FIRST BANCORP /PR/
Form 10-K
March 13, 2012
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

(Mark one)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the Fiscal Year Ended December 31, 2011**

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

**COMMISSION FILE NUMBER 001-14793**

# FIRST BANCORP.

**(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)**

| **Puerto Rico** | **66-0561882** |
|---|---|
| **(State or other jurisdiction of** | **(I.R.S. Employer** |

| **incorporation or organization)** | **Identification No.)** |
|---|---|
| **1519 Ponce de León Avenue, Stop 23** | |
| **Santurce, Puerto Rico** | **00908** |
| **(Address of principal executive office)** | **(Zip Code)** |

**Registrant s telephone number, including area code:**

**(787) 729-8200**

**Securities registered pursuant to Section 12(b) of the Act:**

| **Common Stock ($0.10 par value)** | **New York Stock Exchange** |
|---|---|

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well- known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definite proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

| Large accelerated filer ¨ | Accelerated filer x |
|---|---|
| Non-accelerated filer ¨ (Do not check if a smaller reporting company) | Smaller reporting company ¨ |

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 30, 2011 (the last day of the registrant s most recently completed second quarter) was $87,946,864 based on the closing price of $4.31 per share of common stock on the New York Stock Exchange on June 30, 2011. The registrant had no nonvoting common equity outstanding as of June 30, 2011. For the purposes of the foregoing calculation only, registrant has treated as common stock held by affiliates only common stock of the registrant held by its directors and executive officers and voting stock held by the registrant s employee benefit plans. The registrant s response to this item is not intended to be an admission that any person is an affiliate of the registrant for any purposes other than this response.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date:
205,299,171 shares as of March 2, 2012.

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**FIRST BANCORP**

**2011 ANNUAL REPORT ON FORM 10-K**

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**Forward-Looking Statements**

This Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this Form 10-K or future filings by First BanCorp (the Corporation ) with the Securities and Exchange Commission ( SEC ), in the Corporation s press releases or in other public or stockholder communications, or in oral statements made with the approval of an authorized executive officer, the word or phrases would be, will allow, intends to, will likely result, are expected to, should, anticipate and similar expressions are n identify forward-looking statements.

First BanCorp wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and represent First BanCorp s expectations of future conditions or results and are not guarantees of future performance. First BanCorp advises readers that various factors could cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to, the following:

- uncertainty about whether the Corporation will be able to fully comply with the written agreement dated June 3, 2010 (the Written Agreement ) that the Corporation entered into with the Federal Reserve Bank of New York (the FED or Federal Reserve ) and the order dated June 2, 2010 (the FDIC Order ) and together with the Written Agreement, (the Agreements ) that the Corporation s banking subsidiary, FirstBank Puerto Rico ( FirstBank or the Bank ) entered into with the Federal Deposit Insurance Corporation ( FDIC ) and the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico ( OCIF ) that, among other things, require the Bank to maintain certain capital levels and reduce its special mention, classified, delinquent and non-performing assets;

- uncertainty as to the availability of certain funding sources, such as retail brokered certificates of deposit ( CDs );

- the Corporation s reliance on brokered CDs and its ability to obtain, on a periodic basis, approval from the FDIC to issue brokered CDs to fund operations and provide liquidity in accordance with the terms of the FDIC Order;

- the risk of not being able to fulfill the Corporation s cash obligations or resume paying dividends to the Corporation s stockholders in the future due to the Corporation s inability to receive approval from the FED to receive dividends from FirstBank or FirstBank s failure to generate sufficient cash flow to make a dividend payment to the Corporation;

- the risk of being subject to possible additional regulatory actions;

- the strength or weakness of the real estate markets and of the consumer and commercial credit sectors and their impact on the credit quality of the Corporation s loans and other assets, including the Corporation s construction and commercial real estate loan portfolios, which have contributed and may continue to contribute to, among other things, the high levels of non-performing assets, charge-offs and the provision expense and may subject the Corporation to further risk from loan defaults and foreclosures;

- adverse changes in general economic conditions in the United States ( U.S. ) and in Puerto Rico, including the interest rate scenario, market liquidity, housing absorption rates, real estate prices and disruptions in the U.S. capital markets, which may reduce interest margins, impact funding sources and affect demand for all of the Corporation s products and services and the value of the Corporation s assets;

- an adverse change in the Corporation s ability to attract new clients and retain existing ones;

a decrease in demand for the Corporation s products and services and lower revenues and earnings because of the continued recession in Puerto Rico and the current fiscal problems and budget deficit of the Puerto Rico government;

uncertainty about regulatory and legislative changes for financial services companies in Puerto Rico, the United States and the U.S. Virgin Islands ( USVI ) and British Virgin Islands ( BVI ), which could affect the Corporation s financial performance and could cause the Corporation s actual results for future periods to differ materially from prior results and anticipated or projected results;

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- uncertainty about the effectiveness of the various actions undertaken to stimulate the U.S. economy and stabilize the U.S. financial markets, and the impact such actions may have on the Corporation s business, financial condition and results of operations;

- changes in the fiscal and monetary policies and regulations of the federal government, including those determined by the Federal Reserve, the FDIC, government-sponsored housing agencies and local regulators in Puerto Rico and the U.S. and BVI;

- the risk of possible failure or circumvention of controls and procedures and the risk that the Corporation s risk management policies may not be adequate;

- the risk that the FDIC may further increase the deposit insurance premium and/or require special assessments to replenish its insurance fund, causing an additional increase in the Corporation s non-interest expenses;

- the risk of not being able to recover the assets pledged to Lehman Brothers Special Financing, Inc.;

- the impact to the Corporation s results of operations and financial condition associated with acquisitions and dispositions;

- a need to recognize additional impairments on financial instruments or goodwill relating to acquisitions;

- risks that downgrades in the credit ratings of the Corporation s long-term senior debt will adversely affect the Corporation s ability to access necessary external funds;

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

- general competitive factors and industry consolidation.

The Corporation does not undertake, and specifically disclaims any obligation, to update any of the forward- looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements except as required by the federal securities laws.

Investors should carefully consider these factors and the risk factors outlined under Item 1A, Risk Factors, in this Annual Report on Form 10-K.

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**PART I**

First BanCorp, incorporated under the laws of the Commonwealth of Puerto Rico, is sometimes referred to in this Annual Report on Form 10-K as the Corporation, we, our, or the Registrant .

**Item 1.** ***Business***

**GENERAL**

First BanCorp is a publicly-owned financial holding company that is subject to regulation, supervision and examination by the Federal Reserve Board. The Corporation was incorporated under the laws of the Commonwealth of Puerto Rico to serve as the bank holding company for FirstBank. The Corporation is a full service provider of financial services and products with operations in Puerto Rico, the United States and the U.S. and British Virgin Islands. As of December 31, 2011, the Corporation had total assets of $13.1 billion, total deposits of $9.9 billion and total stockholders equity of $1.4 billion.

The Corporation provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2011, the Corporation controlled two wholly-owned subsidiaries: FirstBank and FirstBank Insurance Agency, Inc. ( FirstBank Insurance Agency ). FirstBank is a Puerto Rico-chartered commercial bank and FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency.

FirstBank is subject to the supervision, examination and regulation of both the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico and the Federal Deposit Insurance Corporation. Deposits are insured through the FDIC Deposit Insurance Fund. In addition, within FirstBank, the Bank s United States Virgin Islands operations are subject to regulation and examination by the United States Virgin Islands Banking Board, the British Virgin Islands operations are subject to regulation by the British Virgin Islands Financial Services Commission and its operations in the state of Florida are subject to regulation and examination by the Florida Office of Financial Regulation. FirstBank Insurance Agency is subject to the supervision, examination and regulation of the Office of the Insurance Commissioner of the Commonwealth of Puerto Rico and operates six offices in Puerto Rico.

FirstBank conducts its business through its main office located in San Juan, Puerto Rico, forty-eight banking branches in Puerto Rico, fourteen branches in the United States Virgin Islands and British Virgin Islands and ten branches in the state of Florida (USA). FirstBank had five wholly-owned subsidiaries with operations in Puerto Rico: First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance company specializing in the origination of small loans with twenty-six offices in Puerto Rico; First Mortgage, Inc. ( First Mortgage ), a residential mortgage loan origination company with thirty-six offices in FirstBank branches and at stand alone sites; First Management of Puerto Rico, a domestic corporation which holds tax-exempt assets; FirstBank Puerto Rico Securities Corp, a broker-dealer subsidiary engaged in municipal bond underwriting and financial advisory services on structured financings principally provided to government entities in the Commonwealth of Puerto Rico; and FirstBank Overseas Corporation, an international banking entity organized under the International Banking Entity Act of Puerto Rico. FirstBank had one active subsidiary with operations outside of Puerto Rico: First Express, a finance company specializing in the origination of small loans with three offices in the USVI.

**BUSINESS SEGMENTS**

The Corporation has six reportable segments: Consumer (Retail) Banking; Commercial and Corporate Banking; Mortgage Banking; Treasury and Investments; United States Operations; and Virgin Islands Operations. These segments are described below:

***Consumer (Retail) Banking***

The Consumer (Retail) Banking segment consists of the Corporation s consumer lending and deposit-taking activities conducted mainly through FirstBank s branch network and loan centers in Puerto Rico. Loans to consumers include auto, boat and personal loans and lines of credit. Deposit products include interest bearing and non-interest bearing checking and savings accounts, Individual Retirement Accounts (IRA) and retail certificates of deposit. Retail deposits gathered through each branch of FirstBank s retail network serve as one of the funding sources for the lending and investment activities. Credit card accounts are issued under FirstBank s name through an alliance with a nationally recognized financial institution, which bears the credit risk.

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***Commercial and Corporate Banking***

The Commercial and Corporate Banking segment consists of the Corporation s lending and other services across a broad spectrum of industries ranging from small businesses to large corporate clients. FirstBank has developed expertise in industries including healthcare, tourism, financial institutions, food and beverage, income-producing real estate and the public sector. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and other products such as cash management and business management services. A substantial portion of this portfolio is secured by the underlying value of the real estate collateral and the personal guarantees of the borrowers. This segment also includes the Corporation s broker-dealer activities, which are primarily concentrated in bonds underwriting and financial advisory services provided to government entities in Puerto Rico.

***Mortgage Banking***

The Mortgage Banking segment conducts its operations mainly through FirstBank and its mortgage origination subsidiary, First Mortgage. These operations consist of the origination, sale and servicing of a variety of residential mortgage loan products. Originations are sourced through different channels such as FirstBank branches, mortgage bankers and in association with new project developers. First Mortgage focuses on originating residential real estate loans, some of which conform to Federal Housing Administration ( FHA ), Veterans Administration ( VA ) and Rural Development ( RD ) standards. Loans originated that meet FHA standards qualify for the FHA s insurance program whereas loans that meet VA and RD standards are guaranteed by those respective federal agencies.

Mortgage loans that do not qualify under these programs are commonly referred to as conventional loans. Conventional real estate loans could be conforming and non-conforming. Conforming loans are residential real estate loans that meet the standards for sale under the Fannie Mae ( FNMA ) and Freddie Mac ( FHLMC ) programs whereas loans that do not meet the standards are referred to as non-conforming residential real estate loans. The Corporation s strategy is to penetrate markets by providing customers with a variety of high quality mortgage products to serve their financial needs faster and simpler and at competitive prices. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. Residential real estate conforming loans are sold to investors like FNMA and FHLMC. Most of the Corporation s residential mortgage loan portfolio consists of fixed-rate, fully amortizing, full documentation loans. The Corporation is not actively engaged in offering negative amortization loans or option adjustable rate mortgage loans. In December 2008, the Corporation obtained Commitment Authority from GNMA to issue GNMA mortgage-backed securities. Under this program, the Corporation has been securitizing FHA/VA mortgage loan production into the secondary market.

***Treasury and Investments***

The Treasury and Investments segment is responsible for the Corporation s treasury and investment management functions. The treasury function, which includes funding and liquidity management, sells funds to the Commercial and Corporate Banking segment, the Mortgage Banking segment, and the Consumer (Retail) Banking segment to finance their respective lending activities and purchases funds gathered by those segments and from the United States Operations segment. Funds not gathered by the different business units are obtained by the Treasury Division through wholesale channels, such as brokered deposits, advances from the FHLB and, repurchase agreements with investment securities, among others.

***United States Operations***

The United States Operations segment consists of all banking activities conducted by FirstBank in the United States mainland. FirstBank provides a wide range of banking services to individual and corporate customers primarily in southern Florida through its ten branches. Our success in attracting core deposits in Florida has enabled us to become less dependent on brokered deposits. The United States Operations segment offers an array of both retail and commercial banking products and services. Consumer banking products include checking, savings and money market accounts, retail CDs, internet banking services, residential mortgages, home equity loans and lines of credit, automobile loans and credit cards through an alliance with a nationally recognized financial institution, which bears the credit risk. Deposits gathered through FirstBank s branches in the United States also serve as one of the funding sources for lending and investment activities in Puerto Rico.

The commercial banking services include checking, savings and money market accounts, CDs, internet banking services, cash management services, remote data capture and automated clearing house, or ACH, transactions. Loan products include the traditional commercial and industrial and commercial real estate products, such as lines of credit, term loans and construction loans.

***Virgin Islands Operations***

The Virgin Islands Operations segment consists of all banking activities conducted by FirstBank in the U.S. and British Virgin Islands, including retail and commercial banking services, with a total of fourteen branches serving the U.S. Virgin Islands of St. Thomas, St. Croix, and St. John, and the British Virgin Islands of Tortola and Virgin Gorda. The Virgin Islands Operations segment is driven by its consumer, commercial lending and deposit-taking activities. Since 2005, FirstBank has been the largest bank in the U.S. Virgin Islands measured by total assets.

For information regarding First BanCorp s reportable segments, please refer to Note 32, Segment Information, to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K.

**Employees**

As of December 31, 2011, the Corporation and its subsidiaries employed 2,490 persons. None of its employees are represented by a collective bargaining group. The Corporation considers its employee relations to be good.

**SIGNIFICANT EVENTS SINCE THE BEGINNING OF 2011**

***Deleveraging and De-risking of the Balance Sheet***

*Sale of Adversely Classified and Non-performing Loans*

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage and C&I loans with an unpaid principal balance of $510.2 million (book value of $269.3 million) to CPG/GS PR NPL, LLC ( CPG/GS ) organized under the Laws of the Commonwealth of Puerto Rico and majority owned by PRLP Ventures LLC ( PRLP ), a company created by Goldman, Sachs & Co. and Caribbean Property Group. In connection with the sale, the Corporation received $88.5 million in cash and a 35% subordinated interest in CPG/GS, and made a loan in the amount of $136.1 million representing seller financing provided by FirstBank. The loan portfolio sold was composed of 73% construction loans, 19% commercial real estate loans and 8% commercial loans. Approximately 93% of the loans were adversely classified loans and 55% were in non-performing status as of December 31, 2010.

The Corporation s primary goal in agreeing to the loan sale transaction was to accelerate the de-risking of the balance sheet and improve the Corporation s risk profile. FirstBank has been operating under the FDIC Order since June of 2010, which, among other things, requires the Bank to improve its risk profile by reducing the level of classified assets and delinquent loans. The Corporation entered into this transaction to reduce the level of classified and non-performing assets and reduce its concentration in residential construction loans in accordance with the terms of the capital plan that the Corporation and FirstBank prepared pursuant to the provisions of the FDIC Order (the Capital Plan ).

*Sale of Performing Residential Mortgage loans*

In two separate transactions during 2011, consistent with the Corporation s deleveraging strategies, the Corporation sold performing residential mortgage loans with an unpaid principal balance of approximately $518 million to another financial institution. The Corporation recognized a gain of approximately $12.1 million associated with these transactions in 2011.

*Sale of Held to Maturity Investment Securities*

On March 7, 2011, the Corporation sold approximately $330 million of mortgage-backed securities that were originally intended to be held to maturity, consistent with deleveraging initiatives included in the Corporation s Capital Plan. The Corporation realized a gain of $18.7 million associated with this transaction. After the sale, in line with the Corporation s ongoing capital management strategy, the remaining $89 million of investment securities held in the held-to-maturity portfolio was reclassified to the available-for-sale portfolio.

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*Balance Sheet Repositioning*

The Corporation also achieved a significant reduction in investment securities as a result of balance sheet repositioning strategies, and in 2011 sold low yielding investment securities such as $500 million of 2-5 year U.S. Treasury Notes (average yield of 1.40%) and $105 million of U.S. Agency floating rate CMOs (average yield of 0.95%). The proceeds from these sales were used, in part, to prepay $400 million of repurchase agreements (average rate of 2.74%) and $100 million of advances from FHLB (average rate of 1.62%). The prepayment penalties of $10.8 million on the early termination of borrowings was offset with gains of $11.0 million from the sale of low yielding securities.

Proceeds from sale of loans and securities were used to repay maturing brokered CDs and Advances from FHLB. Deleverage and de-risking strategies contributed to a significant decrease in the provision for loan losses and improved the net interest margin in 2011.

***Capital Plan Execution***

*Completion of a $525 million Capital Raise and Subsequent Rights Offering*

On October 7, 2011, the Corporation successfully completed a private placement of $525 million in shares of common stock (the capital raise ). The proceeds from the capital raise amounted to approximately $490 million (net of offering costs), of which $435 million have been contributed to the Corporation s wholly owned banking subsidiary, FirstBank. Lead investors include funds affiliated with Thomas H. Lee Partners, L.P. ( THL ) and Oaktree Capital Management, L.P. ( Oaktree ) that purchased from the Corporation an aggregate of $348.2 million ($174.1 million each investor) of shares of the Corporation s common stock.

In connection with the closing, the Corporation issued 150 million shares of common stock at $3.50 per share to institutional investors. Subsequent to the closing, in related transactions, on October 12, 2011 and October 26, 2011, each of THL and Oaktree, respectively, purchased in the aggregate 937,493 shares of common stock from certain of the institutional investors who participated in the capital raise transaction. As of the date of the filing of this Form 10-K, each of THL and Oaktree owns 24.69% of the total shares of common stock outstanding. THL and Oaktree also have the right to designate a person to serve on the Corporation s Board of Directors. In this regard, the Corporation reconstituted its Board of Directors and Michael P. Harmon, a Managing Director with the Principal Group of Oaktree, and Thomas M. Hagerty, a Managing Director at THL were appointed as members of the Bank s and the Corporation s Board of Directors. In addition, Mr. Roberto R. Herencia was appointed as the new non-executive chairman of the Bank s and the Corporation s Board of Directors.

On December 8, 2011, the Corporation completed a rights offering in which the Corporation issued an additional 888,781 shares of common stock at $3.50 per share, and received proceeds of $3.3 million.

*Conversion of the Series G Convertible Cumulative Preferred Stock into Common Stock*

The completion of the aforementioned capital raise enabled the Corporation to compel the conversion of the 424,174 shares of the Corporation s Series G Preferred Stock, held by the U.S. Treasury, into 32.9 million shares of common stock at a conversion price of $9.66. In connection with the conversion, the Corporation paid to the U.S. Treasury $26.4 million for past due undeclared cumulative dividends on the Series G Preferred Stock. With the $525 million capital infusion, the conversion to common stock of the Series G Preferred Stock held by the U.S. Treasury, and the issuance of an additional $3.3 million of capital in the rights offering (after deducting estimated offering expenses and the $26.4 million payment of cumulative dividends on the Series G Preferred Stock), the Corporation increased its total common equity by approximately $834 million.

*Compliance with Regulatory Capital Requirements of the FDIC Order*

The minimum capital ratios established by the FDIC Order are 12% for Total Capital to Risk-Weighted Assets, 10% for Tier 1 Capital to Risk-Weighted Assets and 8% for Leverage (Tier 1 Capital to Average Total Assets). As of December 31, 2011, the Corporation s Total Capital, Tier 1 Capital and Leverage ratios were 17.12%, 15.79%

and 11.91%, respectively, up from 12.02%, 10.73% and 7.57%, respectively, as of December 31, 2010. Meanwhile, FirstBank s Total Capital, Tier 1 Capital and Leverage ratios as of December 31, 2011 were 16.58%, 15.25% and 11.52%, respectively, up from 11.57%, 10.28% and 7.25%, respectively, as of December 31, 2010. All of the capital ratios as of December 31, 2011 are well above the minimum required under the consent order with the FDIC.

***Delisting of the Series A through E Non-convertible, Non-cumulative Preferred Stock***

Effective January 17, 2012, the Corporation delisted all of the series of non-convertible, non-cumulative preferred stock from the New York Stock Exchange. The Corporation has not arranged for listing and/or registration on another national securities exchange or for quotation of the preferred stock in a quotation medium. The Corporation initially announced its intention to delist the non-convertible, non-cumulative preferred stock at the time it made an offer to issue shares of its common stock in exchange for any and all outstanding shares of the non-convertible, non-cumulative preferred stock.

**WEBSITE ACCESS TO REPORT**

The Corporation makes available annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, free of charge on or through its internet website at www.firstbankpr.com (under the Investor Relations section), as soon as reasonably practicable after the Corporation electronically files such material with, or furnishes it to, the SEC.

The Corporation also makes available the Corporation s corporate governance guidelines and principles, the charters of the audit, asset/liability, compensation and benefits, credit, compliance, corporate governance and nominating committees and the codes of conduct and principles mentioned below, free of charge on or through its internet website at www.firstbankpr.com (under the Investor Relations section):

Code of Ethics for Senior Financial Officers

Code of Ethics applicable to all employees

Independence Principles for Directors

Luxury Expenditure Policy

The corporate governance guidelines and principles and the aforementioned charters and codes may also be obtained free of charge by sending a written request to Mr. Lawrence Odell, Executive Vice President and General Counsel, PO Box 9146, San Juan, Puerto Rico 00908.

The public may read and copy any materials First BanCorp files with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. In addition, the public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy, and information statements, and other information regarding issuers that file electronically with the SEC (www.sec.gov).

**MARKET AREA AND COMPETITION**

Puerto Rico, where the banking market is highly competitive, is the main geographic service area of the Corporation. As of December 31, 2011, the Corporation also had a presence in the state of Florida and in the United States and British Virgin Islands. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States mainland.

Competitors include other banks, insurance companies, mortgage banking companies, small loan companies, automobile financing companies, leasing companies, brokerage firms with retail operations, and credit unions in Puerto Rico, the Virgin Islands and the state of Florida. The Corporation s businesses compete with these other firms with respect to the range of products and services offered and the types of clients, customers, and industries served.

The Corporation s ability to compete effectively depends on the relative performance of its products, the degree to which the features of its products appeal to customers, and the extent to which the Corporation meets clients needs and expectations. The Corporation s ability to compete also depends on its ability to attract and retain professional and other personnel, and on its reputation.

The Corporation encounters intense competition in attracting and retaining deposits and its consumer and commercial lending activities. The Corporation competes for loans with other financial institutions, some of which are larger and have greater resources available than those of the Corporation. Management believes that the Corporation has been able to compete effectively for deposits and loans by offering a variety of transaction account products and loans with competitive features, by pricing its products at competitive interest rates, by offering convenient branch locations, and by emphasizing the quality of its service. The Corporation s ability to originate loans depends primarily on the rates and fees charged and the service it provides to its borrowers in making prompt credit decisions. There can be no assurance that in the future the Corporation will be able to continue to increase its deposit base or originate loans in the manner or on the terms on which it has done so in the past.

## SUPERVISION AND REGULATION

### *Recent Events Affecting the Corporation*

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act ), which became law on July 21, 2010, there will be additional regulatory oversight and supervision of the holding company and its subsidiaries.

The Dodd-Frank Act significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes, and the regulations being developed thereunder will include, provisions affecting large and small financial institutions alike, including several provisions that will affect how banks and bank holding companies will be regulated in the future.

The Dodd-Frank Act, among other things, imposes new capital requirements on bank holding companies; provides that a bank holding company must serve as a source of financial and managerial strength to each of its subsidiary banks and stand ready to commit resources to support each of them, changes the base for FDIC insurance assessments to a bank s average consolidated total assets minus average tangible equity, rather than upon its deposit base, and permanently raises the current standard deposit insurance limit to $250,000; extends unlimited insurance for noninterest-bearing transaction accounts through 2012 and expands the FDIC s authority to raise insurance premiums. The legislation also calls for the FDIC to raise the ratio of reserves to deposits from 1.15% to 1.35% for deposit insurance purposes by September 30, 2020 and to offset the effect of increased assessments on insured depository institutions with assets of less than $10 billion. The Dodd-Frank Act also limits interchange fees payable on debit card transactions, establishes as an independent entity within the Federal Reserve the Bureau of Consumer Financial Protection (the CFPB ), which has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards, and contains provisions on mortgage-related matters such as steering incentives, and determinations as to a borrower s ability to repay and prepayment penalties. The CFPB has primary examination and enforcement authority over FirstBank and other banks with over $10 billion in assets with respect to consumer financial products and services effective July 21, 2011.

On June 28, 2011, the Federal Reserve Board approved a final debit card interchange rule that caps a debit card issuer s base fee at 21 cents per transaction and allows an additional 5 basis-point charge per transaction to help cover fraud losses. The Federal Reserve Board issued an interim final rule that also allows a fraud-prevention adjustment of 1 cent per transaction conditioned upon a credit card issuer adopting effective fraud prevention policies and procedures. The Federal Reserve Board also adopted requirements that issuers include two unaffiliated networks for routing debit transactions. Compliance for most types of debit cards is required by April 1, 2012. The effective date for the pricing restrictions was October 1, 2011. We expect that the debit card interchange rule will reduce our interchange fee revenue in line with industry-wide expectations, beginning in the quarter ended December 31, 2011. The new pricing restriction is expected to impact FirstBank by an approximate $2.5 million to $3.0 million annual reduction of revenue related to these transactions, without management actions.

The Dodd-Frank Act also includes provisions that affect corporate governance and executive compensation at all publicly-traded companies and allows financial institutions to pay interest on business checking accounts. The legislation also restricts proprietary trading, places restrictions on the owning or sponsoring of hedge and private

equity funds, and regulates the derivatives activities of banks and their affiliates. The Dodd-Frank Act establishes the Financial Stability Oversight Council, which is to identify threats to the financial stability of the U.S., promote market discipline, and respond to emerging threats to the stability of the U.S. financial system.

The Collins Amendment to the Dodd-Frank Act, among other things, eliminates certain trust preferred securities from Tier I capital. Preferred securities issued under the U.S. Treasury s Troubled Asset Relief Program ( TARP ) are exempted from this treatment. In the case of certain trust preferred securities issued prior to May 19, 2010 by bank holding companies with total consolidated assets of $15 billion or more as of December 31, 2009, these regulatory capital deductions are to be phased in incrementally over a period of three years beginning on January 1, 2013. This provision also requires the federal banking agencies to establish minimum leverage and risk-based capital requirements that will apply to both insured banks and their holding companies. Regulations implementing the Collins Amendment became effective on July 28, 2011, and set as a floor for the capital requirements of the holding company and FirstBank a minimum capital requirement computed using the Federal Reserve s risk-based capital rules. Additional rulemaking as to the Collins Amendment is expected.

A separate legislative proposal would impose a new fee or tax on U.S. financial institutions as part of the 2010 budget plans in an effort to reduce the anticipated budget deficit and to recoup losses anticipated from the TARP. Such an assessment is estimated to be 15-basis points, levied against bank assets minus Tier 1 capital and domestic deposits. It appears that this fee or tax would be assessed only against the 50 or so largest financial institutions in the U.S., which are those with more than $50 billion in assets, and therefore would not directly affect us. However, the large banks that are affected by the tax may choose to seek additional deposit funding in the marketplace, driving up the cost of deposits for all banks. The administration has also considered a transaction tax on trades of stock in financial institutions and a tax on executive bonuses.

The U.S. Congress has also recently adopted additional consumer protection laws such as the Credit Card Accountability Responsibility and Disclosure Act of 2009, and the Federal Reserve has adopted numerous new regulations addressing banks credit card, overdraft and mortgage lending practices. Additional consumer protection legislation and regulatory activity is anticipated in the near future.

Internationally, both the Basel Committee on Banking Supervision and the Financial Stability Board (established in April 2009 by the Group of Twenty ( G-20 ) Finance Ministers and Central Bank Governors to take action to strengthen regulation and supervision of the financial system with greater international consistency, cooperation and transparency) have committed to raise capital standards and liquidity buffers within the banking system ( Basel III ). On September 12, 2010, the Group of Governors and Heads of Supervision agreed to the calibration and phase-in of the Basel III minimum capital requirements (raising the minimum Tier 1 equity ratio to 6.0%, with full implementation by January 2015) and introducing a capital conservation buffer of common equity of an additional 2.5% with implementation by January 2019. The U.S. federal banking agencies have yet to propose regulations for implementing Basel III. On September 28, 2011, the Basel Committee announced plans to consider adjustments to the first liquidity change to be imposed under Basel III, which change would take effect on January 1, 2015. The liquidity coverage ratio being considered would require banks to maintain an adequate level of unencumbered high-quality liquid assets sufficient to meet liquidity needs for a 30 calendar day time horizon.

***Bank Holding Company Activities and Other Limitations***

The Corporation is subject to ongoing regulation, supervision, and examination by the Federal Reserve Board, and is required to file with the Federal Reserve Board periodic and annual reports and other information concerning its own business operations and those of its subsidiaries. In addition, the Corporation is subject to regulation under the Bank Holding Company Act of 1956, as amended ( Bank Holding Company Act ). Under the provisions of the Bank Holding Company Act, a bank holding company must obtain Federal Reserve Board approval before it acquires direct or indirect ownership or control of more than 5% of the voting shares of another bank, or merges or consolidates with another bank holding company. The Federal Reserve Board also has authority under certain circumstances to issue cease and desist orders against bank holding companies and their non-bank subsidiaries.

A bank holding company is prohibited under the Bank Holding Company Act, with limited exceptions, from engaging, directly or indirectly, in any business unrelated to the businesses of banking or managing or controlling banks. One of the exceptions to these prohibitions permits ownership by a bank holding company of the shares of any corporation if the Federal Reserve Board, after due notice and opportunity for hearing, by regulation or order has determined that the activities of the corporation in question are so closely related to the businesses of banking or managing or controlling banks as to be a proper incident thereto.

Under provisions in the Dodd-Frank Act and Federal Reserve Board policy, a bank holding company such as the Corporation is expected to act as a source of financial strength to its banking subsidiaries and to commit support to them. This support may be required at times when, absent such policy, the bank holding company might not otherwise provide such support. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks must be subordinated in right of payment to deposits and to certain other indebtedness of such subsidiary bank. As of December 31, 2011, FirstBank was the only depository institution subsidiary of the Corporation.

The Gramm-Leach-Bliley Act (the GLB Act ) revised and expanded the provisions of the Bank Holding Company Act by including a section that permits a bank holding company to elect to become a financial holding company and engage in a full range of financial activities. In April 2000, the Corporation filed an election with the Federal Reserve Board and became a financial holding company under the GLB Act.

A financial holding company ceasing to meet certain standards is subject to a variety of restrictions, depending on the circumstances. The Corporation and FirstBank must remain well-capitalized and well-managed for regulatory purposes and FirstBank must continue to earn satisfactory or better ratings on its periodic Community Reinvestment Act ( CRA ) examinations to preserve the financial holding company status. Until compliance is restored, the Federal Reserve Board has broad discretion to impose appropriate limitations on the financial holding company s activities. If compliance is not restored within 180 days, the Federal Reserve Board may ultimately require the financial holding company to divest its depository institutions or in the alternative, to discontinue or divest any activities that are permitted only to non-financial holding company bank holding companies.

The potential restrictions are different if the lapse pertains to the Community Reinvestment Act requirement. In that case, until all the subsidiary institutions are restored to at least satisfactory Community Reinvestment Act rating status, the financial holding company may not engage, directly or through a subsidiary, in any of the additional activities permissible under the GLB Act or make additional acquisitions of companies engaged in the additional activities. However, completed acquisitions and additional activities and affiliations previously begun are left undisturbed, as the GLB Act does not require divestiture for this type of situation.

Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The GLB Act specifically provides that the following activities have been determined to be financial in nature : (a) lending, trust and other banking activities; (b) insurance activities; (c) financial or economic advice or services; (d) pooled investments; (e) securities underwriting and dealing; (f) existing bank holding company domestic activities; (g) existing bank holding company foreign activities; and (h) merchant banking activities. The Corporation offers insurance agency services through its wholly-owned subsidiary, FirstBank Insurance Agency. In association with JP Morgan Chase, the Corporation, through FirstBank Puerto Rico Securities, Inc., a wholly owned subsidiary of FirstBank, also offers municipal bond underwriting services focused mainly on municipal and government bonds or obligations issued by the Puerto Rico government and its public corporations. Additionally, FirstBank Puerto Rico Securities, Inc. offers financial advisory services.

In addition, the GLB Act specifically gives the Federal Reserve Board the authority, by regulation or order, to expand the list of financial or incidental activities, but requires consultation with the Treasury, and gives the Federal Reserve Board authority to allow a financial holding company to engage in any activity that is complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

***Sarbanes-Oxley Act***

The Sarbanes-Oxley Act of 2002 ( SOX ) implemented a range of corporate governance and other measures to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of disclosures under federal securities laws. In addition, SOA has established membership requirements and responsibilities for the audit committee, imposed restrictions on the relationship between the Corporation and external auditors, imposed additional responsibilities for the external financial statements on our chief executive officer and chief financial

officer, expanded the disclosure requirements for corporate insiders, required management to evaluate its disclosure controls and procedures and its internal control over financial reporting, and required the auditors to issue a report on the internal control over financial reporting.

Since the 2004 Annual Report on Form 10-K, the Corporation has included in its annual report on Form 10-K its management s assessment regarding the effectiveness of the Corporation s internal control over financial reporting. The internal control report includes a statement of management s responsibility for establishing and maintaining adequate internal control over financial reporting for the Corporation; management s assessment as to the effectiveness of the Corporation s internal control over financial reporting based on management s evaluation, as of year-end; and the framework used by management as criteria for evaluating the effectiveness of the Corporation s internal control over financial reporting. As of December 31, 2011, First BanCorp s management concluded that its internal control over financial reporting was effective. The Corporation s independent registered public accounting firm reached the same conclusion.

***Emergency Economic Stabilization Act of 2008***

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the EESA ) was signed into law. The EESA authorized the Treasury to access up to $700 billion to protect the U.S. economy and restore confidence and stability to the financial markets. One such program under TARP was action by Treasury to make significant investments in U.S. financial institutions through the Capital Purchase Program (CPP). The Treasury s stated purpose in implementing the CPP was to improve the capitalization of healthy institutions, which would improve the flow of credit to businesses and consumers, and boost the confidence of depositors, investors, and counterparties alike. All federal banking and thrift regulatory agencies encouraged eligible institutions to participate in the CPP.

The Corporation applied for, and the Treasury approved, a capital purchase in the amount of $400,000,000. The Corporation entered into a Letter Agreement with the Treasury, pursuant to which the Corporation issued and sold to the Treasury for an aggregate purchase price of $400,000,000 in cash (i) 400,000 shares of Series F Preferred Stock, and (2) a warrant to purchase 389,483 shares of the Corporation s common stock at an exercise price of $154.05 per share, subject to certain anti-dilution and other adjustments. The TARP transaction closed on January 16, 2009. On July 20, 2010, we exchanged the Series F Preferred Stock, plus accrued dividends on the Series F Preferred Stock, for 424,174 shares of a new Series G Preferred Stock and amended the warrant issued on January 16, 2009 and on December 2, 2010 the Agreement and the certificate of designation of the Series G preferred stock were amended to, among other provisions, reduce the required capital amount to compel the conversion of the Series G preferred stock from $500 million to $350 million. On October 7, 2011, we exercised our right to convert the Series G preferred stock into 32,941,797 shares of common stock, which the Treasury owns. As a result of the Capital Raise, the warrant was adjusted to provide for the issuance of approximately 1,285,891 shares of common stock at an exercise price of $3.29 per share.

Under the terms of the Letter Agreement with the Treasury, (i) the Corporation amended its compensation, bonus, incentive and other benefit plans, arrangements and agreements (including severance and employment agreements) to the extent necessary to be in compliance with the executive compensation and corporate governance requirements of Section 111(b) of the Emergency Economic Stability Act of 2008 and applicable guidance or regulations issued by the Secretary of Treasury on or prior to January 16, 2009 and (ii) each Senior Executive Officer, as defined in the Purchase Agreement, executed a written waiver releasing Treasury and the Corporation from any claims that such officers may otherwise have as a result the Corporation s amendment of such arrangements and agreements to be in compliance with Section 111(b). Until such time as Treasury ceases to own any debt or equity securities of the Corporation acquired pursuant to the Purchase Agreement, the Corporation must maintain compliance with these requirements.

***American Recovery and Reinvestment Act of 2009***

On February 17, 2009, the Congress enacted the American Recovery and Reinvestment Act of 2009 ( ARRA ). The Stimulus Act includes federal tax cuts, expansion of unemployment benefits and other social welfare provisions, and domestic spending in education, health care, and infrastructure, including energy sector. The Stimulus Act includes provisions relating to compensation paid by institutions that receive government assistance under TARP, including institutions that have already received such assistance, effectively amending the existing compensation and corporate governance requirements of Section 111(b) of the EESA. The provisions include restrictions on the amounts and forms of compensation payable, provision for possible reimbursement of previously paid compensation and a requirement that compensation be submitted to non-binding say on pay shareholder vote.

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On June 10, 2009, the Treasury issued regulations implementing the compensation requirements under ARRA, which amended the requirements of EESA. The regulations became applicable to existing and new TARP recipients upon publication in the Federal Register on June 15, 2009. The regulations make effective the compensation provisions of ARRA and include rules requiring: (i) review of prior compensation by a Special Master; (ii) restrictions on paying or accruing bonuses, retention awards or incentive compensation for certain employees; (iii) regular review of all employee compensation arrangements by the company s senior risk officer and compensation committee to ensure that the arrangements do not encourage unnecessary and excessive risk-taking or manipulation reporting of earnings; (iv) recoupment of bonus payments based on materially inaccurate information; (v) in the prohibition on severance or change in control payments for certain employees; (vi) adoption of policies and procedures to avoid excessive luxury expenses; and (vii) mandatory say on pay vote by shareholders (which was effective beginning in February 2009). In addition, the regulations also introduce several additional requirements and restrictions, including: (i) Special Master review of ongoing compensation in certain situations; (ii) prohibition on tax gross-ups for certain employees; (iii) disclosure of perquisites; and (iv) disclosure regarding compensation consultants.

***Homeowner Affordability and Stability Plan***

On February 18, 2009, President Obama announced a comprehensive plan to help responsible homeowners avoid foreclosure by providing affordable and sustainable mortgage loans. The Homeowner Affordability and Stability Plan, a $75 billion federal program, provides for a sweeping loan modification program targeted at borrowers who are at risk of foreclosure because their incomes are not sufficient to make their mortgage payments. It also includes refinancing opportunities for borrowers who are current on their mortgage payments but have been unable to refinance because their homes have decreased in value. Under the Homeowner Stability Initiative, Treasury will spend up to $50 billion dollars to make mortgage payments affordable and sustainable for middle-income American families that are at risk of foreclosure. Borrowers who are delinquent on the mortgage for their primary residence and borrowers who, due to a loss of income or increase in expenses, are struggling to keep their payments current may be eligible for a loan modification. Under the Homeowner Affordability and Stability Plan, borrowers who are current on their mortgage but have been unable to refinance because their house has decreased in value may have the opportunity to refinance into a 30-year, fixed-rate loan. Through the program, Fannie Mae and Freddie Mac will allow the refinancing of mortgage loans that they hold in their portfolios or which they guarantee in their own mortgage-backed securities. Lenders were able to begin accepting refinancing applications on March 4, 2009. The Obama Administration announced on March 4, 2009 the new U.S. Department of the Treasury guidelines to enable servicers to begin modifications of eligible mortgages under the Homeowner Affordability and Stability Plan. The guidelines implement financial incentives for mortgage lenders to modify existing first mortgages and sets standard industry practice for modifications.

***USA Patriot Act***

Under Title III of the USA Patriot Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions are required to, among other things, identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Presently, only certain types of financial institutions (including banks, savings associations and money services businesses) are subject to final rules implementing the anti-money laundering program requirements of the USA Patriot Act.

Failure of a financial institution to comply with the USA Patriot Act s requirements could have serious legal and reputational consequences for the institution. The Corporation has adopted appropriate policies, procedures and controls to address compliance with the USA Patriot Act and Treasury regulations.

***Privacy Policies***

Under Title V of the GLB Act, all financial institutions are required to adopt privacy policies, restrict the sharing of nonpublic customer data with parties at the customer s request and establish policies and procedures to protect customer data from unauthorized access. The Corporation and its subsidiaries have adopted policies and procedures in order to comply with the privacy provisions of the GLB Act and the Fair and Accurate Credit Transaction Act of 2003 and the regulations issued thereunder.

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***State Chartered Non-Member Bank and Banking Laws and Regulations in General***

FirstBank is subject to regulation and examination by the OCIF and the FDIC, and is subject to comprehensive federal and state regulations dealing with a wide variety of subjects. The federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their businesses, their investments, their reserves against deposits, the timing and availability of deposited funds, and the nature and amount of and collateral for certain loans. In addition to the impact of regulations, commercial banks are affected significantly by the actions of the Federal Reserve Board as it attempts to control the money supply and credit availability in order to influence the economy. Among the instruments used by the Federal Reserve Board to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate, and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits. The monetary policies and regulations of the Federal Reserve Board have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our future business, earnings, and growth cannot be predicted.

References herein to applicable statutes or regulations are brief summaries of portions thereof which do not purport to be complete and which are qualified in their entirety by reference to those statutes and regulations. Numerous additional regulations and changes to regulations are anticipated as a result of the Dodd-Frank Act, and future legislation may provide additional regulatory oversight of FirstBank. Any change in applicable laws or regulations may have a material adverse effect on the business of commercial banks and bank holding companies, including FirstBank and the Corporation.

There are periodic examinations by the OCIF and the FDIC of FirstBank to test the Bank s compliance with various statutory and regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage. The regulation and supervision are intended primarily for the protection of the FDIC s insurance fund and depositors. The regulatory structure also gives the regulatory authorities discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and for engaging in unsafe or unsound practices. In addition, certain bank actions are required by statute and implementing regulations. Other actions or failure to act may provide the basis for enforcement action, including the filing of misleading or untimely reports with regulatory authorities.

***Dividend Restrictions***

The Corporation is subject to certain restrictions generally imposed on Puerto Rico corporations with respect to the declaration and payment of dividends (i.e., that dividends may be paid out only from the Corporation s net assets in excess of capital or, in the absence of such excess, from the Corporation s net earnings for such fiscal year and/or the preceding fiscal year). The Federal Reserve Board has also issued a policy statement that, as a matter of prudent banking, a bank holding company should generally not maintain a given rate of cash dividends unless its net income available to common shareholders has been sufficient to fund fully the dividends and the prospective rate of earnings retention appears to be consistent with the organization s capital needs, asset quality, and overall financial condition.

On February 24, 2009, the Federal Reserve published the Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies (the Supervisory Letter ), which discusses the ability of bank holding companies to declare dividends and to redeem or repurchase equity securities. The Supervisory Letter is generally consistent with prior Federal Reserve supervisory policies and guidance, although places greater emphasis on discussions with the regulators prior to dividend declarations and redemption or repurchase decisions even when not explicitly required by the regulations. The Federal Reserve provides that the principles discussed in the letter are applicable to all bank holding companies, but are especially relevant for bank holding companies that are either experiencing financial difficulties and/or receiving public funds under the Treasury s TARP Capital Purchase Program. To that end, the Supervisory Letter specifically addresses the Federal Reserve s supervisory considerations for TARP participants.

The Supervisory Letter provides that a board of directors should eliminate, defer, or severely limit dividends if: (i) the bank holding company s net income available to shareholders for the past four quarters, net of dividends paid

during that period, is not sufficient to fully fund the dividends; (ii) the bank holding company s rate of earnings retention is inconsistent with capital needs and overall macroeconomic outlook; or (iii) the bank holding company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Supervisory Letter further suggests that bank holding companies should inform the Federal Reserve in advance of paying a dividend that: (i) exceeds the earnings for the quarter in which the dividend is being paid; or (ii) could result in a material adverse change to the organization s capital structure.

In prior years, the principal source of funds for the Corporation s parent holding company was dividends declared and paid by its subsidiary, FirstBank. Pursuant to the Written Agreement with the Federal Reserve, the Corporation cannot directly or indirectly take dividends or any other form of payment representing a reduction in capital from the Bank without the prior written approval of the Federal Reserve. The ability of FirstBank to declare and pay dividends on its capital stock is regulated by the Puerto Rico Banking Law, the Federal Deposit Insurance Act (the FDIA ), and FDIC regulations. In general terms, the Puerto Rico Banking Law provides that when the expenditures of a bank are greater than receipts, the excess of expenditures over receipts shall be charged against undistributed profits of the bank and the balance, if any, shall be charged against the required reserve fund of the bank. If the reserve fund is not sufficient to cover such balance in whole or in part, the outstanding amount must be charged against the bank s capital account. The Puerto Rico Banking Law provides that, until said capital has been restored to its original amount and the reserve fund to 20% of the original capital, the bank may not declare any dividends.

In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding such bank.

We suspended dividend payments on our common and preferred dividends, including the TARP preferred dividends, commencing effective with the preferred dividend payments for the month of August 2009. Furthermore, so long as any shares of preferred stock remain outstanding and until we obtain the FED s approval, we cannot declare, set apart or pay any dividends on shares of our common stock unless any accrued and unpaid dividends on our preferred stock for the twelve monthly dividend periods ending on the immediately preceding dividend payment date have been paid or are paid contemporaneously and the full monthly dividend on our preferred stock for the then current month has been or is contemporaneously declared and paid or declared and set apart for payment.

***Limitations on Transactions with Affiliates and Insiders***

Certain transactions between financial institutions such as FirstBank and its affiliates are governed by Sections 23A and 23B of the Federal Reserve Act and by Regulation W. An affiliate of a financial institution is any corporation or entity that controls, is controlled by, or is under common control with the financial institution. In a holding company context, the parent bank holding company and any companies which are controlled by such parent bank holding company are affiliates of the financial institution. Generally, Sections 23A and 23B of the Federal Reserve Act (i) limit the extent to which the financial institution or its subsidiaries may engage in covered transactions (defined below) with any one affiliate to an amount equal to 10% of such financial institution s capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such financial institution s capital stock and surplus and (ii) require that all covered transactions be on terms substantially the same, or at least as favorable to the financial institution or affiliate, as those provided to a non-affiliate. The term covered transaction includes the making of loans, purchase of assets, issuance of a guarantee and other similar transactions. In addition, loans or other extensions of credit by the financial institution to the affiliate are required to be collateralized in accordance with the requirements set forth in Section 23A of the Federal Reserve Act. The Dodd-Frank Act added derivatives and securities lending and borrowing transactions to the list of covered transactions subject to Section 23A restrictions.

In addition, Sections 22(h) and (g) of the Federal Reserve Act, implemented through Regulation O, place restrictions on loans to executive officers, directors, and principal stockholders. Under Section 22(h) of the Federal Reserve Act, loans to a director, an executive officer, a greater than 10% stockholder of a financial institution, and certain related interests of these, may not exceed, together with all other outstanding loans to such persons and affiliated interests, the financial institution s loans to one borrower limit, generally equal to 15% of the institution s unimpaired capital and surplus. Section 22(h) of the Federal Reserve Act also requires that loans to directors, executive officers, and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons and also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a financial institution to insiders cannot exceed the institution s unimpaired capital and surplus. Furthermore, Section 22(g) of the Federal Reserve Act places additional restrictions on loans to executive officers.

***Federal Reserve Board Capital Requirements***

The Federal Reserve Board has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve Board capital adequacy guidelines generally require bank holding companies to maintain total capital equal to 8% of total risk-adjusted assets, with at least one-half of that amount consisting of Tier I or core capital and up to one-half of that amount consisting of Tier II or supplementary capital. Tier I capital for bank holding companies generally consists of the sum of common stockholders equity and perpetual preferred stock, subject in the case of the latter to limitations on the kind and amount of such perpetual preferred stock that may be included as Tier I capital, less goodwill and, with certain exceptions, other intangibles. Tier II capital generally consists of hybrid capital instruments, perpetual preferred stock that is not eligible to be included as Tier I capital, term subordinated debt and intermediate-term preferred stock and, subject to limitations, allowances for loan losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no additional capital) for assets such as cash to 100% for the bulk of assets, which are typically held by a bank holding company, including multi-family residential and commercial real estate loans, commercial business loans and commercial loans. Off-balance sheet items also are adjusted to take into account certain risk characteristics.

The federal bank regulatory agencies risk-based capital guidelines for years have been based upon the 1988 capital accord ( Basel I ) of the Basel Committee, a committee of central bankers and bank supervisors from the major industrialized countries. This body develops broad policy guidelines for use by each country s supervisors in determining the supervisory policies they apply. In 2004, it proposed a new capital adequacy framework ( Basel II ) for large, internationally active banking organizations to replace Basel I. Basel II was designed to produce a more risk-sensitive result than its predecessor. However, certain portions of Basel II entail complexities and costs that were expected to preclude their practical application to the majority of U.S. banking organizations that lack the economies of scale needed to absorb the associated expenses.

Effective April 1, 2008, the U.S. federal bank regulatory agencies adopted Basel II for application to certain banking organizations in the United States. The new capital adequacy framework applies to organizations that: (i) have consolidated assets of at least $250 billion; or (ii) have consolidated total on-balance sheet foreign exposures of at least $10 billion; or (iii) are eligible to, and elect to, opt-in to the new framework even though not required to do so under clause (i) or (ii) above; or (iv) as a general matter, are subsidiaries of a bank or bank holding company that uses the new rule. During a two-year phase in period, organizations required or electing to apply Basel II will report their capital adequacy calculations separately under both Basel I and Basel II on a parallel run basis. Given the high thresholds noted above, FirstBank is not required to apply Basel II and does not expect to apply it in the foreseeable future. *See* discussion of Basel III under the Recent Events Affecting the Corporation section.

***Source of Strength Doctrine***

Under provisions in the Dodd-Frank Act, as well as Federal Reserve Board policy and regulation, a bank holding company must serve as a source of financial and managerial strength to each of its subsidiary banks and is expected to stand prepared to commit resources to support each of them. Consistent with this, the Federal Reserve Board has stated that, as a matter of prudent banking, a bank holding company should generally not maintain a given rate of cash dividends unless its net income available to common shareholders has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears to be consistent with the organization s capital needs, asset quality, and overall financial condition.

***Deposit Insurance***

The increase in deposit insurance coverage to up to $250,000 per customer, the FDIC s expanded authority to increase insurance premiums, as well as the recent increase and anticipated additional increase in the number of bank failures have resulted in an increase in deposit insurance assessments for all banks, including FirstBank. The FDIC, absent extraordinary circumstances, is required by law to return the insurance reserve ratio to a 1.15 percent ratio no later than the end of 2013. Citing extraordinary circumstances, the FDIC has extended the time within which the reserve ratio must be restored to 1.15 from five to eight years.

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On February 7, 2011, the FDIC adopted a rule which redefines the assessment base for deposit insurance as required by the Dodd-Frank Act, makes changes to assessment rates, implements the Dodd-Frank Act s Deposit Insurance Fund dividend provisions, and revises the risk-based assessment system for all large insured depository institutions (institutions with at least $10 billion in total assets), such as FirstBank.

If the FDIC is appointed conservator or receiver of a bank upon the bank s insolvency or the occurrence of other events, the FDIC may sell some, part or all of a bank s assets and liabilities to another bank or repudiate or disaffirm most types of contracts to which the bank was a party if the FDIC believes such contract is burdensome. In resolving the estate of a failed bank, the FDIC as receiver will first satisfy its own administrative expenses, and the claims of holders of U.S. deposit liabilities also have priority over those of other general unsecured creditors.

***FDIC Capital Requirements***

The FDIC has promulgated regulations and a statement of policy regarding the capital adequacy of state-chartered non-member banks like FirstBank. These requirements are substantially similar to those adopted by the Federal Reserve Board regarding bank holding companies, as described above.

The regulators require that banks meet a risk-based capital standard. The risk-based capital standard for banks requires the maintenance of total capital (which is defined as Tier I capital and supplementary (Tier 2) capital) to risk-weighted assets of 8%. In determining the amount of risk-weighted assets, weights used (ranging from 0% to 100%) are based on the risks inherent in the type of asset or item. The components of Tier I capital are equivalent to those discussed below under the 3.0% leverage capital standard. The components of supplementary capital include certain perpetual preferred stock, mandatorily convertible securities, subordinated debt and intermediate preferred stock and, generally, allowances for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of capital counted toward supplementary capital cannot exceed 100% of core capital.

