

PEABODY ENERGY CORP
Form 11-K
June 26, 2009

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 11-K**

(Mark One)

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

For the fiscal year ended December 31, 2008

or

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

For the transition period from _____ to _____

**Commission File Number: 1-16463
PEABODY WESTERN-UMWA 401(K) PLAN**

**Full title of the plan
PEABODY ENERGY CORPORATION
701 Market Street, St. Louis, Missouri 63101-1826**

Name of issuer of the securities held pursuant to the plan and the address of its principal executive office

Peabody Western-UMWA 401(k) Plan
Financial Statements and Supplemental Schedule
Years Ended December 31, 2008 and 2007
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Report of Independent Registered Public Accounting Firm

The Plan Administrator
Defined Contribution Administrative Committee

We have audited the accompanying statements of net assets available for benefits of Peabody Western-UMWA 401(k) Plan as of December 31, 2008 and 2007, and the related statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Plan's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan at December 31, 2008 and 2007, and the changes in its net assets available for benefits for the years then ended, in conformity with US generally accepted accounting principles.

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying supplemental schedule of assets (held at end of year) as of December 31, 2008, is presented for purposes of additional analysis and is not a required part of the financial statements but is supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This supplemental schedule is the responsibility of the Plan's management. The supplemental schedule has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

/s/ Ernst & Young LLP

St. Louis, Missouri
June 26, 2009

Peabody Western-UMWA 401(k) Plan
 Statements of Net Assets Available for Benefits

	December 31,	
	2008	2007
Assets:		
Investments, at fair value:		
Investments in mutual funds	\$ 5,564,801	\$ 9,020,139
Investment in common/collective trust	1,432,608	933,186
Investment in Peabody Energy Stock Fund	305,639	659,535
Investment in Patriot Coal Stock Fund		54,845
Participant notes receivable	572,899	630,999
Net assets, at fair value	7,875,947	11,298,704
Adjustment from fair value to contract value for fully benefit-responsive investment contracts	18,729	(7,061)
Net assets available for benefits	\$ 7,894,676	\$ 11,291,643

See accompanying notes.

Peabody Western-UMWA 401(k) Plan
Statements of Changes in Net Assets Available for Benefits

	Years Ended December 31,	
	2008	2007
Additions:		
Interest and dividends	\$ 368,290	\$ 781,303
Net realized and unrealized appreciation of investments		299,650
Net investment income	368,290	1,080,953
Contributions:		
Employee	665,311	655,390
Employer	3,680	5,929
Total contributions	668,991	661,319
Total additions	1,037,281	1,742,272
Deductions:		
Net realized and unrealized depreciation of investments	(3,530,491)	
Withdrawals by participants	(902,349)	(1,464,457)
Administrative expenses	(1,408)	(1,554)
Total deductions	(4,434,248)	(1,466,011)
Net increase (decrease) in net assets available for benefits	(3,396,967)	276,261
Net assets available for benefits at beginning of year	11,291,643	11,015,382
Net assets available for benefits at end of year	\$ 7,894,676	\$ 11,291,643

See accompanying notes.

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements
Years Ended December 31, 2008 and 2007

1. Description of the Plan

The following description of the Peabody Western-UMWA 401(k) Plan (the Plan) provides only general information. Participants should refer to the plan documents for a more complete description of the Plan's provisions.

General

The Plan is a defined contribution plan and participation in the Plan is voluntary. Employees of Peabody Western Coal Company, Big Sky Coal Company, and Seneca Coal Company (collectively, the Employers) who are members of the United Mine Workers of America (UMWA) collective bargaining unit covered by the Western Surface Agreement are eligible for participation on the date of their employment. The Employers are indirect, wholly-owned subsidiaries of Peabody Energy Corporation (Peabody). The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

On October 12, 2007, Peabody's Board of Directors approved a spin-off of portions of its formerly Eastern United States (U.S.) Mining operations business segment through a dividend of all outstanding shares of Patriot Coal Corporation (Patriot). Prior to the spin-off, Peabody received a private letter ruling from the Internal Revenue Service (IRS) on the tax-free nature of the transaction. Patriot stock was distributed to the Peabody stockholders at a ratio of one share of Patriot stock for every 10 shares of Peabody stock held on the record date of October 22, 2007. Likewise, all Plan participants holding Peabody stock in their accounts at the close of business on the record date received similar pro rata distributions.

The Plan allows participants to invest in a selection of mutual funds, a common/collective trust and the Peabody Energy Stock Fund. All investments in the Plan are participant-directed.

Contributions

Each year participants may contribute on a pre-tax basis any whole percentage from 2% to 50% of eligible compensation, as defined in the Plan. Participants may rollover account balances from other qualified defined benefit or defined contribution plans. Additionally, participants may defer the cash equivalent of up to 10 employee benefit days per calendar year. The Employers make matching contributions to the Plan on behalf of all qualified participants. The amount of matching contributions for each qualified participant is 25% of the cash equivalent of employee benefit days that a participant defers.

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements

Participants direct the investment of employee and employer matching contributions into various investment options offered by the Plan. All contributions are subject to certain limitations as defined by the Plan and the IRS.

In the calendar year that a participant is age 50 or older and each year thereafter, certain participants are permitted to make catch-up contributions to the Plan. These participants are able to contribute amounts in excess of the maximum otherwise permitted by the Plan and the IRS, subject to certain limitations.

Vesting

Participants are vested immediately in their own contributions, employer matching contributions and the actual earnings thereon.

Participant Loans

Participants may borrow up to 50% of their vested account balance subject to minimum and maximum amounts of \$1,000 and \$50,000, respectively. The loan is secured by the balance in the participant's account and bears interest at the prime interest rate as published in *The Wall Street Journal* on the first business day of the month in which the loan was made, plus an additional 1%. Principal and interest are paid ratably through payroll deductions. Only one loan may be outstanding at a time.

Participant Accounts

Each participant's account is credited with the participant's contributions, the employer contributions, and plan earnings. The benefit to which a participant is entitled is the vested balance of the participant's account.

Payment of Benefits

Participants are eligible for distribution of their entire account balance upon death, disability, or termination of employment. Participants may elect to receive their distribution as either a lump-sum payment or as installments in certain circumstances, as defined in the Plan. Participants may also elect to transfer their account balance into an individual retirement account or another qualified plan.

Participants who have attained the age of 59^{1/2} have the right to receive a partial or full distribution of their account balance. Withdrawals in cases of hardship are also permitted, as defined in the Plan.

