriving their fair value. These securities are classified as Level 2.
- **Obligations of Puerto Rico, States, and political subdivisions:** Obligations of Puerto Rico, States and political subdivisions include municipal bonds. The bonds are segregated and the like characteristics divided into specific sectors. Market inputs

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used in the evaluation process include all or some of the following: trades, bid price or spread, two sided markets, quotes, benchmark curves including but not limited to Treasury benchmarks, LIBOR and swap curves, market data feeds such as MSRB, discount and capital rates, and trustee reports. These municipal bonds are classified as Level 2. In instances where significant inputs used to value municipal bonds are unobservable, they are classified as Level 3.

- **Mortgage-backed securities:** Certain agency mortgage-backed securities (“MBS”) are priced based on a bond’s theoretical value from similar bonds defined by credit quality and market sector. Their fair value incorporates an option adjusted spread. The agency MBS are classified as Level 2. Other agency MBS such as GNMA Puerto Rico Serials are priced using an internally-prepared pricing matrix with quoted prices from local brokers dealers. These particular MBS are classified as Level 3.
- **Collateralized mortgage obligations:** Agency and private collateralized mortgage obligations (“CMOs”) are priced based on a bond’s theoretical value from similar bonds defined by credit quality and market sector and for which fair value incorporates an option adjusted spread. The option adjusted spread model includes prepayment and volatility assumptions, ratings (whole loans collateral) and spread adjustments. These investment securities are classified as Level 2. CMOs that are priced using significant unobservable inputs are classified as Level 3.
- **Equity securities:** Equity securities with quoted market prices obtained from an active exchange market are classified as Level 1.
- **Corporate securities and mutual funds:** Quoted prices for these security types are obtained from broker dealers. Given that the quoted prices are for similar instruments or do not trade in highly liquid markets, the corporate securities and mutual funds are classified as Level 2. The important variables in determining the prices of Puerto Rico tax-exempt mutual fund shares are net asset value, dividend yield and type of assets in the fund. All funds trade based on a relevant dividend yield taking into consideration the aforementioned variables. In addition, demand and supply also affect the price. Corporate securities that trade less frequently are classified as Level 3.

The following table sets forth by level within the fair value hierarchy the financial assets at fair value:

	Financial Assets at Fair Value as of June 30, 2009			
	Level 1	Level 2	Level 3	Total
US Government and federal agency obligations	-	79	-	79
Puerto Rico, States and political subdivisions obligations	-	13,813	-	13,813
Mortgage and other asset-backed securities	-	19,259	67,026	86,285
Corporate debt and mutual funds	-	12,749	2,812	15,561
Financial instruments owned, at fair value	<u>\$ -</u>	<u>\$ 45,900</u>	<u>\$ 69,838</u>	<u>\$ 115,738</u>

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The following table presents the changes in Level 3 assets measured at fair value for the six months ended June 30, 2009:

	<u>For the six months ended June 30, 2009</u>			
	<u>Balance as of December 31, 2009</u>	<u>Gains (losses) included in earnings</u>	<u>Purchases, sales, issuances, paydowns and maturities</u>	<u>Balance as of June 30, 2009</u>
Puerto Rico, States and political subdivisions obligations	\$ 5,326	\$ 1,847	\$ (7,173)	\$ -
Mortgage and other asset-backed securities	38,369	(497)	29,154	67,026
Corporate debt	2,789	(23)	46	2,812
Financial instruments owned, at fair value	<u>\$ 46,484</u>	<u>\$ 1,327</u>	<u>\$ 22,027</u>	<u>\$ 69,838</u>

**3. Securities Owned**

Securities owned, at fair value, as of June 30, 2009 were as follows:

United States Government and its agencies	\$ 79
State and municipal governments	13,813
Mortgage-backed securities	86,263
Corporate and other securities	15,582
	<u>\$ 115,738</u>

During the year ended November 30, 2004, the Company transferred approximately \$61 million of GNMA mortgage-backed securities to an irrevocable trust in exchange for collateralized mortgage obligation (CMO) certificates. The Company derecognized the mortgage-backed securities transferred given that it relinquished control over such securities. The mortgage-backed securities transferred were accounted for at fair value prior to securitization. The Company subsequently retained approximately \$25 million of such certificates including a residual interest certificate (interest only). Such residual interests are accounted for at fair value and included in the "Mortgage-backed securities" caption above. Cash flows received on the residual retained interest were approximately \$331 for the six months ended June 30, 2009.