The capital regulations of the FDIC establish a minimum 3.0% Tier I capital to total assets requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively will increase the minimum Tier I leverage ratio for such other banks from 4.0% to 5.0% or more. Under these regulations, the highest-rated banks are those that are not anticipating or experiencing significant growth and have well-diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity and good earnings and, in general, are considered a strong banking organization and are rated composite I under the Uniform Financial Institutions Rating System. Leverage or core capital is defined as the sum of common stockholders equity including retained earnings, non-cumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain qualifying supervisory goodwill and certain purchased mortgage servicing rights.

Failure to meet capital guidelines could subject an insured bank to a variety of prompt corrective actions and enforcement remedies under the FDIA (as amended by Federal Deposit Insurance Corporation Improvement Act of 1991 ( FDICIA ), and the Riegle Community Development and Regulatory Improvement Act of 1994), including, with respect to an insured bank, the termination of deposit insurance by the FDIC, and certain restrictions on its business.

Under certain circumstances, a well-capitalized, adequately capitalized or undercapitalized institution may be treated as if the institution were in the next lower capital category. A depository institution is generally prohibited from making capital distributions (including paying dividends), or paying management fees to a holding company if the institution would thereafter be undercapitalized. Institutions that are adequately capitalized but not well-capitalized cannot accept, renew or roll over brokered deposits except with a waiver from the FDIC and are subject to restrictions on the interest rates that can be paid on such deposits. Undercapitalized institutions may not accept, renew or roll over brokered deposits.

The federal bank regulatory agencies are permitted or, in certain cases, required to take certain actions with respect to institutions falling within one of the three undercapitalized categories. Depending on the level of an institution s capital, the agency s corrective powers include, among other things:

- prohibiting the payment of principal and interest on subordinated debt;

- prohibiting the holding company from making distributions without prior regulatory approval;

placing limits on asset growth and restrictions on activities;

placing additional restrictions on transactions with affiliates;

restricting the interest rate the institution may pay on deposits;

prohibiting the institution from accepting deposits from correspondent banks; and
in the most severe cases, appointing a conservator or receiver for the institution.

A banking institution that is undercapitalized is required to submit a capital restoration plan, and such a plan will not be accepted unless, among other things, the banking institution s holding company guarantees the plan up to a certain specified amount. Any such guarantee from a depository institution s holding company is entitled to a priority of payment in bankruptcy.

Although our regulatory capital ratios exceeded the required established minimum capital ratios for a well-capitalized institution as of December 31, 2011 as well as the capital requirements in the Order, because of the Order, FirstBank cannot be regarded as well-capitalized as of December 31, 2011. A bank s capital category, as determined by applying the prompt corrective action provisions of law, however, may not constitute an accurate representation of the overall financial condition or prospects of the Bank, and should be considered in conjunction with other available information regarding financial condition and results of operations.

Set forth below are the Corporation s and FirstBank s capital ratios as of December 31, 2011, based on Federal Reserve and FDIC guidelines, respectively, and the capital ratios required to be attained under the Order:

| | First BanCorp | FirstBank | Well-Capitalized Minimum | Consent Order Minimum |
|---|---|---|---|---|
| **As of December 31, 2011** | | | | |
| Total capital (Total capital to risk-weighted assets) | 17.12% | 16.58% | 10.00% | 12.00% |
| Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) | 15.79% | 15.25% | 6.00% | 10.00% |
| Leverage ratio[(1)] | 11.91% | 11.52% | 5.00% | 8.00% |

(1) Tier 1 capital to average assets.

***Activities and Investments***

The activities as principal and equity investments of FDIC-insured, state-chartered banks such as FirstBank are generally limited to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state-chartered bank generally may not directly or indirectly acquire or retain any equity investments of a type, or in an amount, that is not permissible for a national bank.

***Federal Home Loan Bank System***

FirstBank is a member of the Federal Home Loan Bank (FHLB) system. The FHLB system consists of twelve regional Federal Home Loan Banks governed and regulated by the Federal Housing Finance Agency. The Federal Home Loan Banks serve as reserve or credit facilities for member institutions within their assigned regions. They are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system, and they make loans (advances) to members in accordance with policies and procedures established by the FHLB system and the board of directors of each regional FHLB.

FirstBank is a member of the FHLB of New York (FHLB-NY) and as such is required to acquire and hold shares of capital stock in that FHLB in an amount calculated in accordance with the requirements set forth in applicable laws and regulations. FirstBank is in compliance with the stock ownership requirements of the FHLB-NY. All loans, advances and other extensions of credit made by the FHLB-NY to FirstBank are

secured by a portion of FirstBank s mortgage loan portfolio, certain other investments and the capital stock of the FHLB-NY held by FirstBank.

***Ownership and Control***

Because of FirstBank s status as an FDIC-insured bank, as defined in the Bank Holding Company Act, First BanCorp, as the owner of FirstBank s common stock, is subject to certain restrictions and disclosure obligations under various federal laws, including the Bank Holding Company Act and the Change in Bank Control Act (the

CBCA ). Regulations pursuant to the Bank Holding Company Act generally require prior Federal Reserve Board approval for an acquisition of control of an insured institution (as defined in the Act) or holding company thereof by any person (or persons acting in concert). Control is deemed to exist if, among other things, a person (or persons acting in concert) acquires more than 25% of any class of voting stock of an insured institution or holding company thereof. Under the CBCA, control is presumed to exist subject to rebuttal if a person (or persons acting in concert) acquires more than 10% of any class of voting stock and either (i) the corporation has registered securities under Section 12 of the Securities Exchange Act of 1934, or (ii) no person will own, control or hold the power to vote a greater percentage of that class of voting securities immediately after the transaction. The concept of acting in concert is very broad and also is subject to certain rebuttable presumptions, including among others, that relatives, business partners, management officials, affiliates and others are presumed to be acting in concert with each other and their businesses. The regulations of the FDIC implementing the CBCA are generally similar to those described above.

The Puerto Rico Banking Law requires the approval of the OCIF for changes in control of a Puerto Rico bank. See Puerto Rico Banking Law.

***Standards for Safety and Soundness***

The FDIA, as amended by FDICIA and the Riegle Community Development and Regulatory Improvement Act of 1994, requires the FDIC and the other federal bank regulatory agencies to prescribe standards of safety and soundness, by regulations or guidelines, relating generally to operations and management, asset growth, asset quality, earnings, stock valuation, and compensation. The FDIC and the other federal bank regulatory agencies adopted, effective August 9, 1995, a set of guidelines prescribing safety and soundness standards pursuant to FDIA, as amended. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder.

***Brokered Deposits***

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well-capitalized institutions are not subject to limitations on brokered deposits, while adequately-capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the interest paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits. The Order requires FirstBank to obtain FDIC approval prior to issuing, increasing, renewing or rolling over brokered CDs and to develop a plan to reduce its reliance on brokered CDs. The FDIC has issued temporary approvals permitting FirstBank to renew and/or roll over certain amounts of brokered CDs maturing through March 31, 2012. FirstBank will continue to request approvals for future periods in a manner consistent with its plan to reduce its reliance on brokered CDs.

***Puerto Rico Banking Law***

As a commercial bank organized under the laws of the Commonwealth, FirstBank is subject to supervision, examination and regulation by the Commonwealth of Puerto Rico Commissioner of Financial Institutions ( Commissioner ) pursuant to the Puerto Rico Banking Law of 1933, as amended (the Banking Law ). The Banking Law contains provisions governing the incorporation and organization, rights and responsibilities of directors, officers and stockholders as well as the corporate powers, lending limitations, capital requirements, investment requirements and other aspects of FirstBank and its affairs. In addition, the Commissioner is given extensive rule-making power and administrative discretion under the Banking Law.

The Banking Law authorizes Puerto Rico commercial banks to conduct certain financial and related activities directly or through subsidiaries, including the leasing of personal property and the operation of a small loan business.

The Banking Law requires every bank to maintain a legal reserve which shall not be less than twenty percent (20%) of its demand liabilities, except government deposits (federal, state and municipal) that are secured by actual

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collateral. The reserve is required to be composed of any of the following securities or combination thereof: (1) legal tender of the United States; (2) checks on banks or trust companies located in any part of Puerto Rico that are to be presented for collection during the day following the day on which they are received; (3) money deposited in other banks provided said deposits are authorized by the Commissioner and subject to immediate collection; (4) federal funds sold to any Federal Reserve Bank and securities purchased under agreements to resell executed by the bank with such funds that are subject to be repaid to the bank on or before the close of the next business day; and (5) any other asset that the Commissioner identifies from time to time.

The Banking Law permits Puerto Rico commercial banks to make loans to any one person, firm, partnership or corporation, up to an aggregate amount of fifteen percent (15%) of the sum of: (i) the bank s paid-in capital; (ii) the bank s reserve fund; (iii) 50% of the bank s retained earnings, subject to certain limitations; and (iv) any other components that the Commissioner may determine from time to time. If such loans are secured by collateral worth at least twenty five percent (25%) more than the amount of the loan, the aggregate maximum amount may reach one third (33.33%) of the sum of the bank s paid-in capital, reserve fund, 50% of retained earnings and such other components that the Commissioner may determine from time to time. There are no restrictions under the Banking Law on the amount of loans that are wholly secured by bonds, securities and other evidence of indebtedness of the Government of the United States, or of the Commonwealth of Puerto Rico, or by bonds, not in default, of municipalities or instrumentalities of the Commonwealth of Puerto Rico. The revised classification of the mortgage-related transactions as secured commercial loans to local financial institutions described in the Corporation s restatement of previously issued financial statements (Form 10-K/A for the fiscal year ended December 31, 2004) caused the mortgage-related transactions to be treated as two secured commercial loans in excess of the lending limitations imposed by the Banking Law. In this regard, FirstBank received a ruling from the Commissioner that results in FirstBank being considered in continued compliance with the lending limitations. The Puerto Rico Banking Law authorizes the Commissioner to determine other components which may be considered for purposes of establishing its lending limit, which components may lie outside the statutory lending limit elements mandated by Section 17. After consideration of other components, the Commissioner authorized the Corporation to retain the secured loans to the two financial institutions as it believed that these loans were secured by sufficient collateral to diversify, disperse and significantly diffuse the risks connected to such loans thereby satisfying the safety and soundness considerations mandated by Section 28 of the Banking Law. In July 2009, FirstBank entered into a transaction with one of the institutions to purchase $205 million in mortgage loans that served as collateral to the loan to this institution.

The Banking Law prohibits Puerto Rico commercial banks from making loans secured by their own stock, and from purchasing their own stock, unless such purchase is made pursuant to a stock repurchase program approved by the Commissioner or is necessary to prevent losses because of a debt previously contracted in good faith. The stock purchased by the Puerto Rico commercial bank must be sold by the bank in a public or private sale within one year from the date of purchase.

The Banking Law provides that no officers, directors, agents or employees of a Puerto Rico commercial bank may serve as an officer, director, agent or employee of another Puerto Rico commercial bank, financial corporation, savings and loan association, trust corporation, corporation engaged in granting mortgage loans or any other institution engaged in the money lending business in Puerto Rico. This prohibition is not applicable to the affiliates of a Puerto Rico commercial bank.

The Banking Law requires that Puerto Rico commercial banks prepare each year a balance summary of their operations, and submit such balance summary for approval at a regular meeting of stockholders, together with an explanatory report thereon. The Banking Law also requires that at least ten percent (10%) of the yearly net income of a Puerto Rico commercial bank be credited annually to a reserve fund. This credit is required to be done every year until such reserve fund shall be equal to the total paid-in-capital of the bank.

The Banking Law also provides that when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts shall be charged against the undistributed profits of the bank, and the balance, if any, shall be charged against the reserve fund, as a reduction thereof. If there is no reserve fund sufficient to cover such balance in whole or in part, the outstanding amount shall be charged against the capital account and no dividend shall be declared until said capital has been restored to its original amount and the reserve fund to twenty percent (20%) of the original capital.

The Banking Law requires the prior approval of the Commissioner with respect to a transfer of capital stock of a bank that results in a change of control of the bank. Under the Banking Law, a change of control is presumed to

occur if a person or a group of persons acting in concert, directly or indirectly, acquire more than 5% of the outstanding voting capital stock of the bank. The Commissioner has interpreted the restrictions of the Banking Law as applying to acquisitions of voting securities of entities controlling a bank, such as a bank holding company. Under the Banking Law, the determination of the Commissioner whether to approve a change of control filing is final and non-appealable.

The Finance Board, which is composed of the Commissioner, the Secretary of the Treasury, the Secretary of Commerce, the Secretary of Consumer Affairs, the President of the Economic Development Bank, the President of the Government Development Bank, and the President of the Planning Board, has the authority to regulate the maximum interest rates and finance charges that may be charged on loans to individuals and unincorporated businesses in Puerto Rico. The current regulations of the Finance Board provide that the applicable interest rate on loans to individuals and unincorporated businesses, including real estate development loans but excluding certain other personal and commercial loans secured by mortgages on real estate properties, is to be determined by free competition. Accordingly, the regulations do not set a maximum rate for charges on retail installment sales contracts, small loans, and credit card purchases and set aside previous regulations which regulated these maximum finance charges. Furthermore, there is no maximum rate set for installment sales contracts involving motor vehicles, commercial, agricultural and industrial equipment, commercial electric appliances and insurance premiums.

***International Banking Act of Puerto Rico (  IBE Act  )***

The business and operations of FirstBank International Branch (  FirstBank IBE,  the IBE division of FirstBank) and FirstBank Overseas Corporation (the IBE subsidiary of FirstBank) are subject to supervision and regulation by the Commissioner. Under the IBE Act, certain sales, encumbrances, assignments, mergers, exchanges or transfers of shares, interests or participation(s) in the capital of an international banking entity (an  IBE  ) may not be initiated without the prior approval of the Commissioner. The IBE Act and the regulations issued thereunder by the Commissioner (the  IBE Regulations  ) limit the business activities that may be carried out by an IBE. Such activities are limited in part to persons and assets located outside of Puerto Rico.

Pursuant to the IBE Act and the IBE Regulations, each of FirstBank IBE and FirstBank Overseas Corporation must maintain books and records of all its transactions in the ordinary course of business. FirstBank IBE and FirstBank Overseas Corporation are also required thereunder to submit to the Commissioner quarterly and annual reports of their financial condition and results of operations, including annual audited financial statements.

The IBE Act empowers the Commissioner to revoke or suspend, after notice and hearing, a license issued thereunder if, among other things, the IBE fails to comply with the IBE Act, the IBE Regulations or the terms of its license, or if the Commissioner finds that the business or affairs of the IBE are conducted in a manner that is not consistent with the public interest.

***Puerto Rico Income Taxes***

On January 31, 2011, the Puerto Rico Government approved Act No. 1, which repealed the 1994 Code (  1994 PR Code  ) and replaces it with the Puerto Rico Internal Revenue Code of 2011 (  2011 PR Code  ). The provisions of the 2011 PR Code are generally applicable to taxable years commencing after December 31, 2010. Under the 2011 PR Code, the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operation loss, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carry forward period (7 years under the 2011 PR Code for losses incurred during tax year, except for losses incurred during tax years commenced after December 31, 2004 and before December 31, 2012 that the carryforward period is extended to 10 years). The 2011 PR Code provides a dividend received deduction of 100% on dividends received from  controlled  subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations. Dividend payments from a U.S. subsidiary to the Corporation are subject to a 10% withholding tax based on the provisions of the U.S. Internal Revenue Code.

Under the 2011 PR Code, First BanCorp is subject to a maximum statutory tax rate of 30% (25% for taxable years commencing after December 31, 2013 if certain economic conditions are met by the Puerto Rico economy). The 2011 PR Code also includes an alternative minimum tax of 20% that applies if the Corporation  s regular income tax liability is less than the alternative minimum tax requirements. Prior to the 2011 PR Code, First BanCorp maximum statutory tax rate was 39% except for tax years commenced after December 31, 2008 and before January 1, 2012 which was 40.95% due to the approval by the Puerto Rico Government of Act No. 7 (the  Act  ), to stimulate Puerto Rico  s economy and to reduce the Puerto Rico Government  s fiscal deficit. The act imposed a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which was applicable to corporation, among others, whose combined income exceeds $100,000, effectively resulting in an increased in the maximum statutory tax rate from 39% to 40.95% and an increase in capital gain statutory tax rate from 15% to 15.75%.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through International Banking Entity ( IBE ) of the Bank and through the Bank s subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales in exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which the Act No. 7 imposed a special 5% tax to all IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs net income exceeds 20% of the bank s total net taxable income.

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***United States Income Taxes***

The Corporation is also subject to federal income tax on its income from sources within the United States and on any item of income that is, or is considered to be, effectively connected with the active conduct of a trade or business within the United States. The U.S. Internal Revenue Code provides for tax exemption of portfolio interest received by a foreign corporation from sources within the United States; therefore, the Corporation is not subject to federal income tax on certain U.S. investments which qualify under the term portfolio interest .

***Insurance Operations Regulation***

FirstBank Insurance Agency is registered as an insurance agency with the Insurance Commissioner of Puerto Rico and is subject to regulations issued by the Insurance Commissioner relating to, among other things, licensing of employees, sales, solicitation and advertising practices, and by the FED as to certain consumer protection provisions mandated by the GLB Act and its implementing regulations.

***Community Reinvestment***

Under the Community Reinvestment Act ( CRA ), federally insured banks have a continuing and affirmative obligation to meet the credit needs of their entire community, including low- and moderate-income residents, consistent with their safe and sound operation. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution s discretion to develop the type of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the federal supervisory agencies, as part of the general examination of supervised banks, to assess the bank s record of meeting the credit needs of its community, assign a performance rating, and take such record and rating into account in their evaluation of certain applications by such bank. The CRA also requires all institutions to make public disclosure of their CRA ratings. FirstBank received a satisfactory CRA rating in its most recent examination by the FDIC.

***Mortgage Banking Operations***

FirstBank is subject to the rules and regulations of the FHA, VA, FNMA, FHLMC, HUD and GNMA with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines that include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts, and with respect to VA loans, fix maximum interest rates. Moreover, lenders such as FirstBank are required annually to submit to FHA, VA, FNMA, FHLMC, GNMA and HUD audited financial statements, and each regulatory entity has its own financial requirements. FirstBank s affairs are also subject to supervision and examination by FHA, VA, FNMA, FHLMC, GNMA and HUD at all times to assure

compliance with the applicable regulations, policies and procedures. Mortgage origination activities are subject to, among others, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act, and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder which, among other things, prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. FirstBank is licensed by the Commissioner under the Puerto Rico Mortgage Banking Law, and as such is subject to regulation by the Commissioner, with respect to, among other things, licensing requirements and establishment of maximum origination fees on certain types of mortgage loan products.

Section 5 of the Puerto Rico Mortgage Banking Law requires the prior approval of the Commissioner for the acquisition of control of any mortgage banking institution licensed under such law. For purposes of the Puerto Rico Mortgage Banking Law, the term control means the power to direct or influence decisively, directly or indirectly, the management or policies of a mortgage banking institution. The Puerto Rico Mortgage Banking Law provides that a transaction that results in the holding of less than 10% of the outstanding voting securities of a mortgage banking institution shall not be considered a change in control.

**Item 1A.** ***Risk Factors***

**RISK RELATING TO THE CORPORATION S BUSINESS**

***FirstBank is operating under the order dated June 2, 2010 that FirstBank entered into with the FDIC and OCIF and we are operating under the written agreement dated June 3, 2010 entered into with the FED.***

On June 4, 2010, we announced that FirstBank agreed to the FDIC Order, dated as of June 2, 2010, issued by the FDIC and OCIF, and we entered into the Agreement, dated as of June 3, 2010, with the Federal Reserve. The Agreements stemmed from the FDIC s examination as of the period ended June 30, 2009 conducted during the second half of 2009. Although our regulatory capital ratios exceeded the required established minimum capital ratios for a well-capitalized institution as of December 31, 2011 and complied with the capital ratios required by the FDIC Order and we raised $525 million in the capital raise, FirstBank cannot be regarded as well-capitalized as of December 31, 2011 because of the FDIC Order.

Under the FDIC Order, FirstBank has agreed to address specific areas of concern to the FDIC and OCIF through the adoption and implementation of procedures, plans and policies designed to improve the safety and soundness of FirstBank. These actions include, among others: (1) having and retaining qualified management; (2) increased participation in the affairs of FirstBank by its board of directors; (3) development and implementation by FirstBank of a capital plan to attain a leverage ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 10% and a total risk-based capital ratio of at least 12%; (4) adoption and implementation of strategic, liquidity and fund management and profit and budget plans and related projects within certain timetables set forth in the Order and on an ongoing basis; (5) adoption and implementation of plans for reducing FirstBank s positions in certain classified assets and delinquent and non-accrual loans; (6) refraining from lending to delinquent or classified borrowers already obligated to FirstBank on any extensions of credit so long as such credit remains uncollected, except where FirstBank s failure to extend further credit to a particular borrower would be detrimental to the best interests of FirstBank, and any such additional credit is approved by FirstBank s board of directors; (7) refraining from accepting, increasing, renewing or rolling over brokered CDs without the prior written approval of the FDIC; (8) establishment of a comprehensive policy and methodology for determining the allowance for loan and lease losses and the review and revision of FirstBank s loan policies, including the non-accrual policy; and (9) adoption and implementation of adequate and effective programs of independent loan review, appraisal compliance and an effective policy for managing FirstBank s sensitivity to interest rate risk.

The Written Agreement, which is designed to enhance our ability to act as a source of strength to FirstBank, requires that we obtain prior Federal Reserve approval before declaring or paying dividends, receiving dividends from FirstBank, making payments on subordinated debt or trust preferred securities, incurring, increasing or guaranteeing debt (whether such debt is incurred, increased or guaranteed, directly or indirectly, by us or any of our non-banking subsidiaries) or purchasing or redeeming any capital stock. The Written Agreement also requires us to submit to the Federal Reserve a capital plan and progress reports, comply with certain notice provisions prior to appointing new directors or senior executive officers and comply with certain payment restrictions on severance payments and indemnification restrictions.

We anticipate that we will need to continue to dedicate significant resources to our efforts to comply with the Agreements, which may increase operational costs or adversely affect the amount of time our management has to conduct our operations. If we need to continue to recognize significant reserves, we and FirstBank may not be able to continue to comply with the minimum capital requirements included in the capital plans required by the Agreements.

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If we fail to comply with the Agreements in the future, we may become subject to additional regulatory enforcement action up to and including the appointment of a conservator or receiver for FirstBank.

***We have experienced net losses for eleven consecutive quarters and there is no assurance that our high level of non-performing loans will not adversely affect our results from operations.***

We have not realized net income since the quarter ended March 31, 2009. Furthermore, even though our level of non-performing loans has decreased for seven consecutive quarters, we still have $1.14 billion in non-performing loans. This $1.14 billion in non-performing loans represents approximately 10.78% of our $10.56 billion loans held for investment portfolio. Consequently, this high level of non-performing loans may continue to adversely affect our results of operations.

***Certain funding sources may not be available to us and our funding sources may prove insufficient and/or costly to replace.***

FirstBank relies primarily on its issuance of brokered CDs, as well as customer deposits and advances from the Federal Home Loan Bank, to maintain its lending activities and to replace certain maturing liabilities. As of December 31, 2011, we had $3.7 billion in brokered CDs outstanding, representing approximately 38% of our total deposits, and a reduction of $2.5 billion from year end 2010. Approximately $2.5 billion in brokered CDs mature in 2012, and the average term to maturity of the retail brokered CDs outstanding as of December 31, 2011 was approximately 0.8 year. Approximately 0.7% of the principal value of these CDs is callable at our option.

Although FirstBank has historically been able to replace maturing deposits and advances, we may not be able to replace these funds in the future if our financial condition or general market conditions were to change or the FDIC did not approve our request to issue brokered CDs as required by the Order. The Order requires FirstBank to obtain FDIC approval prior to issuing, increasing, renewing or rolling over brokered CDs and to develop a plan to reduce its reliance on brokered CDs. Although the FDIC has issued temporary approvals permitting FirstBank to renew and/or roll over certain amounts of brokered CDs maturing in the past and we have received approval from the FDIC to renew and/or roll over certain amounts of brokered CDs through March 31, 2012, the FDIC may not continue to issue such approvals, even if the requests are consistent with our plans to reduce the reliance on brokered CDs, and, even if issued, such approvals may not be for amounts of brokered CDs sufficient for FirstBank to meet its funding needs. The use of brokered CDs has been particularly important for the funding of our operations. If we are unable to issue brokered CDs, or are unable to maintain access to our other funding sources, our results of operations and liquidity would be adversely affected.

Alternate sources of funding may carry higher costs than sources currently utilized. If we are required to rely more heavily on more expensive funding sources, profitability would be adversely affected. Although we consider currently available funding sources to be adequate for our liquidity needs, we may seek additional debt financing in the future to achieve our long-term business objectives. Any additional debt financing requires the prior approval from the Federal Reserve, and the Federal Reserve may not approve such additional debt. Additional borrowings, if sought, may not be available to us or on acceptable terms. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit, our credit ratings and our credit capacity. If additional financing sources are unavailable or are not available on acceptable terms, our profitability and future prospects could be adversely affected.

***We depend on cash dividends from FirstBank to meet our cash obligations.***

As a holding company, dividends from FirstBank have provided a substantial portion of our cash flow used to service the interest payments on our trust preferred securities and other obligations. As outlined in the Written Agreement, we cannot receive any cash dividends from FirstBank without prior written approval of the Federal Reserve. In addition, FirstBank is limited by law in its ability to make dividend payments and other distributions to us based on their earnings and capital position. Our inability to receive approval from the Federal Reserve to receive dividends from FirstBank or FirstBank s failure to generate sufficient cash flow to make dividend payments to us, may adversely affect our ability to meet all projected cash needs in the ordinary course of business and may have a detrimental impact on our financial condition.

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***We cannot pay interest, principal or other sums on subordinated debentures or trust preferred securities without prior Federal Reserve approval, which could result in a default.***

The Written Agreement provides that we cannot declare or pay any dividends or make any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities without prior written approval of the Federal Reserve. With respect to our $231.9 million of outstanding subordinated debentures, we had elected to defer the interest payments that were due between September 2010 and September 2011. Although we recently obtained approval from the Federal Reserve to make all distributions of interest for interest extension periods previously deferred and to pay the December 2011 interest payment, future interest payments are subject to Federal Reserve approval. The Corporation elected to defer the interest payments due in March 2012.

Under the indentures, we have the right, from time to time, and without causing an event of default, to defer payments of interest on the subordinated debentures by extending the interest payment period at any time and from time to time during the term of the subordinated debentures for up to twenty consecutive quarterly periods. We may elect extension periods for future quarterly interest payments if the Federal Reserve advises us that it will not approve such future quarterly interest payments. Our inability to receive approval from the Federal Reserve to make distributions of interest, principal or other sums on our trust preferred securities and subordinated debentures could result in a default under those obligations if we need to defer such payments for longer than twenty consecutive quarterly periods.

***Credit quality may result in additional losses.***

The quality of our credits has continued to be under pressure as a result of continued recessionary conditions in the markets we serve that have led to, among other things, higher unemployment levels, much lower absorption rates for new residential construction projects and further declines in property values. Our business depends on the creditworthiness of our customers and counterparties and the value of the assets securing our loans or underlying our investments. When the credit quality of the customer base materially decreases or the risk profile of a market, industry or group of customers changes materially, our business, financial condition, allowance levels, asset impairments, liquidity, capital and results of operations are adversely affected.

We have a significant construction loan portfolio held for investment, in the amount of $427.9 million as of December 31, 2011, mostly secured by commercial and residential real estate properties. Due to their nature, these loans entail a higher credit risk than consumer and residential mortgage loans, since they are larger in size, concentrate more risk in a single borrower and are generally more sensitive to economic downturns. Although we ceased new originations of construction loans, decreasing collateral values, difficult economic conditions and numerous other factors continue to create volatility in the housing markets and have increased the possibility that additional losses may have to be recognized with respect to our current nonperforming assets. Furthermore, given the slowdown in the real estate market, the properties securing these loans may be difficult to dispose of if they are foreclosed. Although we have taken a number of steps to reduce our credit exposure, as of December 31, 2011, we still had $250.0 million in nonperforming construction loans held for investment and it is possible that we will continue to incur credit losses over the near term, which would adversely impact our overall financial performance and results of operations.

***Our allowance for loan losses may not be adequate to cover actual losses, and we may be required to materially increase our allowance, which may adversely affect our capital, financial condition and results of operations.***

We are subject to the risk of loss from loan defaults and foreclosures with respect to the loans we originate and purchase. We establish a provision for loan losses, which leads to reductions in our income from operations, in order to maintain our allowance for inherent loan losses at a level which our management deems to be appropriate based upon an assessment of the quality of the loan portfolio. Although management strives to utilize its best judgment in providing for loan losses, management may fail to accurately estimate the level of inherent loan losses or may have to increase our provision for loan losses in the future as a result of new information regarding existing loans, future increases in non-performing loans, changes in economic and other conditions affecting borrowers or for other reasons beyond our control. In addition, bank regulatory agencies periodically review the adequacy of our allowance for loan losses and may require an increase in the provision for loan losses or the recognition of additional classified loans and loan charge-offs, based on judgments different than those of management.

While we have substantially increased our allowance for loan and lease losses over the past few years, we may have to continue to recognize additional provisions to cover future credit losses in the portfolio. The level of the allowance reflects management s estimates based upon various assumptions and judgments as to specific credit risks, evaluation of industry concentrations, loan loss experience, current loan portfolio quality, present economic,

political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan and lease losses inherently involves a high degree of subjectivity and requires management to make significant estimates and judgments regarding current credit risks and future trends, all of which may undergo material changes. If our estimates prove to be incorrect, our allowance for credit losses may not be sufficient to cover losses in our loan portfolio and our expense relating to the additional provision for credit losses could increase substantially.

Any such increases in our provision for loan losses or any loan losses in excess of our provision for loan losses would have an adverse effect on our future financial condition and results of operations. Given the difficulties facing some of our largest borrowers, these borrowers may fail to continue to repay their loans on a timely basis or we may not be able to assess accurately any risk of loss from the loans to these borrowers.

***Changes in collateral values of properties located in stagnant or distressed economies may require increased reserves.***

Substantially all of our loan portfolio is located within the boundaries of the U.S. economy. Whether the collateral is located in Puerto Rico, the USVI, the BVI or the U.S. mainland, the performance of our loan portfolio and the collateral value backing the transactions are dependent upon the performance of and conditions within each specific real estate market. Puerto Rico entered its sixth-straight year of economic recession in March 2011. Sustained weak economic conditions that have affected Puerto Rico and the United States over the last several years have resulted in declines in collateral values. We measure the impairment based on the fair value of the collateral, if collateral dependent, which is generally obtained from appraisals. Updated appraisals are obtained when we determine that loans are impaired and are updated annually thereafter. In addition, appraisals are also obtained for certain residential mortgage loans on a spot basis based on specific characteristics such as delinquency levels, age of the appraisal and loan-to-value ratios. The appraised value of the collateral may decrease or we may not be able to recover collateral at its appraised value. A significant decline in collateral valuations for collateral dependent loans may require increases in our specific provision for loan losses and an increase in the general valuation allowance. Any such increase would have an adverse effect on our future financial condition and results of operations.

***Interest rate shifts may reduce net interest income.***

Shifts in short-term interest rates may reduce net interest income, which is the principal component of our earnings. Net interest income is the difference between the amounts received by us on our interest-earning assets and the interest paid by us on our interest-bearing liabilities. Differences in the re-pricing structure of our assets and liabilities may result in changes in our profits when interest rates change.

***Increases in interest rates may reduce the value of holdings of securities.***

Fixed-rate securities acquired by us are generally subject to decreases in market value when interest rates rise, which may require recognition of a loss (e.g., the identification of an other-than-temporary impairment on our available-for-sale investments portfolio), thereby adversely affecting our results of operations. Market-related reductions in value also influence our ability to finance these securities.

***Increases in interest rates may reduce demand for mortgage and other loans.***

Higher interest rates increase the cost of mortgage and other loans to consumers and businesses and may reduce demand for such loans, which may negatively impact our profits by reducing the amount of loan interest income.

***Accelerated prepayments may adversely affect net interest income.***

Net interest income of future periods will be affected by our decision to deleverage our investment securities portfolio to preserve our capital position. Also, net interest income could be affected by prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration in the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by our investment in callable securities.

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***Changes in net interest income due to basis risk.***

Basis risk is the risk of adverse consequences resulting from unequal changes in the difference, also referred to as the spread, between two or more rates for different instruments with the same maturity and occurs when market rates for different financial instruments or the indices used to price assets and liabilities change at different times or by different amounts. The interest expense for liability instruments such as brokered CDs may change by the same amount as interest income received from loans or investments. To the extent that the interest rates on loans and borrowings change at different speeds and by different amounts, the margin between our LIBOR-based assets and the higher cost of the brokered CDs may compress and adversely affect net interest income.

***If all or a significant portion of the unrealized losses in our investment securities portfolio on our consolidated balance sheet is determined to be other-than-temporarily impaired, we would recognize a material charge to our earnings and our capital ratios would be adversely affected.***

For the years ended December 31, 2009 and 2010, and 2011, we recognized a total of $1.7 million, $1.2 million, and $2.0 million, respectively, in other-than-temporary impairments. To the extent that any portion of the unrealized losses in our investment securities portfolio is determined to be other-than-temporary and, in the case of debt securities, the loss is related to credit factors, we would recognize a charge to earnings in the quarter during which such determination is made and capital ratios could be adversely affected. Even if we do not determine that the unrealized losses associated with this portfolio require an impairment charge, increases in these unrealized losses adversely affect our tangible common equity ratio, which may adversely affect credit rating agency and investor sentiment towards us. This negative perception also may adversely affect our ability to access the capital markets or might increase our cost of capital. Valuation and other-than-temporary impairment determinations will continue to be affected by external market factors including default rates, severity rates and macro-economic factors.

***Downgrades in our credit ratings could further increase the cost of borrowing funds.***

The Corporation s ability to access new non-deposit sources of funding could be adversely affected by downgrades in our credit ratings. The Corporation s liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation s current credit ratings and any downgrades in such credit ratings can hinder the Corporation s access to external funding and/or cause external funding to be more expensive, which could in turn adversely affect results of operations. Also, changes in credit ratings may further affect the fair value of certain liabilities and unsecured derivatives that consider the Corporation s own credit risk as part of the valuation.

***Our controls and procedures may fail or be circumvented, our risk management policies and procedures may be inadequate and operational risk could adversely affect our consolidated results of operations.***

We may fail to identify and manage risks related to a variety of aspects of our business, including, but not limited to, operational risk, interest-rate risk, trading risk, fiduciary risk, legal and compliance risk, liquidity risk and credit risk. We have adopted and periodically improved various controls, procedures, policies and systems to monitor and manage risk. Any improvements to our controls, procedures, policies and systems, however, may not be adequate to identify and manage the risks in our various businesses. If our risk framework is ineffective, either because it fails to keep pace with changes in the financial markets or our businesses or for other reasons, we could incur losses or suffer reputational damage or find ourselves out of compliance with applicable regulatory mandates or expectations.

We may also be subject to disruptions from external events that are wholly or partially beyond our control, which could cause delays or disruptions to operational functions, including information processing and financial market settlement functions. In addition, our customers, vendors and counterparties could suffer from such events. Should these events affect us, or the customers, vendors or counterparties with which we conduct business, our consolidated results of operations could be negatively affected. When we record balance sheet reserves for probable loss contingencies related to operational losses, we may be unable to accurately estimate our potential exposure, and any reserves we establish to cover operational losses may not be sufficient to cover our actual financial exposure, which may have a material impact on our consolidated results of operations or financial condition for the periods in which we recognize the losses.

***Competition for our employees is intense, and we may not be able to attract and retain the highly skilled people we need to support our business.***

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities in which we engage can be intense, and we may not be able to hire people or retain them, particularly in light of uncertainty concerning evolving compensation restrictions applicable to banks but not applicable to other financial services firms. The unexpected loss of services of one or more of our key personnel

could adversely affect our business because of the loss of their skills, knowledge of our markets and years of industry experience and, in some cases, because of the difficulty of promptly finding qualified replacement personnel. Similarly, the loss of key employees, either individually or as a group, can adversely affect our customers perception of our ability to continue to manage certain types of investment management mandates.

***Further increases in the FDIC deposit insurance premium or in FDIC required reserves may have a significant financial impact on us.***

The FDIC insures deposits at FDIC-insured depository institutions up to certain limits. The FDIC charges insured depository institutions premiums to maintain the Deposit Insurance Fund (the DIF ). Current economic conditions during the last few years have resulted in higher bank failures and expectations of future bank failures. In the event of a bank failure, the FDIC takes control of a failed bank and ensures payment of deposits up to insured limits (which have recently been increased) using the resources of the DIF. The FDIC is required by law to maintain adequate funding of the DIF, and the FDIC may increase premium assessments to maintain such funding.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act ) signed into law on July 21, 2010 requires the FDIC to increase the DIF s reserves against future losses, which will necessitate increased deposit insurance premiums that are to be borne primarily by institutions with assets of greater than $10 billion. On October 19, 2010, the FDIC addressed plans to bolster the DIF by increasing the required reserve ratio for the industry to 1.35 percent (ratio of reserves to insured deposits) by September 30, 2020, as required by the Dodd-Frank Act. The FDIC also proposed to raise its industry target ratio of reserves to insured deposits to 2 percent, 65 basis points above the statutory minimum, but the FDIC does not project that goal to be met until 2027.

The FDIC has recently approved two rules that amend its deposit insurance assessment regulations. The first rule implements a provision in the Dodd-Frank Act that changes the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average Tier 1 capital. The rule also changes the assessment rate schedules for insured depository institutions so that approximately the same amount of revenue would be collected under the new assessment base as would be collected under the current rate schedule and the schedules previously proposed by the FDIC. The second rule revises the risk-based assessment system for all large insured depository institutions (generally, institutions with at least $10 billion in total assets, such as FirstBank). Under the rule, the FDIC uses a scorecard method to calculate assessment rates for all such institutions.

The FDIC may further increase FirstBank s premiums or impose additional assessments or prepayment requirements in the future. The Dodd-Frank Act has removed the statutory cap for the reserve ratio, leaving the FDIC free to set this cap going forward.

***Losses in the value of investments in entities that the Corporation does not control could have an adverse effect on the Corporation s financial condition or results of operations.***

The corporation has investments in entities that it does not control, including a 35% subordinated ownership interest in CPG/GS PR NPL, LLC ( CPG/GS ), organized under the laws of the Commonwealth of Puerto Rico. CPG/GS is seeking to maximize the recovery of its investment in loans that it acquired from Firstbank. The Corporation s 35% interest in CPG/GS is subordinated to the interest of the majority investor in CPG/GS, which is entitled to recover its investment and receive a priority 12% return on its invested capital. The Corporation s equity interest of $43.4 million is also subordinated to the aggregate amount of its loans to CPG/GS in the amount of $201.2 million as of December 31, 2011.

The Corporation s interests in CPG/GS and other entities that it does not control preclude it from exercising control over the business strategy or other operational aspects of these entities. The Corporation cannot provide assurance that these entities will operate in a manner that will increase the value of the Corporation s investments, that the Corporation s proportionate share of income or losses from these entities will continue at the current level in the future or that the Corporation will not incur losses from the holding of such investments. Losses in the values of such investments could adversely affect the Corporation s results of operations.

***We may not be able to recover all assets pledged to Lehman Brothers Special Financing, Inc.***

Lehman Brothers Special Financing, Inc. ( Lehman ) was the counterparty to First BanCorp on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to us, which constituted an event of default under those interest rate swap agreements. We terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement due as of December 31, 2011 under the swap agreements, we have an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately $1.4 million. This exposure was reserved in the third quarter of 2008. We had pledged collateral of $63.6 million with Lehman to guarantee our performance under the swap agreements in the event payment thereunder was required.

The book value of pledged securities with Lehman as of December 31, 2011 amounted to approximately $64.5 million. We believe that the securities pledged as collateral should not be part of the Lehman bankruptcy estate given the facts that the posted collateral constituted a performance guarantee under the swap agreements and was not part of a financing agreement, and that ownership of the securities was never transferred to Lehman. Upon termination of the interest rate swap agreements, Lehman s obligation was to return the collateral to us. During the fourth quarter of 2009, we discovered that Lehman Brothers, Inc., acting as agent of Lehman, had deposited the securities in a custodial account at JP Morgan Chase, and that, shortly before the filing of the Lehman bankruptcy proceedings, it had provided instructions to have most of the securities transferred to Barclays Capital ( Barclays ) in New York. After Barclays s refusal to turn over the securities, during December 2009, we filed a lawsuit against Barclays in federal court in New York demanding the return of the securities. During February 2010, Barclays filed a motion with the court requesting that our claim be dismissed on the grounds that the allegations of the complaint are not sufficient to justify the granting of the remedies therein sought. Shortly thereafter, we filed our opposition motion. A hearing on the motions was held in court on April 28, 2010. The court, on that date, after hearing the arguments by both sides, concluded that our equitable-based causes of action, upon which the return of the investment securities is being demanded, contain allegations that sufficiently plead facts warranting the denial of Barclays motion to dismiss our claim. Accordingly, the judge ordered the case to proceed to trial.

Subsequent to the court decision, the district court judge transferred the case to the Lehman bankruptcy court for trial. Upon such transfer, the Bankruptcy court began to entertain the pre-trial procedures including discovery of evidence. In this regard, an initial scheduling conference was held before the United States Bankruptcy Court for the Southern District of New York on November 17, 2010, at which time a proposed case management plan was approved. Discovery has commenced pursuant to that case management plan and is currently scheduled for completion by March 31, 2012, but this timing is subject to adjustment. While we believe we have valid reasons to support our claim for the return of the securities, we may not succeed in our litigation against Barclays to recover all or a substantial portion of the securities.

Additionally, we continue to pursue our claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to Lehman Brothers Incorporated in Bankruptcy Court, Southern District of New York. An estimated loss was not accrued as we are unable to determine the timing of the claim resolution or whether we will succeed in recovering all or a substantial portion of the collateral or its equivalent value. If additional relevant negative facts become available in future periods, a need to recognize a partial or full reserve of this claim may arise. Considering that the investment securities have not yet been recovered by us, despite our efforts in this regard, we decided to maintain such collateral as a non-performing asset since the second quarter of 2009.

***Our businesses may be adversely affected by litigation.***

From time to time, our customers, or the government on their behalf, may make claims and take legal action relating to our performance of fiduciary or contractual responsibilities. We may also face employment lawsuits or other legal claims. In any such claims or actions, demands for substantial monetary damages may be asserted against us resulting in financial liability or an adverse effect on our reputation among investors or on customer demand for our products and services. We may be unable to accurately estimate our exposure to litigation risk when we record balance sheet reserves for probable loss contingencies. As a result, any reserves we establish to cover any settlements or judgments may not be sufficient to cover our actual financial exposure, which may have a material impact on our consolidated results of operations or financial condition.

In the ordinary course of our business, we are also subject to various regulatory, governmental and law enforcement inquiries, investigations and subpoenas. These may be directed generally to participants in the businesses in which we are involved or may be specifically directed at us. In regulatory enforcement matters, claims for disgorgement, the imposition of penalties and the imposition of other remedial sanctions are possible.

The resolution of legal actions or regulatory matters, if unfavorable, could have a material adverse effect on our consolidated results of operations for the quarter in which such actions or matters are resolved or a reserve is established.

***Our businesses may be negatively affected by adverse publicity or other reputational harm.***

Our relationships with many of our customers are predicated upon our reputation as a fiduciary and a service provider that adheres to the highest standards of ethics, service quality and regulatory compliance. Adverse publicity, regulatory actions, like the Agreements, litigation, operational failures, the failure to meet customer expectations and other issues with respect to one or more of our businesses could materially and adversely affect our

reputation, ability to attract and retain customers or obtain sources of funding for the same or other businesses. Preserving and enhancing our reputation also depends on maintaining systems and procedures that address known risks and regulatory requirements, as well as our ability to identify and mitigate additional risks that arise due to changes in our businesses, the market places in which we operate, the regulatory environment and customer expectations. If any of these developments has a material adverse effect on our reputation, our business will suffer.

***Changes in accounting standards issued by the Financial Accounting Standards Board or other standard-setting bodies may adversely affect our financial statements.***

Our financial statements are subject to the application of U.S. Generally Accepted Accounting Principles ( GAAP ), which is periodically revised and expanded. Accordingly, from time to time, we are required to adopt new or revised accounting standards issued by the Financial Accounting Standards Board. Market conditions have prompted accounting standard setters to promulgate new requirements that further interpret or seek to revise accounting pronouncements related to financial instruments, structures or transactions as well as to revise standards to expand disclosures. The impact of accounting pronouncements that have been issued but not yet implemented is disclosed in footnotes to our financial statements, which are incorporated herein by reference. An assessment of proposed standards is not provided as such proposals are subject to change through the exposure process and, therefore, the effects on our financial statements cannot be meaningfully assessed. It is possible that future accounting standards that we are required to adopt could change the current accounting treatment that we apply to our consolidated financial statements and that such changes could have a material adverse effect on our financial condition and results of operations.

***Any impairment of our goodwill or amortizable intangible assets may adversely affect our operating results.***

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. Under GAAP, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

Goodwill is tested for impairment at least annually. Factors that may be considered a change in circumstances, indicating that the carrying value of the goodwill or amortizable intangible assets may not be recoverable, include reduced future cash flow estimates and slower growth rates in the industry.

The goodwill impairment evaluation process requires us to make estimates and assumptions with regards to the fair value of our reporting units. Actual values may differ significantly from these estimates. Such differences could result in future impairment of goodwill that would, in turn, negatively impact our results of operations and the reporting unit where the goodwill is recorded.

We conducted our annual evaluation of goodwill during the fourth quarter of 2011. This evaluation was a two-step process. The Step 1 evaluation of goodwill allocated to the Florida reporting unit, which is one level below the United States Operations segment, indicated potential impairment of goodwill. The Step 1 fair value for the unit was below the carrying amount of its equity book value as of the October 1, 2011 valuation date, requiring the completion of Step 2. Step 2 required a valuation of all assets and liabilities of the Florida unit, including any recognized and unrecognized intangible assets, to determine the fair value of net assets. To complete Step 2, we subtracted from the unit s Step 1 fair value the determined fair value of the net assets to arrive at the implied fair value of goodwill. The results of the Step 2 analysis indicated that the implied fair value of goodwill of $40.4 million exceeded the goodwill carrying value of $27 million, resulting in no goodwill impairment. If we are required to record a charge to earnings in our consolidated financial statements because an impairment of the goodwill or amortizable intangible assets is determined, our results of operations could be adversely affected.

***The Corporation s judgments regarding accounting policies and the resolution of tax disputes may impact the Corporation s earnings and cash flow.***

Significant judgment is required in determining the Corporation s effective tax rate and in evaluating its tax positions. The Corporation provides for uncertain tax positions when such tax positions do not meet the recognition thresholds or measurement criteria prescribed by applicable GAAP.

Fluctuations in federal, state, local and foreign taxes or a change to uncertain tax positions, including related interest and penalties, may impact the Corporation s effective tax rate. When particular tax matters arise, a number of years may elapse before such matters are audited and finally resolved. In addition, tax positions may be challenged by the Internal Revenue Service ( IRS ) and the tax authorities in the jurisdictions in which we operate and we may estimate and provide for potential liabilities that may arise out of tax audits to the extent that uncertain tax positions fail to meet the recognition standard under Accounting Standard Codification Topic 740. Unfavorable resolution of any tax matter could increase the effective tax rate and could result in material increase in our tax expense. Any resolution of a tax issue may require the use of cash in the year of resolution.

***Our ability to use net operating loss carryforwards to reduce future tax payments may be limited or restricted.***

We have generated significant net operating losses ( NOLs ) as a result of our recent losses. We generally are able to carry NOLs forward to reduce taxable income for the subsequent 7 years (10 years with respect to losses incurred during taxable years 2005 through 2012). The realization of the deferred tax assets ultimately depends on the existence of sufficient taxable income in either the carryback or carryforward periods under the tax law. If we do not generate sufficient taxable income we will lose some of our NOLs.

***We must respond to rapid technological changes, and these changes may be more difficult or expensive than anticipated.***

If competitors introduce new products and services embodying new technologies, or if new industry standards and practices emerge, our existing product and service offerings, technology and systems may become obsolete. Further, if we fail to adopt or develop new technologies or to adapt our products and services to emerging industry standards, we may lose current and future customers, which could have a material adverse effect on our business, financial condition and results of operations. The financial services industry is changing rapidly and, in order to remain competitive, we must continue to enhance and improve the functionality and features of our products, services and technologies. These changes may be more difficult or expensive than we anticipate.

**RISKS RELATED TO BUSINESS ENVIRONMENT AND OUR INDUSTRY**

***Difficult market conditions have affected the financial industry and may adversely affect us in the future.***

Given that most of our business is in Puerto Rico and the United States and given the degree of interrelation between Puerto Rico s economy and that of the United States, we are exposed to downturns in the U.S. economy. Dramatic declines in the U.S. housing market over the past few years, with falling home prices and increasing foreclosures, unemployment and under-employment, have negatively impacted the credit performance of mortgage loans , credit default swaps and other derivatives of cash securities, and resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial banks and investment banks. These write-downs have caused many financial institutions to seek additional capital from private and government entities, merge with larger and stronger financial institutions and, in some cases, fail.

Reflecting concern about the stability of the financial markets in general and the strength of counterparties, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, erosion of consumer confidence, increased market volatility and widespread reduction of business activity in general. The resulting economic pressure on consumers and erosion of confidence in the financial markets have already adversely affected our industry and may adversely affect our business, financial condition and results of operations. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and other financial institutions. In particular, we may face the following risks in connection with these events:

- Our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage, and underwrite the loans become less predictive of future behaviors.

- The models used to estimate losses inherent in the credit exposure require difficult, subjective, and complex judgments, including forecasts of economic conditions and how these economic predictions might impair the ability of the borrowers to repay their loans, which may no longer be capable of accurate estimation and which may, in turn, impact the reliability of the models.

- Our ability to borrow from other financial institutions or to engage in sales of mortgage loans to third parties (including mortgage loan securitization transactions with government-sponsored entities and repurchase agreements) on favorable terms, or at all, could be adversely affected by further disruptions in the capital markets or other events, including deteriorating investor expectations.

- Competitive dynamics in the industry could change as a result of consolidation of financial services companies in connection with current market conditions.

We may be unable to comply with the Agreements, which could result in further regulatory enforcement actions.

We expect to face increased regulation of our industry. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities.

We may be required to pay significantly higher FDIC premiums in the future as a result of changes in the rule that impact the Bank s insurance assessment. The Dodd-Frank Act removed the statutory cap for the reserve ratio, leaving the FDIC free to set this cap going forward.

There may be downward pressure on our stock price.
If current levels of market disruption and volatility continue or worsen, our ability to access capital and our business, financial condition and results of operations may be materially and adversely affected.

***Continuation of the economic slowdown and decline in the real estate market in the U.S. mainland and in Puerto Rico could continue to harm our results of operations.***

The residential mortgage loan origination business has historically been cyclical, enjoying periods of strong growth and profitability followed by periods of shrinking volumes and industry-wide losses. The market for residential mortgage loan originations is currently in decline and this trend could also reduce the level of mortgage loans we may produce in the future and adversely affect our business. During periods of rising interest rates, the refinancing of many mortgage products tends to decrease as the economic incentives for borrowers to refinance their existing mortgage loans are reduced. In addition, the residential mortgage loan origination business is impacted by home values. Over the past few years, residential real estate values in many areas of the U.S. and Puerto Rico have decreased significantly, which has led to lower volumes and higher losses across the industry, adversely impacting our mortgage business.

The actual rates of delinquencies, foreclosures and losses on loans have been higher during the economic slowdown. Rising unemployment, higher interest rates and declines in housing prices have had a negative effect on the ability of borrowers to repay their mortgage loans. Any sustained period of increased delinquencies, foreclosures or losses could continue to harm our ability to sell loans, the prices we receive for loans, the values of mortgage loans held for sale or residual interests in securitizations, which could continue to harm our financial condition and results of operations. In addition, any additional material decline in real estate values would further weaken the collateral loan-to-value ratios and increase the possibility of loss if a borrower defaults. In such event, we will be subject to the risk of loss on such real estate arising from borrower defaults to the extent not covered by third-party credit enhancement.

***Our business concentration in Puerto Rico imposes risks.***

We conduct our operations in a geographically concentrated area, as our main market is Puerto Rico. This imposes risks from lack of diversification in our geographical portfolio. Our financial condition and results of operations are highly dependent on the economic conditions of Puerto Rico, where adverse political or economic developments, among other things, could affect the volume of loan originations, increase the level of non-performing assets, increase the rate of foreclosure losses on loans, and reduce the value of our loans and loan servicing portfolio.

Since March 2006, a number of key economic indicators have shown that the economy of Puerto Rico has been in recession.