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements

Plan Termination

The Plan could be terminated through the collective bargaining process, subject to the provisions of ERISA. Participants' accounts remain fully vested upon termination of the Plan. Currently, the Employers have no intention to terminate the Plan.

Administrative Expenses

All significant administrative expenses of the Plan, including recordkeeping and trustee fees, are paid by the Employer. Participants are required to pay for certain miscellaneous transaction fees.

2. Summary of Significant Accounting Policies

Basis of Presentation

The financial statements of the Plan are prepared using the accrual method of accounting.

Newly Adopted Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under accounting pronouncements that require or permit fair value measurements, but the standard does not require any new fair value measurements. In February 2008, the FASB amended SFAS No. 157 to exclude leasing transactions and to delay the effective date by one year for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008 for the Plan) and did not have a material impact on the financial statements of the Plan. In October 2008, the FASB issued FSP 157-3,

Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP 157-3), which clarified the application of SFAS No. 157 in an inactive market and demonstrated how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon issuance, including prior periods for which financial statements had not been issued. The adoption of FSP 157-3 did not impact the Plan Sponsor's determination of fair value for financial assets. See Note 3 for further information and related disclosures regarding the Plan's valuation methodologies under SFAS No. 157.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements

Valuation of Investments

SFAS No. 157 defines fair value 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. The Plan Sponsor adopted SFAS No. 157 effective January 1, 2008. Although the adoption of SFAS No. 157 did not materially impact the Plan's financial statements, additional disclosures related to fair value measurements are now required. See Note 3 for additional information.

Fully Benefit-Responsive Investment Contracts

The Vanguard Retirement Savings Trust invests in fully benefit-responsive investment contracts. These investment contracts are recorded at fair value (see Note 3); however, since these contracts are fully benefit-responsive, an adjustment is reflected in the statements of net assets available for benefits to present these investments at contract value. Contract value is the relevant measurement attributable to fully benefit-responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the Plan. Contract value represents contributions plus earnings, less participant withdrawals and administrative expenses.

Securities Transactions

Purchases and sales of securities are recorded on a trade-date basis. Realized gains (losses) are computed based on the average cost of securities sold. Interest income is recorded when earned. Dividend income is recorded on the ex-dividend date. Capital gain distributions are included in dividend income.

Payment of Benefits

Benefit distributions are recorded when paid.

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements

3. Fair Value Measurements

As discussed in Note 2, the Plan Sponsor adopted SFAS No. 157 effective January 1, 2008. SFAS No. 157 establishes a three-level fair value hierarchy that categorizes assets and liabilities measured at fair value based on the observability of the inputs utilized in the valuation. These levels include:

Level 1 inputs are quoted prices in active markets for the identical assets or liabilities;

Level 2 inputs other than quoted prices included in Level 1 that are directly or indirectly observable through market-corroborated inputs; and

Level 3 inputs are unobservable, or observable but cannot be market-corroborated, requiring the Plan Sponsor to make assumptions about pricing by market participants.

A financial instrument's level within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Following is a description of the valuation methodologies used for investments measured at fair value, including the general classification of such investments pursuant to the valuation hierarchy.

Mutual Funds

Shares of mutual funds are valued at quoted market prices, which represent the net asset value (NAV) of shares held by the Plan at year-end. NAV is based on the value of the underlying assets owned by the fund, minus its liabilities, and then divided by the number of shares outstanding. The NAV for these investments is a quoted price in an active market and is classified within Level 1 of the valuation hierarchy.

Common/Collective Trust

Units in the common/collective trust are valued at NAV at year-end. These investments are classified within Level 2 of the valuation hierarchy as the NAV for these investments is a derived price in an active market.

Peabody Energy Stock Fund

The Peabody Energy Stock Fund is valued at its unit closing price (comprised of market price plus uninvested cash position, if any) reported on the active market on which the security is traded and is classified within Level 1 of the valuation hierarchy.

Participant Notes Receivable

Participant loans are valued at cost, which approximates market value, and are classified within Level 3 of the valuation hierarchy.

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table presents the financial instruments carried at fair value as of December 31, 2008 by caption on the statement of net assets available for benefits and by SFAS No. 157 valuation hierarchy.

	December 31, 2008			Total
	Level 1	Level 2	Level 3	
Mutual funds	\$ 5,564,801	\$	\$	\$ 5,564,801
Common/collective trust		1,432,608		1,432,608
Peabody Energy Stock Fund	305,639			305,639
Participant notes receivable			572,899	572,899
Total assets at fair value	\$ 5,870,440	\$ 1,432,608	\$ 572,899	\$ 7,875,947

The table below sets forth a summary of changes in the fair value of the Plan's Level 3 investments for the year ended December 31, 2008.

	Year Ended December 31, 2008 Participant notes receivable
Beginning of year	\$ 630,999
Purchases, sales, issuances and settlements, net	(58,100)
End of year	\$ 572,899

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements

4. Investments

The following table represents the appreciation (depreciation) in fair value, as determined by quoted market prices, of the Plan's investments, including those purchased, sold or held during the year.

	Years ended December 31,	
	2008	2007
Mutual funds	\$ (2,983,606)	\$ (67,137)
Peabody Energy Stock Fund	(532,437)	342,301
Patriot Coal Stock Fund	(14,448)	24,486
	\$ (3,530,491)	\$ 299,650

Investments representing 5% or more of the fair value of the Plan's net assets were as follows:

	December 31,	
	2008	2007
Mutual funds:		
Vanguard PRIMECAP Fund	\$ 993,719	\$1,775,750
Vanguard Explorer Fund	940,030	2,142,295
Vanguard Windsor II Fund	910,904	1,630,500
Vanguard Total Bond Market Index Fund	768,450	669,208
Vanguard Target Retirement 2020 Fund	604,901	511,085 *
Vanguard International Growth Fund	525,591	1,234,449
Common/collective trust:		
Vanguard Retirement Savings Trust	1,432,608	933,186
Peabody Energy Stock Fund	305,639 *	659,535

* The Peabody Energy Stock Fund and the Vanguard Target Retirement 2020 Fund did not represent 5% or more of the fair value of the Plan's net assets as of December 31, 2008 and 2007, respectively.