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The following table sets forth the weighted average key economic assumptions used in measuring the fair value of the residual retained interest, for which fair value is based on discounted cash flows, and the sensitivity of those fair values to immediate adverse changes of 10% and 20% in those assumptions:

Fair value of residual retained interest	\$	1,644
Weighted-average life (in years)		4.46
<b>Prepayment speed assumption (annual rate)</b>		13.50%
Impact on fair value of 10% adverse change	\$	(84)
Impact on fair value of 20% adverse change	\$	(152)
<b>Discount rate (annual)</b>		15.76%
Impact on fair value of 10% adverse change	\$	(66)
Impact on fair value of 20% adverse change	\$	(124)

These sensitivities 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 this table, the effect of a variation in a particular assumption on the fair value of the residual 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, which might magnify or counteract the sensitivities).

#### 4. Securities Purchased Under Agreements to Resell

The securities underlying the agreements to resell were delivered to, and are held by the Company. The counterparties to such agreements maintain effective control over such securities. Although the Company is permitted by contract or custom to repledge the securities, it has agreed to resell to the counterparties the same or substantially similar securities at the maturity of the agreements.

The fair value of the collateral securities received by the Company on these transactions as of June 30, 2009 was as follows:

Repledged	\$	218,565
Not repledged		7,548
	\$	<u>226,113</u>

The repledged securities were used as underlying collateral for securities sold under agreements to repurchase.

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#### 5. Goodwill and Other Intangible Assets

On December 7, 2007, the Company acquired from Citigroup Global Markets, Inc. the Puerto Rico operations of the broker-dealer Smith Barney in order to expand the Company's retail business. As part of the agreement, Smith Barney transferred to the Company approximately \$1.2 billion in assets under management.

This transaction was accounted under the purchase method of accounting. The purchase price was allocated between goodwill and other intangible assets.

At June 30, 2009, goodwill and other intangible assets consist of the following:

	Useful Life (years)	
Customer lists	10	\$ 766
Covenant not to compete	3	71
		<u>837</u>
Less - Accumulated amortization		(151)
Other intangibles		<u>686</u>
Goodwill		<u>3,208</u>
Goodwill and other intangibles		<u>\$ 3,894</u>

#### 6. Securities Sold Under Agreements to Repurchase

The following table summarizes certain information on securities sold under agreements to repurchase as of June 30, 2009.

Securities sold under agreements to repurchase	<u>\$ 300,135</u>
Maximum aggregate balance outstanding at any month-end	<u>\$ 376,102</u>
Average monthly aggregate balance outstanding	<u>\$ 260,331</u>
Weighted average interest rate	
At June 30, 2009	<u>0.35%</u>
For the period	<u>0.57%</u>

#### 7. Subordinated Borrowings

The Company has a revolving subordinated loan agreement with Popular, Inc. maturing on November 15, 2012. Under the agreement, the Company may borrow up to \$50,000. The interest rate on this loan is adjusted quarterly to the comparable floating spread for three-months LIBOR plus 12.5 basis points. All borrowings under this agreement qualify as regulatory capital and the agreement includes all statutory restrictions specified by the Uniform Net Capital Rule. The Company had no borrowings outstanding as of June 30, 2009.

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#### **8. Deferred Compensation**

##### **Plan A**

Under the deferred compensation plan for the institutional division employees, participants are required to defer a portion of their incentive performance bonus. The amount deferred and interest thereon are paid to participants as follows: (a) 50% on or before January 31 of the second fiscal year following the fiscal year for which such amounts were contributed and (b) 50% on or before January 31 of the third fiscal year following the fiscal year for which such amounts were contributed.

Total amount deferred related to this plan included in deferred compensation as of June 30, 2009 amounted to \$267.

Total liability under this plan not deferred, included in accrued employee compensation and benefits, amounted to \$727.