On March 24, 2011, the Puerto Rico Planning Board announced the release of Puerto Rico s macroeconomic data for the projections for the fiscal year ending on June 30, 2011 ( Fiscal Year 2011 ) and for the fiscal year ending on June 30, 2012 ( Fiscal Year 2012 ). Fiscal Year 2011 is projected to show a reduction in the real gross national product (the GNP ) of 1.0%, and an increase of 0.7% for Fiscal Year 2012. The Government Development Bank for Puerto Rico s Economic Activity Index, which is a coincident index consisting of four major monthly economic indicators, namely total payroll employment, total electric power consumption, cement sales and gas consumption, and which monitors the actual trend of Puerto Rico s economy, reflected a decrease of 0.9% in the rate of contraction of Puerto Rico s economy during the ten-month period ending in October 2011 as compared to a decrease of 2.6% in the rate of contraction during the same period in 2010. Construction has remained weak since 2009 as Puerto Rico s fiscal situation and decreasing public investment in construction projects has affected the sector.

The government of Puerto Rico is currently implementing efforts to address a fiscal deficit, estimated in its initial stages at approximately $3.2 billion, or over 30% of its annual budget, as its access to the municipal bond market and its credit ratings depended, in part, on achieving a balanced budget. In July 2011, the Commonwealth issued bonds of $300 million for infrastructure projects to continue stimulating the economy. On August 8, 2011, Moody s downgraded the general obligation rating of the Commonwealth of Puerto Rico. The downgrade also applies to those ratings that are based on or capped at the general obligation rating of the Commonwealth. Moody s based the decision on its strong concerns with the continued deterioration of the severely underfunded government retirement systems, weak economic trends and weak finances.

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Some of the measures implemented by the government to reduce expenses included public-sector employee layoffs. Since the government is an important source of employment in Puerto Rico, these measures could have the effect of intensifying the current recessionary cycle. The Puerto Rico Labor Department reported an unemployment rate of 16.1% for the month of October 2011.

The economy of Puerto Rico is very sensitive to the price of oil in the global market since it does not have a significant mass transit system available to the public and most of its electricity is powered by oil. The substantial increase in the price of oil has adversely impacted the economy by reducing disposable income and increasing the operating costs of most businesses and government. Consumer spending is particularly sensitive to wide fluctuations in oil prices.

This decline in Puerto Rico s economy has resulted in, among other things, a downturn in our loan originations, an increase in the level of our non-performing assets, loan loss provisions and charge-offs, particularly in our construction and commercial loan portfolios, an increase in the rate of foreclosure loss on mortgage loans, and a reduction in the value of our loans and loan servicing portfolio, all of which have adversely affected our profitability. If the decline in economic activity continues, there could be further adverse effects on our profitability.

The above economic concerns and uncertainty in the private and public sectors may continue to have an adverse effect on the credit quality of our loan portfolios, as delinquency rates have increased, until the economy stabilizes.

***The failure of other financial institutions could adversely affect us.***

Our ability to engage in routine funding transactions could be adversely affected by future failures of financial institutions and the actions and commercial soundness of other financial institutions. Financial institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to different industries and counterparties and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, investment companies and other institutional clients. In certain of these transactions, we are required to post collateral to secure the obligations to the counterparties. In the event of a bankruptcy or insolvency proceeding involving one of such counterparties, we may experience delays in recovering the assets posted as collateral or may incur a loss to the extent that the counterparty was holding collateral in excess of the obligation to such counterparty.

In addition, many of these transactions expose us to credit risk in the event of a default by our counterparty or client. In addition, the credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to us. Any losses resulting from our routine funding transactions may materially and adversely affect our financial condition and results of operations.

***Legislative and regulatory actions taken now or in the future may increase our costs and impact our business, governance structure, financial condition or results of operations.***

We and our subsidiaries are subject to extensive regulation by multiple regulatory bodies. These regulations may affect the manner and terms of delivery of our services. If we do not comply with governmental regulations, we may be subject to fines, penalties, lawsuits or material restrictions on our businesses in the jurisdiction where the violation occurred, which may adversely affect our business operations. Changes in these regulations can significantly affect the services that we are asked to provide as well as our costs of compliance with such regulations. In addition, adverse publicity and damage to our reputation arising from the failure or perceived failure to comply with legal, regulatory or contractual requirements could affect our ability to attract and retain customers.

Current economic conditions, particularly in the financial markets, have resulted in government regulatory agencies and political bodies placing increased focus and scrutiny on the financial services industry. The U.S. government has intervened on an unprecedented scale, responding to what has been commonly referred to as the financial crisis, by temporarily enhancing the liquidity support available to financial institutions, establishing a commercial paper funding facility, temporarily guaranteeing money market funds and certain types of debt issuances and increasing insurance on bank deposits.

These programs have subjected financial institutions, particularly those participating in Troubled Asset Relief Program ( TARP ), to additional restrictions, oversight and costs. In addition, new proposals for legislation are periodically introduced in the U.S. Congress that could further substantially increase regulation of the financial services industry, impose restrictions on the operations and general ability of firms within the industry to conduct

business consistent with historical practices, including in the areas of interest rates, financial product offerings and disclosures, and have an effect on bankruptcy proceedings with respect to consumer residential real estate mortgages, among other things. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied.

In recent years, regulatory oversight and enforcement have increased substantially, imposing additional costs and increasing the potential risks associated with our operations. If these regulatory trends continue, they could adversely affect our business and, in turn, our consolidated results of operations.

***Financial services legislation and regulatory reforms may have a significant impact on our business and results of operations and on our credit ratings.***

We face increased regulation and regulatory scrutiny as a result of our participation in the TARP. On July 20, 2010, we issued Series G Preferred Stock to the U.S. Treasury in exchange for the shares of Series F Preferred Stock plus accrued and unpaid dividends pursuant to an exchange agreement with the U.S. Treasury dated as of July 7, 2010, as amended ( Exchange Agreement ). We also issued to the U.S. Treasury an amended and restated warrant to replace the original warrant that we issued to the U.S. Treasury in January 2009 under the TARP. On October 7, 2011, we issued 32,941,797 shares of Common stock to the U.S. Treasury upon conversion of all of the Series G Preferred Stock.

On July 21, 2010, the Dodd-Frank Act was signed into law, which significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes, and the regulations developed and to be developed thereunder include or will include, provisions affecting large and small financial institutions alike.

The Dodd-Frank Act, among other things, imposes new capital requirements on bank holding companies; changes the base for FDIC insurance assessments to a bank s average consolidated total assets minus average tangible equity, rather than upon its deposit base, and permanently raises the current standard deposit insurance limit to $250,000; and expands the FDIC s authority to raise insurance premiums. The legislation also calls for the FDIC to raise the ratio of reserves to deposits from 1.15% to 1.35% for deposit insurance purposes by September 30, 2020 and to offset the effect of increased assessments on insured depository institutions with assets of less than $10 billion.

The Dodd-Frank Act also limits interchange fees payable on debit card transactions, establishes the Consumer Financial Protection Bureau (the CFPB ) as an independent entity within the Federal Reserve and contains provisions on mortgage-related matters such as steering incentives, determinations as to a borrower s ability to repay and prepayment penalties. The CFPB has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards.

In July 2011, the CFPB advised us and other banks deemed to be large banks under the Dodd-Frank Act as to the agency s approach to supervision and examination beginning on July 21, 2011. The CFPB supervision and examination approach will be guided toward protecting consumers and compliance with Federal consumer financial protection laws.

The Dodd-Frank Act also includes provisions that affect corporate governance and executive compensation at all publicly-traded companies and allows financial institutions to pay interest on business checking accounts. The legislation also restricts proprietary trading, places restrictions on the owning or sponsoring of hedge and private equity funds, and regulates the derivatives activities of banks and their affiliates.

The Collins Amendment to the Dodd-Frank Act, among other things, eliminates certain trust preferred securities from Tier 1 capital. TARP preferred securities are exempted from this treatment. In the case of certain trust preferred securities issued prior to May 19, 2010 by bank holding companies with total consolidated assets of $15 billion or more as of December 31, 2009, these regulatory capital deductions are to be phased in incrementally over a period of three years beginning on January 1, 2013. This provision also requires the federal banking agencies to establish minimum leverage and risk-based capital requirements that will apply to both insured banks and their holding companies. Regulations implementing the Collins Amendment became effective on July 28, 2011 and set as a floor for the capital requirements of the Corporation and FirstBank a minimum capital requirement computed using FDIC s general risk-based capital rules. Also, bank holding companies subject to the advanced approaches rule need not immediately begin deducting from Tier 1 capital their trust preferred securities and other instruments that are ineligible for insured banks, and may not include in Tier 1 capital any such ineligible instruments issued after May 19, 2010. Additional rulemaking as to the Collins amendment is expected. On June 28, 2011 the Federal Reserve approved a final debit card interchange rule that caps a debit card issuer s base fee at 21 cents per transaction and allows an additional 5-bonus point charge per transaction to help cover fraud

losses. The rule became fully operational October 1, 2011. We expect that the debt card interchange rule will reduce our interchange fee revenue in line with industry-wide expectations, beginning the quarter ending December 31, 2011. The new pricing restriction is expected to negatively impact our fee income by an approximate amount of $2.5 million to $3.0 million.

On January 17, 2012, the FDIC proposed a new regulation that would require state non-member banks with total assets of more than $10 billion as of September 30, 2011, such as FirstBank, to conduct annual capital-adequacy stress tests. The proposed regulation, required by the Dodd-Frank Act, will require FirstBank to provide the FDIC with forward-looking information to assist the FDIC in its overall assessment of its capital adequacy, helping to better identify potential downside risks and the potential impact of adverse outcomes on its financial stability. FirstBank will be expected to take the results of the stress tests into account in making appropriate changes to its capital structure, its exposures, concentrations, and risk positions, any plans for recovery and resolution, and to improve its overall risk management. A summary of the results of the stress tests would be publicly disclosed under the proposed regulations.

These provisions, or any other aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities or change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans, and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations in order to comply, and could therefore also materially and adversely affect our business, financial condition, and results of operations. Our management is actively reviewing the provisions of the Dodd-Frank Act, many of which are to be phased in over the next several months and years, and assessing its probable impact on our operations. However, the ultimate effect of the Dodd-Frank Act on the financial services industry in general, and us in particular, is uncertain at this time.

The U.S. Congress has also adopted additional consumer protection laws such as the Credit Card Accountability Responsibility and Disclosure Act of 2009, and the Federal Reserve has adopted numerous new regulations addressing banks credit card, overdraft and mortgage lending practices. Additional consumer protection legislation and regulatory activity is anticipated in the near future.

Internationally, both the Basel Committee on Banking Supervision and the Financial Stability Board (established in April 2009 by the Group of Twenty ( G-20 ) Finance Ministers and Central Bank Governors to take action to strengthen regulation and supervision of the financial system with greater international consistency, cooperation and transparency) have committed to raise capital standards and liquidity buffers within the banking system ( Basel III ). On September 12, 2010, the Group of Governors and Heads of Supervision agreed to the calibration and phase-in of the Basel III minimum capital requirements (raising the minimum Tier 1 common equity ratio to 4.5% and minimum Tier 1 equity ratio to 6.0%, with full implementation by January 2015) and introducing a capital conservation buffer of common equity of an additional 2.5% with implementation by January 2019. U.S. regulators have yet to propose regulations for implementing Basel III. On September 28, 2011, the Basel Committee announced plans to consider adjustments to the final liquidity charge to be imposed under Basel III, which liquidity charge would take effect on January 1, 2015. The liquidity coverage ratio being considered would require banks to maintain an adequate level of unencumbered high-quality liquid assets sufficient to meet liquidity needs for a 30 calendar day time horizon. Such proposals and legislation, if finally adopted, would change banking laws and our operating environment and that of our subsidiaries in substantial and unpredictable ways. We cannot determine whether such proposals and legislation will be adopted, or the ultimate effect that such proposals and legislation, if enacted, or regulations issued to implement the same, would have upon our financial condition or results of operations.

***Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.***

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

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On January 6, 2010, the member agencies of the Federal Financial Institutions Examination Council, which includes the Federal Reserve, issued an interest rate risk advisory reminding banks to maintain sound practices for managing interest rate risk, particularly in the current environment of historically low short-term interest rates.

The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations may be adverse.

**RISKS RELATING TO AN INVESTMENT IN THE CORPORATION S COMMON STOCK**

***Sales in the public market of the approximately 90% of our outstanding shares of common stock that are covered by a resale registration statement filed under the Securities Act of 1933, including any sales by the small group of large stockholders that hold in the aggregate approximately 76% of those shares, could adversely affect the trading price of our common stock.***

As of March 2, 2012, the following stockholders individually owned more than 9% of our outstanding shares of common stock, or an aggregate of approximately 76% of our outstanding shares: funds affiliated with Thomas H. Lee Partners, L.P. ( THL ), which own approximately 24.69%; fund affiliated with Oaktree Capital Management, L.P. ( Oaktree ), which own approximately 24.69%; the United States Department of the Treasury (the Treasury ), which owns approximately 16.6%; and Wellington Management Company, LLP, which owns approximately 9.85%. The resale of these shares, as well as the additional shares sold in our private placement of 150 million shares in October 2011, is covered by our registration of 186,151,814 shares, or approximately 90% of our outstanding shares, in a registration statement filed under the Securities Act of 1933. We are obligated to keep this registration statement current so that the stockholders can sell their shares in the public market under this registration statement at any time. Approximately 3 million shares have been sold pursuant to this registration statement. The resale of the additional registered shares in the public market, or the perception that these sales might occur, could cause the market price of our common stock to decline.

***Issuance of additional equity securities in the public markets and other capital management or business strategies that we may pursue could also depress the market price of our common stock and could result in dilution of our common stockholders, including purchasers of our common stock under the resale registration statement.***

Generally, we are not restricted from issuing additional equity securities, including our Common stock. We may choose or be required in the future to identify, consider and pursue additional capital management strategies to bolster our capital position. We may issue equity securities (including convertible securities, preferred securities, and options and warrants on our common or preferred stock) in the future for a number of reasons, including to finance our operations and business strategy, to adjust our leverage ratio, to address regulatory capital concerns, to restructure currently outstanding debt or equity securities or to satisfy our obligations upon the exercise of outstanding options or warrants. Future issuances of our equity securities, including Common stock, in any transaction that we may pursue may dilute the interests of our existing common stockholders and cause the market price of our Common stock to decline.

***The market price of our common stock may continue to be subject to significant fluctuations and volatility.***

The stock markets have experienced high levels of volatility during the last few years. These market fluctuations have adversely affected, and may continue to adversely affect, the trading price of our Common stock. In addition, the market price of our Common stock has been subject to significant fluctuations and volatility because of factors specifically related to our businesses and may continue to fluctuate or decline. Factors that could cause fluctuations, volatility or a decline in the market price of our Common stock, many of which could be beyond our control, include the following, in addition to pending resale registration statement discussed above:

- our ability to comply with the Agreements;
- any additional regulatory actions against us;
- changes or perceived changes in the condition, operations, results or prospects of our businesses and market assessments of these changes or perceived changes;

announcements of strategic developments, acquisitions and other material events by us or our competitors, including any future failures of banks in Puerto Rico;

changes in governmental regulations or proposals, or new governmental regulations or proposals, affecting us, including those relating to the financial crisis and global economic downturn and those that may be specifically directed to us;

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- the continued decline, failure to stabilize or lack of improvement in general market and economic conditions in our principal markets;
- the departure of key personnel;
- changes in the credit, mortgage and real estate markets;
- operating results that vary from the expectations of management, securities analysts and investors;
- operating and stock price performance of companies that investors deem comparable to us; and
- the public perception of the banking industry and its safety and soundness.

In addition, the stock market in general, and the NYSE and the market for commercial banks and other financial services companies in particular, have experienced significant price and volume fluctuations that sometimes have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our Common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company s securities, securities class action litigation has often been instituted. A securities class action suit against us could result in substantial costs, potential liabilities and the diversion of management s attention and resources.

***Our suspension of dividends may have adversely affected and may further adversely affect our stock price and could result in the expansion of our board of directors.***

In March 2009, the Board of Governors of the Federal Reserve issued a supervisory guidance letter intended to provide direction to bank holding companies ( BHCs ) on the declaration and payment of dividends, capital redemptions and capital repurchases by BHCs in the context of their capital planning process. The letter reiterates the long-standing Federal Reserve supervisory policies and guidance to the effect that BHCs should only pay dividends from current earnings. More specifically, the letter heightens expectations that BHCs will inform and consult with the Federal Reserve supervisory staff on the declaration and payment of dividends that exceed earnings for the period for which a dividend is being paid. In consideration of the financial results reported for the second quarter ended June 30, 2009, we decided, as a matter of prudent fiscal management and following the Federal Reserve guidance, to suspend payment of dividends. Furthermore, our Agreement with the Federal Reserve precludes us from declaring any dividends without the prior approval of the Federal Reserve. We cannot anticipate if and when the payment of dividends might be reinstated.

This suspension may have adversely affected and may continue to adversely affect our stock price. Further, because dividends on our Series A through Series E Preferred Stock were not paid before January 31, 2011 (18 monthly dividend periods after we suspended dividend payments in August 2009), the holders of that preferred stock have the right to appoint two additional members to our board of directors. Any member of the Board of Directors appointed by the preferred stockholders is required to vacate his or her office if the Corporation returns to payment of dividends in full for twelve consecutive monthly dividend periods.

**Risks Related to the Rights of Holders of Our Common Stock Compared to the Rights of Holders of Our Debt Obligations and Shares of Preferred Stock**

***The holders of our debt obligations, which, as of December 31, 2011, held debt in the amount of $231.9 million, and the holders of our shares of preferred stock still outstanding will have priority over our Common Stock with respect to payment in the event of liquidation, dissolution or winding up and with respect to the payment of dividends.***

In any liquidation, dissolution or winding up of First BanCorp, our Common Stock would rank below all debt claims against us and claims of all of our outstanding shares of Series A through E Preferred Stock, which have a liquidation preference of approximately $63 million.

As a result, holders of our Common Stock will not be entitled to receive any payment or other distribution of assets upon the liquidation, dissolution or winding up of First BanCorp until after all our obligations to our debt holders have been satisfied and holders of senior equity

securities and trust preferred securities have received any payment or distribution due to them.

In addition, we are required to pay dividends on our preferred stock before we pay any dividends on our Common Stock. Holders of our Common Stock will not be entitled to receive payment of any dividends on their shares of our Common Stock unless and until we obtain the Federal Reserve s approval to resume payments of dividends on the shares of outstanding preferred stock.

***Future offerings of preferred stock, which would likely be senior to our Common Stock for purposes of dividend distributions or upon liquidation, may adversely affect the market price of our Common Stock.***

If the Agreements are terminated and we resume the payment of dividends on our outstanding preferred stock, our Board of Directors will again be authorized to issue one or more classes or series of preferred stock from time to time without any action on the part of the stockholders. Our Board of Directors would have the power, without stockholder approval, to set the terms of any such classes or series of preferred stock that may be issued, including voting rights, dividend rights and preferences over our Common Stock with respect to dividends or upon our dissolution, winding up and liquidation and other terms. If we issue preferred shares in the future that have a preference over our Common Stock with respect to the payment of dividends or upon liquidation, or if we issue preferred shares with voting rights that dilute the voting power of our Common Stock, the rights of holders of our Common Stock or the market price of our Common Stock could be adversely affected.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

As of December 31, 2011, First BanCorp owned the following three main offices located in Puerto Rico:

Headquarters Located at First Federal Building, 1519 Ponce de León Avenue, Santurce, Puerto Rico, a 16 story office building. Approximately 60% of the building, an underground three level parking garage and an adjacent parking lot are owned by the Corporation.

Service Center a building located on 1130 Muñoz Rivera Avenue, Hato Rey, Puerto Rico. These facilities accommodate branch operations, data processing and administrative and certain headquarter offices. FirstBank inaugurated the new Service Center during 2010. The recent acquired and renovated building houses 180,000 square feet of modern facilities and over 1,000 employees from operations, FirstMortgage and FirstBank Insurance Agency headquarters and customer service. In addition, it has parking for 750 vehicles and 9 training rooms, including a school for Tellers and a computer room for interactive trainings, as well as a spacious cafeteria for employees and customers.

Consumer Lending Center A three-story building with a three-level parking garage located at 876 Muñoz Rivera Avenue, Hato Rey, Puerto Rico. These facilities are fully occupied by the Corporation.

The Corporation owned 22 branch and office premises and auto lots and leased 100 branch premises, loan and office centers and other facilities. In certain situations, financial services such as mortgage, insurance businesses and commercial banking services are located in the same building. All of these premises are located in Puerto Rico, Florida and in the U.S. and British Virgin Islands. Management believes that the Corporation s properties are well maintained and are suitable for the Corporation s business as presently conducted.

**Item 3. Legal Proceedings**

The Corporation and its subsidiaries are defendants in various lawsuits arising in the ordinary course of business. In the opinion of the Corporation s management, the pending and threatened legal proceedings of which management is aware will not have a material adverse effect on the financial condition or results of operations of the Corporation.

**Item 4. Mine Safety Disclosure**

Not applicable.

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PART II

**Item 5. Market for Registrant s Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities**

**Information about Market and Holders**

The Corporation s common stock is traded on the New York Stock Exchange ( NYSE ) under the symbol FBP. In 2010, following stockholder approvals, the Corporation amended twice its certificate of incorporation to provide for an increase in the number of shares of common stock authorized for issuance from 250 million at the beginning of 2010 to 2.0 billion shares and to provide for the implementation of a one-for-fifteen reverse stock split. Effective January 7, 2011, the Corporation implemented a one-for-fifteen reverse stock split of all outstanding shares of common stock.

On March 2, 2012, there were 559 holders of record of the Corporation s common stock, not including beneficial owners whose shares are held in record names of brokers or other nominees. The last sales price for the common stock on that date was $3.76.

On July 30, 2009, the Corporation announced the suspension of common and preferred stock dividends. The Corporation has no current plans to resume dividend payments on the common stock. The common stock ranks junior to all series of preferred stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Corporation.

The following table sets forth, for the calendar quarters indicated, the high and low closing sales prices and the cash dividends declared on the Corporation s common stock during such periods.

| Quarter Ended | High | Low | Last | Dividends per Share |
|---|---|---|---|---|
| **2011:** | | | | |
| December | $ 4.00 | $ 2.57 | $ 3.49 | $ |
| September | 4.64 | 2.76 | 2.80 | |
| June | 5.17 | 3.62 | 4.31 | |
| March | 7.50 | 4.07 | 5.00 | |
| **2010:** | | | | |
| December | $ 7.18 | $ 3.60 | $ 6.90 | $ |
| September | 9.74 | 4.20 | 4.20 | |
| June | 55.35 | 7.95 | 7.95 | |
| March | 42.60 | 28.35 | 36.15 | |
| **2009:** | | | | |
| December | $ 43.20 | $ 22.65 | $ 34.50 | $ |
| September | 63.00 | 45.15 | 45.75 | |
| June | 113.25 | 59.25 | 59.25 | 1.05 |
| March | 165.75 | 54.45 | 63.90 | 1.05 |

On October 7, 2011, the Corporation successfully completed a private placement of $525 million in shares of common stock (the capital raise ). The proceeds from the capital raise amounted to approximately $490 million (net of offering costs). Lead investors include funds affiliated with Thomas H. Lee Partners, L.P. ( THL ) and Oaktree Capital Management, L.P. ( Oaktree ) that purchased from the Corporation an aggregate of $348.2 million ($174.1 million each investor) of shares of the Corporation s common stock.

In connection with the closing, the Corporation issued 150 million shares of common stock at $3.50 per share to institutional investors. Subsequent to the closing, in related transactions, on October 12, 2011 and October 26, 2011, each of THL and Oaktree, respectively, purchased in the aggregate 937,493 shares of common stock from certain of the institutional investors who participated in the capital raise transaction. As of the date of the filing of this Form 10-K, each of THL and Oaktree owns 24.69% of the total shares of common stock outstanding.

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On December 8, 2011, the Corporation completed a rights offering in which the Corporation issued an additional 888,781 shares of common stock at $3.50 per share, and received proceeds of $3.3 million.

The Corporation has 50,000,000 shares authorized of preferred stock. First BanCorp has five outstanding series of non convertible preferred stock: 7.125% non-cumulative perpetual monthly income preferred stock, Series A (liquidation preference $25 per share); 8.35% non-cumulative perpetual monthly income preferred stock, Series B (liquidation preference $25 per share); 7.40% non-cumulative perpetual monthly income preferred stock, Series C (liquidation preference $25 per share); 7.25% non-cumulative perpetual monthly income preferred stock, Series D (liquidation preference $25 per share,); and 7.00% non-cumulative perpetual monthly income preferred stock, Series E (liquidation preference $25 per share) (collectively the Series A through E Preferred Stock ). Effective January 17, 2012, the Corporation delisted all of the series of non-convertible, non-cumulative preferred stock from the New York Stock Exchange. The Corporation has not arranged for listing and/or registration on another national securities exchange or for quotation of the preferred stock in a quotation medium.

The Series A through E Preferred Stock rank on parity with respect to dividend rights and rights upon liquidation, winding up or dissolution. Holders of each series of preferred stock are entitled to receive cash dividends, when, as and if declared by the board of directors of First BanCorp out of funds legally available for dividends.

The terms of the Corporation s Series A through E Preferred Stock do not permit the Corporation to declare, set apart or pay any dividend or make any other distribution of assets on, or redeem, purchase, set apart or otherwise acquire shares of common stock or of any other class of stock of First BanCorp ranking junior to the preferred stock, unless all accrued and unpaid dividends on the preferred stock and any parity stock for the twelve monthly dividend periods ending on the immediately preceding dividend payment date shall have been paid or are paid contemporaneously; the full monthly dividend on the preferred stock and any parity stock for the then current month has been or is contemporaneously declared and paid or declared and set apart for payment; and the Corporation has not defaulted in the payment of the redemption price of any shares of the preferred stock and any parity stock called for redemption. If the Corporation is unable to pay in full the dividends on the preferred stock and on any other shares of stock of equal rank as to the payment of dividends, all dividends declared upon the preferred stock and any such other shares of stock will be declared pro rata.

The Corporation may not issue shares ranking, as to dividend rights or rights on liquidation, winding up and dissolution, senior to the Series A through E Preferred Stock, except with the consent of the holders of at least two-thirds of the outstanding aggregate liquidation preference of such preferred stock.

*2010 Exchange Offer and Tresury Exchange*

On August 30, 2010, the Corporation completed its offer to issue shares of its common stock in exchange for its outstanding Series A through E preferred stock, which resulted in the issuance of 15,134,347 new shares of common stock in exchange of 19,482,128 shares of preferred stock, or 89% of the outstanding Series A through E preferred stock.

In addition, on July 20, 2010, the Corporation issued $424.2 million Fixed Rate Cumulative Mandatorily Convertible Preferred Stock, Series G, in exchange of the $400 million of fixed rate Cumulative Perpetual Preferred Stock, Series F, that the U.S. Treasury had acquired pursuant to the TARP Capital Purchase Program. Then, on October 7, 2011, the completion of the Capital Raise enabled the Corporation to compel the conversion of the 424,174 shares of Series G preferred stock into 32,941,797 new shares of common stock. The warrant to purchase 389,483 shares of the Corporation s common stock at an initial price of $10.878 was adjusted as a result of the recently completed capital raise to provide for the issuance of approximately 1,285,899 shares of common stock at an exercise price of $3.29 per share.

In connection with the conversion of the Series G Preferred Stock, held by the U.S. Treasury, into common shares at a discount, completed on October 7, 2011, a one-time, non-cash increase in income attributable to common stockholders of $278 million was recognized in the fourth quarter of 2011. This non-cash increase in income available to common stockholders has no effect on the Corporation s overall equity or its regulatory capital. As a result, the Corporation reported a net income attributable to common stockholders on a diluted basis of $195.8 million, or $2.18 per common share in 2011. Please refer to Note 22, Stockholder s Equity, for accounting treatement and further information about the Exchange Offer and Treasury Exchange.

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**Dividends**

The Corporation has a policy of paying quarterly cash dividends on its outstanding shares of common stock subject to its earnings and financial condition. On July 30, 2009, after reporting a net loss for the quarter ended June 30, 2009, the Corporation announced that the Board of Directors resolved to suspend the payment of the common and preferred dividends (including the Series F Preferred Stock dividends), effective with the preferred dividend for the month of August 2009. During 2009, the Corporation declared a cash dividend of $1.05 per share for the first two quarters of the year. The Corporation s ability to pay future dividends will necessarily depend upon its earnings and financial condition. See the discussion under Dividend Restrictions under Item 1 for additional information concerning restrictions on the payment of dividends that apply to the Corporation and FirstBank.

First BanCorp did not purchase any of its equity securities during 2011 or 2010.

The Puerto Rico Internal Revenue Code requires the withholding of income tax from dividend income to be received by resident U.S. citizens, special partnerships, trusts and estates and non-resident U.S. citizens, custodians, partnerships, and corporations from sources within Puerto Rico.

*Resident U.S. Citizens*

A special tax of 10% is imposed on eligible dividends paid to individuals, special partnerships, trusts, and estates to be applied to all distributions unless the taxpayer specifically elects otherwise. Once this election is made it is irrevocable. However, the taxpayer can elect to include in gross income the eligible distributions received and take a credit for the amount of tax withheld. If the taxpayer does not make this election on the tax return, then he can exclude from gross income the distributions received and reported without claiming the credit for the tax withheld.

*Nonresident U.S. Citizens*

Nonresident U.S. citizens have the right to certain exemptions when a Withholding Tax Exemption Certificate (Form 2732) is properly completed and filed with the Corporation. The Corporation, as withholding agent, is authorized to withhold a tax of 10% only from the excess of the income paid over the applicable tax-exempt amount.

*U.S. Corporations and Partnerships*

Corporations and partnerships not organized under Puerto Rico laws that have not engaged in trade or business in Puerto Rico during the taxable year in which the dividend is paid are subject to the 10% dividend tax withholding. Corporations or partnerships not organized under the laws of Puerto Rico that have engaged in trade or business in Puerto Rico are not subject to the 10% withholding, but they must declare the dividend as gross income on their Puerto Rico income tax return.

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***Securities authorized for issuance under equity compensation plans***

The following table summarizes equity compensation plans approved by security holders and equity compensation plans that were not approved by security holders as of December 31, 2011:

| Plan category | Number of Securities to be Issued Upon Exercise of Outstanding Options (A) | | WeightedAverage Exercise Price of Outstanding Options,warrants and rights (B) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (A)) (C) |
|---|---|---|---|---|
| Equity compensation plans approved by stockholders | 129,934 (1) | $ | 202.99 | 8,169,807 (2) |
| Equity compensation plans not approved by stockholders | N/A | | N/A | N/A |
| Total | 129,934 | $ | 202.99 | 8,169,807 |

(1) Stock options granted under the 1997 stock option plan, which expired on January 21, 2007. All outstanding awards under the stock option plan continue in full force and effect, subject to their original terms and the shares of common stock underlying the options are subject to adjustments for stock splits, reorganization and other similar events.

(2) Securities available for future issuance under the First BanCorp 2008 Omnibus Incentive Plan (the Omnibus Plan ), which was initially approved by stockholders on april 29, 2008 and amended with stockholder approval on December 9, 2011 to increase the number of shares reserved for issuance under the Plan. The Omnibus Plan provides for equity-based compensation incentives (the awards ) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. This plan allows the issuance of up to 8,169,807 shares of common stock, subject to adjustments for stock splits, reorganization and other similar events.

**STOCK PERFORMANCE GRAPH**

*The following Performance Graph shall not be deemed incorporated by reference by any general statement incorporating by reference this Annual Report on Form 10-K into any filing under the Securities Act of 1933, as amended (the Securities Act ) or the Exchange Act, except to the extent that First BanCorp specifically incorporates this information by reference, and shall not otherwise be deemed filed under these Acts.*

The graph below compares the cumulative total stockholder return of First BanCorp during the measurement period with the cumulative total return, assuming reinvestment of dividends, of the S&P 500 Index and the S&P Supercom Banks Index (the Peer Group ). The Performance Graph assumes that $100 was invested on December 31, 2006 in each of First BanCorp common stock, the S&P 500 Index and the Peer Group. The comparisons in this table are set forth in response to SEC disclosure requirements, and are therefore not intended to forecast or be indicative of future performance of First BanCorp s common stock.

The cumulative total stockholder return was obtained by dividing (i) the cumulative amount of dividends per share, assuming dividend reinvestment since the measurement point, December 31, 2006, plus (ii) the change in the per share price since the measurement date, by the share price at the measurement date.

**ITEM 6. SELECTED FINANCIAL DATA**

The following table sets forth certain selected consolidated financial data for each of the five years in the period ended December 31, 2011. This information should be read in conjunction with the audited consolidated financial statements and the related notes thereto.

**SELECTED FINANCIAL DATA**

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2008 | 2007 |
| **Condensed Income Statements:** | | | | | |
| Total interest income | $ 659,615 | $ 832,686 | $ 996,574 | $ 1,126,897 | $ 1,189,247 |
| Total interest expense | 266,103 | 371,011 | 477,532 | 599,016 | 738,231 |
| Net interest income | 393,512 | 461,675 | 519,042 | 527,881 | 451,016 |
| Provision for loan and lease losses | 236,349 | 634,587 | 579,858 | 190,948 | 120,610 |
| Non-interest income | 107,981 | 117,903 | 142,264 | 74,643 | 67,156 |
| Non-interest expenses | 338,054 | 366,158 | 352,101 | 333,371 | 307,843 |
| (Loss) income before income taxes | (72,910) | (421,167) | (270,653) | 78,205 | 89,719 |
| Income tax (expense) benefit | (9,322) | (103,141) | (4,534) | 31,732 | (21,583) |
| Net (loss) income | (82,232) | (524,308) | (275,187) | 109,937 | 68,136 |
| Net income (loss) attributable to common stockholders basic | 173,226 | (122,045) | (322,075) | 69,661 | 27,860 |
| Net income (loss) attributable to common stockholders diluted | 195,763 | (122,045) | (322,075) | 69,661 | 27,860 |
| **Per Common Share Results:** | | | | | |
| Net income (loss) per common share basic | $ 2.69 | $ (10.79) | $ (52.22) | $ 11.30 | $ 4.83 |
| Net income (loss) per common share diluted | $ 2.18 | $ (10.79) | $ (52.22) | $ 11.28 | $ 4.81 |
| Cash dividends declared | $ | $ | $ 2.10 | $ 4.20 | $ 4.20 |
| Average shares outstanding | 64,466 | 11,310 | 6,167 | 6,167 | 5,770 |
| Average shares outstanding diluted | 89,658 | 11,310 | 6,167 | 6,176 | 5,791 |
| Book value per common share | $ 6.73 | $ 29.71 | $ 108.70 | $ 161.76 | $ 141.32 |
| Tangible book value per common share [(1)] | $ 6.54 | $ 27.73 | $ 101.45 | $ 153.32 | $ 133.05 |
| **Balance Sheet Data:** | | | | | |
| Total loans, including loans held for sale | $ 10,575,214 | $ 11,956,202 | $ 13,949,226 | $ 13,088,292 | $ 11,799,746 |
| Allowance for loan and lease losses | 493,917 | 553,025 | 528,120 | 281,526 | 190,168 |
| Money market and investment securities | 2,200,888 | 3,369,332 | 4,866,617 | 5,709,154 | 4,811,413 |
| Intangible Assets | 39,787 | 42,141 | 44,698 | 52,083 | 51,034 |
| Deferred tax asset, net | 5,442 | 9,269 | 109,197 | 128,039 | 90,130 |
| Total assets | 13,127,275 | 15,593,077 | 19,628,448 | 19,491,268 | 17,186,931 |
| Deposits | 9,907,754 | 12,059,110 | 12,669,047 | 13,057,430 | 11,034,521 |
| Borrowings | 1,622,741 | 2,311,848 | 5,214,147 | 4,736,670 | 4,460,006 |
| Total preferred equity | 63,047 | 425,009 | 928,508 | 550,100 | 550,100 |
| Total common equity | 1,361,899 | 615,232 | 644,062 | 940,628 | 896,810 |
| Accumulated other comprehensive income (loss), net of tax | 19,198 | 17,718 | 26,493 | 57,389 | (25,264) |
| Total equity | 1,444,144 | 1,057,959 | 1,599,063 | 1,548,117 | 1,421,646 |
| **Selected Financial Ratios (In Percent):** | | | | | |
| **Profitability:** | | | | | |
| Return on Average Assets | (0.57) | (2.93) | (1.39) | 0.59 | 0.40 |
| Return on Average Total Equity | (7.31) | (36.23) | (14.84) | 7.67 | 5.14 |
| Return on Average Common Equity | (13.38) | (80.07) | (34.07) | 7.89 | 3.59 |
| Average Total Equity to Average Total Assets | 7.83 | 8.10 | 9.36 | 7.74 | 7.70 |
| Interest Rate Spread [(2)] | 2.59 | 2.48 | 2.62 | 2.83 | 2.29 |
| Interest Rate Margin[(2)] | 2.86 | 2.77 | 2.93 | 3.20 | 2.83 |
| Tangible common equity ratio [(1)] | 10.25 | 3.80 | 3.20 | 4.87 | 4.79 |
| Dividend payout ratio | | | (4.03) | 37.19 | 88.32 |

| | | | | | |
|---|---|---|---|---|---|
| Efficiency ratio[3] | 67.41 | 63.18 | 53.24 | 55.33 | 59.41 |
| **Asset Quality:** | | | | | |
| Allowance for loan and lease losses to loans held for investment | 4.68 | 4.74 | 3.79 | 2.15 | 1.61 |
| Net charge-offs to average loans | 2.68 | 4.76 | 2.48 | 0.87 | 0.79 |
| Provision for loan and lease losses to net charge-offs | 0.80x | 1.04x | 1.74x | 1.76x | 1.36x |
| Non-performing assets to total assets | 10.19 | 10.02 | 8.71 | 3.27 | 2.56 |
| Non-performing loans held for investment to total loans held for investment | 10.78 | 10.63 | 11.23 | 4.49 | 3.50 |
| Allowance to total non-performing loans held for investment | 43.39 | 44.64 | 33.77 | 47.95 | 46.04 |
| Allowance to total non-performing loans held for investment,excluding residential real estate loans | 61.73 | 65.30 | 47.06 | 90.16 | 93.23 |
| **Other Information:** | | | | | |
| Common Stock Price: End of period | $ 3.49 | $ 6.90 | $ 34.50 | $ 167.10 | $ 109.35 |

(1) Non-gaap measures. Refer to Capital discussion below for additional information of the components and reconciliation of these measures.

(2) On a tax equivalent basis (see Net Interest Income discussion below for reconciliation of these non-GAAP measures).

(3) Non-interest expenses to the sum of net interest income and non-interest income. The denominator includes non-recurring income and changes in the fair value of derivative instruments and financial instruments measured at fair value.

**ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following Management s Discussion and Analysis of Financial Condition and Results of Operations relates to the accompanying consolidated audited financial statements of First BanCorp and should be read in conjunction with such financial statements, including the notes thereto. First BanCorp, incorporated under the laws of the Commonwealth of Puerto Rico, is sometimes referred in this Annual Report on Form 10-K as the Corporation, we, or our.

**EXECUTIVE SUMMARY**

First BanCorp is a diversified financial holding company headquartered in San Juan, Puerto Rico offering a full range of financial products to consumers and commercial customers through various subsidiaries. First BanCorp is the holding company of FirstBank Puerto Rico ( FirstBank or the Bank ) and FirstBank Insurance Agency. Through its wholly-owned subsidiaries, the Corporation operates offices in Puerto Rico, the United States and British Virgin Islands and the State of Florida (USA) specializing in commercial banking, residential mortgage loan originations, finance leases, personal loans, small loans, auto loans, insurance agency and broker-dealer activities.

As described in Item 8, Note 30, Regulatory Matters, Commitments and Contingencies, FirstBank is currently operating under a Consent Order ( the FDIC Order ) with the Federal Deposit Insurance Corporation ( FDIC ) and First BanCorp has entered into a Written Agreement (the Written Agreement and collectively with the Order the Agreements ) with the Board of Governors of the Federal Reserve System (the FED or Federal Reserve ).

As discussed in Item 8, Note 1 to the Consolidated Financial Statements, the Corporation has assessed its ability to continue as a going concern and has concluded that, based on current and expected liquidity needs and sources, management expects the Corporation to be able to meet its obligations for the foreseeable future. If unanticipated market factors emerge, or if the Corporation is unable to successfully execute its strategic operating plans, issue a sufficient amount of brokered certificates of deposit ( CDs ) or comply with the Order, its banking regulators could take further action, which could include actions that may have a material adverse effect on the Corporation s business, results of operations and financial position. Also see Liquidity Risk and Capital Adequacy for additional information.

**Capital Plan Execution**

On October 7, 2011, the Corporation successfully completed a private placement of $525 million in shares of common stock (the capital raise ). The proceeds from the capital raise amounted to approximately $490 million (net of offering costs), of which $435 million have been contributed to the Corporation s wholly owned banking subsidiary, FirstBank. Lead investors include funds affiliated with Thomas H. Lee Partners, L.P. ( THL ) and Oaktree Capital Management, L.P. ( Oaktree ) that purchased from the Corporation an aggregate of $348.2 million ($174.1 million each investor) of shares of the Corporation s common stock.

In connection with the closing, the Corporation issued 150 million shares of common stock at $3.50 per share to institutional investors. Upon the completion of this transaction and the conversion into common stock of the Series G Preferred Stock held by the U.S. Treasury, as further discussed below, each of THL and Oaktree became owners of 24.36% of the Corporation s shares of common stock outstanding. Subsequent to the closing, in related transactions, on October 12, 2011 and October 26, 2011, each of THL and Oaktree, respectively, purchased in the aggregate 937,493 shares of common stock from certain of the institutional investors who participated in the capital raise transaction. As of the date of the filing of this Form 10-K, each of THL and Oaktree owns 24.69% of the total shares of common stock outstanding. THL and Oaktree also have the right to designate a person to serve on the Corporation s Board of Directors. In this regard, the Corporation reconstituted its Board of Directors and Michael P. Harmon, a Managing Director with the Principal Group of Oaktree, and Thomas M. Hagerty, a Managing Director at THL were appointed as members of the Bank s and the Corporation s Board of Directors. In addition, Mr. Roberto R. Herencia was appointed as the new non-executive chairman of the Bank s and the Corporation s Board of Directors.

The completion of the capital raise allowed the conversion of the 424,174 shares of the Corporation s Series G Preferred Stock, held by the U.S. Treasury, into 32.9 million shares of common stock at a conversion price of $9.66.

This conversion required for completion the payment of $26.4 million for past due undeclared cumulative dividends on the Series G Preferred Stock as required by the Corporation s agreement with the U.S. Treasury.

Furthermore, On December 8, 2011, the Corporation completed a rights offering in which the Corporation issued an additional 888,781 shares of common stock at $3.50 per share, and received proceeds of $3.3 million.

With the $525 million capital infusion, the conversion to common stock of the Series G Preferred Stock held by the U.S. Treasury, and the issuance of an additional $3.3 million of capital in the rights offering (after deducting estimated offering expenses and the $26.4 million payment of cumulative dividends on the Series G Preferred Stock), the Corporation increased its total common equity by approximately $834 million.

The minimum capital ratios established by the FDIC Order are 12% for Total Capital to Risk-Weighted Assets, 10% for Tier 1 Capital to Risk-Weighted Assets and 8% for Leverage (Tier 1 Capital to Average Total Assets). As of December 31, 2011, the Corporation s Total Capital, Tier 1 Capital and Leverage ratios were 17.12%, 15.79% and 11.91%, respectively, up from 12.02%, 10.73% and 7.57%, respectively, as of December 31, 2010. Meanwhile, FirstBank s Total Capital, Tier 1 Capital and Leverage ratios as of December 31, 2011 were 16.58%, 15.25% and 11.52%, respectively, up from 11.57%, 10.28% and 7.25%, respectively, as of December 31, 2010. All of the capital ratios as of December 31, 2011 are well above the minimum required under the consent order with the FDIC.

**OVERVIEW OF RESULTS OF OPERATIONS**

First BanCorp s results of operations generally depend primarily upon its net interest income, which is the difference between the interest income earned on its interest-earning assets, including investment securities and loans, and the interest expense incurred on its interest-bearing liabilities, including deposits and borrowings. Net interest income is affected by various factors, including: the interest rate scenario; the volumes, mix and composition of interest-earning assets and interest-bearing liabilities; and the re-pricing characteristics of these assets and liabilities. The Corporation s results of operations also depend on the provision for loan and lease losses, which significantly affected the results for the past three years, non-interest expenses (such as personnel, occupancy, deposit insurance premiums and other costs), non-interest income (mainly service charges and fees on loans and deposits and insurance income), gains (losses) on sales of investments, gains (losses) on mortgage banking activities, and income taxes.

Net loss for the year ended December 31, 2011 amounted to $82.2 million compared to a net loss of $524.3 million for 2010 and a net loss of $275.2 million for 2009.

The narrower loss for 2011, as compared to 2010, primarily reflects: (i) a decrease of $398.2 million in the provision for loan and lease losses driven by lower charges to specific reserves on a reduced level of non-performing and adversely classified loans, and declines in charges to general reserves due to reductions in historical loss rates and the overeall decrease of the loan portfolio. The results for 2010 included a $102.9 million charge to the provision for loan and lease losses associated with the transfer of $447 milion loans held for investment to held for sale in anticipation of the strategic sale of adversely classified and non-performing loans completed early in 2011, (ii) a decrease of $93.8 million in the income tax expense as the previous year included an incremental $93.7 million non-cash charge to the valuation allowance of the Bank s deferred tax asset, and (iii) a decrease of $28.1 million in non-interest expenses driven by reductions of $13.3 million in the provision for off-balance sheet exposures, mainly unfunded loan commitments, and the $5.1 million decrease in losses on real estate owned (REO) operations driven by lower write-downs to the value of REO properties as well as lower realized losses on sales. In addition, the FDIC insurance premium assessment decreased by $6.7 million and local regulatory examination fees decreased by $3.0 million driven by the decrease in the level of the Bank s assets. In the case of the FDIC insurance premium, the decrease is also attributed to the Bank s improved capital position. Partially offsetting these variances was a $68.2 million decrease in net interest income, driven by the decline in average earning assets consistent with the Corporation s deleveraging strategies completed in 2011, and a $9.9 million decrease in non-interest income that was mainly associated with lower gains on sale of investments and non-cash charges of $4.2 million related to the Bank s investment in the unconsolidated entity to which FirstBank sold loans with an unpaid principal balance of $510.2 million, mainly non-performing and adversely classified loans, early in 2011 partially offset by higher gains on sale of residential mortgage loans.

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The following table summarizes the effect of the aforementioned factors and other factors that significantly impacted financial results in previous years on net income (loss) attributable to common stockholders and earnings (loss) per common share for the last three years:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2009 | |
| | Dollars | Per Share | Dollars | Per Share | Dollars | Per Share |
| | (In thousands, except for per common share amounts) | | | | | |
| Net (loss) income attributable to common stockholders for prior year | $ (122,045) | $ (10.79) | $ (322,075) | $ (52.22) | $ 69,661 | $ 11.28 |
| Increase (decrease) from changes in: | | | | | | |
| Net interest income | (68,163) | (6.03) | (57,367) | (9.30) | (8,839) | (1.43) |
| Provision for loan and lease losses | 398,238 | 35.21 | (54,729) | (8.87) | (388,910) | (62.97) |
| Net gain on investments and impairments | (14,705) | (1.30) | (29,598) | (4.80) | 63,953 | 10.36 |
| Net nominal gain (loss) on transactions involving the sale of investment securities matched with the cancellation of borrowings prior to maturity | 438 | 0.04 | (291) | (0.05) | | |
| Equity in losses of unconsolidated entities | (4,227) | (0.37) | | | | |
| Other non-interest income | 8,572 | 0.76 | 5,528 | 0.90 | 3,668 | 0.59 |
| Employees compensation and benefits | 2,651 | 0.23 | 11,608 | 1.88 | 9,119 | 1.48 |
| Professional fees | (597) | (0.05) | (6,070) | (0.98) | 592 | 0.10 |
| Deposit insurance premium | 6,689 | 0.59 | (19,710) | (3.20) | (30,471) | (4.94) |
| Net loss on REO operations | 5,148 | 0.46 | (8,310) | (1.35) | (490) | (0.08) |
| Core deposit intangible impairment | | | 3,988 | 0.65 | (3,988) | (0.65) |
| Provision for off-balance sheet exposures | 13,293 | 1.18 | (6,668) | (1.08) | (2,200) | (0.36) |
| All other operating expenses | 920 | 0.08 | 11,105 | 1.80 | 8,708 | 1.41 |
| Income tax provision | 93,819 | 8.30 | (98,607) | (15.99) | (36,266) | (5.87) |
| Net income (loss) before changes in preferred stock dividends, preferred discount amortization and change in average common shares | 320,031 | 28.31 | (571,196) | (92.61) | (315,463) | (51.08) |
| Change in preferred dividends and preferred discount amortization | 38,246 | 3.38 | 8,642 | 1.40 | (6,612) | (1.07) |
| Favorable impact from issuing common stock in the conversion of the Series G Preferred Stock | 277,995 | 24.58 | | | | |
| Favorable impact from issuing common stock in exchange for Series A through E Preferred Stock | (385,387) | (34.07) | 385,387 | 62.49 | | |
| Favorable impact from issuing Series G Preferred Stock in exchange for Series F Preferred Stock | (55,122) | (4.87) | 55,122 | 8.94 | | |
| Change in average common shares | | (15.15) | | 8.99 | | (0.07) |
| Net income (loss) attributable to common stockholders | $ 195,763 | $ 2.18 | $ (122,045) | $ (10.79) | $ (322,075) | $ (52.22) |

In connection with the conversion of the Series G Preferred Stock, held by the U.S. Treasury, into common shares at a discount, completed on October 7,2011, a one-time, non-cash increase in income attributable to common stockholders of $278 million was recognized in the fourth quarter of 2011. This non-cash increase in income available to common stockholders has no effect on the Corporation s overall equity or its regulatory capital. As a result, the Corporation reported a net income attributable to common stockholders on a diluted basis of $195.8 million, or $2.18 per common share in 2011.

The key components of the Corporation s financial results for the year ended December 31, 2011 include the following:

Net interest income for the year ended December 31, 2011 was $393.5 million compared to $461.7 million and $519.0 million for the years ended December 31, 2010 and 2009, respectively. The decrease for 2011 compared to 2010 was largely attributed to the

decline in the volume of interest-earning assets. The decline in the average volume of interest-earning assets reflects the impact of the Corporation s capital plan deleveraging strategies executed in 2011 in order to preserve and improve the capital position. Average interest-earning assets decreased by $3.5 billion when compared to 2010, reflecting a $1.8 billion reduction in average total loans and leases and a $1.7 billion reduction in average investment securities. The decrease in average loans was driven by loan sales combined with repayments and charge-offs. Meanwhile, the decrease in average investment securities was primarily related to sales and prepayments of U.S. agency MBS as well as U.S. agency debt securities called prior to maturity. Partially offsetting the decline in the average volume of earning assets was an increase of 21 basis points in the net interest margin, excluding fair value adjustments on derivatives and financial liabilities measured at fair value, (for definition and reconciliation of this non-GAAP measure, refer to the *Net Interest Income* discussion below). The main driver behind the improvement in the net interest margin (excluding valuations), from 2.61% in 2010 to 2.82% in 2011, was a decrease in the average cost of funds and the utilization of excess liquidity to pay

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down maturing borrowings (mainly brokered CDs). The Corporation achieved improvements in the mix of funding sources with the planned reduction in brokered CDs and increased balances in core deposits. Rates paid in interest-bearing core deposit accounts were lower than the average rate on matured brokered CDs. The average volume of brokered CDs decreased by $1.9 billion during 2011, while the average balance of non-brokered deposits increased by $372.7 million. In addition, the Corporation benefited from the restructuring of $700 million of repurchase agreements that resulted in a decrease of $2.9 million of interest expense and from the early cancellation of $400 million of repurchase agreements matched with the sale of low yielding investment securities. Refer to the Net Interest Income discussion below for additional information.

The decrease in net interest income for 2010, compared to 2009, was mainly associated with the deleveraging of the Corporation s balance sheet in an attempt to preserve its capital position, including sales of approximately $2.3 billion of investment securities during 2010, mainly U.S. agency MBS, and loan repayments. Net interest income was also affected by compressions in the net interest margin mainly due to lower yields on investments and the adverse impact of maintaining higher than historical liquidity levels. Approximately $1.6 billion in investment securities were called during 2010 and were replaced mainly with lower yielding U.S. agency investment securities. These factors were partially offset by the favorable impact of lower deposit pricing and the roll-off and repayments of higher cost funds, such as maturing brokered CDs, and improved spreads in commercial loans.