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements

5. Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for benefits per the financial statements to the Form 5500:

	December 31,	
	2008	2007
Net assets available for benefits per the financial statements	\$ 7,894,676	\$ 11,291,643
Adjustment from contract value to fair value for fully benefit-responsive contracts	(18,729)	7,061
Net assets available for benefits per the Form 5500	\$ 7,875,947	\$ 11,298,704

6. Related Party Transactions

The Plan invests in shares of mutual funds and units in a common/collective trust managed by an affiliate of its trustee, Vanguard Fiduciary Trust Company, a party-in-interest with respect to the Plan. These transactions are covered by an exemption from the prohibited transaction provisions of ERISA and the Internal Revenue Code of 1986 (the Code), as amended. The Plan also invests in Peabody and Patriot stocks, through the Peabody Energy Stock Fund and the Patriot Coal Stock Fund, respectively, which are permitted parties-in-interest transactions. Effective December 31, 2008, the Plan no longer invests in Patriot Stock through the Patriot Coal Stock Fund.

7. Income Tax Status

The Plan received a determination letter from the IRS dated August 6, 2007, stating that the Plan was qualified under Section 401(a) of the Code and, therefore, the related trust was exempt from taxation. The Plan was amended subsequent to the IRS determination letter. The Plan's administrator believes the Plan is being operated in compliance with the applicable requirements of the Code and, therefore, believes the Plan, as amended, is qualified and the related trust is tax-exempt. Once qualified, the Plan was required to operate in conformity with the Code to maintain its qualification.

Peabody Western-UMWA 401(k) Plan
Notes to Financial Statements

8. Risks and Uncertainties

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statements of net assets available for benefits.

Supplemental Schedule
 Peabody Western-UMWA 401(k) Plan
 Employer ID #86-0766626
 Plan #001
 Schedule H, Line 4i Schedule of Assets (Held at End of Year)
 December 31, 2008

(a)	(b) Identity of Issue	(c) Description of Investment	(d) Cost (1)	(e) Current Value
*	Vanguard PRIMECAP Fund	22,311 shares of mutual fund		\$ 993,719
*	Vanguard Explorer Fund	22,313 shares of mutual fund		940,030
*	Vanguard Windsor II Fund	47,666 shares of mutual fund		910,904
*	Vanguard Total Bond Market Index Fund	75,486 shares of mutual fund		768,450
*	Vanguard International Growth Fund	43,081 shares of mutual fund		525,591
*	Vanguard Target Retirement Income Fund	1,035 shares of mutual fund		9,855
*	Vanguard International Value Fund	385 shares of mutual fund		9,031
*	Vanguard 500 Index Fund	76 shares of mutual fund		6,339
*	Vanguard Extended Market Index Fund	115 shares of mutual fund		2,771
*	Vanguard Developed Markets Index Fund	357 shares of mutual fund		2,682
*	Vanguard Emerging Markets Stock Index Fund	170 shares of mutual fund		2,530
*	Vanguard Target Retirement 2005 Fund	11,420 shares of mutual fund		110,656
*	Vanguard Target Retirement 2010 Fund	8,762 shares of mutual fund		154,297
*	Vanguard Target Retirement 2015 Fund	38,326 shares of mutual fund		366,010
*	Vanguard Target Retirement 2020 Fund	36,506 shares of mutual fund		604,901
*	Vanguard Target Retirement 2025 Fund	13,028 shares of mutual fund		120,766
*	Vanguard Target Retirement 2030 Fund	2,330 shares of mutual fund		36,205
*	Vanguard Target Retirement 2035 Fund	7 shares of mutual fund		64
*	Vanguard Retirement Savings Trust	1,451,337 units of common/collective trust		1,432,608
*	Peabody Energy Stock Fund	8,014 units of stock fund		305,639
*	Various participants	Participant notes receivable, interest rates from 5.0% to 9.25%, maturities through November 25, 2015		572,899
				\$7,875,947

* Denotes party-in-interest

(1) Cost is not presented as all investments are participant directed investments

SIGNATURE

Peabody Western-UMWA 401(k) Plan. Pursuant to the requirements of the Securities Exchange Act of 1934, the plan administrator has duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

Peabody Western-UMWA 401(k) Plan

Date: June 26, 2009

By: /s/ SHARON D. FIEHLER
Sharon D. Fiehler
Peabody Energy Corporation
Executive Vice President and
Chief Administrative Officer

EXHIBIT INDEX

The exhibit below is numbered in accordance with the Exhibit Table of Item 601 of Regulation S-K.

Exhibit

No. Description of Exhibit

23 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.

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align="left" valign="top"> San Juan, Puerto Rico 000926

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The following table summarizes the total compensation for the chief executive officer, the four most highly compensated executive officers who were serving as executive officers at the end of fiscal 2004, and an additional executive officer who would have been among the four most highly compensated but was not an executive officer at the end of fiscal 2004 (collectively referred to as the named executive officers).

Summary Compensation Table

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation	
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$) ⁽¹⁾	Securities Underlying Options (#)	All Other Compensation (\$) ⁽²⁾
José Enrique Fernández Chairman, President and Chief Executive Officer	2004	450,000	200,000	38,400 ⁽³⁾	0	2,100
	2003	400,000	200,200	38,400	0	3,020
	2002	400,000	150,000	47,635	60,000	2,546
José Rafael Fernández Senior Executive Vice President and Chief Operating Officer	2004	285,000	100,000	42,000 ⁽⁴⁾	0	2,100
	2003	250,000	100,200	42,000	0	2,675
	2002	200,000	100,000	36,000	20,000	2,350
Héctor Méndez ⁽⁵⁾ Senior Executive Vice President and Treasurer	2004					
	2003					
	2002					
Néstor Vale ⁽⁶⁾ Senior Executive Vice President Banking Services	2004	225,480	75,000	36,000 ⁽⁷⁾	20,000	74,750 ⁽⁸⁾
	2003					
	2002					
Ganesh Kumar ⁽⁹⁾ Executive Vice President Strategic Planning	2004	106,586	0	12,000 ⁽¹⁰⁾	20,000	52,050 ⁽¹¹⁾
	2003					
	2002					
Norberto González ⁽¹²⁾ Executive Vice President and Acting Chief Financial Officer	2004	195,000	65,000	36,000 ⁽¹³⁾	15,000	2,048
	2003	64,375	30,000	8,000	15,000	416
	2002					

1. Consists of a car allowance and/or an allowance for membership expenses for social and business organizations that in the judgment of our chief executive officer are reasonably appropriate for the performance of such officer's duties as an executive officer of our company.