##### **Plan B**

Under the deferred compensation plan for the retail division employees, the participants' deferred compensation must be deferred completely. The principal and interest thereon have a vesting period of five years. The deferred compensation expense related to this plan is recognized over the vesting period. The interest on the principal amount deferred is the result of earnings of the investment of such principal in certain financial instruments as defined by Plan B. During 2008 the plan was amended to allow participants a one-time option to take a loan from the Company on the amounts granted for the 2003 and 2004 plan years and deferred under the plan until 2009 and 2010, respectively. At June 30, 2009 the plan has a receivable from participants amounting to \$319 included in Other assets in the Statement of Financial Condition related to this amendment. The plan was also amended to modify the deferral period from five to three years for awards declared for fiscal years commencing on January 1, 2008. The awards for fiscal years 2003 through 2007 remain deferred for a period of five years.

Total plan liability as of June 30, 2009 amounted to \$1,037 included as deferred compensation in the Statement of Financial Condition.

##### **Plan Trust**

On October 22, 1999 the Company created a trust (the "Trust") to invest the amount deferred under Plans A and B. The Trust's assets are subject to the claims of the Company's creditors in the event of the Company's insolvency until paid to each Plan's participants at such times as specified above.

The principal balance held by the Trust and any realized and unrealized appreciation are exclusively for the benefit of each Plan's participants

##### **Employee Benefit Plan**

The Company maintains a contributory savings plan which is available to employees with more than three months of service. Company contributions include a matching contribution and an additional discretionary profit sharing contribution. Employees are fully vested on these contributions after five years of service. There were no profit sharing contributions to the plan during the year. The plan's trustee is an affiliated company.

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**9. Income Taxes**

Temporary differences which give rise to the net deferred tax asset at June 30, 2009, are as follows:

<b>Deferred tax asset</b>	
Deferred compensation	\$ 799
Inventory valuation	\$ 683
Other	204
Net deferred tax asset	<u>\$ 1,686</u>
<b>Deferred tax liability</b>	(128)
<b>Net Deferred Tax Asset</b>	<u>\$ 1,558</u>

**10. Derivatives**

Derivative contracts are financial instruments, such as future, forward, swap or option contracts, that derive their value from underlying assets, indices, reference rates or a combination of these factors. Derivatives may involve future commitments to purchase or sell financial instruments. The amounts exchanged are based on the specific terms of the contract with reference to specified rates, securities or indices.

Most of the Company's derivative transactions are entered into for trading purposes. The Company uses derivatives in its trading activities to facilitate customer transactions, to take proprietary positions and as means of risk management. Gains and losses on derivatives used for trading purposes are generally included as "trading gain or loss" in the Statement of Income.

By using derivative instruments, the Company exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligation under a derivative contract, the Company's credit risk will equal the fair-value gain in a derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the Company, thus creating a repayment risk for the Company. The repayment risk is minimized by requiring posting of collateral within certain thresholds. When the fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, assumes no repayment risk.

Options are contracts that grant the purchaser the right to buy or sell the underlying asset by a certain date at a specified price. The risk involved with purchased option contracts is normally limited to the price of the options. Interest rate future contracts are commitments to either purchase or sell designated instruments, such as U.S. Treasury securities, at a future date for a specified price. Future contracts are generally traded on an exchange, and are marked to market daily, and are subject to margin requirements.

The notional amounts of derivative financial instruments represent the volume of these transactions and not the amounts potentially subject to market risk. In addition, measurement of market risk is meaningful only when all related and offsetting transactions are taken into consideration.

The Company entered into mortgage-backed securities (TBAs) for trading purposes. The gross notional amounts of these commitments to sell as of June 30, 2009 amounted to \$5,000 and the

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gross notional amount of the commitments to purchase amounted to \$5,000. The fair value of these derivative financial instruments at June 30, 2009 amounted to \$22 and \$22, respectively.

**Concentration of Credit Risk**

The Company is engaged in various trading and brokerage activities in which counterparties primarily include broker-dealers, banks, and other financial institutions. In the event counterparties do not fulfill their obligations, the Company may be exposed to risk. The risk of default depends on the creditworthiness of the counterparty or issuer of the instrument. It is the Company's policy to review, as necessary, the credit standing of each counterparty. Also, the Company's main business is with individual customers and corporations in Puerto Rico.