The provision for loan and lease losses for 2011 was $236.3 million compared to $634.6 million and $579.9 million for 2010 and 2009, respectively. The decrease for 2011, compared to 2010, was mainly related to lower charges to specific reserves on a reduced level of non-performing and adversely classified loans, and declines in charges to general reserves due to reductions in historical loss rates and the overeall decrease of the loan portfolio. The Corporation s net charge-offs for 2011 were $295.5 million, or 2.68% of average loans, compared to $609.7 million, or 4.76% of average loans for 2010. Net charge-offs in 2010 included $165.1 million associated with loans transferred to held for sale and approximately $89.0 million in charge-offs for non-performing loans sold during 2010, mainly construction and commercial mortgage loans sold at a significant discount in order to reduce the Corporation s exposure in Florida. The provision for all major loans categories, except for commercial and industrial ( C&I ) loans, decreased during 2011 and was $59.1 million less than total net charge-offs reflecting the adequacy of previously established reserves. As further explained below, the results for 2010 included a $102.9 million charge to the provision for loan and lease losses associated with the transfer of $447 million in loans held for investment to held for sale in anticipation of the strategic sale of adversely classified and non-performing loans completed early in 2011.

The increase in the provision for loan and lease losses for 2010, compared to 2009,was mainly due to the charge of $102.9 million associated with loans transferred to held for sale during the fourth quarter as a result of an agreement providing for the strategic sale of loans in a transaction designed to accelerate the de-risking of the Corporation s balance sheet and improve the Corporation s risk profile by selling non-performing and adversely classified loans. Excluding the impact of loans transferred to held for sale, the provision decreased $48.2 million during 2010 mainly related to lower charges to specific reserves for the construction and commercial loan portfolio, a slower migration of loans to non-performing status and the overall reduction of the loan portfolio. The provision for loans and lease losses, excluding the impact of loans transferred to held for sale, is a Non-GAAP measure, refer to the Provision for Loan and Lease Losses , Risk Management and Basis of Presentation discussions below for reconciliation and additional information. Much of the decrease in the provision was related to the construction loan portfolio in Florida and the C&I loan portfolio in Puerto Rico.

During the fourth quarter of 2010, the Corporation transferred loans with an unpaid principal balance of $527 million and a book value of $447 million ($335 million of construction loans, $83 million of commercial mortgage loans and $29 million of commercial and industrial loans) to held for sale. The recorded investment in the loans was written down to a value of $281.6 million, which resulted in 2010 fourth quarter charge-offs of $165.1 million (a $127.0 million charge to construction loans, a $29.5 million charge to commercial mortgage loans and a $8.6 million charge to C&I loans). Further, the provision for loan and lease losses was increased by $102.9 million.

On February 16, 2011, the Corporation completed the sale of loans with an unpaid principal balance of $510.2 million (book value of $269.3 million), at a purchase price of $272.2 million to CPG/GS PR NPL, LLC ( CPG/GS ) an entity majority owned by PRLP Ventures LLC, a company created by Goldman, Sachs & Co. and Caribbean Property Group. The purchase price of $272.2 million was funded with an initial cash contribution by PRLP Ventures LLC of $88.5 million received by FirstBank, a promissory note of

approximately $136 million representing seller financing provided by FirstBank, and a $47.6 million or 35% subordinated equity interest in CPG/GS retained by FirstBank. The loan portfolio sold was composed of 73% construction loans, 19% commercial real estate loans and 8% C&I loans. Approximately 93% of the loans were adversely classified loans and 55% were in non-performing status as of December 31, 2010.

The Corporation s primary goal in agreeing to the loan sale transaction was to accelerate the de-risking of the balance sheet and improve the Corporation s risk profile. The Bank has been operating under an Order imposed by banking regulators since June of 2010, which, among other things, requires the Bank to improve its risk profile by reducing the level of classified assets and delinquent loans. The Bank entered into this transaction to reduce the level of classified and non-performing assets and reduce its concentration in construction loans.

The following table summarizes the impact of the loans transferred to held for sale in the financial statements of 2010:

| (In thousands)<br>2010 | As Reported | Loans transferred to Held for Sale Impact | Excluding Loans transferred to Held for Sale Impact (1) |
|---|---|---|---|
| **Total loans held for investment December 31, 2010** | **$ 11,655,436** | **$ (446,675)** | **$ 12,102,111** |
| Construction loans | 700,579 | (334,220) | 1,034,799 |
| Commercial mortgage | 1,670,161 | (83,211) | 1,753,372 |
| Commercial and Industrial | 4,151,764 | (29,244) | 4,181,008 |
| **Total net charge-offs** | **$ 609,682** | **$ 165,057** | **$ 444,625** |
| Total net charge-offs to average loans | 4.76% | | 3.60% |
| Construction loans | 313,153 | 126,950 | 186,203 |
| Construction loans net charge-offs to average loans | 23.80% | | 18.93% |
| Commercial mortgage | 81,420 | 29,506 | 51,914 |
| Commercial mortgage loans net charge-offs to average loans | 5.02% | | 3.38% |
| Commercial and Industrial | 98,473 | 8,601 | 89,872 |
| Commercial and Industrial loans net charge-offs to average loans | 2.16% | | 1.98% |
| **Loans held for sale December 31, 2010** | **$ 300,766** | **$ 281,618** | **$ 19,148** (2) |
| Construction loans | 207,270 | 207,270 | |
| Commercial mortgage | 53,705 | 53,705 | |
| Commercial and Industrial | 20,643 | 20,643 | |
| **Provision for loans and lease losses** | **$ 634,587** | **$ 102,938** | **$ 531,649** |
| **Net Loss** | **$ (524,308)** | **$ (102,938)** | **$ (421,370)** |
| **Non-performing loans December 31, 2010** | **$ 1,398,310** | **$ 103,883** (3) | **$ 1,502,193** |

1 Non-GAAP measures

2 Consists of certain conforming residential mortgage loans held for sale in the ordinary course of business.

3 Represents charge-offs associated to non-performing loans transferred to held for sale.

Non-interest income for the year ended December 31, 2011 was $108.0 million compared to $117.9 million and $142.3 million for the years ended December 31, 2010 and 2009, respectively. The decrease in 2011 was driven by: (i) the impact in the previous year of a $10.7 million gain recorded on the sale of VISA Class C shares, and (ii) equity in losses of unconsolidated entities of $4.2 million recorded in 2011. Partially offsetting these factors was a $9.7 million increase in revenues from mortgage banking activities

driven by a $12.1 million gain recorded in 2011 for bulk sales of approximately $518 million of performing residential mortgage loans to another financial institution. Refer to Non-Interest Income discussion below for additional information.

The decrease in non-interest income in 2010, compared to 2009, was mainly related to lower gains on sale of investments securities, as the Corporation realized gains of approximately $46.1 million on the sale of approximately $1.2 billion of investment securities, mainly U.S. agency MBS, compared to the $82.8 million gain recorded in 2009 mainly related also to U.S. agency MBS. In addition, a nominal loss of $0.3 million was recorded in 2010, resulting from a transaction in which the Corporation sold approximately $1.2 billion in MBS, combined with the unwinding of $1.0 billion of repurchase agreements as part of a balance sheet repositioning strategy. Partially offsetting these factors were: (i) a $6.9 million increase in gains from sales of VISA shares, (ii) a $5.0 million increase in gains from mortgage banking activities resulting from a higher volume of loans sold in the secondary market, and (iii) a $2.1 million increase in broker-dealer fees.

Non-interest expenses for 2011 were $338.1 million compared to $366.2 million and $352.1 million for 2009 and 2008, respectively. The decrease in non-interest expenses for 2011, as compared to 2009, was

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principally attributable to reductions in credit-related losses such as a $13.3 million decrease in the provision for off-balance sheet exposures, driven by reductions in reserves for unfunded loan commitments, and a $5.1 million decrease in losses on real estate owned (REO) operations attributed to lower write-downs to the value of REO properties as well as lower realized losses on sales. In addition, the FDIC insurance premium assessment decreased by $6.7 million and local regulatory examination fees decreased by $3.0 million driven by the decrease in the level of the Bank s assets. In the case of the FDIC insurance premium, the decrease is also attribiuted to the Bank s improved capital position. Furthermore, the Corporation reported a $2.7 million decrease in employees compensation driven by a lower headcount. Refer Non-Interest Expenses discussion below for additional information.

The increase in 2010 compared to 2009 was principally attributable to an increase of $19.7 million in the FDIC insurance premium expense, as premium rates increased and the average level of deposits grew compared to 2009, an increase of $8.3 million in losses on REO operations driven by write-downs and costs associated with a larger inventory, and an increase of $6.1 million in professional fees. These increases were partially offset by: (i) a decrease of $11.6 million in employees compensation driven by reductions in bonuses and other employee benefits as well as reductions in headcount, (ii) the impact in 2009 of a $4.0 million core deposit intangible impairment charge, and (iii) reductions in other controllable expenses such as a $2.8 million decrease in occupancy expenses and a $1.8 million decrease in marketing-related expenses.

For 2011, the Corporation recorded an income tax expense of $9.3 million, compared to $103.1 million and $4.5 million in 2010 and 2009, respectively. The fluctuation over those was mainly related to an incremental $93.7 million non-cash charge in the fourth quarter of 2010 to the valuation allowance on the Bank s deferred tax asset. Refer to Income Taxes discussion below for additional information.

Total assets as of December 31, 2011 amounted to $13.1 billion, a decrease of $2.5 billion compared to $15.6 billion as of December 31, 2010. The Corporation continued to deleverage its balance sheet and total loans decreased by $1.3 billion mainly attributed to loan sales, including the sale of $518 million of performing residential mortgage loans to another financial institution and the aforementioned sale of a pool of loans, mainly adversely classified loans, with a book value of $269 million to CPG/GS. Charge-offs, sales of trouble assets in Florida and Puerto Rico, foreclosures and prepayments also contributed to a lower loan portfolio. Also, there was a decrease of $1.3 billion in investment securities driven by sales and prepayments of U.S. agency MBS, sales of low yielding U.S. Treasury Notes and, U.S. agency debt securities called prior to maturity. The Corporation used proceeds from sales of loans and securities to paydown maturing brokered CDs and for the early cancellation of repurchase agreements. The decrease in assets is consistent with the Corporation s deleveraging, de-risking and balance sheet repositioning strategies, to among other things, improve its capital position and enhance net interest margins in the future. Refer to the Financial Condition and Operating Data Analysis discussion below for additional information.

As of December 31, 2011, total liabilities amounted to $11.7 billion, a decrease of $2.9 billion as compared to $14.5 billion as of December 31, 2010. The decrease in total liabilities was mainly attributable to a $2.5 billion decrease in brokered CDs, a $400 million decrease in repurchase agreements repaid prior to its schedule maturity, and a $286.0 million decrease in advances from the FHLB. Partially offsetting the aforementioned decreases was an increase of $376.6 million in non-brokered deposits. Refer to the Risk Management Liquidity Risk and Capital Adequacy discussion below for additional information about the Corporation s funding sources.

The Corporation s stockholders equity amounted to $1.4 billion as of December 31, 2011, an increase of $386.2 million compared to the balance as of December 31, 2010, driven by net proceeds of $466.9 million in the recently completed capital raise and rights offering (net of issuance costs and the $26.4 million dividend payment on the Series G Preferred Stock) and an increase of $1.5 million in accumulated other comprehensive income due to higher unrealized gains on available-for-sale investment securities. Partially offsetting these items was the net loss of $82.2 million for 2011. After the completion of the capital raise, the rights offering and the conversion of the Series G Preferred Stock into common stock, the Corporation increased its total common equity to $1.4 billion as of December 31, 2011 from $633.0 million at the end of 2010. Mainly as a result of these transactions, the Corporation s Total Capital, Tier 1 Capital and Leverage ratios increased to 17.12%, 15.79% and 11.91%, respectively, from 12.02%, 10.73% and 7.57%, respectively, as of December 31, 2010. Meanwhile, FirstBank s Total Capital, Tier 1 Capital and Leverage ratios as of December 31, 2011 were 16.58%, 15.25% and 11.52%, respectively, up from 11.57%, 10.28% and 7.25%, respectively, as of December 31, 2010. In addition, the Corporation s tangible common equity ratio increased to 10.25% as of December 31, 2011, from 3.80% as of December 31, 2010 and the Tier 1 common

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ratio to risk-weighted assets ratio increased to 12.96% as of December 31, 2010 from 5.01% as of December 31, 2010. Refer to the Risk Management Capital section below for additional information including further information about these non-GAAP financial measures and the Corporation s capital plan execution. Although all the regulatory capital ratios exceeded the established well capitalized levels, as well as the minimum capital ratios required by the FDIC Order, as of December 31, 2011, FirstBank cannot be treated as a well-capitalized institution under regulatory guidance while operating under the FDIC Order.

Total loan production, including purchases, refinancings and draws from existing commitments, for 2011 was $2.7 billion, compared to $3.0 billion for 2010, as the Corporation continues with its targeted lending activities. The decrease in loan production was mainly related to credit facilities granted to government entities, a decline of $263.7 million, partially offset by increases in residential and C&I loan originations.

Total non-performing loans, including non-performing loans held for sale, were $1.14 billion as of December 31, 2011 compared to $1.40 billion as of December 31, 2010, a decrease of $255.2 million. The completion of the aforementioned loan sale transaction with CPG/GS removed approximately $153.6 million of non-performing loans from the balance sheet. Although non-performing loans decreased as a result of this transaction, the Corporation s investment in CPG/GS is subordinated to the interests of other investors in the entity and, accordingly, the Corporation s investment in CPG/GS in the amount of $43.4 million as of December 31, 2011 is subject to risk. Excluding the impact of this loan sale transaction, non-performing loans decreased by $100.6 million, reflecting decreases in almost all major loan categories, with the exception of commercial mortgage loans. Non-performing residential mortgage loans decreased by $53.9 million driven by loans modified that successfully completed a trial period prior to be restored to accrual status, charge-offs and foreclosures. Other decreases were reflected in non-performing C&I loans held for investment, a decrease of $47.1 million, driven by the sale of a $37 million participation in a syndicated loan, a decrease of $9.8 million in non-performing consumer loans (including finance leases), and a decrease of $13.0 million in non-performing construction loans that was primarily associated with net charge-offs and the repossession and subsequent sale of the underlying collateral of a $33.0 million residential project in Florida. These decreases were partially offset by an increase of $23.2 million in non-performing commercial mortgage loans driven by the inflow to non-performing status of a $36.6 million relationship. It is important to note that while the Corporation did place this relationship in non-accrual status in the fourth quarter of 2011, the relationship is current on its payments and the Corporation has already noted some positives in its performance. Refer to the Risk Management Non-accruing and Non-performing Assets section below for additional information.

## CRITICAL ACCOUNTING POLICIES AND PRACTICES

The accounting principles of the Corporation and the methods of applying these principles conform with generally accepted accounting principles in the United States ( GAAP ). The Corporation s critical accounting policies relate to the 1) allowance for loan and lease losses; 2) other-than-temporary impairments; 3) income taxes; 4) classification and related values of investment securities; 5) valuation of financial instruments; and 6) income recognition on loans. These critical accounting policies involve judgments, estimates and assumptions made by management that affect the amounts recorded for assets and liabilities and for contingent liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates, if different assumptions or conditions prevail. Certain determinations inherently require greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than those originally reported.

### Allowance for Loan and Lease Losses

The Corporation maintains the allowance for loan and lease losses at a level considered adequate to absorb losses currently inherent in the loan and lease portfolio. The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable losses believed to be inherent in the loan portfolio that have not been specifically identified. The determination of the allowance for loan and lease losses requires significant estimates, including the timing and amounts of expected future cash flows on impaired loans, consideration of current economic conditions, and historical loss experience pertaining to the portfolios and pools of homogeneous loans, all of which may be susceptible to change.

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The adequacy of the allowance for loan and lease losses is based on judgments related to the credit quality of the loan portfolio. These judgments consider on-going evaluations of the loan portfolio, including such factors as the economic risks associated to each loan class, the financial condition of specific borrowers, the level of delinquent loans, the value of any collateral and, where applicable, the existence of any guarantees or other documented support. In addition, to the general economic conditions and other factors described above, additional factors also considered include: the impact of changes in the residential real estate value and the internal risk ratings assigned to the loan. Internal risk ratings are assigned to each business loan at the time of approval and are subject to subsequent periodic reviews by the Corporation s senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation s continued evaluation of its asset quality.

The allowance for loan and lease losses is increased through a provision for credit losses that is charged to earnings, based on the quarterly evaluation of the factors previously mentioned, and is reduced by charge-offs, net of recoveries.

The allowance for loan and lease losses consists of specific reserves related to specific valuations for loans considered to be impaired and general reserves. A specific valuation allowance is established for those loans in the Commercial Mortgage, Construction and Commercial and Industrial and Residential Mortgage loan portfolios classified as impaired, primarily when the collateral value of the loan (if the impaired loan is determined to be collateral dependent) or the present value of the expected future cash flows discounted at the loan s effective rate is lower than the carrying amount of that loan. The specific valuation allowance is computed on commercial mortgage, construction, commercial and industrial, and real estate loans with individual principal balances of $1 million or more, TDRs which are individually evaluated, as well as smaller residential mortgage loans and home equity lines of credit considered impaired based on their delinquency and loan-to-value levels. When foreclosure is probable, the impairment measure is based on the fair value of the collateral. The fair value of the collateral is generally obtained from appraisals. Updated appraisals are obtained when the Corporation determines that loans are impaired and are generally updated annually thereafter. In addition, appraisals and/or broker price opinions are also obtained for residential mortgage loans based on specific characteristics such as delinquency levels, age of the appraisal, and loan-to-value ratios. The excess of the recorded investment in collateral dependent loans over the resulting fair value of the collateral is charged-off when deemed uncollectible. For residential mortgage loans the determination of reserves included the incorporation of updated loss factors applicable to loans expected to liquidate over the next twelve months considering the expected realization of similar asset values at disposition.

For all other loans, which include, small, homogeneous loans, such as auto loans, all classes in the consumer loans portfolio, residential mortgages in amounts under $1 million, and commercial and construction loans not considered impaired, the Corporation maintains a general valuation allowance. The risk category of these loans is based on the delinquency and the Corporation updates the factors used to compute the reserve factors on a quarterly basis. The general reserve is primarily determined by applying loss factors according to the loan type and assigned risk category (pass, special mention and substandard not impaired; all doubtful loans are considered impaired). The general reserve for consumer loans is based on factors such as delinquency trends, credit bureau score bands, portfolio type, geographical location, bankruptcy trends, recent market transactions, collateral values, and other environmental factors such as economic forecasts. The analyses of the residential mortgage pools are performed at the individual loan level and then aggregated to determine the expected loss ratio. The model applies risk-adjusted prepayment curves, default curves, and severity curves to each loan in the pool. The severity is affected by the expected house price scenario based on recent house price trends. Default curves are used in the model to determine expected delinquency levels. The risk-adjusted timing of liquidation and associated costs is used in the model and is risk-adjusted for the area in which the property is located (Puerto Rico, Florida, or Virgin Islands). For commercial loans, including construction loans, the general reserve is based on historical loss ratios. Loss ratios are based on the moving average of charge-offs over a historical 24-month loss period, applying adjustments, as necessary to each loss rate based on assessments of recent charge-off trends (12 months), collateral values, and economic and business influences impacting expected losses. The methodology of accounting for all probable losses in loans not individually measured for impairment purposes is made in accordance with authoritative accounting guidance that requires that losses be accrued when they are probable of occurring and estimable.

*Charge-off of Uncollectible Loans* Loan and lease losses are charged-off and recoveries are credited to the allowance for loan and lease losses. Collateral dependent loans in the Construction, Commercial Mortgage and Commercial and Industrial loan portfolios are charged-off to their fair value when loans are considered impaired. Within the consumer loan portfolio, loans in the auto and finance leases classes are reserved at 120 days delinquent and charged-off to their estimated net realizable value when collateral deficiency is deemed uncollectible (i.e. when foreclosure is probable). Within the other consumer loans class, closed-end loans are charged-off when payments

are 120 days in arrears and open-end (revolving credit) consumer loans are charged-off when payments are 180 days in arrears. Residential mortgage loans individually evaluated for impairment purposes based on its delinquency and original loan to value levels are charged-off to its fair value when there is a collateral deficiency on a quarterly basis. Any loan in any portfolio may be charged-off or written down to the fair value of the collateral prior to the policies described above if a loss confirming event occurred. Loss confirming events include, but are not limited to, bankruptcy (unsecured), continued delinquency, or receipt of an asset valuation indicating a collateral deficiency and that asset is the sole source of repayment.

**Other-than-temporary impairments**

On a quarterly basis, the Corporation performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered OTTI. A security is considered impaired if the fair value is less than its amortized cost basis.

The Corporation evaluates if the impairment is other-than-temporary depending upon whether the portfolio consists of fixed income securities or equity securities as further described below. The Corporation employs a systematic methodology that considers all available evidence in evaluating a potential impairment of its investments.

The impairment analysis of fixed income securities places special emphasis on the analysis of the cash position of the issuer and its cash and capital generation capacity, which could increase or diminish the issuer s ability to repay its bond obligations, the length of time and the extent to which the fair value has been less than the amortized cost basis and changes in the near-term prospects of the underlying collateral, if applicable, such as changes in default rates, loss severity given default and significant changes in prepayment assumptions. The Corporation also takes into consideration the latest information available about the overall financial condition of an issuer, credit ratings, recent legislation and government actions affecting the issuer s industry and actions taken by the issuer to deal with the present economic climate. OTTI losses on debt securities must be recognized in earnings if the Corporation has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Corporation does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred. An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI, if any, is recorded as a component of Net impairment losses on investment securities in the statements of (loss) income, while the remaining portion of the impairment loss is recognized in other comprehensive income, net of taxes, provided the Corporation does not intend to sell the underlying debt security and it is more likely than not that the Corporation will not have to sell the debt security prior to recovery. The previous amortized cost basis less the OTTI recognized in earnings is the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value. However, for debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected is accreted as interest income. For further disclosures, refer to Note 4 to the consolidated financial statements.

The impairment model for equity securities was not affected by the aforementioned FASB amendment. The impairment analysis of equity securities is performed and reviewed on an ongoing basis based on the latest financial information and any supporting research report made by a major brokerage firm. This analysis is very subjective and based, among other things, on relevant financial data such as capitalization, cash flow, liquidity, systematic risk, and debt outstanding of the issuer. Management also considers the issuer s industry trends, the historical performance of the stock, credit ratings as well as the Corporation s intent to hold the security for an extended period. If management believes there is a low probability of recovering book value in a reasonable time frame, then an impairment will be recorded by writing the security down to market value. As previously mentioned, equity securities are monitored on an ongoing basis but special attention is given to those securities that have experienced a decline in fair value for six months or more. An impairment charge is generally recognized when the fair value of an equity security has remained significantly below cost for a period of twelve consecutive months or more.

**Income Taxes**

The Corporation is required to estimate income taxes in preparing its consolidated financial statements. This involves the estimation of current income tax expense together with an assessment of temporary differences resulting from differences in the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The determination of current income tax expense involves estimates and assumptions that require the Corporation to assume certain positions based on its interpretation of current tax

regulations. Management assesses the relative benefits and risks of the appropriate tax treatment of transactions, taking into account statutory, judicial and regulatory guidance and recognizes tax benefits only when deemed probable. Changes in assumptions affecting estimates may be required in the future and estimated tax liabilities may need to be increased or decreased accordingly. The accrual of tax contingencies is adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation. The Corporation s effective tax rate includes the impact of tax contingencies and changes to such accruals, as considered appropriate by management. When particular matters arise, a number of years may elapse before such matters are audited by the taxing authorities and finally resolved. Favorable resolution of such matters or the expiration of the statute of limitations may result in the release of tax contingencies which are recognized as a reduction to the Corporation s effective rate in the year of resolution. Unfavorable settlement of any particular issue could increase the effective rate and may require the use of cash in the year of resolution. Information regarding income taxes is included in Note 26 to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K.

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of the Corporation s net deferred tax asset assumes that the Corporation will be able to generate sufficient future taxable income based on estimates and assumptions. If these estimates and related assumptions change, the Corporation may be required to record valuation allowances against its deferred tax asset resulting in additional income tax expense in the consolidated statements of income. Management evaluates its deferred tax asset on a quarterly basis and assesses the need for a valuation allowance, if any. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax asset will not be realized. Changes in the valuation allowance from period to period are included in the Corporation s tax provision in the period of change (see Note 26 to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K).

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is creditable, within certain conditions and limitations, against the Corporation s Puerto Rico tax liability. The Corporation is also subject to taxes on its income from sources within the U.S. Virgin Islands. Any such tax paid is also creditable against the Corporation s Puerto Rico tax liability, subject to certain conditions and limitations.

On January 31, 2011, the Puerto Rico Government approved Act No. 1, which repealed the 1994 Code ( 1994 PR Code ) and replaces it with the Puerto Rico Internal Revenue Code of 2011 ( 2011 PR Code ). The provisions of the 2011 PR Code are generally applicable to taxable years commencing after December 31, 2010. Under the 2011 PR Code, the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operation loss, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carry forward period (7 years under the 2011 PR Code for losses incurred during tax year, except for losses incurred during tax years commenced after December 31, 2004 and before December 31, 2012 that the carryforward period is extended to 10 years). The 2011 PR Code provides a dividend received deduction of 100% on dividends received from controlled subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations. Dividend payments from a U.S. subsidiary to the Corporation are subject to a 10% withholding tax based on the provisions of the U.S. Internal Revenue Code.

Under the 2011 PR Code, First BanCorp is subject to a maximum statutory tax rate of 30% (25% for taxable years commencing after December 31, 2013 if certain economic conditions are met by the Puerto Rico economy). The 2011 PR Code also includes an alternative minimum tax of 20% that applies if the Corporation s regular income tax liability is less than the alternative minimum tax requirements. Prior to the 2011 PR Code, First BanCorp maximum statutory tax rate was 39% except for tax years commenced after December 31, 2008 and before January 1, 2012 which was 40.95% due to the approval by the Puerto Rico Government of Act No. 7 (the Act ), to stimulate Puerto Rico s economy and to reduce the Puerto Rico Government s fiscal deficit. The act imposed a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which was applicable to corporation, among others, whose combined income exceeds $100,000, effectively resulting in an increased in the maximum statutory tax rate from 39% to 40.95% and an increase in capital gain statutory tax rate from 15% to 15.75%.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through International Banking Entity ( IBE ) of the Bank and through the Bank s subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales in exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which the Act No. 7 imposed a special 5% tax to all IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs net income exceeds 20% of the bank s total net taxable income.

The FASB issued authoritative guidance that prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under the authoritative accounting guidance, income tax benefits are recognized and measured upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this model and the tax benefit claimed on a tax return is referred to as an Unrecognized Tax Benefit ( UTB ). The Corporation classifies interest and penalties, if any, related to UTBs as components of income tax expense. Refer to Note 26 of the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for further information related to this accounting guidance.

**Investment Securities Classification and Related Values**

Management determines the appropriate classification of debt and equity securities at the time of purchase. Debt securities are classified as held to maturity when the Corporation has the intent and ability to hold the securities to maturity. Held-to-maturity ( HTM ) securities are stated at amortized cost. Debt and equity securities are classified as trading when the Corporation has the intent to sell the securities in the near term. Debt and equity securities classified as trading securities, if any, are reported at fair value, with unrealized gains and losses included in earnings. Debt and equity securities not classified as HTM or trading, except for equity securities that do not have readily available fair values, are classified as available for sale ( AFS ). AFS securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported net of deferred taxes in accumulated other comprehensive income (a component of stockholders equity) and do not affect earnings until realized or are deemed to be other-than-temporarily impaired. Investments in equity securities that do not have publicly and readily determinable fair values are classified as other equity securities in the statement of financial condition and carried at the lower of cost or realizable value. The assessment of fair value applies to certain of the Corporation s assets and liabilities, including the investment portfolio. Fair values are volatile and are affected by factors such as market interest rates, prepayment speeds and discount rates.

**Valuation of financial instruments**

The measurement of fair value is fundamental to the Corporation s presentation of its financial condition and results of operations. The Corporation holds fixed income and equity securities, derivatives, investments and other financial instruments at fair value. The Corporation holds its investments and liabilities on the statement of financial condition mainly to manage liquidity needs and interest rate risks. A significant part of these assets and liabilities is reflected at fair value on the Corporation s financial statements.

The FASB authoritative guidance for fair value measurements defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs may be used to measure fair value:

**Level 1** Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

**Level 2** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**Level 3** Valuations are observed from unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following is a description of the valuation methodologies used for instruments measured at fair value:

*Medium-Term Notes (Level 2 inputs)*

The fair value of the medium-term note is computed using a discounted cash flow analysis over the full term of the borrowings using the notional amount outstanding. The discount rate used in the valuation considers the 3-month LIBOR forward curve and the credit spread at every cash flow.

*Investment Securities*

The fair value of investment securities is the market value based on quoted market prices (as is the case with equity securities, U.S. Treasury Notes and non-callable U.S. Agency debt securities), when available, or market prices for identical or comparable assets (as is the case with MBS and callable U.S. agency debt) that are based on observable market parameters including benchmark yields, reported trades, quotes from brokers or dealers, issuer spreads, bids, offers and reference data, including market research operations. Observable prices in the market already consider the risk of nonperformance. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument (Level 3), as is the case with certain private label MBS held by the Corporation. Unlike U.S. agency MBS, the fair value of these private label securities cannot be readily determined because they are not actively traded in securities markets. Significant inputs used for fair value determination consist of specific characteristics such as information used in the prepayment model, which follows the amortizing schedule of the underlying loans, which is an unobservable input.

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States; the interest rate on the securities is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread bias on a non-rated security. The market valuation is derived from a model that utilizes relevant assumptions such as prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (i.e. loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, others) in combination with prepayment forecasts obtained from a commercially available prepayment model (ADCO). The variable cash flow of the security is modeled using the 3-month LIBOR forward curve. Loss assumptions were driven by the combination of default and loss severity estimates, taking into account loan credit characteristics (loan-to-value, state, origination date, property type, occupancy loan purpose, documentation type, debt-to-income ratio, other) to provide an estimate of default and loss severity. Refer to Note 4 of the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for additional information about assumptions used in the valuation of private label MBS.

*Derivative Instruments*

The fair value of most of the derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparties when appropriate, except when collateral is pledged. That is, on interest rate swaps, the credit risk of both counterparties is included in the valuation; and on options and caps, only the seller s credit risk is considered. The derivative instruments, namely swaps and caps, were valued using a discounting cash flows approach using US LIBOR and swap rate for each cash flow. Derivatives include interest rate swaps used for protection against rising interest rates and, prior to June 30, 2009, included interest rate swaps to economically hedge brokered CDs and medium-term notes. For these interest rate

swaps, a credit component is not considered in the valuation since the Corporation has fully collateralized with investment securities any mark-to-market loss with the counterparty and, if there were market gains, the counterparty had to deliver collateral to the Corporation.

Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full.

Certain derivatives with limited market activity, as is the case with derivative instruments named as reference caps, were valued using models that consider unobservable market parameters (Level 3). Reference caps were used mainly to hedge interest rate risk inherent in private label MBS, thus were tied to the notional amount of the underlying fixed-rate mortgage loans originated in the United States. The counterparty to these derivative instruments failed on April 30, 2010. The Corporation currently has a claim with the FDIC and the exposure to fair value of $3.0 million was recorded as an accounts receivable. The Corporation no longer accounts for these reference caps as derivative instruments. In the past, significant inputs used for fair value determination consisted of specific characteristics such as information used in the prepayment model which follow the amortizing schedule of the underlying loans, which was an unobservable input. The valuation model used the Black formula, which is a benchmark standard in the financial industry. The Black formula is similar to the Black-Scholes formula for valuing stock options except that the spot price of the underlying is replaced by the forward price. The Black formula uses as inputs the strike price of the cap, forward LIBOR rates, volatility estimates and discount rates to estimate the option value. LIBOR rates and swap rates are obtained from Bloomberg L.P. ( Bloomberg ) every day and are used to build a zero coupon curve based on the Bloomberg LIBOR/Swap curve. The discount factor is then calculated from the zero coupon curve. The cap is the sum of all caplets. For each caplet, the rate is reset at the beginning of each reporting period and payments are made at the end of each period. The cash flow of the caplet is then discounted from each payment date.

**Income Recognition on Loans**

Loans are stated at the principal outstanding balance, net of unearned interest, unamortized deferred origination fees and costs and unamortized premiums and discounts. Fees collected and costs incurred in the origination of new loans are deferred and amortized using the interest method or a method which approximates the interest method over the term of the loan as an adjustment to interest yield. Unearned interest on certain personal, auto loans and finance leases is recognized as income under a method which approximates the interest method. When a loan is paid off or sold, any unamortized net deferred fee (cost) is credited (charged) to income.

Classes are usually disaggregations of a portfolio. For allowance for loan and lease losses purposes, the Corporation s portfolios are: Commercial Mortgage, Construction, Commercial and Industrial, Residential Mortgages, and Consumer loans. The classes within the Residential Mortgage are residential mortgages guaranteed by government organization and other loans. The classes within the Consumer portfolio are: auto, finance leases and other consumer loans. Other consumer loans mainly include unsecured personal loans, home equity lines, lines of credits, and marine financing. The Construction, Commercial Mortgage and Commercial and Industrial are not further segmented into classes.

*Non-Performing and Past Due Loans* Loans on which the recognition of interest income has been discontinued are designated as non-performing. Loans are classified as non-performing when interest and principal have not been received for a period of 90 days or more, with the exception of FHA/VA and other guaranteed residential mortgages which continue to accrue interest. The Corporation continues to accrue interest on government guaranteed loans since principal and interest are guaranteed by the U.S. government, therefore, the risk of loss on these types of loans is very low. Any loan in any portfolio may be placed on non-performing status prior to the policies describe above when there are doubts about the potential to collect all of the principal based on collateral deficiencies or, in other situations, when collection of all of the principal or interest is not expected under the contractual terms due to deterioration in the financial condition of the borrower. For all classes within the loan portfolios, when a loan is placed on non-performing status, any accrued but uncollected interest income is reversed and charged against interest income. Interest income on non-performing loans is recognized only to the extent it is received in cash. However, where there is doubt regarding the ultimate collectability of loan principal, all cash thereafter received is applied to reduce the carrying value of such loans (i.e., the cost recovery method). Loans are restored to accrual status only when future payments of interest and principal are reasonably assured.

*Impaired Loans* A loan in any class is considered impaired when, based upon current information and events, it is probable that the Corporation will be unable to collect all amounts due (including principal and interest) according

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to the contractual terms of the loan agreement. The Corporation measures impairment individually for those loans in the Construction, Commercial Mortgage and Commercial and Industrial portfolios with a principal balance of $1 million or more, including loans for which a charge-off has been recorded based upon the fair value of the underlying collateral. The Corporation also evaluates for impairment purposes certain residential mortgage loans and home equity lines of credit with high delinquency and loan-to-value levels. Generally, consumer loans within any class are not individually evaluated on a regular basis for impairment except for impaired marine financing loans over $1 million and home equity lines with high delinquency and loan-to-value levels.

Impaired loans also include loans that have been modified in troubled debt restructurings ( TDRs ). A restructuring of a loan constitutes a TDR if the creditor for economic or legal reasons related to the debtor s financial difficulties, grants a concession to the debtor that it would not otherwise consider. TDRs typically result from the Corporation s loss mitigation activities and in accordance with guidelines of the government s Home Affordable Mortgage Program, and could include rate reductions, principal forgiveness, forbearance, refinancing of any past due amounts, including interest, escrow and late charges and fees, extensions of maturities and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower s ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Refer to Note 8 for additional qualitative and quantitative information about TDRs. Refer to Note 8 of the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for additional qualitative and quantitative information about TDRs.

The Corporation removes loans from TDR classification, consistent with authoritative guidance, that allows for a TDR to be removed from this classification in years following the modification only when the following two circumstances are met:

(i) The loan is in compliance with the terms of the restructuring agreement and, therefore, is not considered impaired; and

(ii) The loan yields a market interest rate at the time of the restructuring. In other words, the loan was restructured with an interest rate equal to or greater than what the Corporation would have been willing to accept at the time of the restructuring for a new loan with comparable risk.

If both of the conditions are met in, the loan can be removed from the TDR classification in calendar years after the year in which the restructuring took place. A sustained performance period, generally six months, is required prior to removal from TDR classification.

With respect to loan splits, generally, Note A of a loan split is restructured under market terms, and Note B is fully charged-off. If Note A is in compliance with the restructured terms in years following the restructuring, Note A will be removed from the TDR classification.

Interest income on impaired loans in any class is recognized based on the Corporation s policy for recognizing interest on accrual and non-accrual loans.

Loans that are past due 30 days or more as to principal or interest are considered delinquent, with the exception of the residential mortgage, commercial mortgage and construction portfolios that are considered past due when the borrower is in arrears 2 or more monthly payments.

**Recent Accounting Pronouncements**

The FASB has issued the following accounting pronouncements and guidance relevant to the Corporation s operations:

In December 2010, the FASB updated the Accounting Standards Codification ( Codification ) to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. As a result, GAAP improved by eliminating an entity s ability to assert that a reporting unit is not required to perform Step 2 because the carrying amount of the reporting unit is zero or negative despite the existence of qualitative factors that indicate the goodwill is more likely than not impaired. As a result, goodwill impairments may be reported sooner than under current practice. The objective of this Update is to address questions about entities with reporting units with zero or negative carrying amounts because some entities concluded that Step 1 of the test is passed in those circumstances because the fair value of their reporting unit will generally be greater than zero. As a result of that conclusion, some constituents raised concerns that Step 2 of the test is not performed despite factors indicating that goodwill may be impaired. The amendments in this Update do not provide guidance on how to determine the carrying amount or measure the fair value of the reporting unit. For public entities, the amendments in this Update were effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The adoption of this guidance did not have an impact on the Corporation s financial statements.

In December 2010, the FASB updated the Codification to clarify required disclosures of supplementary pro forma information for business combinations. The amendments specify that, if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the year had occurred as of the beginning of the comparable prior annual period only. Additionally, the Update expands disclosures to include a description of the nature and amount of material nonrecurring pro forma adjustments directly attributable to the business combination included in the pro forma revenue and earnings. This guidance was effective for reporting periods beginning after December 15, 2010; early adoption is permitted. The Corporation adopted this guidance with no impact on the financial statements.

In April 2011, the FASB updated the Codification to clarify the guidance on a creditor s evaluation of whether a restructuring constitutes a troubled debt restructuring ( TDR ). Under the amendments, a creditor must separately conclude that a loan modification constitutes a concession and that the debtor is experiencing financial difficulties when evaluating whether a loan modification constitutes a TDR. If a creditor determines that it has granted a concession to a debtor, the creditor must make a separate assessment about whether the debtor is experiencing financial difficulties to determine whether the restructuring constitutes a TDR. The amendments clarify the guidance on a creditor s evaluation of whether it has granted a concession and what constitutes financial difficulty. In addition, the amendments clarify that a creditor is precluded from using the effective interest rate test in the debtor s guidance on restructuring of payables when evaluating whether a restructuring constitutes a TDR. The amendments in this Update are effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The Corporation adopted this guidance during the third quarter of 2011. As a result of adopting the amendments in this Update, the Corporation reassessed all restructurings that occurred on or after the beginning of the current fiscal year (January 1, 2011) for identification as troubled debt restructurings. Upon identifying those receivables as troubled debt restructurings, the Corporations identified them as impaired under the applicable guidance. The amendments in this Update require prospective application of the impairment measurement guidance for those receivables newly identified as TDRs. At the end of the first interim period of adoption (September 30, 2011), the recorded investment in receivables newly identified as TDR under the applicable guidance of this Update was $99.5 million, and the allowance for credit losses associated with those receivables, on the basis of a current evaluation of loss as of September 30, 2011, was $13.0 million. Refer to Note 8 of the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for required disclosures and additional information.

In April 2011, the FASB updated the Codification to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this Update remove from the assessment of effective control the criterion relating to the transferor s ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. The Board concluded that this criterion is not a determining factor of effective control. Consequently, the amendments in this Update also eliminate the requirement to demonstrate that the transferor possesses adequate collateral to fund substantially all the cost of purchasing replacement financial assets. Eliminating the transferor s ability criterion and related implementation guidance from an entity s assessment of effective control should improve the accounting for repurchase agreements and other similar transactions. The amendments in this Update are effective for the

first interim or annual period beginning on or after December 15, 2011, and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Corporation is currently evaluating the impact of the adoption of this guidance on the financial statements.

In May 2011, the FASB updated the Codification to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards (IFRSs). The amendments in this Update apply to all reporting entities that are required or permitted to measure or disclose the fair value of an asset, a liability, or an instrument classified in a reporting entity s shareholders equity in the financial statements and result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. The amendments in this Update are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted. The Corporation is currently evaluating the impact of the adoption of this guidance on the financial statements.

In June 2011, the FASB updated the Codification to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. Under the amendments, an entity has the option to present the total comprehensive income either in a single continuous statement or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. Additionally, this update requires consecutive presentation of the statement of net income and other comprehensive income and requires an entity to present reclassification adjustments on the face of the financial statements from other comprehensive income to net income. The amendments in this Update should be applied retrospectively and are effective for fiscal years beginning after December 15, 2011. Early adoption is permitted, because compliance with the amendments is already permitted. The amendments do not require any transition disclosures. Beginning with the financial statements for the quarter and six-month period ended June 30, 2011, the Corporation is following the guidance of consecutive presentation of the statement of net income and other comprehensive income.

In September 2011, the FASB updated the Codification to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. The amendments in this Update are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity s financial statements for the most recent annual or interim period have not yet been issued. The Corporation is currently evaluating the impact, if any, of the adoption of this guidance on its financial statements.

In December 2011, the FASB updated the Codification to clarify the guidance on the derecognition of in substance real estate in order to resolve the diversity in practice when a parent ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary s nonrecourse debt. Under the amendments in this Update, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary s nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. That is, even if the reporting entity ceases to have a controlling financial interest, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary s operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. The Corporation is currently evaluating the impact, if any, of the adoption of this guidance on its financial statements.

In December 2011, the FASB updated the Codification to enhance and provided converged disclosures about financial and derivative instruments that are either offset on the balance sheet, or are subject to an enforceable master netting arrangement (or other similar arrangement). Entities are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The amendments in this Update are effective for interim and annual period beginning on or after January 1, 2013. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its financial statements.

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## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income is the excess of interest earned by First BanCorp on its interest-earning assets over the interest incurred on its interest-bearing liabilities. First BanCorp s net interest income is subject to interest rate risk due to the re-pricing and maturity mismatch of the Corporation s assets and liabilities. Net interest income for the year ended December 31, 2011 was $393.5 million, compared to $461.7 million and $519.0 million for 2010 and 2009, respectively. On a tax-equivalent basis and excluding the changes in the fair value of derivative instruments and unrealized gains and losses on liabilities measured at fair value net interest income for the year ended December 31, 2011 was $406.0 million, compared to $489.8 million and $567.2 million for 2010 and 2009, respectively.

The following tables include a detailed analysis of net interest income. Part I presents average volumes and rates on an adjusted tax-equivalent basis and Part II presents, also on an adjusted tax-equivalent basis, the extent to which changes in interest rates and changes in volume of interest-related assets and liabilities have affected the Corporation s net interest income. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in volume multiplied by prior period rates), and (ii) changes in rate (changes in rate multiplied by prior period volumes). Rate-volume variances (changes in rate multiplied by changes in volume) have been allocated to the changes in volume and rate based upon their respective percentage of the combined totals.

The net interest income is computed on an adjusted tax-equivalent basis and excluding: (1) the change in the fair value of derivative instruments, and (2) unrealized gains or losses on liabilities measured at fair value. For definition and reconciliation of this non-GAAP measure, refer to discussions below.

**Part I**

| Year Ended December 31, | Average volume | | | Interest income(1) / expense | | | Average rate(1) | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| | (Dollars in thousands) | | | | | | | | |
| Interest-earning assets: | | | | | | | | | |
| Money market & other short-term investments | $ 567,548 | $ 778,412 | $ 182,205 | $ 1,556 | $ 2,049 | $ 577 | 0.27% | 0.26% | 0.32% |
| Government obligations (2) | 1,350,505 | 1,368,368 | 1,345,591 | 20,992 | 32,466 | 54,323 | 1.55% | 2.37% | 4.04% |
| Mortgage-backed securities | 1,181,183 | 2,658,279 | 4,254,044 | 44,140 | 121,587 | 238,992 | 3.74% | 4.57% | 5.62% |
| Corporate bonds | 2,000 | 2,000 | 4,769 | 116 | 116 | 294 | 5.80% | 5.80% | 6.16% |
| FHLB stock | 43,676 | 65,297 | 76,982 | 1,885 | 2,894 | 3,082 | 4.32% | 4.43% | 4.00% |
| Equity securities | 1,377 | 1,481 | 2,071 | 1 | 15 | 126 | 0.07% | 1.01% | 6.08% |
| Total investments (3) | 3,146,289 | 4,873,837 | 5,865,662 | 68,690 | 159,127 | 297,394 | 2.18% | 3.26% | 5.07% |
| Residential mortgage loans | 2,944,367 | 3,488,037 | 3,523,576 | 165,502 | 207,700 | 213,583 | 5.62% | 5.95% | 6.06% |
| Construction loans | 616,980 | 1,315,794 | 1,590,309 | 17,026 | 33,329 | 52,908 | 2.76% | 2.53% | 3.33% |
| C&I and commercial mortgage loans | 5,849,444 | 6,190,959 | 6,343,635 | 237,410 | 262,940 | 263,935 | 4.06% | 4.25% | 4.16% |
| Finance leases | 263,403 | 299,869 | 341,943 | 21,879 | 24,416 | 28,077 | 8.31% | 8.14% | 8.21% |
| Consumer loans | 1,357,381 | 1,506,448 | 1,661,099 | 157,451 | 174,846 | 188,775 | 11.60% | 11.61% | 11.36% |
| Total loans (4)(5) | 11,031,575 | 12,801,107 | 13,460,562 | 599,268 | 703,231 | 747,278 | 5.43% | 5.49% | 5.55% |
| Total interest-earning assets | $ 14,177,864 | $ 17,674,944 | $ 19,326,224 | $ 667,958 | $ 862,358 | $ 1,044,672 | 4.71% | 4.88% | 5.41% |
| Interest-bearing liabilities: | | | | | | | | | |
| Interest-bearing checking accounts | $ 1,014,280 | $ 1,057,558 | $ 866,464 | $ 13,760 | $ 19,060 | $ 19,995 | 1.36% | 1.80% | 2.31% |
| Savings accounts | 2,032,665 | 1,967,338 | 1,540,473 | 20,530 | 24,238 | 19,032 | 1.01% | 1.23% | 1.24% |
| Certificates of deposit | 2,260,106 | 1,909,406 | 1,680,325 | 45,960 | 44,788 | 50,939 | 2.03% | 2.35% | 3.03% |
| Brokered CDs | 5,134,699 | 7,002,343 | 7,300,696 | 111,477 | 160,628 | 227,896 | 2.17% | 2.29% | 3.12% |
| Interest-bearing deposits | 10,441,750 | 11,936,645 | 11,387,958 | 191,727 | 248,714 | 317,862 | 1.84% | 2.08% | 2.79% |
| Loans payable | | 299,589 | 643,618 | | 3,442 | 2,331 | 0.00% | 1.15% | 0.36% |
| Other borrowed funds | 1,459,476 | 2,436,091 | 3,745,980 | 53,873 | 91,386 | 124,340 | 3.69% | 3.75% | 3.32% |
| FHLB advances | 467,522 | 888,298 | 1,322,136 | 16,336 | 29,037 | 32,954 | 3.49% | 3.27% | 2.49% |
| Total interest-bearing liabilities (6) | $ 12,368,748 | $ 15,560,623 | $ 17,099,692 | $ 261,936 | $ 372,579 | $ 477,487 | 2.12% | 2.39% | 2.79% |
| Net interest income | | | | $ 406,022 | $ 489,779 | $ 567,185 | | | |
| Interest rate spread | | | | | | | 2.59% | 2.49% | 2.62% |
| Net interest margin | | | | | | | 2.86% | 2.77% | 2.93% |

(1) On an adjusted tax-equivalent basis. The adjusted tax-equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate as adjusted for changes to enacted tax rates (30.0% for the Corporation s subsidiaries other than IBEs and 25% for the Corporation s IBEs in 2011; 40.95% for the Corporation s subsidiaries other than IBEs and 35.95% for the Corporation s IBES in 2010 and 2009) and adding to it the cost of interest-bearing liabilities. The tax-equivalent adjustment recognizes the income tax savings when comparing taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. Therefore, management believes these measures provide useful information to investors by allowing them to make peer comparisons. Changes in the fair value of derivative instruments and unrealized gains or losses on liabilities measured at fair value are excluded from interest income and interest expense because the changes in valuation do not affect interest paid or received.

(2) Government obligations include debt issued by government sponsored agencies.
(3) Unrealized gains and losses in available-for-sale securities are excluded from the average volumes.
(4) Average loan balances include the average of non-performing loans.
(5) Interest income on loans includes $9.8 million, $10.7 million, and $11.2 million for 2011, 2010 and 2009, respectively, of income from prepayment penalties and late fees related to the Corporation s loan portfolio.
(6) Unrealized gains and losses on liabilities measured at fair value are excluded from the average volumes.

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**Part II**

| | 2011 Compared to 2010 | | | 2010 Compared to 2009 | | |
|---|---|---|---|---|---|---|
| | Increase (decrease) Due to: | | | Increase (decrease) Due to: | | |
| | Volume | Rate | Total | Volume | Rate | Total |
| | (In thousands) | | | | | |
| Interest income on interest-earning assets: | | | | | | |
| Money market & other short-term investments | (560) | 67 | $ (493) | 1,745 | (273) | $ 1,472 |
| Government obligations | (417) | (11,057) | (11,474) | 767 | (22,624) | (21,857) |
| Mortgage-backed securities | (58,369) | (19,078) | (77,447) | (78,371) | (39,034) | (117,405) |
| Corporate bonds | | | | (162) | (16) | (178) |
| FHLB stock | (939) | (70) | (1,009) | (493) | 305 | (188) |
| Equity securities | (1) | (13) | (14) | (28) | (83) | (111) |
| Total investments | (60,286) | (30,151) | (90,437) | (76,542) | (61,725) | (138,267) |
| Residential mortgage loans | (31,123) | (11,075) | (42,198) | (2,101) | (3,782) | (5,883) |
| Construction loans | (18,505) | 2,202 | (16,303) | (8,186) | (11,393) | (19,579) |
| C&I and commercial mortgage loans | (14,102) | (11,428) | (25,530) | (6,528) | 5,533 | (995) |
| Finance leases | (3,008) | 471 | (2,537) | (3,424) | (237) | (3,661) |
| Consumer loans | (17,245) | (150) | (17,395) | (17,825) | 3,896 | (13,929) |
| Total loans | (83,983) | (19,980) | (103,963) | (38,064) | (5,983) | (44,047) |
| Total interest income | (144,269) | (50,131) | (194,400) | (114,606) | (67,708) | (182,314) |
| Interest expense on interest-bearing liabilities: | | | | | | |
| Brokered CDs | (41,080) | (8,071) | (49,151) | (8,958) | (58,310) | (67,268) |
| Other interest-bearing deposits | 7,714 | (15,550) | (7,836) | 16,756 | (18,636) | (1,880) |
| Loans payable | (3,442) | | (3,442) | (2,606) | 3,717 | 1,111 |
| Other borrowed funds | (36,073) | (1,440) | (37,513) | (46,275) | 13,321 | (32,954) |
| FHLB advances | (14,207) | 1,506 | (12,701) | (12,516) | 8,599 | (3,917) |
| Total interest expense | (87,088) | (23,555) | (110,643) | (53,599) | (51,309) | (104,908) |
| Change in net interest income | $ (57,181) | $ (26,576) | $ (83,757) | $ (61,007) | $ (16,399) | $ (77,406) |

Portions of the Corporation s interest-earning assets, mostly investments in obligations of some U.S. Government agencies and sponsored entities, generate interest which is exempt from income tax, principally in Puerto Rico. Also, interest and gains on sales of investments held by the Corporation s international banking entities are tax-exempt under the Puerto Rico tax law, except for a temporary 5% tax rate imposed by the Puerto Rico Government on IBEs net income effective for years that commenced after December 31, 2008 and before January 1, 2012 (refer to the Income Taxes discussion below for additional information). To facilitate the comparison of all interest data related to these assets, the interest income has been converted to an adjusted taxable equivalent basis. The tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate as adjusted for changes to enacted tax rates (30.0% for the Corporation s subsidiaries other than IBEs and 25.0% for the Corporation s IBEs in 2011) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law. Refer to the Income Taxes discussion below for additional information of the Puerto Rico tax law.

The presentation of net interest income excluding the effects of the changes in the fair value of the derivative instruments and unrealized gains or losses on liabilities measured at fair value ( valuations ) provides additional information about the Corporation s net interest income and facilitates comparability and analysis. The changes in the fair value of the derivative instruments and unrealized gains or losses on liabilities measured at fair value have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively, or on interest

payments exchanged with interest rate swap counterparties.