2. Consists of term life insurance premiums, unless otherwise indicated.
3. Consists of a car allowance.
4. Consists of a \$30,000 car allowance and a \$12,000 club membership allowance.
5. Joined the company in August 2004 (after the end of fiscal 2004). His signing bonus, annual salary, annual bonus, annual car allowance and annual club membership allowance are respectively as follows: \$350,000 (\$150,000 on August 1, 2004 and \$200,000 deferred for three years); \$300,000; \$125,000 (guaranteed first two years); \$24,000 and \$19,200. He was granted 30,000 stock options on August 1, 2004 and is entitled to a grant of 10,000 stock options on August 1, 2005.
6. Joined the company in August 2003.
7. Consists of a \$24,000 car allowance and a \$12,000 club membership allowance.
8. Consists of a one-time \$73,000 cash compensation paid at commencement of employment and \$1,750 in term life insurance premiums.
9. Joined the company in January 2004. His annual salary, annual bonus, annual car allowance, annual living allowance, and moving allowance are respectively as follows: \$225,000; \$75,000; \$24,000; \$42,000 and \$30,000.
10. Consists of a car allowance.
11. Consists of \$1,050 in term life insurance premiums and a \$51,000 living and moving allowance.
12. Joined the company in March 2003.
13. Consists of a \$24,000 car allowance and a \$12,000 club membership allowance.

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The table below provides information regarding the options that we granted to the named executive officers during fiscal 2004 under the 1996 Incentive Stock Option Plan:

Name	Options Granted	Percent of Total Options Granted	Exercise Price	Expiration Date	Potential Realizable Values at Assumed Annual Rates of Stock Appreciation	
					5%	10%
José Enrique Fernández	0					
José Rafael Fernández	0					
Héctor Méndez	0					
Néstor Vale	20,000	10.87%	\$23.330	August 7, 2013	\$128,913	\$284,864
Ganesh Kumar	20,000	10.87%	\$26.120	January 27, 2014	\$144,329	\$318,930
Norberto González	15,000	8.15%	\$26.120	January 27, 2014	\$108,247	\$239,198

We did not grant stock options under any other stock option plan to any named executive officer during fiscal 2004.

**Aggregated Option/SAR Exercises
in Last Fiscal Year and
Fiscal Year-End Option/SAR Values**

Name	Shares Acquired on Exercise (#)	Value Realized (\$)	Number of Unexercised Options/SARs at Fiscal Year-End	Unexercised In-the-Money Options/SARs at Fiscal Year-End
			Exercisable/ Unexercisable (#)*	Exercisable/ Unexercisable (\$)
José Enrique Fernández	33,537	708,301	58,325/96,945	941,511/1,497,166

José Rafael Fernández	66,550	1,302,340	27,040/100,032	406,191/1,740,113
Héctor Méndez	0			
Néstor Vale	0		0/22,000	0/128,942
Ganesh Kumar	0		0/20,000	0/19,000
Norberto Gonzalez	0		0/31,500	0/157,305

* Adjusted for stock dividends.

Employment Agreements

José Enrique Fernández

On April 4, 2002, Oriental Bank and José Enrique Fernández entered into an employment agreement for a term of three years, which supercedes and replaces a previous employment agreement dated December 22, 1998, between Oriental Bank and Mr. Fernández. The agreement provides for an increase in salary to \$400,000 in fiscal year 2003, and further increases to \$450,000 in fiscal year 2004 and to \$500,000 in fiscal year 2005, and an annual automobile and expense allowance of \$38,400. The agreement also provides that Oriental Bank will pay for Mr. Fernández's membership in such social and business clubs that in his judgment are reasonably necessary for the performance of his Bank-related duties. Also, under the agreement, Oriental Bank will pay for a 10-year term life insurance policy in the amount of \$1,500,000, covering the life of Mr. Fernández, for the benefit of Mr. Fernández's estate. The agreement also provides that, during its term, the Board of Directors will nominate and recommend to the stockholders the election of Mr. Fernández as a director at any election of directors in which his term as a director will expire, and, if elected, the Board of Directors will name Mr. Fernández to the position of Chairman.

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Pursuant to the agreement, Oriental Bank caused to be granted to Mr. Fernández options to purchase 60,000 shares of common stock. The stock options may be exercised by Mr. Fernández during a period commencing on the first anniversary and ending on the tenth anniversary of the agreement. Notwithstanding the above limitations, these stock options will become immediately exercisable if Mr. Fernández dies or is disabled, retires from employment with Oriental Bank, or if there occurs a change in control of Oriental Bank. The options shall survive one year after termination of the agreement, unless termination is the result of Mr. Fernández's illegal conduct or gross misconduct materially injurious to Oriental Bank, a regulatory order, or as a result of appointment by court or other public authority of a legal custodian for Oriental Bank for the purpose of liquidation.

The agreement may be terminated by Oriental Bank for just cause (as such term is defined in the agreement) at any time. In the event employment is terminated for just cause, Mr. Fernández will have no right to compensation or other benefits for any period after such termination. The agreement also provides for payments and other benefits for Mr. Fernández if there occurs a change in control of Oriental Bank or in the event of involuntary termination of employment in connection with any change in control of Oriental Bank, as defined therein. The term change in control is defined to include any of the following: (i) a change in control as defined in 12 U.S.C. § 1817(j) and 12 C.F.R. § 303.4, or (ii) a change in control that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934, or (iii) when during any period of two consecutive years during the term of the agreement, individuals who at the beginning of such period constitute the Board of Directors cease for any reason to constitute at least a majority thereof, unless the election of each director who was not a director at the beginning of such period has been approved in advance by directors representing at least two-thirds of the directors then in office, who were directors at the beginning of the period.

The agreement also provides that Mr. Fernández may terminate his employment for good reason, which includes: (i) failure by Oriental Bank to comply with any material provision of the agreement, which failure has not been cured within ten (10) days after notice thereof has been given by Mr. Fernández to Oriental Bank; and (ii) any purported termination of Mr. Fernández's employment which is not effected pursuant to a notice of termination satisfying certain requirements set forth in the agreement.

In the event that there occurs a change in control, or if Mr. Fernández is terminated other than for just cause and in connection with a change in control, Oriental Bank will pay Mr. Fernández an amount equal to the aggregate annual compensation paid or payable to him (including salary, bonus, car allowance and the value of any other benefits provided to Mr. Fernández) during the year in which the termination occurs multiplied by 3.00. The payment is to be made in a lump sum on or before the fifth day following the date of termination. If Mr. Fernández terminates his employment for good reason, the severance payments from the Oriental Bank will be equal to the aggregate annual compensation paid or payable to Mr. Fernández (including salary, bonus, car allowance and the value of any other benefits provided to Mr. Fernández) during the year in which the termination occurs multiplied by 2.00. The severance payment is to be made in a lump sum on or before the fifth day following the date of termination.