**11. Commitments and Contingent Liabilities**

At June 30, 2009, the Company has obligations under a number of noncancelable leases, for office space which require rental payments as follows:

<b>Year</b>	<b>Minimum Payments</b>
2010	692
2011	269
2012	29
	<u>\$ 990</u>

Certain lease agreements contain provisions for future rent increases. The total amount of rental payments due over the lease term is being charged to rent expense on the straight-line method over the term of the lease. The difference between rent expense recorded and the amount paid is charged to "Deferred rent obligation", which is included in "Accounts payable to affiliates" in the accompanying Statement of Financial Condition. Total Deferred rent obligation as of June 30, 2009 amounted to \$140.

In the ordinary course of business, the nature of the Company's business subjects it to claims, lawsuits, regulatory examinations and other proceedings. The results of these matters cannot be predicted with certainty. There can be no assurance that these matters will not have a material adverse effect on the Company's results of operations in any future period and a material judgment could have a material adverse impact on the Company's financial condition and results of operations. However, it is the opinion of management, after consultation with legal counsel that, based on information currently available, the ultimate outcome of these matters will not have a material adverse impact on the business, financial condition, operating results or liquidity of the Company although those might be material to operating result for any particular period, depending, in part, upon operating results for that period.

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#### **12. Clearance Agreements**

The Company has clearing and custody agreements with National Financial Services, Inc. ("NFS"), for its retail brokerage operation. The Company's institutional division self-clears its transactions through Bank of New York. NFS is a member of various stock exchanges and subject to the rules and regulations of such organizations as well as those of the Securities and Exchange Commission. Under the terms of the agreement, NFS clears and executes the brokerage transactions of the Company's customers on a fully disclosed basis.

#### **13. Guarantees**

Under the terms of the clearance agreements with NFS, the clearing broker has the right to charge us for losses that result from a counterparty's, introduced by the Company, failure to fulfill its contractual obligations which default could have material effect on our business, financial condition and operating results. The Company is unable to develop an estimate of the maximum assumptions under these agreements and the probable exposure, however, the exposure at June 30, 2009 was immaterial. During 2009, the Company did not pay any amounts related to these guarantees.

#### **14. Related Party Transactions**

In the normal course of business, the Company enters into transactions with affiliated companies. The Statement of Financial Condition at June 30, 2008, included \$36,440 and \$36,726 in resale and repurchase agreements, respectively, with affiliates and affiliated funds. Accrued interest receivable and payable related to these transactions amounted to \$0 and \$1, respectively.

At June 30, 2009, the Company owned securities issued by affiliates and affiliated funds with a fair value of approximately \$11,432. Total cash amounting to \$261 is held by an affiliate at June 30, 2009.

#### **15. Stock-Based Compensation**

The Company participates in Popular, Inc.'s Omnibus Incentive Plan (the "Incentive Plan"), which permits the granting of incentive awards in the form of Annual Incentive Awards, Long-term Performance Unit Awards, Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Units or Performance Shares. Participants in the Incentive Plan are designated by the Compensation Committee of the Board of Directors of Popular, Inc. (or its delegate as determined by the Board). The Company is allocated stock compensation expense based upon an analysis of the awards granted to its employees. This plan provides for the issuance of Popular Inc.'s common stock at a price equal to its fair market value at the grant date, subject to certain plan provisions.

Popular, Inc. uses the fair value method of recording stock options as described in Statement of Financial Accounting Standards No. 123R "Share-Based Payment". All future stock-based compensation awards will be expensed over the vesting period based on the fair value at the date the awards are granted.

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#### **16. Net Capital Requirements**

As a registered broker-dealer, the Company is subject to the Uniform Net Capital Rule 15c3-1 (the "Rule") under the Securities Exchange Act of 1934 and has elected to compute its net capital in accordance with the alternative method of the Rule. Under the alternative method, the Company is required to maintain at all times a net capital equal to the greater of \$250 or 2% of aggregate debit items computed in accordance with the Rule. At June 30, 2009, the Company's net capital of \$17,594 was \$17,229 in excess of required net capital of \$365. The Company's ratio of debt to equity was 0%, which is below the maximum requirement specified by the Rule.