The following table reconciles net interest income in accordance with GAAP to net interest income, excluding valuations, and net interest income on an adjusted tax-equivalent basis. The table also reconciles net interest spread and net interest margin on a GAAP basis to these items excluding valuations and on an adjusted tax-equivalent basis:

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| | $12,368,748 | $12,368,748 | $12,368,748 |
|---|---|---|---|
| | | **Year Ended December 31,** | |
| | **2011** | **2010** | **2009** |
| **Net Interest Income (in thousands)** | | | |
| Interest Income GAAP | $ 659,615 | $ 832,686 | $ 996,574 |
| Unrealized loss (gain) on derivative instruments | 1,548 | 1,266 | (5,519) |
| Interest income excluding valuations | 661,163 | 833,952 | 991,055 |
| Tax-equivalent adjustment | 6,795 | 28,406 | 53,617 |
| Interest income on a tax-equivalent basis excluding valuations | 667,958 | 862,358 | 1,044,672 |
| Interest Expense GAAP | 266,103 | 371,011 | 477,532 |
| Unrealized (loss) gain on derivative instruments and liabilities measured at fair value | (4,167) | 1,568 | (45) |
| Interest expense excluding valuations | 261,936 | 372,579 | 477,487 |
| Net interest income GAAP | $ 393,512 | $ 461,675 | $ 519,042 |
| Net interest income excluding valuations | $ 399,227 | $ 461,373 | $ 513,568 |
| Net interest income on a tax-equivalent basis excluding valuations | $ 406,022 | $ 489,779 | $ 567,185 |
| **Average Balances (in thousands)** | | | |
| Loans and leases | $ 11,031,575 | $ 12,801,107 | $ 13,460,562 |
| Total securities and other short-term investments | 3,146,289 | 4,873,837 | 5,865,662 |
| Average Interest-Earning Assets | $ 14,177,864 | $ 17,674,944 | $ 19,326,224 |
| Average Interest-Bearing Liabilities | $ 12,368,748 | $ 15,560,623 | $ 17,099,692 |
| **Average Yield/Rate** | | | |
| Average yield on interest-earning assets GAAP | 4.65% | 4.71% | 5.16% |
| Average rate on interest-bearing liabilities GAAP | 2.15% | 2.38% | 2.79% |
| Net interest spread GAAP | 2.50% | 2.33% | 2.37% |
| Net interest margin GAAP | 2.78% | 2.61% | 2.69% |
| Average yield on interest-earning assets excluding valuations | 4.66% | 4.72% | 5.13% |
| Average rate on interest-bearing liabilities excluding valuations | 2.12% | 2.39% | 2.79% |
| Net interest spread excluding valuations | 2.54% | 2.33% | 2.34% |
| Net interest margin excluding valuations | 2.82% | 2.61% | 2.66% |

| | | | |
|---|---|---|---|
| Average yield on interest-earning assets on a tax-equivalent basis and excluding valuations | 4.71% | 4.88% | 5.41% |
| Average rate on interest-bearing liabilities excluding valuations | 2.12% | 2.39% | 2.79% |
| Net interest spread on a tax-equivalent basis and excluding valuations | 2.59% | 2.49% | 2.62% |
| Net interest margin on a tax-equivalent basis and excluding valuations | 2.86% | 2.77% | 2.93% |

The following table summarizes the components of the changes in fair values of interest rate swaps and interest rate caps, which are included in interest income:

| | $12,368,7480 | $12,368,7480 | $12,368,7480 |
|---|---|---|---|
| | **Year Ended December 31,** | | |
| *(In thousands)* | **2011** | **2010** | **2009** |
| Unrealized (loss) gain on derivatives (economic undesignated hedges): | | | |
| Interest rate caps | $ | $ (1,174) | $ 3,496 |
| Interest rate swaps on loans | (1,548) | (92) | 2,023 |
| Net unrealized (loss) gain on derivatives (economic undesignated hedges) | $ (1,548) | $ (1,266) | $ 5,519 |

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The following table summarizes the components of the net unrealized gain and loss on derivatives (economic undesignated hedges) and net unrealized gain and loss on liabilities measured at fair value which are included in interest expense:

| *(In thousands)* | Year Ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| | | (In thousands) | |
| Unrealized (gain) loss on derivatives (economic undesignated hedges): | | | |
| Interest rate swaps on brokered CDs and options on stock index options | $ | $ 2 | $ 5,321 |
| Interest rate swaps and other derivatives on medium-term notes | (45) | (51) | 199 |
| Net unrealized (gain) loss on derivatives (economic undesignated hedges) | (45) | (49) | 5,520 |
| Unrealized (gain) loss on liabilities measured at fair value: | | | |
| Unrealized (gain) loss on brokered CDs | | | (8,696) |
| Unrealized (gain) loss on medium-term notes | (4,122) | (1,519) | 3,221 |
| Net unrealized (gain) loss on liabilities measured at fair value: | (4,122) | (1,519) | (5,475) |
| Net unrealized (gain) loss on derivatives (economic undesignated hedges) and liabilities measured at fair value | $ (4,167) | $ (1,568) | $ 45 |

Interest income on interest-earning assets primarily represents interest earned on loans receivable and investment securities.

Interest expense on interest-bearing liabilities primarily represents interest paid on brokered CDs, branch-based deposits, repurchase agreement, advances from the FHLB and FED and notes payable.

Unrealized gains or losses on derivatives represent changes in the fair value of derivatives, primarily interest rate swaps and caps used for protection against rising interest rates and, for 2009, mainly related to interest rate swaps that economically hedged brokered CDs and medium term notes. All interest rate swaps related to brokered CDs were called during the course of 2009 due to the low level of interest rates and, as a consequence, the Corporation exercised its call option on the swapped-to-floating brokered CDs that were recorded at fair value.

Unrealized gains or losses on liabilities measured at fair value represents the change in the fair value of such liabilities (medium-term notes and brokered CDs), other than the accrual of interests.

Derivative instruments, such as interest rate swaps, are subject to market risk. While the Corporation does have certain trading derivatives to facilitate customer transactions, the Corporation does not utilize derivative instruments for speculative purposes. As of December 31, 2011, most of the interest rate swaps outstanding are used for protection against rising interest rates. In the past, the volume of interest rate swaps was much higher, as they were used to convert the fixed-rate of a large portfolio of brokered CDs, mainly those with long-term maturities, to a variable rate and mitigate the interest rate risk related to variable rate loans. Refer to Note 31 of the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for further details concerning the notional amounts of derivative instruments and additional information. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market s expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on net interest income. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future.

**2011 compared to 2010**

Net interest income decreased 15% to $393.5 million for 2011 from $461.7 million in 2010. The decrease in net interest income was mainly related to the decline in the volume of interest-earning assets reflecting the execution of the deleveraging strategies included in the Corporation s capital plan in order to preserve and improve the capital position. Partially offsetting the decline in the average volume of earning assets was an increase of 21 basis points in the net interest margin, excluding valuations, driven by a decrease in the average cost of funds and the utilization of excess liquidity to pay down maturing borrowings (mainly brokered CDs).

Average interest-earning assets decreased by $3.5 billion when compared to 2010, reflecting a $1.8 billion reduction in average total loans and leases and a $1.7 billion reduction in average investment securities. The decrease in average loans was driven by loan sales, including $518 million of performing residential mortgage loans

sold during the first half of 2011, and the aforementioned sale of loans with a principal balance of $510.2 million (mainly adversely classified construction and commercial loans) to CPG/GS, both sales were key elements of the Corporation s capital plan submitted to regulators. Approximately 45% of loans sold to CPG/GS were in accruing status in 2010. Charge-offs, repayments of commercial credit facilities, foreclosures and the full effect of sales of non-performing loans executed in the latter part of 2010 also contributed to the decrease in the average loan portfolio. High levels of non-performing loans also contributed to the decrease in net interest income.

The decrease in average investment securities was primarily related to sales and prepayments of U.S. agency MBS as well as U.S. agency debt securities called prior to maturity. Consistent with the capital plan deleveraging strategies, the Corporation sold early in 2011 approximately $640 million of U.S. agency MBS that carried an average yield of 4.96% in order to improve the Corporation s capital position. In 2011, approximately $303 million of investment securities, mainly U.S. agency debt securities, were called prior to its stated maturity. Proceeds from sales, repayments and calls of loans and securities have been used to reduce maturing brokered CDs and advances from FHLB.

In addition, as part of the Corporation s balance sheet repositioning strategies, the Corporation sold in 2011 low-yielding investment securities, including $105 million of U.S. agency floating rate CMOs (average yield of 0.95%) and $500 million of 2-5 Years U.S Treasury Notes (average yield of 1.40%). The proceeds from these sales were used, in part, to prepay $400 million of repurchase agreements that carried an average rate of 2.74% and $100 million of advances from the FHLB that carried an average rate of 1.62%, thus, contributing to the improvement in the net interest margin. The prepayment penalties of $10.8 million on the early termination of borrowings was offset with gains of $11.0 million from the sale of low-yielding investment securities.

The decrease in net interest income includes a $6.0 million variance attributed to unrealized losses on derivative instruments and financial liabilities measured at fair value, mainly related to the fair value of medium-term notes resulting from significant reduction in market interest rates, as well as the expectation for a sustained low interest rate environment. The reduction in rates is reflected in the discount factors of the instruments projected cash flows.

Partially offsetting the decrease in average-earning assets was an improvement of 21 basis points in the net interest margin, excluding valuations, driven by a reduction in the average cost of funding, an improved deposits mix and the utilization of excess liquidity to pay down maturing borrowings. The Corporation achieved improvements in the mix of funding sources with a reduction in brokered CDs, while increasing core deposits at lower rates. Rates paid in interest-bearing core deposit accounts were lower than in 2010 and were lower than the average rate on matured brokered CDs. The average volume of brokered CDs decreased by $1.9 billion during 2011, while the average balance of non-brokered deposits increased by $372.7 million. During 2011, the Corporation repaid approximately $3.2 billion of brokered CDs with an average cost of 1.87% and renewed $674 million with an average cost of 1.10%. In addition, the Corporation benefited from the restructuring of $700 million of repurchase agreements that resulted in a decrease of $2.9 million of interest expense, as compared to 2010, and from the aforementioned early cancellation of $400 million of repurchase agreements matched with the sale of low yielding investment securities.

On an adjusted tax-equivalent basis and excluding valuations, net interest income decreased by $83.8 million, or 17%, for 2011 compared to 2010. The decrease for 2011 includes a decrease of $21.6 million, compared to 2010, in the tax-equivalent adjustment. The tax-equivalent adjustment increases interest income on tax-exempt securities and loans by an amount which makes tax-exempt income comparable, on a pre-tax basis, to the Corporation s taxable income as previously stated. The decrease in the tax-equivalent adjustment was mainly related to decreases in the interest rate spread on tax-exempt assets and lower yields on U.S. agency securities and MBS held by IBEs.

**2010 compared to 2009**

Net interest income decreased 11% to $461.7 million for 2010 from $519.0 million in 2009. The decrease in net interest income was mainly related to the deleveraging of the Corporation s balance sheet to preserve its capital position, the adverse impact on net interest margin of maintaining a higher liquidity position and continued pressures from the high level of non-performing loans. Partially offsetting the decrease in average interest-earning assets were reduced funding costs and improved spreads in commercial loans.

The average volume of interest-earning assets for 2010 decreased by $1.7 billion compared to 2009. The reduction in average earning assets primarily reflected a decrease of $991.8 million for 2010 in average investment securities and other short term investments, and a decrease of $659.5 million for 2010 in average loans. The decrease is consistent with the Corporation s deleveraging and balance sheet repositioning strategy for capital preservation purposes, and was achieved mainly by selling investment securities and reducing the loan portfolio via paydowns and charge-offs.

The decrease in average securities was driven by the sale of approximately $2.3 billion of investment securities during 2010, mainly U.S. agency MBS, including the sale during the third quarter of 2010 of $1.2 billion of U.S. agency MBS that was matched with the early extinguishment of a matching set of repurchase agreements.

Given the Corporation s balance sheet structure and the shape and level of the yield curve, which in turn is reflected in the valuation of the securities and the repurchase agreements, the Corporation took advantage of market conditions during the third quarter of 2010 and completed the sale of approximately $1.2 billion of MBS that was matched with the early termination of approximately $1.0 billion of repurchase agreements. The cost of the unwinding of the repurchase agreements of $47.4 million offset the gain of $47.1 million realized on the sale of investment securities. The repaid repurchase agreements were scheduled to mature at various dates between January 2011 and October 2012 and had a weighted average cost of 4.30%, which was higher than the average yield of 3.93% on the securities that were sold. This balance sheet re-structuring transaction, through which $1 billion of higher cost liabilities was disposed without material earnings impact in the immediate term, provided for enhancement of net interest margin, while also improved the Corporation s leverage ratio.

The average volume of all major loan categories, in particular the average volume of construction and commercial loans, decreased for 2010 compared to 2009. The average volume of construction loans decreased by $274.5 million, mainly due to the charge-off activity, repayments and the sale of non-performing credits, including the partial effect of the approximately $118.4 million of non-performing construction loans sold in 2010. The decrease also showed the effect of some very early improvements in residential construction projects in Puerto Rico. On September 2, 2010, the Government of Puerto Rico enacted legislation that provides, among other things, incentives to buyers of residences on the Island. The decrease in average commercial loans of $152.7 million for 2010, as compared to 2009, was primarily related to both paydowns and charge-offs, including repayments of facilities granted to the Puerto Rico and Virgin Islands governments. The average volume of residential mortgage loans decreased by $35.5 million for 2010, compared to 2009, driven by $174.3 million in sales of performing residential loans in the secondary market, and by charge-offs and paydowns. The average volume of consumer loans (including finance leases) decreased by $196.7 million for 2010, compared to 2009, resulting from paydowns and charge-offs that exceeded new loan originations.

As mentioned above, the deleveraging and balance sheet repositioning strategies resulted in a net reduction in securities and loans that allowed a reduction in average wholesale funding of $2.4 billion for 2010, including repurchase agreements, advances and brokered CDs. The average balance of brokered CDs decreased to $7.0 billion for 2010 from $7.3 billion for 2009. The average balance of interest-bearing deposits, excluding brokered CDs, increased by 20%, or $847.0 million, for 2010, as compared to 2009.

Net interest margin on an adjusted tax-equivalent basis and excluding valuations decreased to 2.77% for 2010 from 2.93% for 2009, adversely affected by the maintenance of excess liquidity in the balance sheet due to the prevailing economic environment. Liquidity volumes were significantly higher than normal levels as reflected in average balances in money market and overnight funding of $778.4 million for 2010 compared to $182.2 million for 2009. Also affecting the margin were the lower yields on investments affected by the MBS sales and the approximately $1.6 billion in investment securities called during 2010 that were replaced with lower yielding U.S. agency investment securities. The high volume of non-performing loans continued to pressure net interest margins as interest payments of approximately $6.2 million during 2010 were applied against the related principal balance for loans recorded under the cost-recovery method. Partially offsetting the aforementioned factors was the reduction in funding costs and improved spreads in commercial loans. The overall average cost of funding decreased by 40 basis points for 2010, compared to 2009, as the Corporation benefited from the lower deposit pricing on its core and brokered CDs and from the roll-off and repayments of higher cost funds, such as maturing brokered CDs. The higher yield on commercial loans resulted from a wider LIBOR spread, higher spreads on loan renewals and improved pricing, as the Corporation has been increasing the use of interest rate floors in new commercial loan agreements.

On an adjusted tax-equivalent basis and excluding valuations, net interest income decreased by $77.4 million, or 13%, for 2010 compared to 2009. The decrease for 2010 includes a decrease of $25.2 million, compared to 2009, in the tax-equivalent adjustment. The tax-equivalent adjustment increases interest income on tax-exempt securities and loans by an amount which makes tax-exempt income comparable, on a pre-tax basis, to the Corporation s taxable income as previously stated. The decrease in the tax-equivalent adjustment was mainly related to decreases in the interest rate spread on tax-exempt assets, primarily due to a higher proportion of taxable assets to total interest-

earning assets resulting from the maintenance of a higher liquidity position and lower yields on U.S. agency and MBS held by the Bank s IBE subsidiary. The Corporation replaced securities called and prepayments and sales of MBS with shorter-term securities.

**Provision for Loan and Lease Losses**

The provision for loan and lease losses is charged to earnings to maintain the allowance for loan and lease losses at a level that the Corporation considers adequate to absorb probable losses inherent in the portfolio. The adequacy of the allowance for loan and lease losses is also based upon a number of additional factors including trends in charge-offs and delinquencies, current economic conditions, the fair value of the underlying collateral and the financial condition of the borrowers, and, as such, includes amounts based on judgments and estimates made by the Corporation. Although the Corporation believes that the allowance for loan and lease losses is adequate, factors beyond the Corporation s control, including factors affecting the economies of Puerto Rico, the United States, the U.S. Virgin Islands and the British Virgin Islands, may contribute to delinquencies and defaults, thus necessitating additional reserves.

During 2011, the Corporation recorded a provision for loan and lease losses of $236.3 million, compared to $634.6 million in 2009 and $579.9 million in 2009.

**2011 compared to 2010**

The provision for loans and lease losses for 2011 of $236.3 million decreased by $398.3 million, or 63%, compared to the provision recorded for 2010. The provision for 2010 includes a charge of $102.9 million associated with loans transferred to held for sale in anticipation of the aforementioned strategic sale of loans to CPG/GS. Excluding the provision related to loans transferred to held for sale, the provision decreased by $295.3 million in 2011, as compared to 2010, mainly related to lower charges to specific reserves on a reduced level of non-performing and adversely classified loans, and declines in charges to general reserves due to reductions in historical loss rates, driven by lower net charge-offs, and the overeall decrease of the loan portfolio. The provision for all major loans categories, except for C&I loans, decreased during 2011 and was $59.1 million less than total net charge-offs reflecting the adequacy of previously established reserves. The allowance coverage for the non-impaired portfolio (general reserve) is determined using a methodology that incorporates historical loss rates and risk ratings by loan category. Loss rates are based on the moving average of charge-offs over a historical 24-month loss period, applying adjustments, as necessary, to each loss rate based on assessments of recent charge-offs trends (12 months), collateral values, and economic and business influences impacting expected losses.

In terms of geography and categories, in Puerto Rico, the Corporation recorded a provision of $170.1 million in 2011, compared to $488.0 million in 2010. The provision for construction loans in Puerto Rico decreased by $210.7 million in 2011, as compared to 2010, driven by reductions in non-performing and adversely classified loans reflected in lower charges to specific reserves. Also, the provision for construction loans in Puerto Rico in 2010 includes $83.0 million associated with loans transferred to held for sale. The provision for residential mortgage loans in Puerto Rico decreased by $43.6 million mainly due to improvements in delinquency and charge-offs trends, while the provision for consumer and finance leases decreased by $33.4 million also reflecting improvements in delinquency and historical loss rates commensurate with certain improvement in economic indicators and the overall decrease of this portfolio. Decreases in historical loss rates and lower charges to specific reserves also caused a reduction of $42.0 million in the provision for commercial mortgage loans in Puerto Rico. A higher level of non-performing C&I loans maintained during most of 2011 and higher loss rates attributed to economic indicators related to this portfolio, were the main drivers for an increase of $11.7 million in the provision for C&I loans in Puerto Rico.

With respect to the portfolio in the United States, the Corporation recorded a provision of $28.2 million in 2011, compared to $119.5 million in 2010. The decrease was mainly related to declines in the provision for construction, commercial mortgage and residential mortgage loans. The provision for construction loans in the United States decreased by $61.6 million in 2011 driven by lower charges to specific reserves on a reduced level of loans driven by sales of non-performing loans over the last two years. This portfolio has been reduced significantly over the last two years from $299.5 million at the beginning of 2010 to $23.6 million at the end of 2011. The provision for commercial mortgage loans decreased by $22.5 million in 2011 mainly attributed to improved loss rates resulting from a decline in net charge-offs, while the provision for residential mortgage loans decreased by $8.6 million driven by lower charge-offs and non-performing levels.

The Virgin Islands region recorded an increase of $10.9 million in the provision for loan losses in 2011, compared to 2010, mainly related to charges to the specific reserve assigned to a $100 million construction loan relationship placed in non-accrual status early in 2011. As of December 31, 2011, the book value of this relationship amounted to $74.6 million.

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The provision to net-charge offs ratio, excluding the provision and net charge-offs of loans transferred to held for sale, of 80% for 2011, compared to 120% for 2010, reflects, among other things, charge-offs recorded during the year that did not require additional provisioning.

Refer to the discussions under Credit Risk Management below for an analysis of the allowance for loan and lease losses, non-performing assets, impaired loans and related information, and refer to the discussions under Financial Condition and Operating Analysis Loan Portfolio and under Risk Management Credit Risk Management below for additional information concerning the Corporation s loan portfolio exposure in the geographic areas where the Corporation does business.

**2010 compared to 2009**

The provision for loans and lease losses for 2010 of $634.6 million, including $102.9 million associated with loans transferred to held for sale, increased by $54.7 million, or 9%, compared to the provision recorded for 2009. Excluding the provision related to loans transferred to held for sale, the provision decreased by $48.2 million to $531.7 million for 2010. The decrease was mainly related to lower charges to specific reserves for the construction and commercial portfolio, a slower migration of loans to non-performing status and the overall reduction of the loan portfolio. Much of the decrease in the provision is related to the construction loan portfolio in Florida and the C&I loan portfolio in Puerto Rico. The decreases in the provisioning for these portfolios, excluding the provision related to loans transferred to held for sale, were partially offset by an increase in the provision for the residential mortgage loans portfolio affected by increases in historical loss rates and declines in collateral value. The provision to net-charge offs ratio, excluding the provision and net charge-offs of loans transferred to held for sale, of 120% for 2010, compared to 174% for 2009, reflects, among other things, charge-offs recorded during the year that did not require additional provisioning, including certain non-performing loans sold during the year. Expressed as a percent of period-end total loans receivable, the reserve coverage ratio increased to 4.74% at December 31, 2010, compared with 3.79% at December 31, 2009.

With respect to the United States loan portfolio, the Corporation recorded a $119.5 million provision for 2010, compared to $188.7 million for 2009. The decrease was mainly related to the construction loan portfolio and reflected lower charges to specific reserves, the slower migration of loans to non-performing status and the overall reduction of the Corporation s exposure to construction loans in Florida to $78.5 million as of December 31, 2010 from $299.5 million as of December 31, 2009. The provision for construction loans in the United States decreased by $68.4 million for 2010 as the non-performing construction loans portfolio in this region decreased by 79% to $49.6 million, compared to $246.3 million as of December 31, 2009. As of December 31, 2010, approximately $70.9 million, or 90%, of the total exposure to construction loans in Florida was individually measured for impairment. The Corporation halted construction lending in Florida and continues to reduce its credit exposure in this market through the disposition of assets and different loss mitigation initiatives as the end of this difficult economic cycle appears to be approaching. During 2010, the Corporation completed the sale of approximately $206.5 million of non-performing construction and commercial mortgage loans and other non-performing assets in Florida.

The Corporation recorded a $488.0 million provision for loan and lease losses associated with the Puerto Rico s loan portfolio, including the $102.9 million provision relating to the transfer of loans to held for sale, compared to a provision of $366.0 million in 2009. Excluding the provision relating to the loans transferred to held for sale, the provision in Puerto Rico increased by $19.1 million to $385.1 million for 2010. The increase in the total provision was mainly related to the residential and commercial mortgage loan portfolio, which increased by $47.5 million and $48.8 million, respectively, driven by negative trends in loss rates and falling property values confirmed by recent appraisals and/or broker price opinions. The reserve factors for residential mortgage loans were recalibrated in 2010 as part of further segmentation and analysis of this portfolio for purposes of computing the required specific and general reserves. The review included the incorporation of updated loss factors to loans expected to liquidate considering the expected realization of the values of similar assets at disposition. The provision for construction loans increased by $94.5 million mainly related to higher charges to specific reserves in 2010 and increases to the general reserve factors. This was partially offset by a decrease of $74.0 million in the provision for the C&I loan portfolio attributable to the slower migration of loans to non-performing and/or impaired status, the overall reduction in the C&I portfolio size and the determination that lower reserves were required for certain loans that were individually evaluated for impairment in 2010, based on the underlying value of the collateral, when compared to the reserves required for these loans in periods prior to 2010.

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**Non-interest Income**

The following table presents the composition of non-interest income:

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| | | (In thousands) | |
| Other service charges on loans | $ 6,775 | $ 7,224 | $ 6,830 |
| Service charges on deposit accounts | 12,472 | 13,419 | 13,307 |
| Mortgage banking activities | 23,320 | 13,615 | 8,605 |
| Rental income | | | 1,346 |
| Insurance income | 4,456 | 7,752 | 8,668 |
| Broker-dealer income | 1,385 | 2,176 | 61 |
| Other operating income | 22,810 | 18,460 | 18,301 |
| Non-interest income before net gain on investments and loss on early extinguishment of borrowings | 71,218 | 62,646 | 57,118 |
| Proceeds from securities litigation settlement | 679 | | 248 |
| Gain on VISA shares | | 10,668 | 3,784 |
| Net gain on sale of investments | 53,117 | 93,179 | 82,772 |
| OTTI on equity securities | | (603) | (388) |
| OTTI on debt securities | (1,971) | (582) | (1,270) |
| Net gain on investments | 51,825 | 102,662 | 85,146 |
| Loss on early extinguishment of borrowings | (10,835) | (47,405) | |
| Equity in losses of unconsolidated entities | (4,227) | | |
| Total | $ 107,981 | $ 117,903 | $ 142,264 |

Non-interest income primarily consists of other service charges on loans; service charges on deposit accounts; commissions derived from various banking, securities and insurance activities; gains and losses on mortgage banking activities; and net gains and losses on investments and impairments.

Other service charges consist mainly of service charges on credit card-related activities and other non-deferrable fees (e.g. agent, commitment, unused and drawing fees) generated from lending activities.

Service charges on deposit accounts include monthly fees and other fees on deposit accounts.

Income from mortgage banking activities includes gains on sales and securitization of loans and revenues earned for administering residential mortgage loans originated by the Corporation and subsequently sold with servicing retained. In addition, lower-of-cost-or-market valuation adjustments to the Corporation s residential mortgage loans held for sale portfolio and servicing rights portfolio, if any, are recorded as part of mortgage banking activities.

Rental income represents income generated by the Corporation s subsidiary, First Leasing, on the daily rental of various types of motor vehicles. As part of its strategies to focus on its core business, the Corporation divested its short-term rental business during the fourth quarter of 2009.

Insurance income consists of insurance commissions earned by the Corporation s subsidiary, FirstBank Insurance Agency, Inc., and the Bank s subsidiary in the U.S. Virgin Islands, FirstBank Insurance V.I., Inc. These subsidiaries offer a wide variety of insurance business (see below for additional information about the insurance-related activities in the Virgin Islands).

The other operating income category is composed of miscellaneous fees such as debit, credit card and point of sale (POS) interchange fees and check and cash management fees and includes commissions from the Corporation s broker-dealer subsidiary, FirstBank Puerto Rico Securities.

The net gain (loss) on investment securities reflects gains or losses as a result of sales that are consistent with the Corporation s investment policies as well as OTTI charges on the Corporation s investment portfolio.

Equity in earnings (losses) of unconsolidated entities is related to the FirstBank s investment in CPG/GS, the entity that purchased $269 million of loans from FirstBank during the first quarter of 2011. The Bank held a 35%

subordinated ownership interest in CPG/GS. The majority owner of CPG/GS is entitled to recover its initial investment and a priority return of 12% prior to any return paid to the Bank. Accordingly, the Bank s investment of $43.4 million in CPG/GS is at risk. Refer to Financial Condition and Operating Data Analysis Commercial and Construction Loans and to Note 13 of the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for additional information about the Bank s investment in CPG/GS, including information about the determination of the initial value of the investment.

**2011 compared to 2010**

Non-interest income decreased $9.9 million, or 8%, to $108.0 million in 2011, primarily reflecting:

- The impact in the previous year of a $10.7 million gain on the sale of VISA Class C shares.

- Equity in losses of unconsolidated entities of $4.2 million in 2011 ; a non-cash charge related to the Bank s investment in CPG/GS.

- A $0.5 million decrease in income from insurance activities. During the first quarter of 2011, the Corporation sold substantially all of the assets of FirstBank Insurance VI and the reduction in income from insurance activities of $3.3 million in 2011 was partially offset by a gain of $2.8 million realized on the sale of such assets.

- A lower volume of sales of investment securities. Excluding the impact of the balance sheet restructuring transactions discussed below, there was a $4.0 million decrease in gains from sale of investments. The Corporation recorded in 2011 a gain of $38.6 million on the sale of approximately $640 million of MBS and a gain of $3.5 million attributable to a tender offer by the Puerto Rico Housing Finance Authority to purchase certain of its outstanding bonds. Bonds held by the Corporation with a book value of $19.8 million were exchanged for cash as part of the tender offer and the difference between the cash received and the book value of such instruments was recorded as part of Net gain on sale of investments in the table above. Meanwhile, in 2010 the Corporation recorded a gain of $44.1 million on the sale of approximately $903 million of MBS and a $2.0 million gain on the sale of approximately $250 million of U.S. Treasury Notes.

The aforementioned factors were partially offset by:

- An increase of $9.7 million in income from mortgage banking activities driven by $12.1 million in gains recorded for completed bulk sales of approximately $518 million of performing residential mortgage loans to another financial institution, partially offset by higher temporary impairments on the value of servicing assets.

- A $1.1 million increase in fees from cash management services provided to corporate customers.

As part of the Corporation s balance sheet repositioning strategies, the Corporation sold in 2011 low-yielding investment securities, including $105 million of U.S. agency floating rate CMOs (average yield of 0.95%) and $500 million of 2-5 Years U.S Treasury Notes (average yield of 1.40%). The proceeds from these sales were used, in part, to prepay $400 million of repurchase agreements that carried an average rate of 2.74% and $100 million of advances from the FHLB that carried an average rate of 1.62%, thus, contributing to the improvement in the net interest margin. Prepayment penalties of $10.8 million for the early termination of borrowings were offset with gains of $11.0 million from the sale of low-yielding investment securities. In 2010, approximately $1.0 billion of repurchase agreements, with an average cost of 4.30%, were early terminated. The prepayment penalties of the repurchase agreements of $47.4 million was offset by a gain of $47.1 million on the sale of approximately $1.2 billion of U.S. agency MBS.

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**2010 compared to 2009**

Non-interest income decreased $24.4 million, or 17%, to $117.9 million in 2010, primarily reflecting:

Lower gains on sale of investments securities, other than the sale of MBS that was matched with the early termination of repurchase agreements, as the Corporation realized gains of approximately $46.1 million on the sale of approximately $1.2 billion of investment securities, mainly U.S. agency MBS, compared to the $82.8 million gain recorded in 2009. Also, a nominal loss of $0.3 million was recorded in 2010, resulting from a transaction in which the Corporation sold approximately $1.2 billion in MBS, combined with the unwinding of $1.0 billion of repurchase agreements as part of a balance sheet repositioning strategy.

A $1.3 million decrease in rental income due to the divestiture of the short-term rental business operated by the Corporation s subsidiary, First Leasing, during the fourth quarter of 2009.

A $0.9 million decrease in income from insurance-related activities.

Partially offsetting the aforementioned decreases were:

A $6.9 million increase in gains from sales of VISA shares.

A $5.0 million increase in income from mortgage banking activities, primarily related to gains (including the recognition of servicing rights) of $12.1 million recorded on the sale of approximately $174.3 million of residential mortgage loans in the secondary market compared to gains of $7.4 million on the sale of approximately $117.0 million of residential mortgage loans during 2009.

A $2.1 million increase in broker-dealer income mainly related to bond underwriting fees.

**Non-Interest Expense**

The following table presents the components of non-interest expenses:

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| | | (In thousands) | |
| Employees compensation and benefits | $ 118,475 | $ 121,126 | $ 132,734 |
| Occupancy and equipment | 61,924 | 59,494 | 62,335 |
| Deposit insurance premium | 53,603 | 60,292 | 40,582 |
| Other taxes, insurance and supervisory fees | 17,715 | 21,210 | 20,870 |
| Professional fees | 21,884 | 21,287 | 15,217 |
| Servicing and processing fees | 9,145 | 8,984 | 10,174 |
| Business promotion | 12,283 | 12,332 | 14,158 |
| Communications | 7,117 | 7,979 | 8,283 |
| Net loss on REO operations | 25,025 | 30,173 | 21,863 |
| Other | 10,883 | 23,281 | 25,885 |
| Total | $ 338,054 | $ 366,158 | $ 352,101 |

**2011 compared to 2010**

Non-interest expense decreased by $28.1 million to $338.1 million principally attributable to:

- A $13.3 million decrease in the provision for probable losses on off-balance sheet exposures, mainly for credit exposures on unfunded loans commitments and letters of credit. A charge of $7.1 million was recorded in 2010 compare to reserve releases of approximately $6.2 million recorded in 2011 mainly related to the non-performing construction loans sold to CPG/GS early in 2011 and further decreases in adversely classified construction and commercial loans.

- A $5.1 million decrease in losses on real estate owned (REO) operations attributed to lower write-downs to the value of REO properties as well as lower realized losses on sales.

- A decrease of $6.7 million in the FDIC insurance premium and of $3.0 million in local regulatory examination fees, primarily related to the decrease in total assets. In the case of the FDIC insurance premium, the decrease was also attribiuted to the Bank s improved capital position.

- A $2.7 million decrease in employees compensation driven by reductions in headcount.

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Partially offsetting the decreases mentioned above, was a $2.4 million increase in occupancy and equipment expenses, mainly related to certain electronic equipments placed in service during 2011.

**2010 compared to 2009**

Non-interest expense increased by $14.1 million to $366.2 million principally attributable to:

- An increase of $19.7 million in the FDIC deposit insurance premium expense, mainly related to increases in premium rates and a higher average volume of deposits.
- An $8.3 million increase in losses from REO operations due to write-downs to the value of repossessed residential and commercial properties as well as higher costs associated with a larger inventory.
- A $6.1 million increase in professional fees, attributable in part to higher legal fees related to collections and foreclosure procedures and mortgage appraisals, as well as in the implementation of strategic initiatives.

Partially offsetting the increases mentioned above:

- A $11.6 million decrease in employees compensation and benefits from reductions in bonuses and incentive compensation, coupled with the impact of a reduction in headcount. During 2010, the Corporation reduced its headcount by approximately 195 or 7%.
- The impact in 2009 of a non-recurring $2.6 million charge to property tax expense attributable to the reassessed value of certain properties.
- A $1.8 million decrease in business promotion expenses due to a lower level of marketing activities.
- The impact in 2009 of a $4.0 million impairment charge associated with the core deposit intangible asset in the Corporation s Florida operations included as part of Other expenses in the above table.

The Corporation intends to continue improving its operating efficiency by further reducing controllable expenses, rationalizing its business operations and enhancing its technological infrastructure through targeted investments.

**Income Taxes**

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is creditable, within certain conditions and limitations, against the Corporation s Puerto Rico tax liability. The Corporation is also subject to U.S.Virgin Islands taxes on its income from sources within that jurisdiction. Any such tax paid is also creditable against the Corporation s Puerto Rico tax liability, subject to certain conditions and limitations.

On January 31, 2011, the Puerto Rico Government approved Act No. 1, which repealed the 1994 Code ( 1994 PR Code ) and replaces it with the Puerto Rico Internal Revenue Code of 2011 ( 2011 PR Code ). The provisions of the 2011 PR Code are generally applicable to taxable years commencing after December 31, 2010. Under the 2011 PR Code, the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss, a particular subsidiary must be able to demonstrate

sufficient taxable income within the applicable carry forward period (7 years under the 2011 PR Code for losses incurred during tax year, except for losses incurred during tax years commenced after December 31, 2004 and before December 31, 2012, that the carryforward period is extended to 10 years ). The 2011 PR Code provides a dividend received deduction of 100% on dividends received from controlled subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations. Dividend payments from a U.S. subsidiary to the Corporation are subject to a 10% withholding tax based on the provisions of the U.S. Internal Revenue Code.

Under the 2011 PR Code, First BanCorp is subject to a maximum statutory tax rate of 30% (25% for taxable years commencing after December 31, 2013 if certain economic conditions are met by the Puerto Rico economy). The 2011 PR Code also includes an alternative minimum tax of 20% that applies if the Corporation s regular income tax liability is less than the alternative minimum tax requirements. Prior to the 2011 PR Code, First BanCorp maximum statutory tax rate was 39% except for tax years commenced after December 31, 2008 and before January 1, 2012 which was 40.95% due to the approval by the Puerto Rico Government of Act No. 7 (the Act ), to stimulate Puerto Rico s economy and to reduce the Puerto Rico Government s fiscal deficit. The Act imposed a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which was applicable to corporations, among others, whose combined income exceeds $100,000, effectively resulting in an increase in the maximum statutory tax rate from 39% to 40.95% and an increase in capital gain statutory tax rate from 15% to 15.75%.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through International Banking Entity ( IBE ) of the Bank and through the Bank s subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which the Act No. 7 imposed a special 5% tax to all IBEs. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs net income exceeds 20% of the bank s total net taxable income.

For additional information relating to income taxes, see Note 26 to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K, including the reconciliation of the statutory to the effective income tax rate for 2011, 2010 and 2009.

**2011 compared to 2010**

For 2011, the Corporation recorded an income tax expense of $9.3 million compared to an income tax expense of $103.1 million for 2010. The lower income tax expense is mainly related to the impact in the previous year 2010 of an incremental $93.7 million non-cash charge to the valuation allowance of the Bank s deferred tax asset. The income tax expense for 2011 includes unrecognized tax benefits ( UTBs ) of $3.2 million, including accrued interest, as further discussed below. As of December 31, 2011, the deferred tax asset, net of a valuation allowance of $368.9 million, amounted to $5.4 million compared to $9.3 million as of December 31, 2010. The Corporation continued to increase the valuation allowance related to deferred tax assets created in connection with the operations of its banking subsidiary, FirstBank.

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on the consideration of all available evidence, using a more likely than not realization standard. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. In making such assessment, significant weight is to be given to evidence that can be objectively verified, including both positive and negative evidence. Consideration must be given to all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of the reversal of temporary differences and carryforwards, taxable income in carryback years and tax planning strategies. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance, and recognizes tax benefits only when deemed probable of realization.

In assessing the weight of positive and negative evidence, a significant negative factor that resulted in increases of the valuation allowance was that the Corporation s banking subsidiary, FirstBank Puerto Rico, continues in a three-year historical cumulative loss position as of the end of the year 2011, mainly due to charges to the provision for loan and lease losses as a result of the economic downturn. As of December 31, 2011, management concluded that $5.4 million of the deferred tax asset will be realized. The Corporation s deferred tax assets for which it has not established a valuation allowance relate to profitable subsidiaries and to amounts that can be realized through future

reversals of existing taxable temporary differences. To the extent the realization of a portion, or all, of the tax asset becomes more likely than not based on changes in circumstances (such as, improved earnings, changes in tax laws or other relevant changes), a reversal of that portion of the deferred tax asset valuation allowance will then be recorded.

During the third quarter of 2011, the Corporation recorded new UTBs of $2.4 million and related accrued interest of $0.8 million, all of which would, if recognized, affect the Corporations effective tax rate. The Corporation classified all interest and penalties, if any, related to tax uncertainties as income tax expense. As of December 31, 2011, the Corporation s accrued interest that relates to tax uncertainties amounted to $0.8 million. The amount of UTBs may increase or decrease for various reasons, including changes in the amounts for current tax year positions, the expiration of open income tax returns due to the expiration of statutes of limitations, changes in management s judgment about the level of uncertainty, the status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions. The years 2007 through 2009 have been examined by the United States Internal Revenue Service ( IRS ) and disputed issues have been taken to administrative appeals. Although the timing of the resolution and/or closure of audits is highly uncertain, the Corporation believes it is reasonably possible that the IRS will conclude this audit within the next twelve months. If any issues addressed in the IRS audit are resolved in a manner not consistent with Management s expectations, the Corporation could be required to adjust its provision for income taxes in the period such resolution occurs. The Corporation currently cannot reasonably estimate a range of possible changes to existing reserves.

**2010 compared to 2009**

For 2010, the Corporation recorded an income tax expense of $103.1 million compared to an income tax expense of $4.5 million for 2009. The income tax expense for 2010 is mainly related to an incremental $93.7 million non-cash charge in the fourth quarter of 2010 to record a full valuation allowance on the Bank s deferred tax asset. As of December 31, 2010, the deferred tax asset, net of a valuation allowance of $445.8 million, amounted to $9.3 million compared to $109.2 million as of December 31, 2009. The decrease was mainly associated with the aforementioned $93.7 million charge to fully reserve the Bank s deferred tax asset.

**OPERATING SEGMENTS**

Based upon the Corporation s organizational structure and the information provided to the Chief Executive Officer of the Corporation and, to a lesser extent, the Board of Directors, the operating segments are driven primarily by the Corporation s lines of business for its operations in Puerto Rico, the Corporation s principal market, and by geographic areas for its operations outside of Puerto Rico. As of December 31, 2011, the Corporation had six reportable segments: Consumer (Retail) Banking; Commercial and Corporate Banking; Mortgage Banking; Treasury and Investments; United States operations; and Virgin Islands operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation s organizational chart, nature of the products, distribution channels and the economic characteristics of the products were also considered in the determination of the reportable segments. For information regarding First BanCorp s reportable segments, please refer to Note 32 Segment Information to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K.

The accounting policies of the segments are the same as those described in Note 1 Nature of Business and Summary of Significant Accounting Policies to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K. The Corporation evaluates the performance of the segments based on net interest income, the estimated provision for loan and lease losses, non-interest income and direct non-interest expenses. The segments are also evaluated based on the average volume of their interest-earning assets less the allowance for loan and lease losses. In 2011, other operating expenses not allocated to a particular segment amounted to $84.5 million. Expenses pertaining to corporate administrative functions that support the operating segment but are not specifically attributable to or managed by any segment are not included in the reported financial results of the operating segments. The unallocated corporate expenses include certain general and administrative expenses and related depreciation and amortization expenses.

The Treasury and Investment segment lends funds to the Consumer (Retail) Banking, Mortgage Banking and Commercial and Corporate Banking segments to finance their lending activities and borrows funds from those segments and from the United States Operations Segment. The Consumer (Retail) Banking and the United States

Operations segment also lend funds to other segments. The interest rates charged or credited by Treasury and Investment, the Consumer (Retail) Banking and the United States Operations segments are allocated based on market rates. The difference between the allocated interest income or expense and the Corporation s actual net interest income from centralized management of funding costs is reported in the Treasury and Investments segment.

*Consumer(Retail)Banking*

The Consumer (Retail) Banking segment consists of the Corporation s consumer lending and deposit-taking activities conducted mainly through FirstBank s branch network and loan centers in Puerto Rico. Loans to consumers include auto, boat and personal loans and lines of credit. Deposit products include interest bearing and non-interest bearing checking and savings accounts, Individual Retirement Accounts (IRA) and retail certificates of deposit. Retail deposits gathered through each branch of FirstBank s retail network serve as one of the funding sources for the lending and investment activities.

Consumer lending has been mainly driven by auto loan originations. The Corporation follows a strategy of seeking to provide outstanding service to selected auto dealers that provide the channel for the bulk of the Corporation s auto loan originations.

Personal loans and, to a lesser extent, marine financing and a small revolving credit portfolio also contribute to interest income generated on consumer lending. Credit card accounts are issued under FirstBank s name through an alliance with a nationally recognized financial institution, which bears the credit risk. Management plans to continue to be active in the consumer loans market, applying the Corporation s strict underwriting standards. Other activities included in this segment are finance leases and insurance activities in Puerto Rico.

The highlights of the Consumer (Retail) Banking segment financial results for the year ended December 31, 2011 include the following:

Segment income before taxes for the year ended December 31, 2011 was $55.6 million compared to $23.7 million and $24.2 million for the years ended December 31, 2010 and 2009, respectively.

Net interest income for the year ended December 31, 2011 was $138.4 million compared to $141.2 million and $133.8 million for the years ended December 31, 2010 and 2009, respectively. The decrease in net interest income reflects a diminished consumer loan portfolio due to principal repayments and charge-offs mainly relating to the auto, personal and boat loan portfolios combined with a reduction in loan originations, as compared to 2010. Partially offsetting the decerase in volume of the portfolio were lower rates paid on core deposits and larger amounts charged to other segments as the core deposit base increased in 2011. The increase in 2010, compared to 2009, was mainly associated with lower interest rates paid on the Bank s core deposit base. The consumer loan portfolio is mainly composed of fixed-rate loans financed with shorter-term borrowings, thus positively affected by lower deposit costs as well as from a larger core deposit base as amounts charged to other segments also increased during 2010.

The provision for loan and lease losses for 2011 decreased by $33.7 million compared to 2010 and increased by $5.5 million when comparing 2010 with the same period in 2009. The decrease in the provision mainly resulted from improvements in delinquency and historical loss rates commensurate with the overall decrease of this portfolio. The increase in the provision for 2010, compared to 2009, mainly resulted from increases in general reserve factors associated with economic factors.

Non-interest income for the year ended December 31, 2011 was $27.7 million compared to $28.9 million and $32.0 million for the years ended December 31, 2010 and 2009, respectively. The decrease in 2011 was mainly related to lower service charges and overdraft fees on deposit accounts and lower credit card related fees on a reduced underlying portfolio. Regulation E eliminated the Courtesy Overdraft Protection Service resulting in overdraft fees reductions for various products and a decrease in overdraft fees was also experienced in electronic transactions. In addition, non-interest income was adversely impact by lower debit cards interchange fees given the newly mandated lower interchange fee structure (Durbin Amendment) implemented on October 1, 2011. The Durbin Amendment put a cap on how much banks and debit networks are allowed to charge for a Check/Debit card transaction, this resulted in a reduction of approximately $0.6 million in interchange fees in 2011. The cap is currently set at $0.21 + 0.05% of the transaction. The decrease for 2010,

compared to 2009, was mainly related to lower income from daily vehicle rental activities as the Corporation divested its short-term rental business during the fourth quarter of 2009. Lower insurance income and lower credit card related fees also contributed to the decrease in non-interest income, partially offset by higher service charges on deposit accounts and higher interchanges fee revenue and other ATM fee income.

Direct non-interest expenses for the year ended December 31, 2011 were $92.5 million compared to $94.7 million and $95.3 million for the years ended December 31, 2010 and 2009, respectively. The decrease for 2011 was primarily due to a decrease in headcount as well as reduced marketing activities, partially offset by higher losses in the valuation and sales of repossessed boats. The decrease in direct non-interest expenses for 2010, as compared to 2009, was primarily due to a decrease in headcount and reductions in bonuses and overtime costs as well as reduced marketing activities for loan and deposit products and lower occupancy costs, partially offset by an increase in the FDIC insurance premium.

*Commercial and Corporate Banking*

The Commercial and Corporate Banking segment consists of the Corporation s lending and other services across a broad spectrum of industries ranging from small businesses to large corporate clients. FirstBank has developed expertise in industries including healthcare, tourism, financial institutions, food and beverage, income-producing real estate and the public sector. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and other products such as cash management and business management services. This segment also includes the Corporation s broker-dealer activities, which are primarily concentrated in bonds underwriting and financial advisory services provided to government entities in Puerto Rico. A substantial portion of the commercial and corporate banking portfolio is secured by the underlying value of the real estate collateral and the personal guarantees of the borrowers. Although commercial loans involve greater credit risk than a typical residential mortgage loan because they are larger in size and more risk is concentrated in a single borrower, the Corporation has and maintains a credit risk management infrastructure designed to mitigate potential losses associated with commercial lending, including underwriting and loan review functions, sales of loan participations and continuous monitoring of concentrations within portfolios.

The highlights of the Commercial and Corporate Banking segment financial results for the year ended December 31, 2011 include the following:

Segment income before taxes for the year ended December 31, 2011 was $30.6 million compared to loss of $202.5 million for 2010 and loss of $141.3 million for the year ended December 31, 2009.

Net interest income for the year ended December 31, 2011 was $190.5 million compared to $210.9 million and $187.9 million for the years ended December 31, 2010 and 2009, respectively. The decrease in net interest income for 2011, compared to 2010, was mainly related to a lower volume of loans driven by loans sales and principal repayments, including the aforementioned sale of loans to CPG/GS with an unpaid principal balance of $510.2 million, of which approximately 45% was in accruing status in 2010. Continued pressures in net interest margins associated to the level of non-performing loans also contributed to the decrease in net interest income in this segment, partially offset by lower interest rates charged by other business segments due to reductions in the average cost of funding. The increase in net interest income for 2010, compared to 2009, was mainly related to lower interest rates charged by other business segments due to the overall decrease in the average cost of funding and due to higher spreads on loan renewals and improved pricing. As previously stated, the Corporation has been increasing the use of interest rate floors in new and renegotiated commercial loan agreements.

The provision for loan losses for 2011 was $118.5 million compared to $359.4 million and $290.1 million for 2010 and 2009, respectively. The decrease in 2011, compared to 2010, was mainly related to lower provisions for construction and commercial mortgage loans. The provision for construction loans in Puerto Rico decreased by $210.7 million in 2011, as compared to 2010, driven by reductions in non-performing and adversely classified loans reflected in lower charges to specific reserves. Decreases in historical loss rates and lower charges to specific reserves caused a reduction of $42.0 million in the provision for commercial mortgage loans in Puerto Rico. The provision for this segment in 2010 includes $102.9 million associated with loans transferred to held for sale that were

subsequently sold to CPG/GS early in 2011.The increase in 2010 was mainly related to the aforementioned $102.9 million charge to the provision associated with loans transferred to held for sale. Excluding the provision relating to loans transferred to held for sale, the provision decreased by $33.6 million. The decrease was mainly related to a reduction in the provision for the C&I loan portfolio attributable to the slower migration of loans to non-performing and/or impaired status, the overall reduction in the C&I portfolio size and the determination that lower reserves were required for certain loans that were individually evaluated for impairment in 2010, based on the underlying value of the collateral, when compared to the reserves required for these loans in periods prior to 2010. Refer to the Provision for Loan and Lease Losses discussion above and to the Risk Management Allowance for Loan and Lease Losses and Non-performing Assets discussion below for additional information with respect to the credit quality of the Corporation s commercial and construction loan portfolio.

Total non-interest income for the year ended December 31, 2011 amounted to $8.6 million compared to non-interest income of $9.0 million and $5.7 million for the years ended December 31, 2010 and 2009, respectively. The slight decrease in non-interest income for 2011, compared to 2010, was mainly attributable to lower underwriting fees from broker-dealer activities, as fewer deals were closed in 2011, combined with lower non-deferrable loan fees. Partially offsetting, these decreases was an increase in cash management fees from corporate customers. The increase in non-interest income for 2010, compared to 2009, was mainly attributable to fees and commissions earned by broker-dealer activities that were concentrated in providing underwriting and financial advisory services to government entities in Puerto Rico. Also, an increase in cash management fees from corporate customers and higher non-deferrable loans fees such as agent, commitment and drawing fees from commercial customers contributed to the increase in non-interest income in 2010.

Direct non-interest expenses for 2011 were $50.0 million compared to $63.0 million and $44.9 million for 2010 and 2009, respectively. The decrease for 2011, compared to 2010, was primarily due to the $13.3 million decrease in the provision for probable losses on off-balance sheet exposures, mainly unfunded loans commitments and letters of credit. A charge of $7.1 million was recorded in 2010 compare to reserve releases of approximately $6.2 million recorded in 2011 mainly related to the non-performing construction loans sold to CPG/GS early in 2011 and further decreases in adversely classified construction and commercial loans. In addition, the decrease was related to the portion of the decrease in the FDIC deposit insurance premium allocated to this segment and lower losses in the valuation and sales of REO commercial properties. The increase for 2010 was primarily due to the portion of the increase in the FDIC deposit insurance premium allocated to this segment; this was partially offset by a reduction in compensation expense. Also, for 2010 higher losses on REO operations contributed to the increase in expenses due to write-downs and higher costs associated with a larger inventory as well as higher professional service fees and an increase in the provision for unfunded loan commitments.

*Mortgage Banking*

The Mortgage Banking segment conducts its operations mainly through FirstBank and its mortgage origination subsidiary, FirstMortgage. These operations consist of the origination, sale and servicing of a variety of residential mortgage loans products. Originations are sourced through different channels such as FirstBank branches, mortgage bankers and in association with new project developers. FirstMortgage focuses on originating residential real estate loans, some of which conform to Federal Housing Administration ( FHA ), Veterans Administration ( VA ) and Rural Development ( RD ) standards. Loans originated that meet FHA standards qualify for the FHA s insurance program whereas loans that meet VA and RD standards are guaranteed by their respective federal agencies.