The agreement contains provisions restricting Mr. Fernández's ability to engage or participate in, become a director of, or render advisory or other services to any firm or entity competitive with Oriental Bank. The agreement does not contain any provision restricting Mr. Fernández's right to compete against Oriental Bank upon termination of employment.

José Rafael Fernández

On February 16, 2001, Oriental Financial Group and José Rafael Fernández entered into an employment agreement for a term of forty-two months commencing on January 1, 2001 and terminating on June 30, 2004. Notwithstanding the foregoing, the agreement provides for an automatic one-year extension after the original termination date unless a non-extension notice is provided by either party to the other party 120 days before the expiration date. No such notice

was provided and, therefore, the agreement was extended for an additional one-year period until June 30, 2005. The agreement provides for a minimum base salary of \$200,000 from January 1, 2001,

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through June 30, 2002; \$250,000 from July 1, 2002, through June 30, 2003, and \$285,000 from July 1, 2003, through June 30, 2004; an annual automobile and expense allowance of \$30,000; an annual allowance of \$6,000 during the first year of the agreement and \$10,000 per year from January 1, 2002, to the expiration of the term of the agreement for membership expenses for social and business clubs that in the judgment of Oriental Financial Group's chief executive officer are reasonably appropriate to the performance of the duties of Mr. Fernández pursuant to the agreement; and an annual performance bonus of not less than \$100,000 commencing in fiscal year 2002. Any salary increases for this agreement, or extensions thereof, shall be mutually agreed to by Oriental Financial Group and Mr. Fernández. The agreement also provides that Mr. Fernández will be entitled to participate in, and receive the benefits of, any stock option plan, profit sharing plan or other plans, benefits and privileges given to employees and executives of Oriental Financial Group for which Mr. Fernández may qualify. Such benefits will be provided to Mr. Fernández while he is employed under the terms of the agreement or any extension thereof. Pursuant to the agreement, Oriental Financial Group granted Mr. Fernández options to purchase not less than 20,000 shares of common stock starting in fiscal year 2002. The stock options may be exercised by Mr. Fernández during a period commencing on the first and ending on the tenth anniversary of the agreement. Notwithstanding the above limitations, these stock options will become immediately exercisable if Mr. Fernández dies, is disabled, retires from employment with Oriental Financial Group or if there occurs a change in control of Oriental Financial Group. The options shall survive one year after termination of the agreement, unless termination is the result of Mr. Fernández's illegal conduct or gross misconduct materially injurious to Oriental Financial Group, a regulatory order, or as a result of appointment by court or other public authority of a legal custodian for Oriental Financial Group for the purpose of liquidation.

The agreement may be terminated by Oriental Financial Group for just cause (as such term is defined in the agreement) at any time. In the event that employment is terminated for just cause, Mr. Fernández will have no right to compensation or other benefits for any period after such termination. The agreement also provides for payment and other benefits for Mr. Fernández if there occurs a change in control of Oriental Financial Group or in the event of involuntary termination of employment in connection with any change in control of Oriental Financial Group, as defined therein. The term change in control is defined to include any of the following: (i) a change in control as defined in 12 U.S.C. § 1817(j) and 12 C.F.R. § 303.4; or (ii) a change in control that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934.

The agreement also provides that Mr. Fernández may terminate his employment for good reason, which includes: (i) failure by Oriental Financial Group to comply with any material provision of the agreement, which failure has not been cured within ten (10) days after notice thereof has been given by Mr. Fernández to Oriental Financial Group; and (ii) any purported termination of Mr. Fernández's employment which is not affected pursuant to a notice of termination satisfying certain requirements set forth in the agreement.

In the event that there occurs a change of control, or if Mr. Fernández is terminated other than for just cause and in connection with a change in control, Oriental Financial Group will pay Mr. Fernández an amount equal to the aggregate annual compensation paid or payable to him (including salary, bonus, car allowance and the value of any other benefits provided to Mr. Fernández) during the year the termination occurs multiplied by 3.00. The payment is to be made in a lump sum on or before the fifth day following the date of termination. If Mr. Fernández terminates his employment for good reason, the severance payments from Oriental Financial Group will be equal to the aggregate annual compensation paid or payable to Mr. Fernández (including salary, bonus, car allowance and the value of any other benefits provided to Mr. Fernández) during the year in which the termination occurs multiplied by 2.00. The severance payment is to be made in a lump sum on or before the fifth day following the date of termination.

The agreement contains provisions restricting Mr. Fernández's ability to engage or participate in, become a director of, or render advisory or other services to any firm or entity competitive with Oriental Financial Group for a period of one year subsequent to the termination of the agreement. The agreement further contains provisions protecting the confidential information and trade secrets of Oriental Financial Group while Mr. Fernández is employed by Oriental

Financial Group.

Table of Contents*Marcial Díaz*

On March 15, 2001, Oriental Financial Group and Marcial Díaz entered into an employment agreement for a term of thirty-six months commencing on March 15, 2001 and terminating on March 14, 2004. Notwithstanding the foregoing, the agreement provides for an automatic one-year extension after the original termination date unless a non-extension notice is provided by either party to the other party 120 days before the expiration date. No such notice was provided and, therefore, the agreement was extended for an additional one-year period until March 15, 2005. The agreement provides for a minimum base salary of \$126,000 from March 15, 2001, through March 14, 2002, and further increases to \$146,000 and \$171,000 from March 15, 2002, through March 14, 2003, and from March 15, 2003, through March 14, 2004, respectively, an annual automobile and expense allowance of \$18,000; an annual allowance of \$10,000 for membership expenses for social and business clubs that in the judgment of Oriental Financial Group's chief executive officer are reasonably appropriate to the performance of the duties of Mr. Díaz pursuant to the agreement; and an annual performance bonus of not less than \$80,000 for fiscal year 2002 and not less than \$100,000 for fiscal year 2003 and subsequent fiscal years. Any salary increases for this agreement, or extensions thereof, shall be mutually agreed to by Oriental Financial Group and Mr. Díaz. The agreement also provides that Mr. Díaz will be entitled to participate in, and receive the benefits of, any stock option plan, profit sharing plan or other plans, benefits and privileges given to employees and executives of Oriental Financial Group for which Mr. Díaz may qualify. Such benefits will be provided to Mr. Díaz while he is employed under the terms of the agreement or any extension thereof. Pursuant to the agreement, Oriental Financial Group granted Mr. Díaz options to purchase 15,000 shares of common stock at the signing of the agreement and not less than 15,000 shares of common stock each year thereafter. The stock options may be exercised by Mr. Díaz during a period commencing on the first and ending on the tenth anniversary of the agreement. Notwithstanding the above limitations, such stock options will become immediately exercisable if Mr. Díaz dies, is disabled, retires from employment with Oriental Financial Group or if there occurs a change in control of Oriental Financial Group. The options shall survive one year after termination of the agreement, unless termination is the result of Mr. Díaz' illegal conduct or gross misconduct materially injurious to Oriental Financial Group, a regulatory order, or as a result of appointment by court or other public authority of a legal custodian for Oriental Financial Group for the purpose of liquidation.