Mortgage loans that do not qualify under these programs are commonly referred to as conventional loans. Conventional real estate loans could be conforming and non-conforming. Conforming loans are residential real estate loans that meet the standards for sale under the Fannie Mae ( FNMA ) and Freddie Mac ( FHLMC ) programs whereas loans that do not meet those standards are referred to as non-conforming residential real estate loans. The Corporation s strategy is to penetrate markets by providing customers with a variety of high quality mortgage products to serve their financial needs faster and simpler and at competitive prices. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. Residential real estate conforming loans are sold to investors like FNMA and FHLMC. In December 2008, the Corporation obtained Commitment Authority from GNMA to issue GNMA mortgage-backed securities. Under this program, since early 2009, the Corporation has been securitizing FHA/VA mortgage loan production into the secondary market.

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The highlights of the Mortgage Banking segment financial results for the year ended December 31, 2011 include the following:

- Segment income before taxes for the year ended December 31, 2011 was $7.2 million compared to a loss of $38.9 million for 2010 and loss of $14.3 million for the year ended December 31, 2009.

- Net interest income for the year ended December 31, 2011 was $56.9 million compared to $63.8 million and $39.2 million for the years ended December 31, 2010 and 2009, respectively. The decrease in net interest income for 2011 was mainly related to the sale of approximately $518 million of performing residential mortgage loans to another financial institution, partially offset by a decrease in the average cost of funding. The increase in net interest income for 2010 was mainly related to the decrease in the average cost of funding and, to a lesser extent, reductions in non-performing loans levels. The Mortgage banking portfolio is principally composed of fixed-rate residential mortgage loans tied to long-term interest rates that are financed with shorter-term borrowings, thus positively affected in a declining interest rate scenario as the one prevailing in 2010.

- The provision for loan and lease losses for 2011 was $33.7 million compared to $76.9 million and $29.7 million for the years ended December 31, 2010 and 2009, respectively. The decrease in 2011 was mainly related to improvements in delinquency and charge-offs trends. The increase in 2010 was driven by negative trends in loss rates and falling property values confirmed by recent appraisals and/or broker price opinions. The reserve factors for residential mortgage loans were recalibrated in 2010 as part of further segmentation and analysis of this portfolio for purposes of computing the required specific and general reserves. The review included the incorporation of updated loss factors to loans expected to liquidate considering the expected realization of the values of similar assets at disposition.

- Non-interest income for the year ended December 31, 2011 was $22.3 million compared to $13.2 million and $8.5 million for the years ended December 31, 2010 and 2009, respectively. The increase in 2011, compared to 2010, was mainly related to $12.1 million in gains recorded for completed bulk sales of approximately $518 million of performing residential mortgage loans, partially offset by higher temporary impairments on the value of servicing assets The increase in 2010, compared to 2009, was due to gains (including the recognition of servicing rights) of $12.1 million recorded on the sale of approximately $174.3 million of residential mortgage loans in the secondary market. compared to gains of $7.4 million on the sale of approximately $117.0 million of residential mortgage loans during 2009.

- Direct non-interest expenses in 2011 were $38.3 million compared to $39.0 million and $32.3 million for 2010 and 2009, respectively. The decrease in 2011, compared to 2010, was also mainly related to the portion of the FDIC deposit insurance premium allocated to this segment, and a decrease in marketing expenses. The increase in 2010 was also mainly related to the portion of the FDIC deposit insurance premium allocated to this segment, higher losses on REO operations associated with a higher volume of repossessed properties and write-downs to the value of REO properties.

*Treasury and Investments*

The Treasury and Investments segment is responsible for the Corporation s treasury and investment management functions. In the treasury function, which includes funding and liquidity management, this segment sells funds to the Commercial and Corporate Banking segment, the Mortgage Banking segment, and the Consumer (Retail) Banking segment to finance their respective lending activities and purchase funds gathered by those segments and from the United States Operations segment. Funds not gathered by the different business units are obtained by the Treasury Division through wholesale channels, such as brokered deposits, Advances from the FHLB, repurchase agreements with investment securities, among others.

Since the Corporation is a net borrower of funds, the securities portfolio does not result from the investment of excess funds. The securities portfolio is a leverage strategy for the purposes of liquidity management, interest rate management and earnings enhancement.

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The interest rates charged or credited by Treasury and Investments are based on market rates.

The highlights of the Treasury and Investments segment financial results for the year ended December 31, 2011 include the following:

- Segment loss before taxes for the year ended December 31, 2011 amounted to $27.7 million compared to income of $18.9 million for 2010 and income of $171.4 million for the year ended December 31, 2009.

- Net interest loss for the year ended December 31, 2011 was $63.6 million compared to net interest loss of $30.5 million and net interest income of $94.4 million for the years ended December 31, 2010 and 2009, respectively. The higher net interest loss for 2011, compared to 2010, was mainly attributed to the deleverage of the investment securities portfolio (refer to the Financial and Operating Data Analysis Investment Activities discussion below for additional information about investment sales and calls in 2011) and due to the decrease in the amount credited to this segment due to the reductions in wholesale funding and lower interest rates. The decrease in 2010 was also mainly attributed to the deleverage of the investment securities portfolio, the decrease in the amount credited to this segment due to the reductions in wholesale funding and lower interest rates, and the effect of maintaining higher than historical levels of liquidity, which affected the Corporation s net interest margin during 2010.

- Non-interest income for the year ended December 31, 2011 amounted to $41.6 million compared to income of $55.2 million and of $84.4 million for the years ended December 31, 2010 and 2009, respectively. The decrease in 2011, compared to 2010, reflects the impact in 2010 of a $10.7 million gain on the sale of VISA Class C shares and a lower volume of sales of investment securities. Excluding the impact of the balance sheet restructuring transactions discussed above, there was a $4.0 million decrease in gains from sale of investments. The Corporation recorded in 2011 a gain of $38.6 million on the sale of approximately $640 million of MBS and a gain of $3.5 million attributable to the tender offer by the Puerto Rico Housing Finance Authority. Meanwhile, in 2010 the Corporation recorded a gain of $44.1 million on the sale of approximately $903 million of MBS and a $2.0 million gain on the sale of approximately $250 million of U.S. Treasury Notes. The decrease in 2010, compared to 2009, was mainly related to lower gains on the sale of investment securities as the Corporation realized gains of approximately $46.1 million on the sale of approximately $1.2 billion of investment securities, mainly U.S. agency MBS, compared to the $82.8 million gain recorded in 2009.

- Direct non-interest expenses for 2011 were $5.7 million compared to $5.9 million and $7.4 million for 2010 and 2009, respectively. The decrease in 2011, compared to 2010, mainly attributed to lower local regulatory examination fees attributed to the decrease in the investment portfolio and lower compensation expenses. The decrease in 2010, compared to 2009, was mainly associated with professional service fees.

*United States Operations*

The United States Operations segment consists of all banking activities conducted by FirstBank in the United States mainland. FirstBank provides a wide range of banking services to individual and corporate customers primarily in southern Florida through its ten branches. Our success in attracting core deposits in Florida has enabled us to become less dependent on brokered deposits. The United States Operations segment offers an array of both retail and commercial banking products and services. Consumer banking products include checking, savings and money market accounts, retail CDs, internet banking services, residential mortgages, home equity loans and lines of credit, automobile loans and credit cards through an alliance with a nationally recognized financial institution, which bears the credit risk. Deposits gathered through FirstBank s branches in the United States also serve as one of the funding sources for lending and investment activities.

The commercial banking services include checking, savings and money market accounts, CDs, internet banking services, cash management services, remote data capture and automated clearing house, or ACH, transactions. Loan products include the traditional commercial and industrial and commercial real estate products, such as lines of credit, term loans and construction loans.

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The highlights of the United States operations segment financial results for the year ended December 31, 2011 include the following:

Segment loss before taxes for the year ended December 31, 2011 was $36.0 million compared to a loss of $145.8 million and a loss of $222.3 million for the years ended December 31, 2010 and 2009, respectively.

Net interest income for the year ended December 31, 2011 was $21.5 million compared to $15.2 million and $2.6 million for the years ended December 31, 2010 and 2009, respectively. The increase in 2011, as compared to 2010, was mainly related to higher charges made to operating segments in Puerto Rico as a significant portion of the increase in the core deposit base was related to the Corporation s operations in the United States. The increase in 2010 was mainly related to a higher amount of assets financed by a larger core deposit base at lower rates than brokered CDs that funded a portion of assets during 2009 and also due to higher charges made to operating segments in Puerto Rico. The Corporation reduced the reliance on brokered CDs during 2010 and, as of December 31, 2010, the entire United States operations are funded by deposits gathered through the branch network in Florida and from advances from the FHLB. Also, lower reversals of interest income due to the lower level of inflows of loans to non-accruing status contributed to the improvement in net interest income.

The provision for loan losses for 2011 was $28.2 million compared to $119.5 million and $188.7 million for 2010 and 2009, respectively. The decrease in 2011, compared to 2010, was mainly related to declines in the provision for construction, commercial mortgage and residential mortgage loans. The provision for construction loans in the United States decreased by $61.6 million in 2011 driven by lower charges to specific reserves on a reduced level of loans driven by sales of non-performing loans over the last two years. This portfolio has been reduced significantly over the last two years from $299.5 million at the beginning of 2010 to $23.6 million at the end of 2011. The provision for commercial mortgage loans decreased by $22.5 million in 2011 mainly attributed to improved loss rates resulting from a decline in net charge-offs, while the provision for residential mortgage loans decreased by $8.6 million driven by lower charge-offs and non-performing levels.The decrease in 2010, as compared to 2009, was mainly related to the construction loan portfolio and reflected lower charges to specific reserves, the slower migration of loans to non-performing status and the overall reduction of the Corporation s exposure to construction loans in Florida. The provision for construction loans in the United States decreased by $68.4 million in 2010 as the non-performing construction loans portfolio in this region decreased by 79% to $49.6 million, compared to $246.3 million as of December 31, 2009. Refer to the Provision for Loan and Lease Losses discussion above and to the Risk Management Allowance for Loan and Lease Losses and Non-performing Assets discussion below for additional information with respect to the credit quality of the loan portfolio in the United States.

Total non-interest income for the year ended December 31, 2011 amounted to $1.3 million compared to non-interest income of $0.9 million and non-interest income of $1.5 million for the years ended December 31, 2010 and 2009, respectively. The increase in non-interest income in 2011, compared to 2010, was mainly related to loan securitization activities. The decrease in non-interest income for 2010, compared to 2009, was mainly related to the sale of corporate bonds in 2009 on which the Corporation realized a gain of $0.9 million.

Direct non-interest expenses in 2011 were $30.5 million compared to $42.3 million and $37.7 million for 2009 and 2008, respectively. The decrease in 2011, compared to 2010, was mainly related to lower losses on the sale of REO properties, a decrease in legal fees associated with collections and foreclosures procedures and a decrease in the FDIC insurance premium expense. The increase in 2010 was driven by increases in the FDIC insurance premium expense, higher losses on REO operations and increases in professional service fees.

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*Virgin Islands Operations*

The Virgin Islands Operations segment consists of all banking activities conducted by FirstBank in the U.S. and British Virgin Islands, including retail and commercial banking services, with a total of fourteen branches serving the U.S. Virgin Islands of St. Thomas, St. Croix and St. John, and the British Virgin Islands of Tortola and Virgin Gorda. The Virgin Islands Operations segment is driven by its consumer, commercial lending and deposit-taking activities. Since 2005, FirstBank has been the largest bank in the U.S. Virgin Islands measured by total assets.

Loans to consumers include auto, boat, lines of credit, personal loans and residential mortgage loans. Deposit products include interest bearing and non-interest bearing checking and savings accounts, Individual Retirement Accounts (IRA) and retail certificates of deposit. Retail deposits gathered through each branch serve as the funding sources for the lending activities.

The highlights of the Virgin Islands operations segment financial results for the year ended December 31, 2011 include the following:

- Segment loss before taxes for the year ended December 31, 2011 was $13.9 million compared to income of $3.2 million and income of $0.7 million for the years ended December 31, 2010 and 2009, respectively.

- Net interest income for the year ended December 31, 2011 was $49.9 million compared to $61.2 million and $61.1 million for the years ended December 31, 2010 and 2009, respectively. The decrease in net interest income in 2011, compared to 2010, was mainly related to the increase of $94.1 million in non-performing construction loans and the overall decrease in the residential and consumer loan portfolios. The increase in net interest income in 2010 was primarily due to the decrease in the cost of funding due to maturing CDs renewed at lower prevailing rates and reductions in rates paid on interest-bearing and savings accounts due to the decline in market interest rates.

- The provision for loan and lease losses for 2011 increased by $10.9 million compared to the same period in 2010 and increased by $1.9 million when comparing 2010 with the same period in 2009. The increase in 2011, compared to 2010, was mainly related to charges to the specific reserve assigned to a $100 million construction loan relationship placed in non-accrual status early in 2011. The increase in the provision for 2010 was mainly associated with the construction loan portfolio and in particular related with charges to specific reserves of $6.4 million allocated to one construction project classified as impaired loan during 2010. This was partially offset by decreases in general reserve factors allocated to this loan portfolio that incorporate the significantly lower historical charge-offs in this region. .

- Non-interest income for the year ended December 31, 2011 was $10.7 million compared to $10.7 million and $10.2 million for the years ended December 31, 2010 and 2009, respectively. The amount for 2011 remained almost unchanged, compared to 2010, reflecting a slight increase in revenues from mortgage banking activities driven by a higher volume of loan sales, offset by lower service charges on deposit accounts. The increase for 2010, as compared to 2009, was mainly related to higher fees on loans related to credit facilities to the Virgin Islands government.

- Direct non-interest expenses for the year ended December 31, 2011 were $36.5 million compared to $41.6 million and $45.4 million for the years ended December 31, 2010 and 2009, respectively. The decrease in 2011, compared to 2010, was mainly related to the decrease in the FDIC insurance premium expense and decreases in compensation and related expenses and in occupancy-related costs such as rental and depreciation expenses. The decrease in 2010, as compared to 2009, was mainly due to reductions in compensation, mainly due to headcount, overtime and bonuses reductions, and reductions in occupancy costs and business promotion expenses.

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**FINANCIAL CONDITION AND OPERATING DATA ANALYSIS**

**Financial Condition**

The following table presents an average balance sheet of the Corporation for the following years:

| | 2011 | December 31, 2010 (In thousands) | 2009 |
|---|---|---|---|
| **ASSETS** | | | |
| Interest-earning assets: | | | |
| Money market & other short-term investments | $ 567,548 | $ 778,412 | $ 182,205 |
| Government obligations | 1,350,505 | 1,368,368 | 1,345,591 |
| Mortgage-backed securities | 1,181,183 | 2,658,279 | 4,254,044 |
| Corporate bonds | 2,000 | 2,000 | 4,769 |
| FHLB stock | 43,676 | 65,297 | 76,982 |
| Equity securities | 1,377 | 1,481 | 2,071 |
| Total investments | 3,146,289 | 4,873,837 | 5,865,662 |
| Residential mortgage loans | 2,944,367 | 3,488,037 | 3,523,576 |
| Construction loans | 616,980 | 1,315,794 | 1,590,309 |
| Commercial loans | 5,849,444 | 6,190,959 | 6,343,635 |
| Finance leases | 263,403 | 299,869 | 341,943 |
| Consumer loans | 1,357,381 | 1,506,448 | 1,661,099 |
| Total loans | 11,031,575 | 12,801,107 | 13,460,562 |
| Total interest-earning assets | 14,177,864 | 17,674,944 | 19,326,224 |
| Total non-interest-earning assets[1] | 177,852 | 196,098 | 480,998 |
| Total assets | $ 14,355,716 | $ 17,871,042 | $ 19,807,222 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | |
| Interest-bearing liabilities: | | | |
| Interest-bearing checking accounts | $ 1,014,280 | $ 1,057,558 | $ 866,464 |
| Savings accounts | 2,032,665 | 1,967,338 | 1,540,473 |
| Certificates of deposit | 2,260,106 | 1,909,406 | 1,680,325 |
| Brokered CDs | 5,134,699 | 7,002,343 | 7,300,696 |
| Interest-bearing deposits | 10,441,750 | 11,936,645 | 11,387,958 |
| Loans payable[2] | | 299,589 | 643,618 |
| Other borrowed funds | 1,459,476 | 2,436,091 | 3,745,980 |
| FHLB advances | 467,522 | 888,298 | 1,322,136 |
| Total interest-bearing liabilities | 12,368,748 | 15,560,623 | 17,099,692 |
| Total non-interest-bearing liabilities[3] | 862,420 | 863,215 | 852,943 |
| Total liabilities | 13,231,168 | 16,423,838 | 17,952,635 |
| Stockholders equity: | | | |
| Preferred stock | 341,658 | 744,585 | 909,274 |

| | | | |
|---|---|---|---|
| Common stockholders equity | 782,890 | 702,619 | 945,313 |
| Stockholders equity | 1,124,548 | 1,447,204 | 1,854,587 |
| Total liabilities and stockholders equity | $ 14,355,716 | $ 17,871,042 | $ 19,807,222 |

(1) Includes the allowance for loan and lease losses and the valuation on investment securities available-for-sale.
(2) Consists of short-term borrowings under the FED Discount Window Program.
(3) Includes changes in fair value of liabilities elected to be measured at fair value .

The Corporation s total average assets were $14.4 billion and $17.9 billion as of December 31, 2011 and 2010, respectively, a decrease for 2011 of $3.5 billion or 20% as compared to 2010. The decrease in average assets was due to: (i) a decrease of $1.8 billion in average loans reflecting the sale of loans to CPG/GS with a principal balance of $510.2 million, additional sales in 2011 of C&I and construction non-performing loans with an unpaid principal balance of $110.9 million, bulk sales of $518 million of performing residential mortgage loans to another financial institution, and charge-offs and prepayments, and (ii) a decrease of $1.7 billion in average investment securities, mainly due to sales of mortgage-backed securities over the last two years and the utilization of excess liquidity to paydown matured borrowings.

The Corporation s total average liabilities were $13.2 billion and $16.4 billion as of December 31, 2011 and 2010, respectively, a decrease of $3.2 billion or 19% as compared to 2010. The decrease in average liabilities is mainly a result of the Corporation s decision to deleverage its balance sheet by the roll-off of maturing brokered CDs and advances from FHLB combined with the early cancellation of repurchase agreements.

**Assets**

Total assets as of December 31, 2011 amounted to $13.1 billion, a decrease of $2.5 billion compared to $15.6 billion as of December 31, 2010. The Corporation continued to deleverage its balance sheet and total loans decreased by $1.3 billion mainly attributed to loan sales, including the sale of $518 million of performing residential mortgage loans to another financial institution and the aforementioned sale of a pool of loans, mainly adversely classified loans, with a book value of $269 million to CPG/GS Charge-offs, sales of trouble assets in Florida and Puerto Rico, foreclosures and prepayments also contributed to a lower loan portfolio. In addtion, there was a decrease of $1.3 billion in investment securities driven by sales and prepayments of U.S. agency MBS, sales of low yielding U.S. Treasury Notes and, U.S. agency debt securities called prior to maturity. The Corporation used proceeds from sales of loans and securities to paydown maturing brokered CDs and for the early cancellation of repurchase agreements. The decrease in assets is consistent with the Corporation s deleveraging, de-risking and balance sheet repositioning strategies, to among other things, improve its capital position during 2011 and enhance net interest margins in the future.

**Loans Receivable, including loans held for sale**

The following table presents the composition of the loan portfolio including loans held for sale as of year-end for each of the last five years.

| *(In thousands)* | **2011** | **2010** | **2009** | **2008** | **2007** |
|---|---|---|---|---|---|
| Residential mortgage loans | $ 2,873,785 | $ 3,417,417 | $ 3,595,508 | $ 3,481,325 | $ 3,143,497 |
| Commercial loans: | | | | | |
| Commercial mortgage loans | 1,565,411 | 1,670,161 | 1,693,424 | 1,635,978 | 1,353,439 |
| Construction loans | 427,863 | 700,579 | 1,492,589 | 1,526,995 | 1,454,644 |
| Commercial and Industrial loans | 3,856,695 | 3,861,545 | 4,927,304 | 3,757,508 | 3,156,938 |
| Loans to local financial institutions collateralized by real estate mortgages and pass-through trust certificates | 273,821 | 290,219 | 321,522 | 567,720 | 624,597 |
| Total commercial loans | 6,123,790 | 6,522,504 | 8,434,839 | 7,488,201 | 6,589,618 |
| Finance leases | 247,003 | 282,904 | 318,504 | 363,883 | 378,556 |
| Consumer loans | 1,314,814 | 1,432,611 | 1,579,600 | 1,744,480 | 1,667,151 |
| Total loans held for investment | 10,559,392 | 11,655,436 | 13,928,451 | 13,077,889 | 11,778,822 |
| Less: | | | | | |
| Allowance for loan and lease losses | (493,917) | (553,025) | (528,120) | (281,526) | (190,168) |
| Total loans held for investment, net | 10,065,475 | 11,102,411 | 13,400,331 | 12,796,363 | 11,588,654 |
| Loans held for sale | 15,822 | 300,766 | 20,775 | 10,403 | 20,924 |
| Total loans, net | $ 10,081,297 | $ 11,403,177 | $ 13,421,106 | $ 12,806,766 | $ 11,609,578 |

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**Lending Activities**

As of December 31, 2011, the Corporation s total loans, net of allowance, decreased by $1.3 billion, when compared with the balance as of December 31, 2010. All major loan categories decreased from 2010 levels, driven by sales of both performing and non-performing loans combined with charge-offs and principal repayments and a lower volume of loan originations.

As discussed in detail in the executive overview section, early in 2011 the Corporation completed the sale of a pool of loans with a book value of $269.3 million, mainly adversely classified and non-performing loans, to CPG/GS. In addition, the Corporation completed bulk sales of $518 million of performing residential mortgage loans to another financial institution in 2011 and sold two large non-performing relationships with an aggregate book value of approximately $70 million (charge-offs of $8.9 million at the time of sale were recorded for these loans in 2011).

As shown in the table above, the 2011 loans held for investment portfolio was comprised of commercial (58%), residential real estate (27%), and consumer and finance leases (15%). Of the total gross loans held for investment portfolio of $10.6 billion as of December 31, 2011, approximately 84% has credit risk concentration in Puerto Rico, 8% in the United States (mainly in the state of Florida) and 8% in the Virgin Islands, as shown in the following table:

| As of December 31, 2011 | Puerto Rico | Virgin Islands | United States | Total |
|---|---|---|---|---|
| | | (In thousands) | | |
| Residential mortgage loans | $ 2,179,690 | $ 405,730 | $ 288,365 | $ 2,873,785 |
| Commercial mortgage loans | 1,066,571 | 65,075 | 433,765 | 1,565,411 |
| Construction loans | 258,785 | 145,519 | 23,559 | 427,863 |
| Commercial and Industrial loans | 3,579,784 | 232,116 | 44,795 | 3,856,695 |
| Loans to a local financial institution collateralized by real estate mortgages | 273,821 | | | 273,821 |
| Total commercial loans | 5,178,961 | 442,710 | 502,119 | 6,123,790 |
| Finance leases | 247,003 | | | 247,003 |
| Consumer loans | 1,226,277 | 57,369 | 31,168 | 1,314,814 |
| Total loans held for investment | $ 8,831,931 | $ 905,809 | $ 821,652 | $ 10,559,392 |
| Loans held for sale | 12,955 | 2,867 | | 15,822 |
| Total loans, gross | $ 8,844,886 | $ 908,676 | $ 821,652 | $ 10,575,214 |

First BanCorp relies primarily on its retail network of branches to originate residential and consumer loans. The Corporation supplements its residential mortgage originations with wholesale servicing released mortgage loan purchases from mortgage bankers. The Corporation manages its construction and commercial loan originations through centralized units and most of its originations come from existing customers as well as through referrals and direct solicitations.

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The following table sets forth certain additional data (including loan production) related to the Corporation s loan portfolio net of the allowance for loan and lease losses for the dates indicated:

| | For the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2008 | 2007 |
| | | | (In thousands) | | |
| Beginning balance | $ 11,403,177 | $ 13,421,106 | $ 12,806,766 | $ 11,609,578 | $ 11,105,684 |
| Residential real estate loans originated and purchased | 563,138 | 526,389 | 591,889 | 690,365 | 715,203 |
| Construction loans originated and purchased | 93,183 | 175,260 | 433,493 | 475,834 | 678,004 |
| C&I and Commercial mortgage loans originated and purchased | 1,480,192 | 1,706,604 | 3,153,278 | 2,175,395 | 1,898,157 |
| Finance leases originated | 83,651 | 90,671 | 80,716 | 110,596 | 139,599 |
| Consumer loans originated and purchased | 493,511 | 508,577 | 514,774 | 788,215 | 653,180 |
| Total loans originated and purchased | 2,713,675 | 3,007,501 | 4,774,150 | 4,240,405 | 4,084,143 |
| Sales and securitizations of loans | (1,175,463) | (529,413) | (464,705) | (164,583) | (147,044) |
| Repayments and prepayments | (2,422,071) | (3,704,221) | (3,010,857) | (2,589,120) | (3,084,530) |
| Other decreases [(1) (2)] | (438,021) | (791,796) | (684,248) | (289,514) | (348,675) |
| Net (decrease) increase | (1,321,880) | (2,017,929) | 614,340 | 1,197,188 | 503,894 |
| Ending balance | $ 10,081,297 | $ 11,403,177 | $ 13,421,106 | $ 12,806,766 | $ 11,609,578 |
| Percentage (decrease) increase | (11.59)% | (15.04)% | 4.80% | 10.31% | 4.54% |

(1) Includes the change in the allowance for loan and lease losses and cancellation of loans due to the repossession of the collateral.

(2) For 2008, is net of $19.6 million of loans from the acquisition of Virgin Islands Community Bank ( VICB ). For 2007, includes the recharacterization of securities collateralized by loans of approximately $183.8 million previously accounted for as a secured commercial loan with a former financial institution.

**Residential Real Estate Loans**

As of December 31, 2011, the Corporation s residential real estate loan portfolio held for investment decreased by $543.6 million as compared to the balance as of December 31, 2010. The majority of the Corporation s outstanding balance of residential mortgage loans consists of fixed-rate, fully amortizing, full documentation loans. In accordance with the Corporation s underwriting guidelines, residential real estate loans are mostly fully documented loans, and the Corporation is not actively involved in the origination of negative amortization loans or adjustable-rate mortgage loans. The decrease was a combination of sales of approximately $518 million of performing loans to another financial institution, and sales of $118.8 million to FNMA and FHLMC in the secondary market. Charge-offs of $39.0 million, foreclosures and paydowns also contributed to the decrease.

Residential real estate loan production and purchases for the year ended December 31, 2011 increased by $36.7 million, compared to the same period in 2010 and decreased by $65.5 million for 2010, compared to the same period in 2009. Residential real estate loans represent 21% of total loans originated and purchased for 2011. The Corporation s strategy is to penetrate markets by providing customers with a variety of high quality mortgage products. The Corporation s residential mortgage loan originations continued to be driven by FirstMortgage, its mortgage loan origination subsidiary. FirstMortgage supplements its internal direct originations through its retail network with an indirect business strategy. The Corporation established in 2005 a strategic program to purchase ongoing residential mortgage loan production from mortgage bankers in Puerto Rico. Purchases of $180.7 million in 2011were mainly conforming residential mortgage loans. Purchases of conforming residential mortgage loans provide the Corporation the flexibility to retain or sell the loans, including through securitization transactions depending upon whether the Corporation wants to retain high yielding loans and improve net interest margins or generate profits by selling loans. When the Corporation sells such loans, it generally keeps the servicing of the loans.

**Commercial and Construction Loans**

As of December 31, 2011, the Corporation s commercial and construction loan portfolio held for investment decreased by $398.7 million, as compared to the balance as of December 31, 2010, due mainly to $218.7 million in charge-offs, principal repayments and the sale of approximately $70 million of two large non-performing loans. The Corporation s commercial loans are primarily variable and adjustable-rate loans.

Total commercial and construction loans originated amounted to $1.6 billion for 2011, a decrease of $308.5 million when compared to originations during 2010. The decrease in commercial and construction loan production for 2011, compared to 2010, was mainly related to credit facilities extended to the Puerto Rico and Virgin Islands government. Origination related to government entities amounted to $438.8 million in 2011 compared to $702.6 million in 2010.

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage and C&I loans with an aggregate book value of $269.3 million to CPG/GS. In exchange for the sale, the Corporation received $88.5 million in cash and a 35% subordinated interest in CPG/GS. In connection with the sale, FirstBank provided seller financing to CPG/GS in the amount of $136.1 million under 7-year loan that bears variable interest at 30-day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity s assets as well as the 65% ownership interest of the majority owner of CPG/GS, PRLP Ventures LLC ( PRLP ). As of December 31, 2011, the carrying amount of the loan is $126.7 million and is included in the Corporation s C&I loan receivable portfolio; the carrying value of FirstBank s equity interest in CPG/GS is $43.4 million as of December 31, 2011, accounted under the equity method and included as part of Investment in unconsolidated entities in the Consolidated Statements of Financial Condition. The 35% interest of FirstBank in CPG/GS is subordinated to PRLP s priority right to recover its initial investment and receive a priority return of 12%. Accordingly, FirstBank s equity interest in CPG/GS is subject to the risk of loss depending upon the performance of the transferred loans. Refer to Note 13 to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for additional information about the determination of the value of the FirstBank s investment in CPG/GS.

FirstBank also provided an $80 million advance facility to CPG/GS to fund unfunded commitments and costs to complete projects under construction, which was fully disbursed in the year ended December 31, 2011, and a $20 million working capital line of credit to fund certain expenses of CPG/GS. These loans bear variable interest at 30-day LIBOR plus 300 basis points. As of December 31, 2011, the carrying value of the advance facility and working capital line were $74.5 million and $0, respectively, and are included in the Corporation s C&I loan receivable portfolio.

As of December 31, 2011, the Corporation had $360.1 million outstanding of credit facilities granted to the Puerto Rico Government and/or its political subdivisions, up from $325.1 million as of December 31, 2010, and $139.4 million granted to the Virgin Islands government, up from $84.3 million as of December 31, 2010. A substantial portion of these credit facilities are obligations that have a specific source of income or revenues identified for their repayment, such as property taxes collected by the central Government and/or municipalities. Another portion of these obligations consists of loans to public corporations that obtain revenues from rates charged for services or products, such as electric power and water utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it. The Corporation also has loans to various municipalities in Puerto Rico for which the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment.

Aside from loans extended to the Puerto Rico Government and its political subdivisions, the largest loan to one borrower as of December 31, 2011 in the amount of $273.8 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual real-estate loans, mostly 1-4 residential mortgage loans.

Construction loans originations decreased by $82.1 million in 2011, from $175.3 million in 2010, due to the strategic decision by the Corporation to reduce its exposure to construction projects in both Puerto Rico and the United States. The Corporation has significantly reduced its exposure to construction loans in its Florida operations and construction loan originations in Puerto Rico are mainly draws from existing commitments. More than 93% of the construction loan originations in 2011 are related to disbursements from previous established commitments and new loans are mainly associated with construction loans to individuals. In Puerto Rico, absorption rates on low income residential projects financed by the Corporation showed signs of improvement during 2010 and 2011 but the market is still under pressure because of an oversupply of housing units compounded by lower demand and diminished consumer purchasing power and confidence.

During 2011, $111.8 million of commercial construction projects were converted to commercial mortgage loans or commercial loans, of which $103.6 million are located in Puerto Rico and $4.7 million in Florida and $3.5

million in the Virgin Islands. As a key initiative to increase the absorption rate in residential construction projects, the Corporation has engaged in discussions with developers to review sales strategies and provide additional incentives to supplement the Puerto Rico Government housing stimulus package enacted in September 2010. From September 1, 2010 to December 31, 2012, the Government of Puerto Rico is providing tax and transaction fees incentives to both purchasers and sellers (whether a Puerto Rico resident or not) of new and existing residential property, as well as commercial property with a sales price of no more than $3 million. Among its provisions, the housing stimulus package provides various types of income and property taxes exemptions as well as reduced closing costs, including:

Purchase/Sale of New Residential Property within the Period
- Any long term capital gain upon the subsequent sale of new residential property will be 100% exempt from the payment of income taxes. The purchaser will have an exemption for five years on the payment of property taxes. The cost of filing stamps and seals are waived for the period.

These benefits will be reduced for the period from July 1, 2012 through December 31, 2012 by 50% that is:

- 50% exemption of real property taxes,

- 50% discount on stamps and rights needed, and

- 50% exemption of the capital gain realized if the property is not the principal residence of the seller.

Purchase/Sale of Existing Residential Property, or Commercial Property with a Sales Price of No More than $3 Million, within the Period ( Qualified Property )
- Any long term capital gain upon selling Qualified Property within the Period will be 100% exempt from the payment of income taxes. Fifty percent of the long term capital gain derived from the future sale of the foregoing property will be exempt from the payment of income taxes, including the basic alternative tax and the alternative minimum tax. Fifty percent of the cost of filing stamps and seals are waived during the period.

These benefits will be reduced for the period from July 1, 2012 through December 31, 2012 by 50% that is:

- 25% discount on stamps and rights needed, and

- 25% exemption of the capital gain realized if the property is not the principal residence of the seller.

Rental Income from Residential Properties
- Income derived from the rental of new or existing residential property will be exempt from income taxes for a period of up to 10 calendar years, commencing on January 1, 2011.

This legislation is aimed to alleviate some of the stress in the construction industry.

The construction loan portfolio held for investment in Puerto Rico decreased by $178.5 million during 2011 driven mainly by loans converted to permanent financing commercial mortgage and C&I loans and charge-offs of $46.3 million. In Florida, the construction portfolio decreased by $55.0 million, driven by the repossession and subsequent sale of the underling collateral of a $33.0 million residential project and charge-offs of $11.5 million in 2011. In the Virgin Islands, the construction portfolio decreased by $39.2 million mainly due to charge-offs of $42.8 million associated with two commercial projects.

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The composition of the Corporation s construction loan portfolio held for investment as of December 31, 2011 by category and geographic location follows:

| As of December 31, 2011 | Puerto Rico | Virgin Islands | United States | Total |
|---|---|---|---|---|
| | | (In thousands) | | |
| Loans for Residential housing projects | | | | |
| High Rise (1) | $ 7,928 | $ | $ | $ 7,928 |
| Mid Rise (2) | 26,751 | 4,939 | 292 | 31,982 |
| Single Family detach | 36,843 | 1,505 | 3,443 | 41,791 |
| Total for residential housing projects | 71,522 | 6,444 | 3,735 | 81,701 |
| Construction Loans to individuals secured by residential properties | 9,980 | 7,578 | | 17,558 |
| Condo-conversion loans | 4,920 | | | 4,920 |
| Loans for commercial projects | 44,595 | 88,979 | | 133,574 |
| Bridge loans residential | 42,926 | | | 42,926 |
| Bridge loans commercial | | 25,700 | 12,697 | 38,397 |
| Land loans residential | 47,299 | 13,913 | 7,133 | 68,345 |
| Land loans commercial | 36,533 | 2,126 | | 38,659 |
| Working Capital | 1,648 | 1,041 | | 2,689 |
| Total before net deferred fees and allowance for loan losses | $ 259,423 | $ 145,781 | $ 23,565 | $ 428,769 |
| Net deferred fees | (638) | (262) | (6) | (906) |
| Total construction loan portfolio, gross | 258,785 | 145,519 | 23,559 | 427,863 |
| Allowance for loan losses | (51,540) | (29,746) | (10,100) | (91,386) |
| Total construction loan portfolio, net | $ 207,245 | $ 115,773 | $ 13,459 | $ 336,477 |

(1) For purposes of the above table, high-rise portfolio is composed of buildings with more than 7 stories, composed of two projects in Puerto Rico.
(2) Mid-rise relates to buildings up to 7 stories.

The following table presents further information on the Corporation s construction portfolio as of and for the year ended December 31, 2011:

| | |
|---|---|
| Total Undisbursed Funds under existing commitments | $ 128,334 |
| Construction loans in non-accrual status (1) | $ 250,022 |
| Net charge offs Construction loans (2) | $ 100,760 |
| Allowance for Loan Losses | $ 91,386 |
| Non-performing construction loans to total construction loans | 58.44% |

| | |
|---|---|
| Allowance for Loan Losses construction loans to total construction loans | 21.36% |
| Net charge offs to total average construction loans | 16.33% |

(1) Excludes $4.8 million of non-performing construction loans held for sale.

(2) Includes charge-offs of $11.5 million related to construction loans in Florida, $46.3 million related to construction loans in Puerto Rico and $42.9 million related to construction loans in the Virgin Islands.

The following summarizes the construction loans for residential housing projects in Puerto Rico segregated by the estimated selling price of the units:

| | (in Thousands) |
|---|---|
| Construction loan portfolio: | |
| Under $300K | 40,817 |
| $300K to $600K | 5,495 |
| Over $600K | 25,210 |
| | $ 71,522 |

(1) Mainly composed of one single-family detached project that accounts for approximately 72% of the residential housing projects in Puerto Rico. With selling prices over $600k.

**Consumer Loans and Finance Leases**

As of December 31, 2011, the Corporation s portfolio of consumer loans and finance leases decreased by $153.7 million, as compared to the portfolio balance as of December 31, 2010. This is mainly the result of repayments and charge-offs that on a combined basis more than offset the volume of loan originations during 2011. Nevertheless, the Corporation experienced a decrease in net charge-offs of consumer loans and finance leases that amounted to $37.7 million for 2011, as compared to $53.9 million for 2010.

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Consumer loan originations are principally driven through the Corporation s retail network. For the year ended December 31, 2011, consumer loan and finance lease originations amounted to $577.2 million, a decrease of $22.1 million or 4% compared to 2011 mainly related to auto financings. Consumer loan originations are driven by auto loan originations through a strategy of seeking to provide outstanding service to selected auto dealers who provide the channel for the bulk of the Corporation s auto loan originations. This strategy is directly linked to our strong and stable auto floor plan relationships, which are the foundation of a successful auto loan generation operation. The Corporation s relations with floor plan dealers are strong and directly benefit the Corporation s consumer lending operation. Finance leases are mostly composed of loans to individuals to finance the acquisition of a motor vehicle and typically have five-year terms and are collateralized by a security interest in the underlying assets.

**Investment Activities**

As part of its strategy to diversify its revenue sources and maximize its net interest income, First BanCorp maintains an investment portfolio that is classified as available-for-sale. The Corporation s total investment securities portfolio as of December 31, 2011 amounted to $2.0 billion, a reduction of $1.3 billion from December 31, 2010 mainly due to sales and prepayments of U.S. agency MBS and sales of U.S Treasury Securities. The reduction was the net result of approximately $640 million of U.S. agency MBS, $500 million of U.S. Treasury Notes and $105 million of U.S. agency floating rate CMOs sold in 2011, the call prior to maturity of approximately $303.3 million of investment securities (mainly U.S. agency debt securities) and MBS prepayments.

As previously discussed, as part of the balance sheet restructuring strategies, the Corporation sold during 2011 approximately $500 million of low-yielding U.S. Treasury Notes and $105 million of floating rate U.S. agency CMOs and used proceeds, in part, to prepay $400 million of repurchase agreements that carried an average rate of 2.74% and $100 million of advances from the FHLB that carried an average rate of 1.62%, thus, contributing to the improvement in the net interest margin. Prepayment penalties of $10.8 million were offset with gains of $11.0 million from the sale of U.S. Treasury Notes and floating rate U.S. agency CMOs. This transactions contributed to the improvement in the net interest margin.

The sales completed in 2011 also included the sale of $330 million of MBS originally intended to be held to maturity as a result of the deleveraging initiatives included in the Corporation s capital plan in order to preserve and improve the Corporation s capital position. After the sale and consistent with the Corporation s ongoing capital management strategy, the remaining $89 million of investment securities held-to-maturity portfolio was reclassified to the available-for-sale portfolio during the first quarter of 2011. Over 83% of the Corporation s available-for-sale portfolio is invested in U.S. Government and Agency debentures and fixed-rate U.S. government sponsored-agency MBS (mainly GNMA, FNMA and FHLMC fixed-rate securities). The Corporation s investment in equity securities is minimal.

The following table presents the carrying value of investments as of December 31, 2011 and 2010:

| | 2011 | 2010 |
|---|---|---|
| | (In thousands) | |
| Money market investments | $ 239,669 | $ 115,560 |
| Investment securities held-to-maturity, at amortized cost: | | |
| U.S. Government and agencies obligations | | 8,487 |
| Puerto Rico Government obligations | | 23,949 |
| Mortgage-backed securities | | 418,951 |
| Corporate bonds | | 2,000 |
| | | 453,387 |
| Investment securities available-for-sale, at fair value: | | |
| U.S. Government and agencies obligations | 778,577 | 1,212,067 |
| Puerto Rico Government obligations | 222,613 | 136,841 |
| Mortgage-backed securities | 921,024 | 1,395,486 |
| Corporate bonds | 1,013 | |
| Equity securities | 41 | 59 |

| | | |
|---|---|---|
| | 1,923,268 | 2,744,453 |
| Other equity securities, including $36.7 million and $54.6 million of FHLB stock as of December 31, 2011 and 2010, respectively | 37,951 | 55,932 |
| Total money market and investment securities | $ 2,200,888 | $ 3,369,332 |

Mortgage-backed securities as of December 31, 2011 and 2010, consist of:

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| *(In thousands)* | **2011** | **2010** |
|---|---|---|
| Held-to-maturity | | |
| FHLMC certificates | $ | $ 2,569 |
| FNMA certificates | | 416,382 |
| | | 418,951 |
| Available-for-sale | | |
| FHLMC certificates | 26,148 | 1,817 |
| GNMA certificates | 762,006 | 991,378 |
| FNMA certificates | 71,664 | 215,059 |
| Collateralized Mortgage Obligations issued or guaranteed by FHLMC, FNMA and GNMA | | 114,915 |
| Other mortgage pass-through certificates | 61,206 | 72,317 |
| | 921,024 | 1,395,486 |
| Total mortgage-backed securities | $ 921,024 | $ 1,814,437 |

The carrying values of investment securities classified as available for sale as of December 31, 2011 by contractual maturity (excluding mortgage-backed securities and equity securities) are shown below:

| *(Dollars in thousands)* | **Carrying amount** | **Weighted average yield %** |
|---|---|---|
| U.S. Government and agencies obligations | | |
| Due within one year | $ 778,577 | 0.65 |
| Due after one year through five years | | |
| | 778,577 | 0.65 |
| Puerto Rico Government obligations | | |
| Due within one year | 8,670 | 4.20 |
| Due after one year through five years | 70,760 | 2.63 |
| Due after five years through ten years | 118,249 | 5.07 |
| Due after ten years | 24,934 | 5.74 |
| | 222,613 | 4.33 |
| Corporate bonds | | |
| Due after ten years | 1,013 | 5.80 |
| Total | 1,002,203 | 1.47 |
| Mortgage-backed securities | 921,024 | 3.85 |
| Equity securities | 41 | |
| Total investment securities available-for-sale | $ 1,923,268 | 2.60 |

Total proceeds from the sale of securities during the year ended December 31, 2011 amounted to approximately $1.6 billion (2010 $2.4 billion). The Corporation realized gross gains of approximately $53.1 million in 2011 (2010 $93.7 million gross gains and realized gross losses of approximately $0.5 million). There were no realized gross losses in 2011. The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of December 31, 2011 and 2010 was $1.3 million. During 2010, the Corporation

realized a gain of $10.7 million on the sale of Visa Class C shares.

For the years ended December 31, 2011 and 2010, the Corporation recorded OTTI charges through earnings of $1.4 million and $0.6 million, respectively, related to the credit loss portion of available-for-sale private label MBS. In addition, in the fourth quarter of 2011 recorded an OTTI charge through earnings of $0.6 million related to its $1.4 million investment in a collateralized debt obligation. With respect to equity securities, in 2010 the Corporation recorded OTTI charges of approximately $0.4 million on certain equity securities held in its available-for-sale investment portfolio related to financial institutions in Puerto Rico. Management concluded that the declines in value of the securities were other-than-temporary; as such, the cost basis of these securities was written down to the market value as of the date of the analysis and was reflected in earnings as a realized loss. Refer to Note 4 to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for additional information regarding the Corporation s evaluation of other-than temporary impairment on available-for-sale securities.

Net interest income of future periods will be affected by the Corporation s decision to deleverage its investment securities portfolio to preserve its capital position and from balance sheet repositioning strategies. Also, net interest income could be affected by prepayments of mortgage-backed securities. Acceleration in the prepayments of

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mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration in the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by the Corporation s investment in callable securities. Approximately $303.3 million of investment securities, mainly U.S. Agency debentures, with an average yield of 1.19% were called during 2011. As of December 31, 2011, the Corporation has approximately $184.1 million in debt securities (Puerto Rico government securities) with embedded calls and with an average yield of 4.12%. Refer to the Risk Management section below for further analysis of the effects of changing interest rates on the Corporation s net interest income and of the interest rate risk management strategies followed by the Corporation. Also refer to Note 4 to the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for additional information regarding the Corporation s investment portfolio.

***Investment Securities and Loans Receivable Maturities***

The following table presents the maturities or repricing of the loan and investment portfolio as of December 31, 2011:

| | | 2-5 Years | | Over 5 Years | | |
|---|---|---|---|---|---|---|
| | One Year or Less | Fixed Interest Rates | Variable Interest Rates | Fixed Interest Rates | Variable Interest Rates | Total |
| | | | (In thousands) | | | |
| Investments:[1] | | | | | | |
| Money market investments | $ 239,669 | $ | $ | $ | $ | $ 239,669 |
| Mortgage-backed securities | 110,547 | 21,851 | | 788,626 | | 921,024 |
| Other securities[2] | 868,640 | 70,760 | | 144,196 | | 1,083,596 |
| Total investments | 1,218,856 | 92,611 | | 932,822 | | 2,244,289 |
| Loans:[1][2][3] | | | | | | |
| Residential mortgage | 554,583 | 74,687 | | 2,255,573 | | 2,884,843 |
| C&I and commercial mortgage | 4,619,509 | 465,436 | 122,223 | 488,759 | | 5,695,927 |
| Construction | 387,858 | 13,008 | | 31,761 | | 432,627 |
| Finance leases | 23,573 | 201,844 | | 21,586 | | 247,003 |
| Consumer | 167,061 | 844,731 | | 303,022 | | 1,314,814 |
| Total loans | 5,752,584 | 1,599,706 | 122,223 | 3,100,701 | | 10,575,214 |
| Total earning assets | $ 6,971,440 | $ 1,692,317 | $ 122,223 | $ 4,033,523 | $ | $ 12,819,503 |

(1) Scheduled repayments reported in the maturity category in which the payment is due and variable rate loans and investments according to repricing frequency.
(2) Equity securities available-for-sale, other equity securities and loans having no stated scheduled of repayment and no stated maturity were included under the one year or less category .
(3) Non-accruing loans were included under the one year or less category .

***Goodwill and other intangible assets***

Business combinations are accounted for using the purchase method of accounting. Assets acquired and liabilities assumed are recorded at estimated fair value as of the date of acquisition. After initial recognition, any resulting intangible assets are accounted for as follows:

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Goodwill

The Corporation evaluates goodwill for impairment on an annual basis, generally during the fourth quarter, or more often if events or circumstances indicate there may be impairment. The Corporation evaluated goodwill for impairment as of October 1, 2011. Goodwill impairment testing is performed at the segment (or reporting unit ) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill. The Corporation s goodwill is mainly related to the acquisition of FirstBank Florida in 2005.

The goodwill impairment analysis is a two-step process. The first step ( Step 1 ) involves a comparison of the estimated fair value of the reporting unit to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is not considered impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of the impairment.

The second step ( Step 2 ) involves calculating an implied fair value of the goodwill for each reporting unit for which the first step indicated a potential impairment. The implied fair value of goodwill is determined in a manner similar to the calculation of the amount of goodwill in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

In determining the fair value of a reporting unit, which is based on the nature of the business and reporting unit s current and expected financial performance, the Corporation uses a combination of methods, including market price multiples of comparable companies, as well as a discounted cash flow analysis ( DCF ). The Corporation evaluates the results obtained under each valuation methodology to identify and understand the key value drivers in order to ascertain that the results obtained are reasonable and appropriate under the circumstances.

The computations require management to make estimates and assumptions. Critical assumptions that are used as part of these evaluations include:

- a selection of comparable publicly traded companies, based on the nature of the business, location and size;
- the discount rate applied to future earnings, based on an estimate of the cost of equity;
- the potential future earnings of the reporting unit; and
- the market growth and new business assumptions.

For purposes of the market comparable approach, valuation was determined by calculating price to tangible equity multiples of the comparable companies and applying these multiples to the reporting unit to derive an implied value of equity.

For purposes of the DCF analysis approach, the valuation is based on estimated future cash flows. The financial projections used in the DCF analysis for the reporting unit are based on the most recent available data. The growth assumptions included in these projections are based on management s expectations of the reporting unit s financial prospects as well as particular plans for the entity (i.e. restructuring plans). The cost of equity was estimated using the capital asset pricing model (CAPM) using comparable companies, an equity risk premium, the rate of return of a riskless asset, a size premium based on the size of the reporting unit and a specific company risk premium. The discount rate was estimated to be 16.5 percent. The resulting discount rate was analyzed in terms of reasonability given current market conditions.

The Step 1 evaluation of goodwill allocated to the Florida reporting unit, which is one level below the United States business segment, indicated potential impairment of goodwill. The Step 1 fair value for the unit under both valuation approaches (market and DCF) was below the carrying

amount of its equity book value as of the valuation

date (October 1), requiring the completion of Step 2. In accordance with accounting standards, the Corporation performed a valuation of all assets and liabilities of the Florida unit, including any recognized and unrecognized intangible assets, to determine the fair value of net assets. To complete Step 2, the Corporation subtracted from the unit s Step 1 fair value the determined fair value of the net assets to arrive at the implied fair value of goodwill. The results of the Step 2 analysis indicated that the implied fair value of goodwill of $40.4 million exceeded the goodwill carrying value of $27 million, resulting in no goodwill impairment. The analysis of results for Step 2 indicated that the fair value of the reporting unit was mainly driven by the deteriorated fair value of the loan portfolios and not the fair value of the reporting unit as going concern. The discount in the loan portfolios is mainly attributable to market participants expected rates of returns, which affected the market discount on the Florida commercial mortgage and residential mortgage portfolios. The fair value of the loan portfolio determined for the Florida reporting unit represented a discount of $101 million.

The fair value in the Florida unit Step 1 was offset by a reduction in the fair value of its net assets, resulting in an implied fair value of goodwill that exceeded the recorded book value of goodwill. If the Step 1 fair value of the Florida unit declines further without a corresponding decrease in the fair value of its net assets or if loan discounts improve without a corresponding increase in the Step 1 fair value, the Corporation may be required to record a goodwill impairment charge. The Corporation engaged a third-party valuator to assist management in the annual evaluation of the Florida unit goodwill (including Step 1 and Step 2), including the valuation of loan portfolios as of the October 1 valuation date. In reaching its conclusion on impairment, management analyzed with the valuator the methodologies, assumptions and results supporting the relevant values for the goodwill and determined that they were reasonable.

The goodwill impairment evaluation process requires the Corporation to make estimates and assumptions with regards to the fair value of the reporting units. Actual values may differ significantly from these estimates. Such differences could result in future impairment of goodwill that would, in turn, negatively impact the Corporation s results of operations and the profitability of the reporting unit where goodwill is recorded.

Goodwill was not impaired as of December 31, 2011 or 2010, nor was any goodwill written-off due to impairment during 2011, 2010 and 2009.

Other Intangibles

Definite life intangibles, mainly core deposits, are amortized over their estimated lives, generally on a straight-line basis, and are reviewed periodically for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

The Corporation performed impairment tests for the year ended December 31, 2011 and determined that no impairment was needed to be recognized for other intangible assets. As a result of an impairment evaluation of core deposit intangibles, there was an impairment charge of $4.0 million recorded in 2009 related to core deposits of FirstBank Florida attributable to decreases in the base of acquired core deposits, no impairment charge was required for 2010.

**RISK MANAGEMENT**

**General**

Risks are inherent in virtually all aspects of the Corporation s business activities and operations. Consequently, effective risk management is fundamental to the success of the Corporation. The primary goals of risk management are to ensure that the Corporation s risk taking activities are consistent with the Corporation s objectives and risk tolerance and that there is an appropriate balance between risk and reward in order to maximize stockholder value.

The Corporation has in place a risk management framework to monitor, evaluate and manage the principal risks assumed in conducting its activities. First BanCorp s business is subject to eight broad categories of risks: (1) liquidity risk, (2) interest rate risk, (3) market risk, (4) credit risk, (5) operational risk, (6) legal and compliance risk, (7) reputational risk, and (8) contingency risk. First BanCorp has adopted policies and procedures designed to identify and manage risks to which the Corporation is exposed, specifically those relating to liquidity risk, interest rate risk, credit risk, and operational risk.

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**Risk Definition**

*Liquidity Risk*

Liquidity risk is the risk to earnings or capital arising from the possibility that the Corporation will not have sufficient cash to meet the short-term liquidity demands such as from deposit redemptions or loan commitments. Refer to Liquidity and Capital Adequacy section below for further details.

*Interest Rate Risk*

Interest rate risk is the risk to earnings or capital arising from adverse movements in interest rates, refer to Interest Rate Risk Management section below for further details.

*Market Risk*

Market risk is the risk to earnings or capital arising from adverse movements in market rates or prices, such as interest rates or equity prices. The Corporation evaluates market risk together with interest rate risk, refer to Interest Rate Risk Management section below for further details.

*Credit Risk*

Credit risk is the risk to earnings or capital arising from a borrower s or a counterparty s failure to meet the terms of a contract with the Corporation or otherwise to perform as agreed. Refer to Credit Risk Management section below for further details.

*Operational Risk*

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This risk is inherent across all functions, products and services of the Corporation. Refer to Operational Risk section below for further details.

*Legal and Regulatory Risk*

Legal and regulatory risk is the risk to earnings and capital arising from the Corporation s failure to comply with laws or regulations that can adversely affect the Corporation s reputation and/or increase its exposure to litigation.

*Reputational Risk*

Reputational risk is the risk to earnings and capital arising from any adverse impact on the Corporation s market value, capital or earnings of negative public opinion, whether true or not. This risk affects the Corporation s ability to establish new relationships or services, or to continue servicing existing relationships.

*Contingency Risk*

Contingency risk is the risk to earnings and capital associated with the Corporation s preparedness for the occurrence of an unforeseen event.

**Risk Governance**

The following discussion highlights the roles and responsibilities of the key participants in the Corporation s risk management framework:

*Board of Directors*

The Board of Directors oversees the Corporation s overall risk governance program with the assistance of the Asset and Liability Committee, Credit Committee and the Audit Committee in executing this responsibility.

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*Asset and Liability Committee*

The Asset and Liability Committee of the Corporation is appointed by the Board of Directors to assist the Board of Directors in its oversight of the Corporation s policies and procedures related to asset and liability management relating to funds management, investment management, liquidity, interest rate risk management, capital adequacy and use of derivatives. In doing so, the Committee s primary general functions involve:

- The establishment of a process to enable the recognition, assessment, and management of risks that could affect the Corporation s assets and liabilities management;
- The identification of the Corporation s risk tolerance levels for yield maximization relating to its assets and liabilities;
- The evaluation of the adequacy and effectiveness of the Corporation s risk management process relating to the Corporation s assets and liabilities, including management s role in that process; and
- The evaluation of the Corporation s compliance with its risk management process relating to the Corporation s assets and liabilities.

*Credit Committee*

The Credit Committee of the Board of Directors is appointed by the Board of Directors to assist the Board of Directors in its oversight of the Corporation s policies and procedures related to all matters of the Corporation s lending function. In doing so, the Committee s primary general functions involve:

- The establishment of a process to enable the identification, assessment, and management of risks that could affect the Corporation s credit management;
- The identification of the Corporation s risk tolerance levels related to its credit management;
- The evaluation of the adequacy and effectiveness of the Corporation s risk management process related to the Corporation s credit management, including management s role in that process;
- The evaluation of the Corporation s compliance with its risk management process related to the Corporation s credit management; and
- The approval of loans as required by the lending authorities approved by the Board of Directors.

*Audit Committee*

The Audit Committee of First BanCorp is appointed by the Board of Directors to assist the Board of Directors in fulfilling its responsibility to oversee management regarding:

- The conduct and integrity of the Corporation s financial reporting to any governmental or regulatory body, shareholders, other users of the Corporation s financial reports and the public;

The Corporation s systems of internal control over financial reporting and disclosure controls and procedures;

The qualifications, engagement, compensation, independence and performance of the Corporation s independent auditors, their conduct of the annual audit of the Corporation s financial statements, and their engagement to provide any other services;

The Corporation s legal and regulatory compliance;

The implementation of the Corporation s related person transaction policy as established by the Board of Directors;

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- The implementation of the Corporation s code of business conduct and ethics as established by management and the Board of Directors; and

- The preparation of the Audit Committee report required to be included in the Corporation s annual proxy statement by the rules of the Securities and Exchange Commission.

In performing this function, the Audit Committee is assisted by the Chief Risk Officer ( CRO ) and the Risk Management Council ( RMC ), and other members of senior management.

*Strategic Planning Committee*

The Strategic Planning Committee of the Corporation is appointed by the Board of Directors of the Corporation to assist and advise management with respect to, and monitor and oversee on behalf of the Board, corporate development activities not in the ordinary course of the Corporation s business and strategic alternatives under consideration from time to time by the Corporation, including, but not limited to, acquisitions, mergers, alliances, joint ventures, divestitures, capitalization of the Corporation and other similar corporate transactions.

*Compliance Committee*

The Compliance Committee of the Corporation is appointed by the Board of Directors to assist the Board of the Bank in fulfilling its responsibility to ensure the Corporation and the Bank comply with the provisions of the Order entered into with the FDIC and the OCIF and the Written Agreement entered into with the FED. Once the Agreements are terminated by the FDIC, OCIF and the FED the Committee will cease to exist.

*Executive Risk Management Committee*

The Executive Risk Management Committee is appointed by the Chief Executive Officer to assist the Corporation in overseeing, and receiving information regarding the Corporation s policies, procedures and practices related to the Corporation s risks. In doing so, the Council s primary general functions involve:

- The appointment of persons responsible for the Corporation s significant risks;

- The development of the risk management infrastructure needed to enable it to monitor risk policies and limits established by the Board of Directors;

- The evaluation of the risk management process to identify any gap and the implementation of any necessary control to close such gap;

- The establishment of a process to enable the recognition, assessment, and management of risks that could affect the Corporation; and

- The provision to the Board of Directors of appropriate information about the Corporation s risks.

Refer to Interest Rate Risk, Credit Risk, Liquidity, Operational, Legal and Regulatory Risk Management -Operational Risk discussion below for further details of matters discussed in the Risk Management Council.

*Other Management Committees*

As part of its governance framework, the Corporation has various additional risk management related-committees. These committees are jointly responsible for ensuring adequate risk measurement and management in their respective areas of authority. At the management level, these committees include:

(1) Management s Investment and Asset Liability Committee ( MIALCO ) oversees interest rate and market risk, liquidity management and other related matters. Refer to Liquidity Risk and Capital Adequacy and Interest Rate Risk Management discussions below for further details.

(2) Information Technology Steering Committee  is responsible for the oversight of and counsel on matters related to information technology including the development of information management policies and procedures throughout the Corporation.

(3) Bank Secrecy Act Committee  is responsible for oversight, monitoring and reporting of the Corporation s compliance with the Bank Secrecy Act.

(4) Credit Committees (Delinquency and Credit Management Committee)  oversees and establishes standards for credit risk management processes within the Corporation. The Credit Management Committee is responsible for the approval of loans above an established size threshold. The Delinquency Committee is responsible for the periodic review of (1) past due loans, (2) overdrafts, (3) non-accrual loans, (4) other real estate owned ( OREO ) assets, and (5) the bank s watch list and non-performing loans.

(5) Vendor Management Committee  oversees policies, procedures and related practices related to the Corporation s vendor management efforts. The Vendor Management Committee primarily general functions involve the establishment of a process and procedures to enable the recognition, assessment, management and monitoring of vendor management risks.

*Officers*

As part of its governance framework, the following officers play a key role in the Corporation s risk management process:

(1) Chief Executive Officer is responsible for the overall risk governance structure of the Corporation.

(2) Chief Risk Officer is responsible for the oversight of the risk management organization as well as risk governance processes. In addition, the CRO with the collaboration of the Risk Assessment Manager manages the operational risk program.

(3) Commercial Credit Risk Officer, Retail Credit Risk Officer, Chief Lending Officer and other senior executives, are responsible of managing and executing the Corporation s credit risk program.

(4) Chief Financial Officer together with the Corporation s Treasurer manages the Corporation s interest rate and market and liquidity risks programs and, together with the Corporation s Chief Accounting Officer, is responsible for the implementation of accounting policies and practices in accordance with GAAP and applicable regulatory requirements. The Chief Financial Officer is assisted by the Risk Assessment Manager in the review of the Corporation s internal control over financial reporting.

(5) Chief Accounting Officer is responsible for the development and implementation of the Corporation s accounting policies and practices and the review and monitoring of critical accounts and transactions to ensure that they are managed in accordance with GAAP and applicable regulatory requirements.

*Other Officers*

In addition to a centralized Enterprise Risk Management function, certain lines of business and corporate functions have their own Risk Managers and support staff. The Risk Managers, while reporting directly within their respective line of business or function, facilitate communications with the Corporation s risk functions and work in partnership with the CRO and CFO to ensure alignment with sound risk management practices and expedite the implementation of the enterprise risk management framework and policies.

**Liquidity and Capital Adequacy, Interest Rate Risk, Credit Risk, Operational, Legal and Regulatory Risk Management**

The following discussion highlights First BanCorp s adopted policies and procedures for liquidity risk, interest rate risk, credit risk, operational risk, legal and regulatory risk.

**Liquidity Risk and Capital Adequacy**

Liquidity is the ongoing ability to accommodate liability maturities and deposit withdrawals, fund asset growth and business operations, and meet contractual obligations through unconstrained access to funding at reasonable market rates. Liquidity management involves forecasting funding requirements and maintaining sufficient capacity to meet the needs for liquidity and accommodate fluctuations in asset and liability levels due to changes in the Corporation s business operations or unanticipated events.

The Corporation manages liquidity at two levels. The first is the liquidity of the parent company, which is the holding company that owns the banking and non-banking subsidiaries. The second is the liquidity of the banking subsidiary. As of December 31, 2011, FirstBank could not pay any dividend to the parent company except upon receipt of prior approval by the FED.

The Asset and Liability Committee of the Board of Directors is responsible for establishing the Corporation s liquidity policy as well as approving operating and contingency procedures, and monitoring liquidity on an ongoing basis. The MIALCO, using measures of liquidity developed by management, which involve the use of several assumptions, reviews the Corporation s liquidity position on a monthly basis. The MIALCO oversees liquidity management, interest rate risk and other related matters. The MIALCO, which reports to the Board of Directors Asset and Liability Committee, is composed of senior management officers, including the Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, the Retail Financial Services Director, the Risk Manager of the Treasury and Investments Division, the Financial Analysis and Asset/Liability Director and the Treasurer. The Treasury and Investments Division is responsible for planning and executing the Corporation s funding activities and strategy; monitoring liquidity availability on a daily basis and reviewing liquidity measures on a weekly basis. The Treasury and Investments Accounting and Operations area of the Comptroller s Department is responsible for calculating the liquidity measurements used by the Treasury and Investment Division to review the Corporation s liquidity position on a monthly basis, the Financial Analysis and and Asset/Liability Director estimates the liquidity gap for longer periods.

In order to ensure adequate liquidity through the full range of potential operating environments and market conditions, the Corporation conducts its liquidity management and business activities in a manner that will preserve and enhance funding stability, flexibility and diversity. Key components of this operating strategy include a strong focus on the continued development of customer-based funding, the maintenance of direct relationships with wholesale market funding providers, and the maintenance of the ability to liquidate certain assets when, and if, requirements warrant.

The Corporation develops and maintains contingency funding plans. These plans evaluate the Corporation s liquidity position under various operating circumstances and allow the Corporation to ensure that it will be able to operate through periods of stress when access to normal sources of funds is constrained. The plans project funding requirements during a potential period of stress, specify and quantify sources of liquidity, outline actions and procedures for effectively managing through a difficult period, and define roles and responsibilities. In the Contingency Funding Plan, the Corporation stresses the balance sheet and the liquidity position to critical levels that imply difficulties in getting new funds or even maintaining its current funding position, thereby ensuring the ability to honor its commitments, and establishing liquidity triggers monitored by the MIALCO in order to maintain the ordinary funding of the banking business. Three different scenarios are defined in the Contingency Funding Plan: local market event, credit rating downgrade, and a concentration event. They are reviewed and approved annually by the Board of Directors Asset and Liability Committee.

The Corporation manages its liquidity in a proactive manner, and maintains a sound liquidity position. Multiple measures are utilized to monitor the Corporation s liquidity position, including basic liquidity and time-based reserve measures. The Corporation has maintained basic liquidity (cash, free liquid assets and secured lines of credit) in excess of the self-imposed minimum limit of 5% of total assets. As of December 31, 2011, the estimated basic liquidity ratio was approximately 7.6%, including un-pledged investment securities, FHLB lines of credit, and cash. At year end, the Corporation had $506 million available for additional credit on FHLB lines of credit. Unpledged liquid securities as of December 31, 2011 mainly consisted of fixed-rate MBS and U.S. agency debentures totaling approximately $62.4 million. The Corporation does not rely on uncommitted inter-bank lines of credit (federal funds lines) to fund its operations and does not include them in the basic liquidity computation. Most of the cash balances are deposited with the Federal Reserve Bank generating interest income based on a 0.25% rate. As of December 31, 2011, the holding company had $44.8 million of cash and cash equivalents. Cash and cash equivalents at the Bank level as of December 31, 2011 were approximately $440.1 million. The Bank has $100 million, $159 million and $7.4 million in repurchase agreements, FHLB advances and notes payable, respectively,

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maturing over the next twelve months. In addition, it had $3.7 billion in brokered CDs as of December 31, 2011, of which $2.5 billion mature over the next twelve months. Liquidity at the Bank level is highly dependent on bank deposits, which fund 75.9% of the Bank s assets (or 47.5% excluding brokered CDs).The Corporation has continued to issue brokered CDs pursuant to temporary approvals received from the FDIC to renew or roll over certain amounts of brokered CDs through March 31, 2012. Management cannot be certain it will continue to obtain waivers from the restrictions to issue brokered CDs under the Order to meet its obligations and execute its business plans.

*Sources of Funding*

The Corporation utilizes different sources of funding to help ensure that adequate levels of liquidity are available when needed. Diversification of funding sources is of great importance to protect the Corporation s liquidity from market disruptions. The principal sources of short-term funds are deposits, including brokered CDs, securities sold under agreements to repurchase, and lines of credit with the FHLB. The Asset Liability Committee of the Board of Directors reviews credit availability on a regular basis. The Corporation has also securitized and sold mortgage loans as a supplementary source of funding. Issuances of commercial paper have also in the past provided additional funding. Long-term funding has also been obtained through the issuance of notes and, to a lesser extent, long-term brokered CDs. The cost of these different alternatives, among other things, is taken into consideration.

The Corporation has deleveraged its balance sheet by reducing the amounts of brokered CDs. The reductions in brokered CDs are consistent with the requirements of the Order that preclude the issuance of brokered CDs without FDIC approval and require a plan to reduce the amount of brokered CDs. Brokered CDs decreased $2.5 billion to $3.7 billion as of December 31, 2011 from $6.3 billion as of December 31, 2010. At the same time, as the Corporation focuses on reducing its reliance on brokered deposits, it is seeking to add core deposits.

The Corporation continues to have the support of creditors, including repurchase agreements counterparties, the FHLB, and other agents such as wholesale funding brokers. While liquidity is an ongoing challenge for all financial institutions, management believes that the Corporation s available borrowing capacity and efforts to grow retail deposits and the recently completed $525 million capital raise will be adequate to provide the necessary funding for the Corporation s business plans in the foreseeable future. Refer to Capital discussion below for additional information about the recently completed capital raise.

The Corporation s principal sources of funding are:

*Deposits*

The following table presents the composition of total deposits:

| | Weighted-Average Rate as of December 31, 2011 | As of December 31, 2011 | 2010 | 2009 |
|---|---|---|---|---|
| | | (Dollars in thousands) | | |
| Savings accounts | 0.99% | $ 2,145,625 | $ 1,938,475 | $ 1,761,646 |
| Interest-bearing checking accounts | 1.10% | 1,066,753 | 1,012,009 | 998,097 |
| Certificates of deposit | 1.87% | 5,989,587 | 8,440,574 | 9,212,282 |
| Interest-bearing deposits | 1.57% | 9,201,965 | 11,391,058 | 11,972,025 |
| Non-interest-bearing deposits | | 705,789 | 668,052 | 697,022 |
| Total | | $ 9,907,754 | $ 12,059,110 | $ 12,669,047 |
| Interest-bearing deposits: | | | | |
| Average balance outstanding | | $ 10,441,750 | $ 11,936,645 | $ 11,387,958 |
| Non-interest-bearing deposits: | | | | |
| Average balance outstanding | | $ 702,690 | $ 709,792 | $ 698,754 |
| | | 1.84% | 2.08% | 2.79% |

| Weighted average rate during the period on interest-bearing deposits |
| --- |

*Brokered CDs* A large portion of the Corporation s funding has been retail brokered CDs issued by FirstBank. Total brokered CDs decreased from $6.3 billion at December 31, 2010 to $3.7 billion as of December 31, 2011. Although all the regulatory capital ratios exceeded the established well capitalized levels at December 31, 2011 and the minimum capital requirements of the FDIC Order, because of the Order with the FDIC, FirstBank cannot be considered a well capitalized institution under regulatory

guidance and cannot replace maturing brokered CDs without the prior approval of the FDIC. Since the issuance of the Order, the FDIC has granted the Bank temporary waivers to enable it to continue accessing the brokered deposit market through March 31, 2012. The Bank will request approvals for future periods. The Corporation used proceeds from repayments and sales of loans and investments to pay down maturing borrowings, including brokered CDs. Also, the Corporation successfully implemented its core deposit growth strategy that resulted in an increase of $365.8 million, or 7%, in core deposits during 2011. Core deposits exclude brokered deposits and public funds.

The average remaining term to maturity of the retail brokered CDs outstanding as of December 31, 2011 is approximately 0.8 years. Approximately 0.7% of the principal value of these certificates is callable at the Corporation s option.

The use of brokered CDs has been particularly important for the growth of the Corporation. The Corporation encounters intense competition in attracting and retaining regular retail deposits in Puerto Rico. The brokered CDs market is very competitive and liquid, and the Corporation has been able to obtain substantial amounts of funding in short periods of time. This strategy has enhanced the Corporation s liquidity position, since the brokered CDs are insured by the FDIC up to regulatory limits and can be obtained faster compared to regular retail deposits. Should the FDIC fail to approve waivers for the renewal of brokered CD s, the Corporation would accelerate the deleveraging through a systematic disposition of assets to meet its liquidity needs. During 2011, the Corporation issued $674.0 million in brokered CDs to renew maturing brokered CDs having an average coupon of 0.83% (all-in cost of 1.10%). Management believes it will continue to obtain waivers from the restrictions in the issuance of brokered CDs under the Order to meet its obligations and execute its business plans.

The following table presents a maturity summary of brokered and retail CDs with denominations of $100,000 or higher as of December 31, 2011.

| | **Total (In thousands)** |
|---|---|
| Three months or less | $ 1,041,701 |
| Over three months to six months | 704,897 |
| Over six months to one year | 1,581,370 |
| Over one year | 1,724,657 |
| Total | $ 5,052,625 |

Certificates of deposit in denominations of $100,000 or higher include brokered CDs of $3.7 billion issued to deposit brokers in the form of large ($100,000 or more) certificates of deposit that are generally participated out by brokers in shares of less than $100,000 and are therefore insured by the FDIC. Certificates of deposit with denominations of $100,000 or higher also include $8.2 million of deposits through the Certificate of Deposit Account Registry Service (CDARS).

*Retail deposits* The Corporation s deposit products also include regular savings accounts, demand deposit accounts, money market accounts and retail CDs. Total deposits, excluding brokered CDs, increased by $376.6 million to $6.2 billion from the balance of $5.8 billion as of December 31, 2010, reflecting increases in core-deposit products such as money market, savings, retail CD and interest-bearing checking accounts spread through the Corporation s geographic segments. Refer to Note 14 in the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for further details.

Refer to the Net Interest Income discussion above for information about average balances of interest-bearing deposits, and the average interest rate paid on deposits for the years ended December 31, 2011, 2010 and 2009.

***Borrowings***

As of December 31, 2011, total borrowings amounted to $1.6 billion as compared to $2.3 billion and $5.2 billion as of December 31, 2010 and 2009, respectively.

The following table presents the composition of total borrowings as of the dates indicated:

| | Weighted Average Rate as of December 31, 2011 | 2011 | As of December 31, 2010 | 2009 |
|---|---|---|---|---|
| | | (Dollars in thousands) | | |
| Federal funds purchased and securities sold under agreements to repurchase | 3.27% | $ 1,000,000 | $ 1,400,000 | $ 3,076,631 |
| Loans payable (1) | | | | 900,000 |
| Advances from FHLB | 3.59% | 367,440 | 653,440 | 978,440 |
| Notes payable | 5.34% | 23,342 | 26,449 | 27,117 |
| Other borrowings | 3.17% | 231,959 | 231,959 | 231,959 |
| Total (2) | | $ 1,622,741 | $ 2,311,848 | $ 5,214,147 |
| Weighted-average rate during the period | | 3.64% | 3.55% | 2.79% |

(1) Advances from the FED under the FED Discount Window Program.

(2) Includes $1.2 billion as of December 31, 2011 that are tied to variable rates or matured within a year.

*Securities sold under agreements to repurchase* The Corporation s investment portfolio is funded in part with repurchase agreements. Securities sold under repurchase agreements were $1.0 billion as of December 31, 2011, compared with $1.4 billion as of December 31, 2010. The decrease relates to the aforementioned $400 million of repurchase agreements repaid prior to maturity. As part of the Corporation s balance sheet restructuring strategies, approximately $400 million of repurchase agreements were repaid prior to maturity during 2011, realizing a loss of $10.6 million on the early extinguishment. The repaid repurchase agreements were scheduled to mature at various dates between September 2011 and September 2012 and had a weighted average cost of 2.74%. Prepayment penalties of $10.6 million for the early termination of the repurchase agreements were offset with gains of $11.0 million from the sale of low-yielding investment securities. In addition, during 2011, the Corporation restructured $700 million of repurchase agreements through amendments that include three to four year maturity extensions and are expected to result in additional reductions in the average cost of funding. This transactions contributed to improvements in the net interest margin. One of the Corporation s strategies has been the use of structured repurchase agreements and long-term repurchase agreements to reduce exposure to interest rate risk by lengthening the final maturities of its liabilities while keeping funding costs at reasonable levels. All of the $1.0 billion of repurchase agreements outstanding as of December 31, 2011 consist of structured repurchase agreements. The access to this type of funding was affected by the liquidity turmoil in the financial markets witnessed in the second half of 2008 and in 2009. In addition to repos, the Corporation has been able to maintain access to credit by using cost-effective sources such as FHLB advances. Refer to Note 16 in the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for further details about repurchase agreements outstanding by counterparty and maturities.

Under the Corporation s repurchase agreements, as is the case with derivative contracts, the Corporation is required to pledge cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines due to changes in interest rates, a liquidity crisis or any other factor, the Corporation will be required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity. Given the quality of the collateral pledged, recently the Corporation has not experienced significant margin calls from counterparties arising from credit-quality-related write-downs in valuations and, as of December 31, 2011, it had only $0.5 million of cash equivalent instruments deposited in connection with collateralized interest rate swap agreements.

*Advances from the FHLB* The Corporation s Bank subsidiary is a member of the FHLB system and obtains advances to fund its operations under a collateral agreement with the FHLB that requires the Bank to maintain qualifying mortgages as collateral for advances taken. As of December 31, 2011 and 2010, the

outstanding balance of FHLB advances was $367.4 million and $653.4 million, respectively. Approximately $208.4 million of outstanding advances from the FHLB has maturities of over one year. As part of its precautionary initiatives to safeguard access to credit and obtain low interest rates, the Corporation has been pledging assets with the FHLB while at the same time the FHLB has been revising its credit guidelines and haircuts in the computation of the availability of credit lines. At December 31, 2011, the Corporation had $506 million available for additional credit on FHLB lines of credit.

Though currently not in use, other sources of short-term funding for the Corporation include commercial paper and federal funds purchased. Furthermore, in previous years the Corporation entered into several financing transactions to diversify its funding sources, including the issuance of notes payable and Junior subordinated debentures as part of its longer-term liquidity and capital management activities. No assurance can be given that these sources of liquidity will be available and, if available, will be on comparable terms.

In 2004, FBP Statutory Trust I, a statutory trust that is wholly owned by the Corporation and not consolidated in the Corporation s financial statements, sold to institutional investors $100 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.1 million of FBP Statutory Trust I variable rate common securities, were used by FBP Statutory Trust I to purchase $103.1 million aggregate principal amount of the Corporation s Junior Subordinated Deferrable Debentures.

Also in 2004, FBP Statutory Trust II, a statutory trust that is wholly-owned by the Corporation and not consolidated in the Corporation s financial statements, sold to institutional investors $125 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.9 million of FBP Statutory Trust II variable rate common securities, were used by FBP Statutory Trust II to purchase $128.9 million aggregate principal amount of the Corporation s Junior Subordinated Deferrable Debentures.

The trust preferred debentures are presented in the Corporation s consolidated statement of financial condition as Other Borrowings, net of related issuance costs. The variable rate trust preferred securities are fully and unconditionally guaranteed by the Corporation. The $100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the $125 million issued in September 2004 mature on September 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust preferred securities). The trust preferred securities, subject to certain limitations, qualify as Tier I regulatory capital under current Federal Reserve rules and regulations. Section 171of the Dodd-Frank Act (the Collins Amendment ) excludes Trust Preferred Securities from Tier 1 Capital and has a provision to effectively phase-out the use of trust preferred securities issued before May 19, 2010 as Tier 1 Capital over a 3-year period commencing on January 1, 2013. At December 31, 2011, the Corporation had $225 million in trust preferred securities that are subject to the phase-out.

With respect to the outstanding subordinated debentures, the Corporation had elected to defer the interest payments that were due in September and December 2010; in March, June and September 2011 and in March 2012. Although the Corporation recently obtained approval from the Federal Reserve to make all distributions of interest for interest extension periods previously deferred and to pay the December 2011 interest payment, future interest payments are subject to Federal Reserve approval. The Corporation elected to defer the interest payments due in March 2012.

The Corporation s principal uses of funds are the origination of loans and the repayment of maturing deposits and borrowings. The Corporation has committed substantial resources to its mortgage banking subsidiary, FirstMortgage Inc. As a result, the ratio of residential real estate loans as a percentage of total loans has increased over time from 14% at December 31, 2004 to 27% at December 31, 2011. Commensurate with the increase in its mortgage banking activities, the Corporation has also invested in technology and personnel to enhance the Corporation s secondary mortgage market capabilities. The enhanced capabilities improve the Corporation s liquidity profile as they allow the Corporation to derive liquidity, if needed, from the sale of mortgage loans in the secondary market. The U.S. (including Puerto Rico) secondary mortgage market is still highly liquid in large part because of the sale or guarantee programs of the FHA, VA, HUD, FNMA and FHLMC. The Corporation obtained Commitment Authority to issue GNMA mortgage-backed securities from GNMA and, under this program, the Corporation completed the securitization of approximately $214.4 million of FHA/VA mortgage loans into GNMA MBS during 2011. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.

*Impact of Credit Ratings on Access to Liquidity and Valuation of Liabilities*

The Corporation s liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation s current credit ratings and any further downgrades in credit ratings can hinder the Corporation s access to external funding and/or cause external funding to be more expensive, which could in turn adversely affect results of operations. Also, changes in credit ratings may further affect the fair value of certain liabilities and unsecured derivatives that consider the Corporation s own credit risk as part of the valuation.

The Corporation does not have any outstanding debt or derivative agreements that would be affected by credit downgrades. Furthermore, given our non-reliance on corporate debt or other instruments directly linked in terms of pricing or volume to credit ratings, the liquidity of the Corporation so far has not been affected in any material way by downgrades in the past. The Corporation s ability to access new non-deposit sources of funding, however, could be adversely affected by credit downgrades.

Upon completion of the capital raise, the Corporation s and the Bank s credit ratings were upgraded by Moody s Investor Service ( Moody s ) and Standard & Poor s ( S&P ), and the credit outlook was upgraded by Fitch Ratings Limited ( Fitch ). The Corporation s credit as a long-term issuer is currently rated B+ by S&P and CC on credit watch positive by Fitch. At the FirstBank subsidiary level, long-term issuer ratings are currently B3 by Moody s, six notches below their definition of investment grade; B+ by S&P four notches below their definition of investment grade, and CC on credit watch positive by Fitch, eight notches below their definition of investment grade.

*Cash Flows*

Cash and cash equivalents were $446.6 million and $370.3 million as of December 31, 2011 and 2010, respectively. These balances increased by $76.3 million and decreased by $333.8 million from December 31, 2010 and 2009, respectively. The following discussion highlights the major activities and transactions that affected the Corporation s cash flows during 2011 and 2010.

*Cash Flows from Operating Activities*

First BanCorp s operating assets and liabilities vary significantly in the normal course of business due to the amount and timing of cash flows. Management believes cash flows from operations, available cash balances and the Corporation s ability to generate cash through short- and long-term borrowings will be sufficient to fund the Corporation s operating liquidity needs.

For the year ended December 31, 2011 and 2010, net cash provided by operating activities was $156.9 million and $237.2 million, respectively. Net cash generated from operating activities was higher than net loss reported largely as a result of adjustments for operating items such as the provision for loan and lease losses and in 2010 due to non-cash charges recorded to increase Corporation s valuation allowance for deferred tax assets, partially offset by adjustments to net income from the gain on sale of investments.

*Cash Flows from Investing Activities*

The Corporation s investing activities primarily relate to originating loans to be held to maturity and purchasing, selling and repayments of available-for-sale and held-to-maturity investment securities. For the year ended December 31, 2011, net cash provided by investing activities was $2.3 billion, primarily reflecting proceeds from loans (including sales and paydowns), as well as proceeds from securities sold or called during 2011 and MBS prepayments. Proceeds from sales of securities and loans and from repayments of loans and MBS were used in part to pay down maturing brokered CDs and other funding sources and for the early cancellation of certain repurchase agreements and FHLB advances.

For the year ended December 31, 2010, net cash provided by investing activities was $3.0 billion, primarily reflecting proceeds from loans, as well as proceeds from securities sold or called during 2010 and MBS prepayments. Partially offsetting these sources of cash were cash used for loan origination disbursements and certain purchases of available-for-sale securities.

*Cash Flows from Financing Activities*

The Corporation s financing activities primarily include the receipt of deposits and issuance of brokered CDs, the issuance and payments of long-term debt, the issuance of equity instruments and activities related to its short-term funding. In addition, the Corporation paid monthly dividends on its preferred stock and quarterly dividends on its common stock until it announced the suspension of dividends beginning in August 2009. During 2011, net cash used in financing activities was $2.4 billion due to repayments of maturing brokered CDs coupled with the early repayments of repurchase agreements and related penalties as well as repayments of FHLB advances and notes payable matured. Partially offsetting these cash reductions were net proceeds of $466.9 million from the $525 million capital raise and the $3 million from the rights offering (net of issuance costs and the $26.4 million payment of cumulative dividends of the Series G Preferred Stock converted to common in 2011).

During 2010, net cash used in financing activities was $3.6 billion due to the Corporation s balance sheet repositioning strategies and deleveraging of the balance sheet, including the early termination of repurchase agreements and related costs and pay down of maturing repurchase agreements as well as advances from the FHLB and the FED and brokered CDs. Partially offsetting these cash reductions was the growth of the core deposit base.

**Capital**

The Corporation s stockholders equity amounted to $1.4 billion as of December 31, 2011, an increase of $386.2 million compared to the balance as of December 31, 2010, driven by net proceeds of $466.9 million in the recently completed capital raise and rights offering (net of issuance costs and the dividend payment on the Series G Preferred Stock) and an increase of $1.5 million in accumulated other comprehensive income due to higher unrealized gains on available-for-sale investment securities. Partially offsetting these items was the net loss of $82.2 million for 2011. Based on the Agreement with the FED, currently neither First BanCorp, nor FirstBank, is permitted to pay dividends on capital securities without prior approval. For the year ended December 31, 2009, the Corporation declared in aggregate cash dividends of $2.10 per common share, none in 2011 and 2010. Total cash dividends paid on common shares amounted to $13.0 million for 2009, none in 2011 and 2010. Dividends declared and paid on preferred stock amounted to $30.1 million in 2009. On July 20, 2010, we exchanged the 400,000 shares of the Series F Preferred Stock, that we previously had sold to the U.S. Treasury, plus accrued dividends on the Series F Preferred Stock, for 424,174 shares of the Series G Preferred Stock and on October 7, 2011, as part of the conversion of the Series G Preferred Stock into common shares, the Corporation paid $26.4 million of cumulative dividends required to complete the conversion.

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into the Order with the FDIC (see Executive Summary ). Although all of FirstBank s regulatory capital ratios exceeded the established well capitalized levels at December 31, 2011 and the minimum capital requirements established by the FDIC Order, because of the Order with the FDIC, FirstBank cannot be considered a well capitalized institution under regulatory guidance. Set forth below are First BanCorp s, and FirstBank Puerto Rico s regulatory capital ratios as of December 31, 2011 and December 31, 2010, based on existing established FED and FDIC guidelines.

| | | | Banking Subsidiary | |
|---|---|---|---|---|
| | First BanCorp | FirstBank | To be well capitalized | Consent Order Requirements over time |
| **As of December 31, 2011** | | | | |
| Total capital (Total capital to risk-weighted assets) | 17.12% | 16.58% | 10.00% | 12.00% |
| Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) | 15.79% | 15.25% | 6.00% | 10.00% |
| Leverage ratio | 11.91% | 11.52% | 5.00% | 8.00% |
| **As of December 31, 2010** | | | | |
| Total capital (Total capital to risk-weighted assets) | 12.02% | 11.57% | 10.00% | 12.00% |
| Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) | 10.73% | 10.28% | 6.00% | 10.00% |
| Leverage ratio | 7.57% | 7.25% | 5.00% | 8.00% |

The improvement in the capital ratios was primarily related to a $525 million capital raise completed in the fourth quarter of 2011, as further discussed below, coupled with the deleveraging strategies completed during the year. In March 2011, the Corporation submitted an updated Capital Plan (the Capital Plan ) to the regulators. The Capital Plan contemplated a $350 million capital raise through the issuance of new common shares for cash, and other actions to reduce the Corporation s and the Bank s risk-weighted assets, strengthen their capital positions and meet the minimum capital ratios required under the FDIC Order. Among the strategies contemplated in the Capital Plan were reductions of the Corporation s loan and investment securities portfolio. The Capital Plan identified specific targeted Leverage, Tier 1 Capital to Risk-Weighted

Assets and Total Capital to Risk-Weighted Assets ratios to be

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achieved by the Bank each calendar quarter until the capital levels required under the FDIC Order are achieved. Although all of the regulatory capital ratios exceeded the minimum capital ratios for well-capitalized levels, as well as the minimum capital ratios required by the FDIC Order, as of December 31, 2011, FirstBank cannot be treated as a well-capitalized institution under regulatory guidance while operating under the FDIC Order.

On October 7, 2011, the Corporation successfully completed a private placement of $525 million shares of common stock (the capital raise ). The proceeds from the capital raise amounted to approximately $490 million (net of offering costs), of which $435 million have been contributed to the Corporation s wholly owned banking subsidiary, FirstBank. As previously reported, lead investors include funds affiliated with Thomas H. Lee Partners, L.P. ( THL ) and Oaktree Capital Management, L.P. ( Oaktree ) that purchased from the Corporation an aggregate of $348.2 million ($174.1 million each investor) of shares of the Corporation s common stock.

In connection with the closing, the Corporation issued 150 million shares of common stock at $3.50 per share to institutional investors. Upon the completion of this transaction and the conversion into common stock of the Series G Preferred Stock held by the U.S. Treasury, as further discussed below, each of THL and Oaktree became owners of 24.36% of the Corporation s shares of common stock outstanding. Subsequent to the closing, in related transactions, on October 12, 2011 and October 26, 2011, each of THL and Oaktree, respectively, purchased in the aggregate 937,493 shares of common stock from certain of the institutional investors who participated in the capital raise transaction. As of the date of the filing of this Form 10-K, each of THL and Oaktree owns 24.69% of the total shares of common stock outstanding. THL and Oaktree also have the right to designate a person to serve on the Corporation s Board of Directors. In this regard, the Corporation reconstituted its Board of Directors and Michael P. Harmon, a Managing Director with the Principal Group of Oaktree, and Thomas M. Hagerty, a Managing Director at THL were appointed as directors. Messrs Harmon and Hagerty have also been appointed members of the Bank s Board of Directors. In addition, Mr. Roberto R. Herencia was appointed as the new non-executive chairman of the Bank s and the Corporation s Board of Directors.

The completion of the capital raise allowed the conversion of the 424,174 shares of the Corporation s Series G Preferred Stock, held by the U.S. Treasury, into 32.9 million shares of common stock at a conversion price of $9.66. This conversion required for completion the payment of $26.4 million for past due undeclared cumulative dividends on the Series G Preferred Stock as required by the agreement with the U.S. Treasury.

Furthermore, On December 8, 2011, the Corporation completed a rights offering in which the Corporation issued an additional 888,781 shares of common stock at $3.50 per share, and received proceeds of $3.3 million.

With the $525 million capital infusion, the conversion to common stock of the Series G Preferred Stock held by the U.S. Treasury, and the issuance of an additional $3.3 million of capital in the rights offering (after deducting estimated offering expenses and the $26.4 million payment of cumulative dividends on the Series G Preferred Stock), the Corporation increased its total common equity by approximately $834 million.

Prior to the capital raise, deleveraging strategies incorporated into the Capital Plan and completed during the year ended December 31, 2011 include:

- Sales of performing first lien residential mortgage loans The Bank completed sales of approximately $518 million of residential mortgage loans to another financial institution.

- Sales of investment securities The Bank completed sales of approximately $632 million of U.S. Agency MBS.

- Sale of commercial loan participations The Bank sold approximately $45 million in loan participations.

- Sale of adversely classified and non-performing loans The Bank sold loans with a book value of $269.3 million to CPG/GS PR NPL, LLC ( CPG/GS ), an entity created by Goldman, Sachs & Co. and Caribbean Property Group in exchange for $88.5 million of cash, an acquisition loan of $136.1 million and a 35% subordinated interest in CPG/GS. Approximately 93% of the loans were adversely classified loans and 55% were in non-performing status.

The tangible common equity ratio and tangible book value per common share are non-GAAP measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill and core deposit intangibles. Tangible assets are total assets less goodwill and core deposit intangibles. Refer to Basis of Presentation section below for additional

information.

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The following table is a reconciliation of the Corporation s tangible common equity and tangible assets for the years ended December 31, 2011 and 2010, respectively:

| *(In thousands, except ratios and per share information)* | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Total equity GAAP | $ 1,444,144 | $ 1,057,959 |
| Preferred equity | (63,047) | (425,009) |
| Goodwill | (28,098) | (28,098) |
| Core deposit intangible | (11,689) | (14,043) |
| **Tangible common equity** | **$ 1,341,310** | **$ 590,809** |
| Total assets GAAP | $ 13,127,275 | $ 15,593,077 |
| Goodwill | (28,098) | (28,098) |
| Core deposit intangible | (11,689) | (14,043) |
| **Tangible assets** | **$ 13,087,488** | **$ 15,550,936** |
| **Common shares outstanding** | **205,134** | **21,304** |
| **Tangible common equity ratio** | **10.25%** | **3.80%** |
| **Tangible book value per common share** | **$ 6.54** | **$ 27.73** |

The Tier 1 common equity to risk-weighted assets ratio is calculated by dividing (a) Tier 1 capital less non-common elements including qualifying perpetual preferred stock and qualifying trust preferred securities, by (b) risk-weighted assets, which assets are calculated in accordance with applicable bank regulatory requirements. Refer to Basis of Presentation section below for additional information.

The following table reconciles stockholders equity (GAAP) to Tier 1 common equity:

| *(In thousands)* | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Total equity GAAP | $ 1,444,144 | $ 1,057,959 |
| Qualifying preferred stock | (63,047) | (425,009) |
| Unrealized gain on available-for-sale securities (1) | (19,234) | (17,736) |
| Disallowed deferred tax asset (2) | | (815) |
| Goodwill | (28,098) | (28,098) |
| Core deposit intangible | (11,689) | (14,043) |
| Cumulative change gain in fair value of liabilities acounted for under a fair value option | (2,009) | (2,185) |
| Other disallowed assets | (922) | (226) |
| **Tier 1 common equity** | **$ 1,319,145** | **$ 569,847** |
| **Total risk-weighted assets** | **$ 10,180,226** | **$ 11,372,856** |
| **Tier 1 common equity to risk-weighted assets ratio** | **12.96%** | **5.01%** |

1-

Tier 1 capital excludes net unrealized gains (losses) on available-for-sale debt securities and net unrealized gains on available-for-sale equity securities with readily determinable fair values, in accordance with regulatory risk-based capital guidelines. In arriving at Tier 1 capital, institutions are required to deduct net unrealized losses on available-for-sale equity securities with readily determinable fair values, net of tax.

2- Approximately $13 million of the Corporation's net deferred tax assets at December 31, 2011 (December 31, 2010 $13 million) were included without limitation in regulatory capital pursuant to the risk-based capital guidelines, while approximately $0 of such assets at December 31, 2011 (December 31, 2010 $0.8 million) exceeded the limitation imposed by these guidelines and, as "disallowed deferred tax assets," were deducted in arriving at Tier 1 capital. According to regulatory capital guidelines, the deferred tax assets that are dependent upon future taxable income are limited for inclusion in Tier 1 capital to the lesser of: (i) the amount of such deferred tax asset that the entity expects to realize within one year of the calendar quarter end-date, based on its projected future taxable income for that year or (ii) 10% of the amount of the entity's Tier 1 capital. Approximately $8 million of the Corporation's other net deferred tax liability at December 31, 2011 (December 31, 2010 $5 million) represented primarily the deferred tax effects of unrealized gains and losses on available-for-sale debt securities, which are permitted to be excluded prior to deriving the amount of net deferred tax assets subject to limitation under the guidelines.

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**Off-Balance Sheet Arrangements**

In the ordinary course of business, the Corporation engages in financial transactions that are not recorded on the balance sheet, or may be recorded on the balance sheet in amounts that are different from the full contract or notional amount of the transaction. These transactions are designed to (1) meet the financial needs of customers, (2) manage the Corporation s credit, market or liquidity risks, (3) diversify the Corporation s funding sources and (4) optimize capital.

As a provider of financial services, the Corporation routinely enters into commitments with off-balance sheet risk to meet the financial needs of its customers. These financial instruments may include loan commitments and standby letters of credit. These commitments are subject to the same credit policies and approval process used for on-balance sheet instruments. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. As of December 31, 2011, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately $569.7 million and $77.8 million, respectively. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met. Generally, the Corporation s mortgage banking activities do not involve interest rate lock agreements with its prospective borrowers.

**Contractual Obligations and Commitments**

The following table presents a detail of the maturities of the Corporation s contractual obligations and commitments, which consist of CDs, long-term contractual debt obligations, operating leases, commitments to sell mortgage loans and commitments to extend credit:

| | Contractual Obligations and Commitments | | | | |
|---|---|---|---|---|---|
| | As of December 31, 2011 | | | | |
| | Total | Less than 1 year | 1-3 years | 3-5 years | After 5 years |
| | (In thousands) | | | | |
| Contractual obligations: | | | | | |
| Certificates of deposit (1) | $ 5,989,587 | $ 3,933,056 | $ 1,974,669 | $ 68,510 | $ 13,353 |
| Securities sold under agreements to repurchase | 1,000,000 | 100,000 | 200,000 | 400,000 | 300,000 |
| Advances from FHLB | 367,440 | 159,000 | 208,440 | | |
| Notes payable | 23,342 | 7,374 | | | 15,968 |
| Other borrowings | 231,959 | | | | 231,959 |
| Operating leases | 49,878 | 8,527 | 12,567 | 9,427 | 19,357 |
| Other contractual obligations | 5,341 | 4,168 | 1,173 | | |
| Total contractual obligations | $ 7,667,547 | $ 4,212,125 | $ 2,396,849 | $ 477,937 | $ 580,637 |
| Commitments to sell mortgage loans | $ 20,226 | $ 20,226 | | | |
| Standby letters of credit | $ 25,448 | $ 25,448 | | | |
| Commitments to extend credit: | | | | | |
| Lines of credit | $ 440,431 | $ 440,431 | | | |
| Letters of credit | 52,340 | 52,340 | | | |
| Commitments to originate loans | 129,271 | 129,271 | | | |
| Total commercial commitments | $ 622,042 | $ 622,042 | | | |

(1) $3.2 million of tax liability, including accrued interest of $0.8 million, associated with unrecognized tax benefits (UTBs) have been excluded due to the high degree of uncertainty regarding the timing of future cash outflows associated with such obligations.

The Corporation has obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under other commitments to sell mortgage loans at fair value and to extend credit. Commitments to extend credit are agreements to lend to a customer as

long as there is no violation of any condition established in the contract. Other contractual obligations result mainly from contracts for the rental and maintenance of equipment. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. There have been no significant or unexpected draws on existing commitments. In the case of credit cards and personal lines of credit, the Corporation can cancel at any time and without cause cancel the unused credit facility.

Lehman Brothers Special Financing, Inc. ( Lehman ) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due

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to the Corporation, which constituted an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement due as of December 31, 2011 under the swap agreements, the Corporation has an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately $1.4 million. This exposure was reserved in the third quarter of 2008. The Corporation had pledged collateral of $63.6 million with Lehman to guarantee its performance under the swap agreements in the event payment thereunder was required. As of December 31, 2011, the Corporation maintained a non-performing account receivable of $64.5 million related to the collateral pledged with Lehman.

The Corporation believes that the securities pledged as collateral should not be part of the Lehman bankruptcy estate given the fact that the posted collateral constituted a performance guarantee under the swap agreements and was not part of a financing agreement, and that ownership of the securities was never transferred to Lehman. Upon termination of the interest rate swap agreements, Lehman s obligation was to return the collateral to the Corporation. During the fourth quarter of 2009, the Corporation discovered that Lehman Brothers, Inc., acting as agent of Lehman, had deposited the securities in a custodial account at JP Morgan Chase, and that, shortly before the filing of the Lehman bankruptcy proceedings, it had provided instructions to have most of the securities transferred to Barclays Capital ( Barclays ) in New York. After Barclays s refusal to turn over the securities, during December 2009, the Corporation filed a lawsuit against Barclays in federal court in New York demanding the return of the securities.

During February 2010, Barclays filed a motion with the court requesting that the Corporation s claim be dismissed on the grounds that the allegations of the complaint are not sufficient to justify the granting of the remedies therein sought. Shortly thereafter, the Corporation filed its opposition motion. A hearing on the motions was held in court on April 28, 2010. The court, on that date, after hearing the arguments by both sides, concluded that the Corporation s equitable-based causes of action, upon which the return of the investment securities is being demanded, contain allegations that sufficiently plead facts warranting the denial of Barclays motion to dismiss the Corporation s claim. Accordingly, the judge ordered the case to proceed to trial. Subsequent to the court decision, the district court judge transferred the case to the Lehman bankruptcy court for trial. Upon such transfer, the bankruptcy court began to entertain the pre-trial procedures including discovery of evidence. In this regard, an initial scheduling conference was held before the United States Bankruptcy Court for the Southern District of New York on November 17, 2010, at which time a proposed case management plan was approved. Discovery has commenced pursuant to that case management plan and is currently scheduled for completion by March 31, 2012, but this timing is subject to adjustment. While the Corporation believes it has valid reasons to support its claim for the return of the securities, the Corporation may not succeed in its litigation against Barclays to recover all or a substantial portion of the securities.

Additionally, the Corporation continues to pursue its claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to Lehman Brothers Incorporated in the United States Bankruptcy Court for the Southern District of New York. An estimated loss was not accrued as the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value. If additional relevant negative facts become available in future periods, a need to recognize a partial or full reserve of this claim may arise. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the Corporation has maintained such collateral as a non-performing asset since the second quarter of 2009.

**Interest Rate Risk Management**

First BanCorp manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income and to maintain stability of profitability under varying interest rate environments. The MIALCO oversees interest rate risk and meetings focus on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, securities market values, recent or proposed changes to the investment portfolio, alternative funding sources and related costs, hedging and the possible purchase of derivatives such as swaps and caps, and any tax or regulatory issues which may be pertinent to these areas. The MIALCO approves funding decisions in light of the Corporation s overall strategies and objectives.

The Corporation performs on a quarterly basis a consolidated net interest income simulation analysis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a one-to-five-year time horizon, assuming gradual upward and downward interest rate movements of 200 basis points, achieved during a twelve-month period. Simulations are carried out in two ways:

(1) Using a static balance sheet prepared as of the simulation date, and

(2) Using a dynamic balance sheet based on recent patterns and current strategies.

The balance sheet is divided into groups of assets and liabilities detailed by maturity or re-pricing and their corresponding interest yields and costs. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and costs, the possible exercise of options, changes in prepayment rates, deposits decay and other factors which may be important in projecting the future growth of net interest income.

The Corporation uses a simulation model to project future movements in the Corporation s balance sheet and income statement. The starting point of the projections generally corresponds to the actual values on the balance sheet on the date of the simulation.

These simulations are highly complex, and use many simplifying assumptions that are intended to reflect the general behavior of the balance sheet components over the period in question. It is unlikely that actual events will match these assumptions in all cases. For this reason, the results of these forward-looking computations are only approximations of the true sensitivity of net interest income to changes in market interest rates.

The following table presents the results of the simulations as of December 31, 2011 and December 31, 2010. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives and liabilities measured at fair value:

| | **December 31, 2011 Net Interest Income Risk (Projected for the next 12 months)** | | | | **December 31, 2010 Net Interest Income Risk (Projected for the next 12 months)** | | | |
|---|---|---|---|---|---|---|---|---|
| | **Static Simulation** | | **Growing Balance Sheet** | | **Static Simulation** | | **Growing Balance Sheet** | |
| *(Dollars in millions)* | **$ Change** | **% Change** | **$ Change** | **% Change** | **$ Change** | **% Change** | **$ Change** | **% Change** |
| +200 bps ramp | $ 19.2 | 4.47% | $ 29.2 | 6.74% | $ 24.8 | 5.37% | $ 24.8 | 5.60% |
| -200 bps ramp | $ (3.8) | (0.88)% | $ 3.7 | 0.85% | $ (22.8) | (4.94)% | $ (24.2) | (5.48)% |

The Corporation continues to manage its balance sheet structure to control the overall interest rate risk and preserve its capital position. The Corporation continued with a deleveraging and balance sheet repositioning strategy. During 2011, the Corporation sold approximately $745 million of MBS and floating rate CMOs and $500 million of U.S. Treasury Notes, while the loan portfolio decreased by $1.3 billion. This decrease in assets resulting from the deleveraging strategy and the utilization of excess liquidity allowed a reduction of $3.2 billion in wholesale funding since December 31, 2010, including brokered CDs, FHLB Advances and repurchase agreements. In addition, the Corporation continues to grow its core deposit base while adjusting the mix of its funding sources to better match the expected average life of the assets.

Taking into consideration the above-mentioned facts for modeling purposes, the net interest income for the next twelve months under a non-static balance sheet scenario, is estimated to increase by $29.2 million in a gradual parallel upward move of 200 basis points when compared against the Corporation s flat or unchanged interest rate forecast scenario.

Following the Corporation s risk management policies, modeling of the downward parallel rates moves by anchoring the short end of the curve, (falling rates with a flattening curve) was performed, even though, given the current level of rates as of December 31, 2011, some market interest rate were projected to be close to zero. Under this scenario the net interest income for the next twelve months in a non-static balance sheet scenario is estimated to increase by $3.7 million.

*Derivatives.* First BanCorp uses derivative instruments and other strategies to manage its exposure to interest rate risk caused by changes in interest rates beyond management s control.

The following summarizes major strategies, including derivative activities, used by the Corporation in managing interest rate risk:

*Interest rate cap agreements* Interest rate cap agreements provide the right to receive cash if a reference interest rate rises above a contractual rate. The value increases as the reference interest rate rises. The Corporation enters into interest rate cap agreements for protection from rising interest rates. Specifically, the interest rate on certain

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of the Corporation s commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the referenced residential mortgage collateral, less a contractual servicing fee. During the second quarter of 2010, the counterparty for interest rate caps for certain private label MBS was taken over by the FDIC, which resulted in the immediate cancelation of all outstanding commitments, and as a result, interest rate caps with a notional amount of $90.4 million are no longer considered to be derivative financial instruments. The total exposure to fair value of $3.0 million related to such contracts was reclassified to an account receivable.

*Interest rate swaps* Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of December 31, 2011, most of the interest rate swaps outstanding are used for protection against rising interest rates. Similar to unrealized gains and losses arising from changes in fair value, net interest settlements on interest rate swaps are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being economically hedged.

*Indexed options* Indexed options are generally over-the-counter (OTC) contracts that the Corporation enters into in order to receive the appreciation of a specified Stock Index (e.g., Dow Jones Industrial Composite Stock Index) over a specified period in exchange for a premium paid at the contract s inception. The option period is determined by the contractual maturity of the notes payable tied to the performance of the Stock Index. The credit risk inherent in these options is the risk that the exchange party may not fulfill its obligation.