The agreement may be terminated by Oriental Financial Group for just cause (as such term is defined in the agreement) at any time. In the event that employment is terminated for just cause, Mr. Díaz will have no right to compensation or other benefits for any period after such termination. The agreement also provides for payment and other benefits for Mr. Díaz if there occurs a change in control of Oriental Financial Group or in the event of involuntary termination of employment in connection with any change in control of Oriental Financial Group, as defined therein. The term change in control is defined to include any of the following: (i) a change in control as defined in 12 U.S.C. § 1817(j) and 12 C.F.R. § 303.4; or (ii) a change in control that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934.

The agreement also provides that Mr. Díaz may terminate his employment for good reason, which includes: (i) failure by Oriental Financial Group to comply with any material provision of the agreement, which failure has not been cured within ten (10) days after notice thereof has been given by Mr. Díaz to Oriental Financial Group, and (ii) any purported termination of Mr. Díaz' employment which is not affected pursuant to a notice of termination satisfying certain requirements set forth in the agreement.

In the event that there occurs a change of control, or if Mr. Díaz is terminated other than for just cause and in connection with a change in control, Oriental Financial Group will pay Mr. Díaz an amount equal to the aggregate annual compensation paid or payable to him (including salary, bonus, car allowance and the value of any other benefits provided to Mr. Díaz) during the year the termination occurs multiplied by 3.00. The payment is to be made in a lump sum on or before the fifth day following the date of termination. If Mr. Díaz terminates his employment for good reason, the severance payments from Oriental Financial Group will be equal to the aggregate annual

compensation paid or payable to Mr. Díaz (including salary, bonus, car allowance and the value of any other benefits provided to Mr. Díaz) during the year in which the termination occurs multiplied by 2.00. The severance payment is to be made in a lump sum on or before the fifth day following the date of termination.

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The agreement contains provisions restricting Mr. Díaz's ability to engage or participate in, become a director of, or render advisory or other services to any firm or entity competitive with Oriental Financial Group for a period of one year subsequent to the termination of the agreement. The agreement further contains provisions protecting the confidential information and trade secrets of Oriental Financial Group while Mr. Díaz is employed by Oriental Financial Group.

401(k)/1165(e) Plan

All of our employees, including the employees of our subsidiaries, are eligible to participate in the Oriental Group CODA Profit Sharing Plan (the 401(k)/1165(e) Plan). The 401(k)/1165(e) Plan is qualified under Sections 1165(a) and 1165(e) of the Puerto Rico Internal Revenue Code of 1994. The 401(k)/1165(e) Plan offers eligible participants eleven investment alternatives, including several U.S. mutual funds, a money-market account, and our shares of common stock. Contributions made through payroll deductions not in excess of 10% of annual base salary or \$8,000, whichever is less, may be accumulated per year as before-tax savings. We contribute 80 cents for each dollar contributed by an employee up to \$832 per year. The matching contribution is invested in our shares of common stock. The 401(k)/1165(e) Plan became effective on January 1, 1992. During fiscal 2004, we contributed 7,195 shares of common stock to the 401(k)/1165(e) Plan valued at approximately \$194,768 at June 30, 2004.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The following report does not constitute soliciting material and shall not be deemed filed or incorporated by reference into any other filing of the company under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the company specifically incorporates it by reference.

Oriental Financial Group Inc. operates in a highly competitive industry where the quality, creativity and professionalism of its executive officers is of utmost importance to the success, profitability and growth of Oriental Financial Group. Accordingly, the compensation program of Oriental Financial Group, which is managed by the Compensation Committee, is intended to retain and appropriately reward experienced and well-trained executive officers, align the long-term interests of the executive officers with those of the stockholders and tie total compensation opportunities to the achievement of Oriental Financial Group's institutional goals and the achievement of goals for each of its subsidiaries.

The Compensation Committee evaluates the performance of management, reviews the compensation levels of members of management, and evaluates and reviews all aspects of compensation for Oriental Financial Group's executive officers.

In evaluating the performance and compensation of all of the executive officers, the Compensation Committee reviews available peer group information for comparable financial institutions or bank holding companies in Puerto Rico and in the United States and assesses the performance in accordance with the overall attainment of Oriental Financial Group's goals for such fiscal year, which are set forth in Oriental Financial Group's three-year business plan that is updated and approved by the Board of Directors every fiscal year.

Bonus

The compensation program for Oriental Financial Group's executive officers provides for a performance bonus, which purpose is to maximize the efficiency and effectiveness of Oriental Financial Group's operations. The bonuses that are paid to the executive officers are linked to the performance of Oriental Financial Group as an institution as well as to the performance of each of Oriental Financial Group's subsidiaries. In addition, in the event the institutional

and individual goals are achieved, the bonus amounts that are generally paid to the executive officers are determined so that the total salary and bonus compensation paid to them is competitive with the amounts paid by comparable financial institutions or bank holding companies in Puerto Rico and in the United States.

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Long-Term Compensation

The compensation program for the executive officers also contemplates long-term incentive compensation in the form of stock options granted under Oriental Financial Group's stock option plans. Oriental Financial Group's stock option plans provide for ownership of the shares of common stock which, in turn, creates a direct relationship between the performance of Oriental Financial Group, as reflected by the market value of the shares of common stock, and executive compensation, and further creates a direct link between the interests of the executive officers and the interests of the stockholders.

The awards are made by the administrators of Oriental Financial Group's stock option plans, which are the members of the Compensation Committee. The plan administrators are given absolute discretion to select which of the eligible persons will be granted stock options and the amount of stock options to be granted to such persons. In general terms, the plan administrators, in determining such amounts, consider total compensation information obtained from various comparable financial institutions or bank holding companies in Puerto Rico and in the United States that they track, as well as the general trend in total compensation in the financial services industry.

Fiscal 2004 Results

Among the results of operations for fiscal 2004 that the Compensation Committee placed particular emphasis when it approved the bonuses paid and the stock options granted to the executive officers, which amounts are set forth in separate tables in this proxy statement, are the following: (i) Oriental Financial Group reported net income of \$63.6 million compared to \$51.3 million in fiscal 2003, representing an increase of 24.0%, and earnings per diluted share of \$2.78 compared to \$2.41 in fiscal 2003, representing an increase of 15.4%; and (ii) total financial assets managed and owned by Oriental Financial Group were \$6.4 billion and total stockholders' equity was \$294.7 million as of June 30, 2004, compared to \$5.7 billion and \$201.7 million, respectively, as of June 30, 2003, which represents an increase of 12.3% in total financial assets managed and owned, and an increase of 46.1% in total stockholders' equity.

Compensation of Chairman, President and Chief Executive Officer

Mr. José Enrique Fernández, who serves as the Chairman of the Board, President and Chief Executive Officer of Oriental Financial Group and of Oriental Bank, negotiated the terms of his agreement with Oriental Bank at arm's length with Oriental Bank's Board of Directors. The current terms of Mr. Fernández's employment, including his salary and certain other compensation arrangements, are described in this Proxy Statement under "Executive Compensation Employment Agreements."

Mr. Fernández's compensation in terms of bonus and any additional stock options granted to him under Oriental Financial Group's stock option plans was determined in accordance with Oriental Financial Group's compensation program described above and was based on considerations of competitive industry practice as well as the overall performance of Oriental Financial Group. In making such determination, the Compensation Committee took into consideration Oriental Financial Group's performance as a whole during fiscal 2004 (as described above) and the achievement of goals which are geared to ensure Oriental Financial Group's continued long-term growth and the enhancement of stockholder value, such as the further diversification of Oriental Financial Group's asset base and the emphasis on expanding Oriental Financial Group's financial services and non-interest income.

**SUBMITTED BY THE COMPENSATION
COMMITTEE**

Julian S. Inclán
Alberto Richa-Angelini
Emilio Rodriguez

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Compensation Committee Interlocks and Insider Participation

None of the members of the Compensation Committee has served as an officer or employee of the company or any of its subsidiaries.

AUDIT COMMITTEE REPORT

The following report does not constitute soliciting material and shall not be deemed filed or incorporated by reference into any other filing of the company under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the company specifically incorporates it by reference.

The Audit Committee assists the Board of Directors in its oversight of Oriental Financial Group Inc.'s financial reporting process. The Audit Committee's responsibilities are more fully described in its charter, a copy of which may be obtained upon request from the Secretary of the Board.

Management has the primary responsibility for the preparation and integrity of Oriental Financial Group's financial statements, accounting and financial reporting principles, and internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Oriental Financial Group's independent auditors are responsible for performing an independent audit of the consolidated financial statements and expressing an opinion on the conformity of those financial statements with accounting principles generally accepted in the United States of America.

In fulfilling its oversight responsibilities, the Audit Committee has reviewed and discussed the audited financial statements for fiscal 2004 with Oriental Financial Group's management and has discussed with Deloitte & Touche LLP the matters that are required to be discussed by Statement on Auditing Standards No. 61, *Communication with Audit Committees*. In addition, Deloitte & Touche LLP has provided the Audit Committee with the written disclosures and the letter required by the Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*, and the Audit Committee has discussed with Deloitte & Touche LLP their independence.

Based on such reviews and discussions, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in Oriental Financial Group's annual report on Form 10-K for the fiscal year ended June 30, 2004, for filing with the U.S. Securities and Exchange Commission.

**SUBMITTED BY THE AUDIT
COMMITTEE**

Diego Perdomo, C.P.A.
Miguel Vázquez-Deynes
Alberto Richa-Angelini
Efraín Archilla

INDEBTEDNESS OF MANAGEMENT

Certain transactions involving loans and deposits were transacted during fiscal 2004 between Oriental Bank, some of its directors and executive officers, including those of its affiliates, and persons related to or affiliated with such persons. All such transactions were made in the ordinary course of business on substantially the same terms, including interest rates, collateral and repayment terms, as those prevailing at the time for comparable transactions with other

persons, and did not involve more than the normal risk of uncollectability or other unfavorable features. At present, none of the loans to such directors and executive officers, including persons related to or affiliated with such persons, is non-performing.

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

We are required to identify any director, executive officer or person who owns more than ten percent of our equity securities who failed to timely file with the Securities and Exchange Commission a required report under Section 16(a) of the Securities Exchange Act of 1934. Based solely on the review of copies of such forms and on other information furnished to us by such individuals, we believe that during and with respect to fiscal 2004, our directors and executive officers, and persons who own more than 10% of our equity securities, timely filed all required reports thereunder, except that José Enrique Fernández, José Rafael Fernández, Norberto González, and Elmer Garrastazú, each an executive officer, inadvertently failed to timely file an Annual Statement of Beneficial Ownership of Securities (Form 5) for their acquisitions of our shares of common stock through the 401(k)/1165(e) Plan.

Table of Contents**STOCK PERFORMANCE GRAPH**

The stock performance graph below compares the cumulative total stockholder return of our shares of common stock from June 30, 1994, to June 30, 2004, with the cumulative total return of the Standard & Poor's 500 Composite Stock Index, the Dow Jones US Total Market Index, and the Standard & Poor's Diversified Financial Services Index. The Standard & Poor's 500 Composite Stock Index is a broad index which includes a wide variety of issuers and industries representative of a cross section of the market. After careful consideration, we have decided to use the same composition of companies that made up the Standard & Poor's Diversified Financial Services Index, although the index retired in 2002. This index included a wide array of financial institutions or bank holding companies comparable to us. We have historically used this index and see it as an adequate representation of peer group industry guidance for us.

Cumulative Total Return

	6/94	6/95	6/96	6/97	6/98	6/99	6/00	6/01	6/02	6/03	6/04
OFG	100.00	106.02	136.06	248.81	412.39	366.65	226.79	311.79	470.94	611.88	724.24
S&P	100.00	126.07	158.85	213.97	278.50	341.88	366.67	312.29	256.11	256.76	305.83
DJ	100.00	125.35	157.98	206.84	266.77	321.88	352.37	299.13	245.02	247.77	298.27
PG	100.00	116.13	164.33	256.01	397.35	462.19	515.00	573.87	467.49	493.71	573.75

COMPARISON OF 10 YEAR CUMULATIVE TOTAL RETURN*
 AMONG ORIENTAL FINANCIAL GROUP, INC., THE S & P 500 INDEX,
 THE DOW JONES US TOTAL MARKET INDEX AND A PEER GROUP

*\$100 invested on 6/30/94 in stock or index-including reinvestment of dividends. Fiscal year ending June 30.

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www.researchdatagroup.com/S&P.htm

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The Board of Directors recognizes that the market price of our shares of common stock is influenced by many factors, only one of which is our financial performance. The stock price performance graph shown above is not necessarily indicative of future price performance.

INDEPENDENT AUDITORS

The Audit Committee of the Board of Directors has not yet selected any accounting firm to audit our financial statements for the current fiscal year. The Audit Committee is currently evaluating proposals by several accounting firms, including Deloitte & Touche LLP which has served as our independent public accountants since fiscal 2002. Services provided to us and our subsidiaries by Deloitte & Touche in fiscal 2004 included the examination of our consolidated financial statements, limited revisions of our quarterly reports, audits of our subsidiaries, audits of our employee benefits plan, services related to our filings with the Securities and Exchange Commission and other regulatory agencies, and consultations on various tax and accounting matters.

The Audit Committee reviewed and approved all non-audit services rendered by Deloitte & Touche to the company and its subsidiaries, and concluded that the provision of such services was compatible with the maintenance of Deloitte & Touche's independence in the conduct of its auditing functions. The Audit Committee has adopted a pre-approval policy regarding the procurement of audit and non-audit services. The Audit Committee intends to review such policy periodically. A copy of such policy is available on our website at www.orientalonline.com.

The aggregate fees billed by Deloitte & Touche in fiscals 2004 and 2003 for the various services provided to us were as follows:

Type of Fees	2004	2003
Audit Fees	\$346,480	\$202,816
Audit-Related Fees	87,950	70,231
Tax Fees	91,095	28,350
All Other Fees	0	122,603
	<u>\$525,525</u>	<u>\$424,000</u>

As defined by the Securities and Exchange Commission, (i) audit fees are fees for professional services rendered by the company's principal accountant for the audit of the company's annual financial statements and review of financial statements included in the company's Form 10-Q, or for services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years; (ii) audit-related fees are fees for assurance and related services by the company's principal accountant that are reasonably related to the performance of the audit or review of the company's financial statements and are not reported under audit fees; (iii) tax fees are fees for professional services rendered by the company's principal accountant for tax compliance, tax advice, and tax planning; and (iv) all other fees are fees for products and services provided by the company's principal accountant, other than the services reported under audit fees, audit-related fees, and tax fees.

Deloitte & Touche will have representatives present at the annual meeting who will have an opportunity to make a brief statement if they desire to do so, and who will be available to respond to appropriate questions.

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STOCKHOLDER PROPOSALS

Stockholder proposals intended to be presented at the 2005 annual meeting of stockholders must be set forth in writing and received by Carlos O. Souffront, Esq., Secretary of the Board of Directors, Oriental Financial Group Inc., P.O. Box 195115, San Juan, Puerto Rico 00919-5115, no later than the close of business on June 6, 2005.

ANNUAL REPORTS

A copy of our annual report to stockholders for fiscal 2004 accompanies this proxy statement. The annual report is not part of the proxy solicitation materials.

Upon receipt of a written request, we will furnish to any stockholder without charge a copy of our annual report on Form 10-K, including the consolidated financial statements, for fiscal 2004, and a list of the exhibits thereto required to be filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934. Such written request should be directed to Oriental Financial Group Inc., Investor Relations c/o Anreder & Company, 10 E. 40th Street, Suite 1308, New York, NY 10016; Telephone: (212) 532-3232 or (800) 421-1003; Facsimile: (212) 679-7999; E-mail: ofg@anreder.com.

BY ORDER OF THE BOARD OF DIRECTORS

José Enrique Fernández
Chairman of the Board, President and
Chief Executive Officer

October 4, 2004
San Juan, Puerto Rico

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ORIENTAL FINANCIAL GROUP INC.

REVOCABLE PROXY

This proxy is solicited on behalf of the Board of Directors of Oriental Financial Group Inc. for use only at the annual meeting of stockholders to be held on October 26, 2004, and at any adjournment or postponement of that meeting. This proxy may be revoked by the undersigned at any time before it is exercised.

The undersigned, being a stockholder of Oriental Financial Group Inc. (the Company), hereby authorizes the Board of Directors of the Company or any successors in their respective positions, as proxies with full powers of substitution, to represent the undersigned at the annual meeting of stockholders of the Company to be held at conference room 9-A of the McConnell Valdés law offices located at 270 Muñoz Rivera Avenue, San Juan, Puerto Rico, on Tuesday, October 26, 2004, at 10:00 a.m., and at any adjournment or postponement of that meeting, and thereat to act with respect to all votes that the undersigned would be entitled to cast, if then personally present, as follows:

ELECTION OF DIRECTORS

- o **FOR** all nominees listed below (except as marked to the contrary below).
- o **WITHOUT AUTHORITY** to vote for all nominees listed below.

To serve until the 2005 annual meeting of stockholders or until his successor is duly elected and qualified: Mr. Juan C. Aguayo. To serve until the 2007 annual meeting of stockholders or until their successors are duly elected and qualified: Messrs. Emilio Rodríguez, Alberto Richa-Angelini, and Miguel Vázquez-Deynes.

INSTRUCTIONS: To withhold authority to vote or to cumulate the votes for one or more of the above nominee(s), write the name(s) of the nominee(s) and the manner in which such votes shall be withheld or cumulated in the space provided below.

Name	Number of Votes (Withheld or Cumulated, Please Specify)
_____	_____
_____	_____
_____	_____
_____	_____

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In their discretion, the proxies are authorized to vote this proxy with respect to (i) the approval of the minutes of the last meeting of stockholders; (ii) the election of any person as director if any nominee is unable to serve or, for good cause, will not serve; (iii) matters incident to the conduct of the annual meeting; and (iv) such other matters as may properly come before the annual meeting. Except with respect to procedural matters incident to the conduct of the annual meeting, management at present knows of no other business to be brought before the meeting other than those matters described in the accompanying proxy statement.

Shares of common stock of the Company will be voted as specified in this proxy. In the absence of any express indication that the shares to be voted should be cumulated in a particular fashion, the votes represented by executed proxies will be distributed equally among the four nominees or in such other fashion as will most likely ensure the election of the nominees. If no specification is made above, shares will be voted FOR the election of directors. This proxy cannot be voted for any person who is not a nominee of the Company's Board of Directors.

The undersigned hereby acknowledges receipt of the accompanying proxy statement for the annual meeting prior to signing this proxy.

Date: _____, 2004.

Signature

Signature, if held jointly

Please sign exactly as your name(s) appear(s) on this proxy. When signing in a representative capacity, please give your title.

PLEASE MARK, SIGN, DATE AND PROMPTLY RETURN THIS PROXY USING THE ENCLOSED ENVELOPE.