*Forward Contracts* Forward contracts are sales of to-be-announced ( TBA ) mortgage-backed securities that will settle over the standard delivery date and do not qualify as regular way security trades. Regular-way security trades are contracts with no net settlement provision and no market mechanism to facilitate net settlement and they provide for delivery of a security within the time generally established by regulations or conventions in the market-place or exchange in which the transaction is being executed. The forward sales are considered derivative instruments that need to be marked-to-market. These securities are used to hedge the FHA/VA residential mortgage loans securitizations of the mortgage-banking operations. Unrealized gains (losses) are recognized as part of mortgage banking activities in the Consolidated Statement of Loss.

For detailed information regarding the volume of derivative activities (e.g. notional amounts), location and fair values of derivative instruments in the statement of financial condition and the amount of gains and losses reported in the statement of (loss) income, refer to Note 31 in the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K.

The following tables summarize the fair value changes of the Corporation s derivatives as well as the source of the fair values:

**Fair Value Change**

| (In thousands) | Year ended December 31, 2011 |
|---|---|
| Fair value of contracts outstanding at the beginning of year | $ (4,796) |
| Contracts terminated or called during the year | (15) |
| Changes in fair value during the year | (1,746) |
| Fair value of contracts outstanding as of December 31, 2011 | $ (6,557) |

**Source of Fair Value**

| *(In thousands)* | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| **As of December 31, 2011** | Maturity Less Than One Year | Maturity 1-3 Years | Maturity 3-5 Years | Maturity In Excess of 5 Years | Total Fair Value |
| Pricing from observable market inputs | $ (168) | $ (433) | $ (3) | $ (5,953) | $ (6,557) |
| | $ (168) | $ (433) | $ (3) | $ (5,953) | $ (6,557) |

Derivative instruments, such as interest rate swaps, are subject to market risk. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market s expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve as well as the level of interest rates.

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As of December 31, 2011 and 2010, all of the derivative instruments held by the Corporation were considered economic undesignated hedges.

Refer to Note 28 of the Corporation s audited financial statements for the year ended December 31, 2011 included in Item 8 of this Form 10-K for additional information regarding the fair value determination of derivative instruments.

The use of derivatives involves market and credit risk. The market risk of derivatives stems principally from the potential for changes in the value of derivative contracts based on changes in interest rates. The credit risk of derivatives arises from the potential of default from the counterparty. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. Master netting agreements incorporate rights of set-off that provide for the net settlement of contracts with the same counterparty in the event of default. All of the Corporation s interest rate swaps are supported by securities collateral agreements, which allow the delivery of securities to and from the counterparties depending on the fair value of the instruments, to minimize credit risk.

Set forth below is a detailed analysis of the Corporation s credit exposure by counterparty with respect to derivative instruments outstanding as of December 31, 2011 and December 31, 2010.

| | 000,00 | 000,00 | 000,00 | 000,00 | 000,00 | 000,00 |
|---|---|---|---|---|---|---|
| (In thousands) | As of December 31, 2011 | | | | | |
| Counterparty | Rating[1] | Notional | Total Exposure at Fair Value[2] | Negative Fair Values | Total Fair Value | Accrued interest receivable (payable) |
| Interest rate swaps with rated counterparties: | | | | | | |
| JP Morgan | A | $ 34,347 | $ | $ (6,386) | $ (6,386) | $ |
| Credit Suisse First Boston | A+ | 2,720 | | (381) | (381) | |
| Goldman Sachs | A | 6,515 | 899 | | 899 | |
| Morgan Stanley | A | 107,894 | | | | |
| | | 151,476 | 899 | (6,767) | (5,868) | |
| Other derivatives: | | | | | | |
| Other derivatives (3) | | 136,128 | 378 | (1,067) | (689) | (166) |
| Total | | $ 287,604 | $ 1,277 | $ (7,834) | $ (6,557) | $ (166) |

(1) Based on the S&P and Fitch Long Term Issuer Credit Ratings.
(2) For each counterparty, this amount includes derivatives with positive fair value excluding the related accrued interest receivable/payable.
(3) Credit exposure with several Puerto Rico counterparties for which a credit rating is not readily available and forward contracts.

| (In thousands) | As of December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| Counterparty | Rating[1] | Notional | Total Exposure at Fair Value[2] | Negative Fair Values | Total Fair Value | Accrued interest receivable (payable) |
| Interest rate swaps with rated counterparties: | | | | | | |
| JP Morgan | A+ | $ 42,808 | $ 889 | $ (4,865) | $ (3,976) | $ |
| Credit Suisse First Boston | A+ | 5,493 | | (327) | (327) | |
| Goldman Sachs | A | 6,515 | 664 | | 664 | |
| Morgan Stanley | A | 108,829 | 1 | | 1 | |
| | | 163,645 | 1,554 | (5,192) | (3,638) | |
| Other derivatives (3) | | 127,837 | 351 | (1,509) | (1,158) | (140) |

| | | | | | |
|---|---|---|---|---|---|
| Total | $ 291,482 | $ 1,905 | $ (6,701) | $ (4,796) | $ (140) |

(1) Based on the S&P and Fitch Long Term Issuer Credit Ratings.
(2) For each counterparty, this amount includes derivatives with positive fair value excluding the related accrued interest receivable/payable.
(3) Credit exposure with several Puerto Rico counterparties for which a credit rating is not readily available and forward contracts.

The discounting of the cash flows is performed using US dollar LIBOR-based discount rates or yield curves that account for the industry sector and the credit rating of the counterparty and/or the Corporation. Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments resulted in an unrealized gain of approximately $0.8 million as of December 31, 2011.

***Credit Risk Management***

First BanCorp is subject to credit risk mainly with respect to its portfolio of loans receivable and off-balance sheet instruments, mainly derivatives and loan commitments. Loans receivable represents loans that First BanCorp holds for investment and, therefore, First BanCorp is at risk for the term of the loan. Loan commitments represent commitments to extend credit, subject to specific conditions, for specific amounts and maturities. These commitments may expose the Corporation to credit risk and are subject to the same review and approval process as for loans. Refer to Contractual Obligations and Commitments above for further details. The credit risk of derivatives arises from the potential of the counterparty s default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and information on the Corporation s derivative credit risk exposure, refer to Interest Rate Risk Management section above. The Corporation manages its credit risk through credit policy, underwriting, independent loan review and quality control procedures, statistical analysis, comprehensive financial analysis, and established management committees. The Corporation also employs proactive collection and loss mitigation efforts. Furthermore, personnel performing structured loan workout functions are responsible for mitigating defaults and minimizing losses upon default within each region and for each business segment. In the case of C&I, commercial mortgage and costruction loan portfolios, the Special Asset Group ( SAG ) focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of REO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary.

The Corporation may also have risk of default in the securities portfolio. The securities held by the Corporation are principally fixed-rate mortgage-backed securities and U.S. Treasury and agency securities. Thus, a substantial portion of these instruments is backed by mortgages, a guarantee of a U.S. government-sponsored entity or the full faith and credit of the U.S. government.

Management, comprised of the Corporation s Commercial Credit Risk Officer, Retail Credit Risk Officer, Chief Lending Officer and other senior executives, has the primary responsibility for setting strategies to achieve the Corporation s credit risk goals and objectives. These goals and objectives are documented in the Corporation s Credit Policy.

*Allowance for Loan and Lease Losses and Non-performing Assets*

*Allowance for Loan and Lease Losses*

The allowance for loan and lease losses represents the estimate of the level of reserves appropriate to absorb inherent credit losses. The amount of the allowance was determined by empirical analysis and judgments regarding the quality of each individual loan portfolio. All known relevant internal and external factors that affected loan collectibility were considered, including analyses of historical charge-off experience, migration patterns, changes in economic conditions, and changes in loan collateral values. For example, factors affecting the economies of Puerto Rico, Florida (USA), the US Virgin Islands and the British Virgin Islands may contribute to delinquencies and defaults above the Corporation s historical loan and lease losses. Such factors are subject to regular review and may change to reflect updated performance trends and expectations, particularly in times of severe stress such as have been experienced since 2008. The process includes judgmental and quantitative elements that may be subject to significant change. There is no certainty that the allowance will be adequate over time to cover credit losses in the portfolio because of continued adverse changes in the economy, market conditions, or events adversely affecting specific customers, industries or markets. To the extent actual outcomes differ from our estimates, the credit quality of our customer base materially decreases or the risk profile of a market, industry, or group of customers changes materially, or if the allowance is determined to not be adequate, additional provisions for credit losses could be required, which could adversely affect our business, financial condition, liquidity, capital, and results of operations in future periods.

The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable losses believed to be inherent in the loan portfolio that have not been specifically identified. Internal risk ratings are assigned to each business loan at the time of approval and are subject to subsequent periodic reviews by the Corporation s senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation s continued evaluation of its asset quality. Refer to Critical Accounting Policies Allowance for Loan and Lease Losses section above for additional information about the methodology used by the Corporation to determine specific reserves and the general valuation allowance.

The Corporation continued to strengthen its reserve coverages. The allowance for loan losses to total loans for residential mortgage loans increased from 1.82% at December 31, 2010 to 2.39% as of December 31, 2011. The commercial mortgage reserve coverage increased from 6.32% at December 31, 2010 to 6.96% at December 31, 2011. The C&I loans reserve coverage ratio increased from 3.68% at December 31, 2010 to 3.98% at December 31, 2011. The construction loans reserve coverage ratio decreased slightly from 21.69% in December, 2010 to 21.36% at December 31, 2011, driven by the decrease in non-performing and adversely classified loans. The consumer and finance leases reserve coverage ratio decreased from 4.69% in December 2010 to 3.87% at December 31, 2011 due to decreases in delinquency levels, historical loss rates and improvements in certain market and economic indicators relevant to this segment.

Substantially all of the Corporation s loan portfolio is located within the boundaries of the U.S. economy. Whether the collateral is located in Puerto Rico, the U.S. and British Virgin Islands or the U.S. mainland (mainly in the state of Florida), the performance of the Corporation s loan portfolio and the value of the collateral supporting the transactions are dependent upon the performance of and conditions within each specific area real estate market. Economic reports related to the real estate market in Puerto Rico indicate that the real estate market experienced readjustments in value driven by the loss of income due to the unemployment of consumers, reduced demand and the general economic conditions. The Corporation sets adequate loan-to-value ratios upon original approval following its regulatory and credit policy standards. The real estate market for the U.S. Virgin Islands remains fairly stable. In the Florida market, residential real estate has experienced a very slow turnover, but the Corporation continues to reduce its credit exposure through disposition of assets and different loss mitigation initiatives.

As shown in the following table, the allowance for loan and lease losses amounted to $493.9 million, or 4.68% of total loans, at December 31, 2011, compared with $553.0 million, or 4.74% of total loans at December 31, 2010. Refer to the Provision for Loan and Lease Losses discussion above for additional information.

The following table sets forth an analysis of the activity in the allowance for loan and lease losses during the periods indicated:

| Year Ended December 31, | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | |
| Allowance for loan and lease losses, beginning of year | $ 553,025 | $ 528,120 | $ 281,526 | $ 190,168 | $ 158,296 |
| Provision for loan and lease losses: | | | | | |
| Residential mortgage | 45,339 | 93,883 | 45,010 | 13,032 | 2,736 |
| Commercial mortgage | 54,513 | 119,815[(1)] | 73,861 | 8,269 | 1,567 |
| Commercial and Industrial | 78,711 | 68,336[(2)] | 143,697 | 35,032 | 18,128 |
| Construction | 40,174 | 300,997[(3)] | 264,246 | 53,109 | 23,502 |
| Consumer and finance leases | 17,612 | 51,556 | 53,044 | 81,506 | 74,677 |
| Total provision for loan and lease losses | 236,349 | 634,587 | 579,858 | 190,948 | 120,610 |
| Charge-offs: | | | | | |
| Residential mortgage | (39,826) | (62,839) | (28,934) | (6,256) | (985) |
| Commercial mortgage | (51,207) | (82,708)[(4)] | (25,871) | (3,664) | (1,333) |
| Commercial and Industrial | (69,783) | (99,724)[(5)] | (35,696) | (25,911) | (9,927) |
| Construction | (103,131) | (313,511)[(6)] | (183,800) | (7,933) | (3,910) |
| Consumer and finance leases | (45,478) | (64,219) | (70,121) | (73,308) | (78,675) |
| | (309,425) | (623,001) | (344,422) | (117,072) | (94,830) |
| Recoveries: | | | | | |
| Residential mortgage | 835 | 121 | 73 | | 1 |
| Commercial mortgage | 90 | 1,288 | 667 | | |
| Commercial and Industrial | 2,921 | 1,251 | 1,188 | 1,678 | 659 |
| Construction | 2,371 | 358 | 200 | 198 | 78 |
| Consumer and finance leases | 7,751 | 10,301 | 9,030 | 6,875 | 5,354 |
| | 13,968 | 13,319 | 11,158 | 8,751 | 6,092 |
| Net charge-offs | (295,457) | (609,682) | (333,264) | (108,321) | (88,738) |
| Other adjustments[(7)] | | | | 8,731 | |
| Allowance for loan and lease losses, end of year | $ 493,917 | $ 553,025 | $ 528,120 | $ 281,526 | $ 190,168 |
| Allowance for loan and lease losses to year end total loans held for investment | 4.68% | 4.74% | 3.79% | 2.15% | 1.61% |
| Net charge-offs to average loans outstanding during the year | 2.68% | 4.76%[(8)] | 2.48% | 0.87% | 0.79% |
| Provision for loan and lease losses to net charge-offs during the year | 0.80x | 1.04x[(9)] | 1.74x | 1.76x | 1.36x |

(1) Includes provision of $11.3 million associated with loans transferred to held for sale in 2010.
(2) Includes provision of $8.6 million associated with loans transferred to held for sale in 2010.
(3) Includes provision of $83.0 million associated with loans transferred to held for sale in 2010.
(4) Includes charge-offs of $29.5 million associated with loans transferred to held for sale in 2010.
(5) Includes charge-offs of $8.6 million associated with loans transferred to held for sale in 2010.
(6) Includes charge-offs of $127.0 million associated with loans transferred to held for sale in 2010.

(7) For 2008, carryover of the allowance for loan losses related to the $218 million auto loan portfolio acquired from Chrysler.

(8) Includes net charge-offs totaling $165.1 million associated with loans transferred to held for sale. Total net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale, was 3.60% in 2010.

(9) Provision for loan and lease losses to net charge-offs, excluding provision and net charge-offs relating to loans transferred to held for sale, was 1.20x for the year ended December 31, 2010.

The following table sets forth information concerning the allocation of the Corporation s allowance for loan and lease losses by loan category and the percentage of loan balances in each category to the total of such loans as of the dates indicated:

| | 2011 | | 2010 | | 2009 | | 2008 | | 2007 | |
|---|---|---|---|---|---|---|---|---|---|---|
| *(In thousands)* | **Amount** | **Percent** | **Amount** | **Percent** | **Amount** | **Percent** | **Amount** | **Percent** | **Amount** | **Percent** |
| | | | | | **(Dollars in thousands)** | | | | | |
| Residential mortgage | $ 68,678 | 27% | $ 62,330 | 29% | $ 31,165 | 26% | $ 15,016 | 27% | $ 8,240 | 27% |
| Commercial mortgage loans | 108,992 | 15% | 105,596 | 14% | 67,201 | 11% | 18,544 | 12% | 13,939 | 11% |
| Construction loans | 91,386 | 4% | 151,972 | 6% | 164,128 | 11% | 83,482 | 12% | 38,108 | 12% |
| Commercial and Industrial loans (including loans to local financial institutions) | 164,490 | 39% | 152,641 | 36% | 182,778 | 38% | 73,589 | 33% | 62,790 | 33% |
| Consumer loans and finance leases | 60,371 | 15% | 80,486 | 15% | 82,848 | 14% | 90,895 | 16% | 67,091 | 17% |
| | $ 493,917 | 100% | $ 553,025 | 100% | $ 528,120 | 100% | $ 281,526 | 100% | $ 190,168 | 100% |

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The following table sets forth information concerning the composition of the Corporation s allowance for loan and lease losses as of December 31, 2011 and 2010 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance:

| **As of December 31, 2011** | | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | **Residential Mortgage Loans** | **Commercial Mortgage Loans** | **C&I Loans** | **Construction Loans** | **Consumer and Finance Leases** | **Total** |
| Impaired loans without specific reserves: | | | | | | |
| Principal balance of loans, net of charge-offs | $ 181,081 | $ 13,797 | $ 40,453 | $ 33,759 | $ 2,840 | $ 271,930 |
| Impaired loans with specific reserves: | | | | | | |
| Principal balance of loans, net of charge-offs | 423,340 | 354,954 | 223,572 | 213,388 | 20,192 | 1,235,446 |
| Allowance for loan and lease losses | 48,566 | 59,167 | 58,652 | 44,768 | 3,749 | 214,902 |
| Allowance for loan and lease losses to principal balance | 11.47% | 16.67% | 26.23% | 20.98% | 18.57% | 17.39% |
| Loans with general allowance | | | | | | |
| Principal balance of loans | 2,269,364 | 1,196,660 | 3,866,491 | 180,716 | 1,538,785 | 9,052,016 |
| Allowance for loan and lease losses | 20,112 | 49,824 | 105,838 | 46,618 | 56,623 | 279,015 |
| Allowance for loan and lease losses to principal balance | 0.89% | 4.16% | 2.74% | 25.80% | 3.68% | 3.08% |
| Total portfolio, excluding loans held for sale | | | | | | |
| Principal balance of loans | $ 2,873,785 | $ 1,565,411 | $ 4,130,516 | $ 427,863 | $ 1,561,817 | $ 10,559,392 |
| Allowance for loan and lease losses | 68,678 | 108,991 | 164,490 | 91,386 | 60,372 | 493,917 |
| Allowance for loan and lease losses to principal balance | 2.39% | 6.96% | 3.98% | 21.36% | 3.87% | 4.68% |
| **As of December 31, 2010** | | | | | | |
| Impaired loans without specific reserves: | | | | | | |
| Principal balance of loans, net of charge-offs | $ 244,648 | $ 32,328 | $ 54,631 | $ 25,074 | $ 659 | $ 357,340 |
| Impaired loans with specific reserves: | | | | | | |
| Principal balance of loans, net of charge-offs | 311,187 | 150,442 | 325,206 | 237,970 | 1,496 | 1,026,301 |
| Allowance for loan and lease losses | 42,666 | 26,869 | 65,030 | 57,833 | 264 | 192,662 |
| Allowance for loan and lease losses to principal balance | 13.71% | 17.86% | 20.00% | 24.30% | 17.65% | 18.77% |
| Loans with general allowance | | | | | | |
| Principal balance of loans | 2,861,582 | 1,487,391 | 3,771,927 | 437,535 | 1,713,360 | 10,271,795 |
| Allowance for loan and lease losses | 19,664 | 78,727 | 87,611 | 94,139 | 80,222 | 360,363 |
| Allowance for loan and lease losses to principal balance | 0.69% | 5.29% | 2.32% | 21.52% | 4.68% | 3.51% |
| Total loans held for investment | | | | | | |
| Principal balance of loans | $ 3,417,417 | $ 1,670,161 | $ 4,151,764 | $ 700,579 | $ 1,715,515 | $ 11,655,436 |
| Allowance for loan and lease losses | 62,330 | 105,596 | 152,641 | 151,972 | 80,486 | 553,025 |
| Allowance for loan and lease losses to principal balance | 1.82% | 6.32% | 3.68% | 21.69% | 4.69% | 4.74% |

The following tables show the activity for impaired loans held for investment and related specific reserve during 2011:

| | 2011 (In thousands) |
|---|---|
| **Impaired Loans:** | |
| Balance at beginning of year | $ 1,383,641 |
| Loans determined impaired during the year | 873,486 |
| Net charge-offs | (233,692) |
| Loans sold, net of charge-offs | (36,898) |
| Increases to impaired loans (disbursements) | 16,692 |
| Foreclosures | (69,400) |
| Loans no longer considered impaired | (252,519) |
| Paid in full or partial payments | (173,934) |
| Balance at end of year | $ 1,507,376 |

| | 2011 (In thousands) |
|---|---|
| **Specific Reserve:** | |
| Balance at beginning of year | $ 192,662 |
| Provision for loan losses | 255,932 |
| Net charge-offs | (233,692) |
| Balance at end of year | $ 214,902 |

***Credit Quality***

Credit quality performance in 2011 continued to show signs of improvements, as demonstrated by, among other things, a $255.2 million decrease in non-performing loans, including a reduction of $153.6 million associated with non-performing loans sold to CPG/GS, and a $297.9 million decrease in adversely classified commercial and construction loans. Total adversely classified commercial and construction decreased to $1.201 billion as of December 31, 2011 ($490.4 million C&I loans; $422.8 million commercial mortgage loans; $287.3 million construction loans) from $1.499 billion as of December 31, 2010 ($579.6 million C&I loans; $389.3 million commercial mortgage loans; $529.6 million construction loans). Sales, charge-offs, loan modifications and payments resulted in a lower ending balance of non-performing loans. Other key credit quality metrics showed improvements, including declines in net charge-offs and a $421.1 million decline in total delinquencies (loans 30 days or more past due and non-accrual).

***Non-performing Loans and Non-performing Assets***

Total non-performing assets consist of non-performing loans, foreclosed real estate and other repossessed properties as well as non-performing investment securities. Non-performing loans are those loans on which the accrual of interest is discontinued. When a loan is placed in non-performing status, any interest previously recognized and not collected is reversed and charged against interest income.

*Non-performing Loans Policy*

*Residential Real Estate Loans* The Corporation generally classifies real estate loans in non-performing status when interest and principal have not been received for a period of 90 days or more.

*Commercial and Construction Loans* The Corporation places commercial loans (including commercial real estate and construction loans) in non-performing status when interest and principal have not been received for a period of 90 days or more or when collection of all of principal or interest is not expected due to deterioration in the financial condition of the borrower.

*Finance Leases* Finance leases are classified in non-performing status when interest and principal have not been received for a period of 90 days or more.

*Consumer Loans* Consumer loans are classified in non-performing status when interest and principal have not been received for a period of 90 days or more.

Cash payments received on certain loans that are impaired and collateral dependent are recognized when collected in accordance with the contractual terms of the loans. The principal portion of the payment is used to reduce the principal balance of the loan, whereas the interest portion is recognized on a cash basis (when collected). However, when management believes that the ultimate collectability of principal is in doubt, the interest portion is applied to principal. The risk exposure of this portfolio is diversified as to individual borrowers and industries among other factors. In addition, a large portion is secured with real estate collateral.

***Other Real Estate Owned (OREO)***

OREO acquired in settlement of loans is carried at the lower of cost (carrying value of the loan) or fair value less estimated costs to sell off the real estate. Appraisals are obntained periodically, generally, on an annual basis.

***Other Repossessed Property***

The other repossessed property category includes repossessed boats and autos acquired in settlement of loans. Repossessed boats and autos are recorded at the lower of cost or estimated fair value.

***Other non-performing assets***

This category presents investment securities reclassified to non-performing status, at their book value.

***Past Due Loans 90 days and still accruing***

These are accruing loans which are contractually delinquent 90 days or more. These past due loans are either current as to interest but delinquent in the payment of principal or are insured or guaranteed under applicable FHA and VA programs.

Troubled Debt Restructuring ( TDRs ) are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure generally for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower s ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan.

The following table presents non-performing assets as of the dates indicated:

| | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | |
| Non-performing loans held for investment: | | | | | |
| Residential mortgage | $ 338,208 | $ 392,134 | $ 441,642 | $ 274,923 | $ 209,077 |
| Commercial mortgage | 240,414 | 217,165 | 196,535 | 85,943 | 46,672 |
| Commercial and Industrial | 270,171 | 317,243 | 241,316 | 58,358 | 26,773 |
| Construction | 250,022 | 263,056 | 634,329 | 116,290 | 75,494 |
| Finance leases | 3,485 | 3,935 | 5,207 | 6,026 | 6,250 |
| Consumer | 36,062 | 45,456 | 44,834 | 45,635 | 48,784 |
| Total non-performing loans held for investment | 1,138,362 | 1,238,989 | 1,563,863 | 587,175 | 413,050 |
| REO | 114,292 | 84,897 | 69,304 | 37,246 | 16,116 |
| Other repossessed property | 15,392 | 14,023 | 12,898 | 12,794 | 10,154 |
| Other assets [(1)] | 64,543 | 64,543 | 64,543 | | |
| Total non-performing assets, excluding loans held for sale | 1,332,589 | 1,402,452 | 1,710,608 | 637,215 | 439,320 |
| Non-performing loans held for sale | 4,764 | 159,321 | | | |
| Total non-performing assets, including loans held for sale | $ 1,337,353 | $ 1,561,773 | $ 1,710,608 | $ 637,215 | $ 439,320 |
| Past due loans 90 days and still accruing | $ 130,816 | $ 144,113 | $ 165,936 | $ 471,364 | $ 75,456 |
| Non-performing assets to total assets | 10.19% | 10.02%[(2)] | 8.71% | 3.27% | 2.56% |
| Non-performing loans held for investment to total loans held for investment | 10.78% | 10.63% | 11.23% | 4.49% | 3.50% |
| Allowance for loan and lease losses | $ 493,917 | $ 553,025 | $ 528,120 | $ 281,526 | $ 190,168 |
| Allowance to total non-performing loans held for investment | 43.39% | 44.64% | 33.77% | 47.95% | 46.04% |
| Allowance to total non-performing loans held for investment, excluding residential real estate loans | 61.73% | 65.30% | 47.06% | 90.16% | 93.23% |

(1) Collateral pledged with Lehman Brothers Special Financing, Inc.
(2) Non-performing assets, excluding non-performing loans held for sale, to total assets, excluding non-performing loans transferred to held for sale, was 10.15% and 9.03% as of December 31, 2011 and 2010, respectively.

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The following table shows non-performing assets by geographic segment:

| | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | |
| **Puerto Rico:** | | | | | |
| Non-performing loans held for investment: | | | | | |
| Residential mortgage | $ 297,595 | $ 330,737 | $ 376,018 | $ 244,843 | $ 195,278 |
| Commercial mortgage | 170,949 | 177,617 | 128,001 | 61,459 | 43,649 |
| Commercial and Industrial | 261,189 | 307,608 | 229,039 | 54,568 | 24,357 |
| Construction | 137,478 | 196,948 | 385,259 | 71,127 | 25,506 |
| Finance leases | 3,485 | 3,935 | 5,207 | 6,026 | 6,250 |
| Consumer | 34,888 | 43,241 | 40,132 | 40,313 | 42,779 |
| Total non-performing loans held for investment | 905,584 | 1,060,086 | 1,163,656 | 478,336 | 337,819 |
| REO | 85,788 | 67,488 | 49,337 | 22,012 | 13,593 |
| Other repossessed property | 15,283 | 13,839 | 12,634 | 12,221 | 9,399 |
| Investment securities [1] | 64,543 | 64,543 | 64,543 | | |
| Total non-performing assets, excluding loans held for sale | 1,071,198 | 1,205,956 | 1,290,170 | 512,569 | 360,811 |
| Non-performing loans held for sale | 4,764 | 159,321 | | | |
| Total non-performing assets, including loans held for sale | $ 1,075,962 | $ 1,365,277 | $ 1,290,170 | $ 512,569 | $ 360,811 |
| Past due loans 90 days and still accruing | $ 118,888 | $ 142,756 | $ 128,016 | $ 220,270 | $ 73,160 |
| **Virgin Islands:** | | | | | |
| Non-performing loans held for investment: | | | | | |
| Residential mortgage | $ 11,470 | $ 9,655 | $ 9,063 | $ 8,492 | $ 6,004 |
| Commercial mortgage | 12,851 | 7,868 | 11,727 | 1,476 | 1,887 |
| Commercial and Industrial | 7,276 | 6,078 | 8,300 | 2,055 | 2,131 |
| Construction | 110,594 | 16,473 | 2,796 | 4,113 | 3,542 |
| Consumer | 518 | 927 | 3,540 | 3,688 | 5,186 |
| Total non-performing loans held for investment | 142,709 | 41,001 | 35,426 | 19,824 | 18,750 |
| REO | 7,200 | 2,899 | 470 | 430 | 777 |
| Other repossessed property | 67 | 108 | 221 | 388 | 494 |
| Total non-performing assets, excluding loans held for sale | 149,976 | 44,008 | 36,117 | 20,642 | 20,021 |
| Non-performing loans held for sale | | | | | |
| Total non-performing assets, including loans held for sale | $ 149,976 | $ 44,008 | $ 36,117 | $ 20,642 | $ 20,021 |
| Past due loans 90 days and still accruing | $ 11,204 | $ 1,358 | $ 23,876 | $ 27,471 | $ 998 |
| **Florida:** | | | | | |
| Non-performing loans held for investment: | | | | | |
| Residential mortgage | $ 29,143 | $ 51,742 | $ 56,561 | $ 21,588 | $ 7,795 |
| Commercial mortgage | 56,614 | 31,680 | 56,807 | 23,007 | 1,136 |
| Commercial and Industrial | 1,706 | 3,557 | 3,977 | 1,736 | 285 |
| Construction | 1,950 | 49,635 | 246,274 | 41,050 | 46,446 |
| Consumer | 656 | 1,288 | 1,162 | 1,634 | 819 |

| | | | | | |
|---|---|---|---|---|---|
| Total non-performing loans held for investment | 90,069 | 137,902 | 364,781 | 89,015 | 56,481 |
| REO | 21,304 | 14,510 | 19,497 | 14,804 | 1,746 |
| Other repossessed property | 42 | 76 | 43 | 185 | 261 |
| Total non-performing assets, excluding loans held for sale | 111,415 | 152,488 | 384,321 | 104,004 | 58,488 |
| Non-performing loans held for sale | | | | | |
| Total non-performing assets, including loans held for sale | $ 111,415 | $ 152,488 | $ 384,321 | $ 104,004 | $ 58,488 |
| Past due loans 90 days and still accruing | $ 724 | $ | $ 14,044 | $ 223,623 | $ 1,298 |

Total non-performing loans were $1.14 billion as of December 31, 2011, down from $1.40 billion at December 31, 2010. The completion of the loan sale transaction with CPG/GS, in which the Corporation has a 35% subordinated interest, removed approximately $153.6 million of non-performing loans and $257 million of adversely classified loans from the balance sheet. The Bank s 35% interest in CPG/GS is subordinated to the interest of the majority investor in CPG/GS, which is entitled to recover it investment and receive a priority 12% return on its invested capital. The Corporation s subordinated interest in CPG/GS and its loans to CPG/GS as of December 31, 2011 in the aggregate amount of $201.2 million expose the Corporation to the loss of its investment and performance issues on the loans. Total non-performing loans held for investment, which exclude non-performing loans held for sale, were $1.14 billion at December 31, 2011, which represented 10.78% of total loans held for investment. This was down $100.6 million from December 31, 2010. The decrease in non-performing loans held for investment reflected declines in all loan categories, except for the construction loan portfolio.

Non-performing residential mortgage loans decreased by $53.9 million, or 14%, from the balance as of December 31, 2010. The decrease was associated with several factors, including: (i) the restoration to accrual status of

modified loans that successfully completed a trial performance period, (ii) charge-offs, and (iii) foreclosures that contributed, in part to the $29.4 million increase in the REO portfolio. The amount of loans restored to accrual status due to payments received was offset by the inflows to non-performing registered during the year. Non-performing residential mortgage loans decreased by $33.1 million and $22.6 million in Puerto Rico and the United States, respectively, while non-performing residential mortgage loans in the Virgin Islands increased by $1.8 million. Approximately $233.7 million, or 69% of total non-performing residential mortgage loans, have been written down to their net realizable value.

C&I non-performing loans held for investment decreased by $47.1 million, or 15%, during 2011, reflecting primarily the sale of a participation in a syndicated loan, charge-offs and a decline in the level of inflows. The decline was mainly in Puerto Rico where C&I non-performing loans decreased by $46.4 million. During the fourth quarter of 2011, the Corporation received a payment from the sale of a participation in a syndicated loan and removed from the books its largest individual C&I non-performing loan of approximately $37 million. In addition, the Corporation received aggregate payments of approximately $25.4 million on two non-performing loans in Puerto Rico and one loan that was paid-off. Net charge-offs of $66.9 million, of which $65.6 million relate to the Puerto Rico portfolio also contributed to the decrease in C&I non-performing loans. The aforementioned decreases were partially offset by inflows, including seven large relationships that entered into non-performing status during the third quarter of 2011 that in aggregate amounted to approximately $38 million. Most of these loans reflect current delinquencies under 90 days but placed in non-performing due to financial difficulties of borrowers. Non-performing C&I loans in the United States decreased by $1.9 million, to $1.7 million, and, in the Virgin Islands, C&I non-performing loans increased by $1.2 million to $7.3 million as of December 31, 2011.

Non-performing construction loans held for investment decreased by $13.0 million, or 5%, during 2011, mainly driven by charge-offs and the sale of troubled assets. Construction loans net charge-offs amounted to $100.8 million in 2011. Non-performing construction loans in Puerto Rico decreased by $59.5 million mainly due to net charge-offs of $46.3 million. Principal repayments and foreclosures also contributed to the decrease in non-performing construction loans in Puerto Rico. In the United States, non-performing construction loans decreased by $47.7 million driven by the repossession and subsequent sale of the underlying collateral of a $33.0 million residential project in Florida, a $2.1 million loans which was formally restructured so as to be reasonably assured of principal and interest repayment and performance according to its modified terms, and a $2.3 million loan paid-off. There were no inflows of construction projects into non-performing status in the United States during 2011. In the Virgin Islands region, a $14.7 million loan associated with the development of a commercial real estate project, a $3.4 million mid-rise residential project, and a $100 million relationship engaged in a commercial project were the main drivers behind the increase of $94.1 million in construction non-performing loans for this region.

The levels of non-accrual consumer loans, including finance leases, showed a $9.8 million decrease during 2011. The decrease was mainly related to auto financings in Puerto Rico.

Non-performing commercial mortgage loans held for investment increased by $23.2 million during 2011. The increase was primarily concentrated in Puerto Rico, reflecting an increase of $46.4 million mainly related to the inflow to non-performing status of two relationships totaling $82.7 million. It is important to note, that while the Corporation did place one of these relationships amounting to $36.6 million in non-accrual status during the fourth quarter of 2011, the relationship is current on its payments and the Corporation has already noted some positives in its performance. Non-performing commercial mortgage loans in the United States increased by $24.9 million driven by the inflow to non-performing status of three relationships that aggregated $33.9 million. Non-performing commercial mortgage loans in the Virgin Islands increased by $5.0 million mainly associated with the inflow to non-performing status of two relationships engaged in rental and leasing of commercial properties totaling $7.7 million.

At December 31, 2011, approximately $187.1 million of the loans placed in non-accrual status, mainly construction and commercial loans, were current, or had delinquencies of less than 90 days in their interest payments, including $138.7 million of TDRs maintained in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full colectibility. Collections are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant.

During the year ended December 31, 2011, interest income of approximately $4.4 million related to non-performing loans with a carrying value of $672.5 million as of December 31, 2011, mainly non-performing construction and commercial loans, was applied against the related principal balances under the cost-recovery method.

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The allowance to non-performing loans held for investment ratio as of December 31, 2011 was 43.39%, compared to 44.64% as of December 31, 2010. As of December 31, 2011, approximately $399.7 million, or 35%, of total non-performing loans held for investment have been charged-off to their net realizable value as shown in the following table.

| (Dollars in thousands) | Residential Mortgage Loans | Commercial Mortgage Loans | C&I Loans | Construction Loans | Consumer and Finance Leases | Total |
|---|---|---|---|---|---|---|
| **As of December 31, 2011** | | | | | | |
| Non-performing loans held for investment, charged-off to realizable value | $ 233,703 | $ 21,925 | $ 70,462 | $ 70,959 | $ 2,605 | $ 399,654 |
| Other non-performing loans held for invesment | 104,505 | 218,489 | 199,709 | 179,063 | 36,942 | 738,708 |
| Total non-performing loans held for invesment | $ 338,208 | $ 240,414 | $ 270,171 | $ 250,022 | $ 39,547 | $ 1,138,362 |
| Allowance to non-performing loans held for investment | 20.31% | 45.33% | 60.88% | 36.55% | 152.66% | 43.39% |
| Allowance to non-performing loans held for investment excluding non-performing loans charged-off to realizable value | 65.72% | 49.88% | 82.36% | 51.04% | 163.42% | 66.86% |
| **As of December 31, 2010** | | | | | | |
| Non-performing loans held for investment, charged-off to realizable value | $ 291,118 | $ 20,239 | $ 101,151 | $ 32,139 | $ 659 | $ 445,306 |
| Other non-performing loans held for invesment | 101,016 | 196,926 | 216,092 | 230,917 | 48,732 | 793,683 |
| Total non-performing loans held for invesment | $ 392,134 | $ 217,165 | $ 317,243 | $ 263,056 | $ 49,391 | $ 1,238,989 |
| Allowance to non-performing loans held for investment | 15.90% | 48.62% | 48.11% | 57.77% | 162.96% | 44.64% |
| Allowance to non-performing loans held for investment excluding non-performing loans charged-off to realizable value | 61.70% | 53.62% | 70.64% | 65.81% | 165.16% | 69.68% |

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico and in accordance with the government s Home Affordable Modification Program guidelines. Depending upon the nature of borrowers financial condition, restructurings or loan modifications through this program as well as other restructurings of individual commercial, commercial mortgage, construction and residential mortgage loans in the U.S. mainland fit the definition of TDR. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor s financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of December 31, 2011, the Corporation s total TDR loans of $820.5 million consisted of $372.8 million of residential mortgage loans, $100.5 million of commercial and industrial loans, $218.1 million of commercial mortgage loans, $109.3 million construction loans and $19.8 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to $5.9 million as of December 31, 2011.

The Corporation s loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments for a significant period of time, and reduction of interest rates either permanently (up to 2010) or for a period of up to two years (step-up rates). Additionally, in limited cases,

the restructuring may provide for the forgiveness of contractually due principal or interest. Uncollected interest is added to the end of the loan term at the time of the restructuring and not recognized as income until collected or when the loan is paid off. These programs are available to only those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in foreclosure action absent some lender concession. Notwithstanding, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

In addition to residential loans modified in TDRs described above, the Corporation also enters into trial modifications with certain borrowers. Trial modifications generally represent a three month period whereby the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Trial modifications lasting more than three months are considered TDRs. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification where the terms of the loan are formally modified. Approximately 60% of all loans that entered into a trial modification during 2011 became permanent modifications as of December 31, 2011. Substantially all permanent modifications are considered TDRs and are included in the TDR disclosures herein. As of December 31, 2011, the Corporation had 108 loans that were in trial modifications and were not considered TDRs, with an unpaid principal balance of $13.0 million and a carrying value of $12.6 million.

For the commercial real estate, commercial and industrial, and the construction portfolios, at the time of the restructuring, the Corporation determines, on a loan by loan basis, whether a concession was granted for economic or legal reasons related to the borrower s financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waiving of borrower covenants; forgiveness of principal or interest; or other contract changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collections function. The function s objective is to minimize both early stage delinquencies and losses upon default of commercial loans. The group utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third party consultants. In the case of residential construction projects and large commercial loans, the function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and restructuring of large commercial loans. In addition, the Corporation extends, renews and restructures loans with satisfactory credit profiles. Many commercial loan facilities are structured as lines of credit, which are mainly one year in term and therefore are required to be renewed annually. Other facilities may be restructured or extended from time to time based upon changes in the borrower s business needs, use of funds, timing of completion of projects and other factors. If the borrower is not deemed to have financial difficulties, extensions, renewals and restructurings are done in the normal course of business and not considered concessions, and the loans continue to be recorded as performing.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower s ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation s interest income by returning a non-performing loan to performing status, if applicable, and increase cash flows by providing for payments to be made by the borrower, and avoid increases in foreclosure and real estate owned costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses.

The following table provides a breakdown between accrual and nonaccrual status of TDRs as of December 31, 2011:

| | December 31, 2011 | | |
|---|---|---|---|
| | **Accrual** | **Nonaccrual (1)** | **Total TDRs** |
| Non- FHA/VA Residential Mortgage loans | $ 282,519 | $ 90,264 | $ 372,783 |
| Commercial Mortgage Loans | 130,874 | 87,253 | 218,127 |
| Commercial & Industrial Loans | 22,301 | 78,205 | 100,506 |
| Construction Loans | 1,467 | 107,806 | 109,273 |
| Consumer Loans Auto | 5,096 | 3,614 | 8,710 |
| Finance Leases | 1,774 | 30 | 1,804 |
| Consumer Loans Other | 7,118 | 2,178 | 9,296 |
| Total Troubled Debt Restructurings | $ 451,149 | $ 369,350 | $ 820,499 |

(1) Included in non-accrual loans are $138.1 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full colectibility.

The REO portfolio, which is part of non-performing assets, increased by $29.4 million, mainly reflecting increases in both residential and commercial properties foreclosures in Puerto Rico, partially offset by sales and fair value adjustments. Consistent with the Corporation s assessment of the value of properties and current and future market conditions, management continues to execute strategies to dispose of the real estate acquired in satisfaction of debt. During 2011, the Corporation sold approximately $51.7 million of REO properties ($17.0 million in Florida, $34.0 million in Puerto Rico and $0.7 million in the Virgin Islands). These figures exclude the aforementioned $33.0 million construction loan in Florida which was acquired through foreclosure and sold during the second quarter of 2011.

The over 90-day delinquent, but still accruing, loans, excluding loans guaranteed by the U.S. Government, decreased by $17.2 million to $45.6 million, or 0.43% of total loans held for investment, at December 31, 2011. Loans 30-89 days delinquent also decreased by $152.6 million, or 35%, to $273.7 million as of December 31, 2011.

*Net Charge-Offs and Total Credit Losses*

Total net charge-offs for 2011 were $295.5 million, or 2.68% of average loans. This was down $314.2 million, or 52%, from $609.7 million, or 4.76%, in 2010. The decrease includes the impact in 2010 of $165.1 million of charge-offs associated with the loans transferred to held for sale. Excluding the charge-offs related to loans transferred to held for sale, lower net charge-offs were reflected in the United States portfolio, a decrease of $118.1 million, primarily in construction and commercial mortgage loans, and in Puerto Rico, a decrease of $68.0 million, primarily in the construction, C&I and residential loan portfolios. Net charge-offs in the Virgin Islands increased by $37.0 million, as further discussed below.

Construction loans net charge-offs in 2011 were $100.8 million, or 16.33% of average loans, down from $313.2 million, or 23.80% of average loans in 2010. The decrease of $212.4 million includes the impact in 2010 of $127.0 million of charge-offs associated with construction loans transferred to held for sale in Puerto Rico. Net charge-offs for construction loans in the Virgin Islands amounted to $42.9 million, or 43% of total net charge-offs for construction loans in 2011, of which $32.9 million relate to the aforementioned $100 million relationship placed in non-performing status early in 2011. Construction loans net charge-offs in Puerto Rico amounted to $46.3 million, driven by seven relationships with charge-offs totaling $41.6 million associated with commercial and residential projects. In the United States, construction loans net charge-offs were $11.5 million, of which approximately $5.1 million was related to the foreclosure of a land loan that was sold during the second quarter of 2011. The construction portfolio in Florida has been considerably reduced over the past three years to $23.6 million as of December 31, 2011.

Commercial mortgage loans net charge-offs in 2011 were $51.1 million, or 3.21% of average loans, down from $81.4 million, or 5.02% of average loans in 2010. The decrease includes the impact in 2010 of $29.5 million of charge-offs associated with commercial mortgage loans transferred to held for sale in Puerto Rico. Net charge-offs for commercial mortgage loans in 2011 were mainly driven by a $28.3 million charge-off related to an $85.6 million relationship in Puerto Rico restructured through a loan split. Commercial mortgage loans net charge-offs in the United States amounted to $7.1 million, of which $1.2 million relate to another restructured relationship through a loan split.

C&I loans net charge-offs in 2011 were $66.9 million, or 1.57%, down from $98.5 million, or 2.16% of related loans, recorded in 2010. The decrease includes the impact in 2010 of $8.6 million of charge-offs associated with C&I loans transferred to held for sale in Puerto Rico. Approximately 98%, or $65.6 million, of net charge-offs recorded in 2011 were in Puerto Rico, of which $43.9 million relate to eleven relationships with individual charge-offs in excess of $1 million. No significant C&I loans charge-offs were recorded in the United States or Virgin Islands portfolio.

Residential mortgage loans net charge-offs were $39.0 million, or 1.32% of related average loans. This was down from $62.7 million, or 1.80% of related average balances in 2010. Approximately $26.0 million in charge-offs ($19.8 million in Puerto Rico, $5.8 million in Florida and $0.4 million in the Virgin Islands) resulted from valuations for impairment purposes of residential mortgage loan portfolios considered homogeneous given high delinquency and loan-to-value levels, compared to $40.1 million recorded in 2010 ($29.2 million in Puerto Rico, $10.3 million in Florida and $0.6 million in Virgin Islands). Net charge-offs for residential mortgage loans also include $8.8 million related to the foreclosure of loans in 2011, compared to $10.0 million recorded for foreclosures in 2010. The total amount of the residential mortgage loan portfolio that had been charged-off to its net realizable value as of December 31, 2011 amounted to $233.7 million. This represents approximately 69% of the total non-performing residential mortgage loan portfolio outstanding as of December 31, 2011. Loss rates in the Corporation s Puerto Rico operations continue to be lower than loss rates in the Florida market.

Net charge-offs of consumer loans and finance leases in 2011 were $37.7 million compared to net charge-offs of $53.9 million for 2010. Net charge-offs as a percentage of related loans decreased to 2.33% from 2.98% for 2010. Performance of this portfolio on both absolute and relative terms continued to be consistent with management s views regarding the underlying quality of the portfolio.

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The following table shows net charge-offs to average loans ratio by loan categories for the last five years.

| | For the year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2008 | 2007 |
| Residential mortgage | 1.32% | 1.80%(1) | 0.82% | 0.19% | 0.03% |
| Commercial mortgage | 3.21% | 5.02%(2) | 1.64% | 0.27% | 0.10% |
| Commercial and Industrial | 1.57% | 2.16%(3) | 0.72% | 0.59% | 0.26% |
| Construction | 16.33% | 23.80%(4) | 11.54% | 0.52% | 0.26% |
| Consumer loans and finance leases | 2.33% | 2.98% | 3.05% | 3.19% | 3.48% |
| Total loans | 2.68% | 4.76%(5) | 2.48% | 0.87% | 0.79% |

(1) Includes net charge-offs totaling $7.8 million associated with non-performing residential mortgage loans sold in a bulk sale.
(2) Includes net charge-offs totaling $29.5 million associated with loans transferred to held for sale. Commercial mortgage net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale, was 3.38%.
(3) Includes net charge-offs totaling $8.6 million associated with loans transferred to held for sale. Commercial and Industrial net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale, was 1.98%.
(4) Includes net charge-offs totaling $127.0 million associated with loans transferred to held for sale. Construction net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale, was 18.93%.
(5) Includes net charge-offs totaling $165.1 million associated with loans transferred to held for sale. Total net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale, was 3.60%.

The following table presents net charge-offs to average loans held in portfolio by geographic segment:

| | December 31, 2011 | December 31, 2010 | December 31, 2009 |
|---|---|---|---|
| **PUERTO RICO:** | | | |
| Residential mortgage | 1.32% | 1.79%(1) | 0.64% |
| Commercial mortgage | 4.10% | 3.90%(2) | 0.82% |
| Commercial and Industrial | 1.64% | 2.27%(3) | 0.72% |
| Construction | 11.60% | 23.57%(4) | 4.88% |
| Consumer and finance leases | 2.39% | 2.99% | 2.93% |
| Total loans | 2.40% | 4.26%(5) | 1.44% |
| **VIRGIN ISLANDS:** | | | |
| Residential mortgage | 0.09% | 0.18% | 0.08% |
| Commercial mortgage | 0.00% | 0.00% | 2.79% |
| Commercial and Industrial (6) | 0.31% | -0.44% | 0.59% |
| Construction | 25.87% | 3.16% | 0.00% |
| Consumer and finance leases | 1.08% | 2.01% | 3.50% |
| Total loans | 4.79% | 0.75% | 0.73% |
| **FLORIDA:** | | | |
| Residential mortgage | 3.09% | 3.88% | 2.84% |
| Commercial mortgage | 1.56% | 8.23% | 3.02% |
| Commercial and Industrial | 1.83% | 4.80% | 1.87% |
| Construction | 22.35% | 44.65% | 29.93% |
| Consumer and finance leases | 1.66% | 5.26% | 7.33% |
| Total loans | 3.34% | 13.35% | 11.70% |

(1) Includes net charge-offs totaling $7.8 million associated with non-performing residential mortgage loans sold in a bulk sale.
(2) Includes net charge-offs totaling $29.5 million associated with loans transferred to held for sale. Commercial mortgage net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale in Puerto Rico, was 1.24%.
(3)

Includes net charge-offs totaling $8.6 million associated with loans transferred to held for sale. Commercial and Industrial net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale in Puerto Rico, was 2.08%.

(4) Includes net charge-offs totaling $127.0 million associated with loans transferred to held for sale.Construction net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale in Puerto Rico, was 15.27%.

(5) Includes net charge-offs totaling $165.1 million associated with loans transferred to held for sale. Total net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale in Puerto Rico, was 2.83%.

(6) For 2010, recoveries in C&I loans in the Virgin Islands exceeded charge-offs.

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Total credit losses (equal to net charge-offs plus losses on REO operations) for 2011 amounted to $320.5 million, or 2.88% to average loans and repossessed assets, respectively, in contrast to credit losses of $639.9 million, or a loss rate of 4.96%, for 2010. Excluding the $165.1 million of charge-offs associated with loans transferred to held for sale, total credit losses for 2010 amounted to $474.8 million or 3.81% to average loans and repossessed assets.

The following table presents a detail of the REO inventory and credit losses for the periods indicated:

| | Year Ended December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (Dollars in thousands) | |
| **REO** | | |
| REO balances, carrying value: | | |
| Residential | $ 67,612 | $ 56,210 |
| Commercial | 36,242 | 22,634 |
| Construction | 10,438 | 6,053 |
| Total | $ 114,292 | $ 84,897 |
| REO activity (number of properties): | | |
| Beginning property inventory, | 479 | 449 |
| Properties acquired | 453 | 96 |
| Properties disposed | (355) | (66) |
| Ending property inventory | 577 | 479 |
| Average holding period (in days) | | |
| Residential | 331 | 255 |
| Commercial | 321 | 311 |
| Construction | 336 | 469 |
| | 328 | 285 |
| REO operations (loss) gain: | | |
| Market adjustments and (losses) gain on sale: | | |
| Residential | $ (8,712) | $ (9,120) |
| Commercial | (5,795) | (8,591) |
| Condo-conversion projects | | (2,274) |
| Construction | (936) | (1,473) |
| | (15,443) | (21,458) |
| Other REO operations expenses | (9,582) | (8,715) |
| **Net Loss on REO operations** | $ (25,025) | $ (30,173) |
| **CHARGE-OFFS** | | |
| Residential charge-offs, net | (38,991) | (62,718) |
| Commercial charge-offs, net | (117,980) | (179,893) |
| Construction charge-offs, net | (100,760) | (313,153) |
| Consumer and finance leases charge-offs, net | (37,726) | (53,918) |
| Total charge-offs, net | (295,457) | (609,682) |

| | | |
|---|---|---|
| **TOTAL CREDIT LOSSES (1)** | $ (320,482) | $ (639,855) |
| | | |
| **LOSS RATIO PER CATEGORY (2):** | | |
| Residential | 1.59% | 2.03% |
| Commercial | 2.11% | 3.04% |
| Construction | 16.18% | 23.88% |
| Consumer | 2.31% | 2.96% |
| **TOTAL CREDIT LOSS RATIO (3)** | **2.88%** | **4.96%** |

(1) Equal to REO operations (losses) gains plus Charge-offs, net.
(2) Calculated as net charge-offs plus market adjustments and gains (losses) on sale of REO divided by average loans and repossessed assets.
(3) Calculated as net charge-offs plus net loss on REO operations divided by average loans and repossessed assets.

**Operational Risk**

The Corporation faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products. Coupled with external influences such as market conditions, security risks, and legal risk, the potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Corporation has developed, and continues to enhance, specific internal controls, policies and procedures that are designated to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Corporation s business operations are functioning within the policies and limits established by management.

The Corporation classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate-wide risks, such as information security, business recovery, and legal and compliance, the Corporation has specialized groups, such as the Legal Department, Information Security, Corporate Compliance, Information Technology and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups.

**Legal and Compliance Risk**

Legal and compliance risk includes the risk of non-compliance with applicable legal and regulatory requirements, the risk of adverse legal judgments against the Corporation, and the risk that a counterparty s performance obligations will be unenforceable. The Corporation is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has been significantly increasing over the last several years. The Corporation has established and continues to enhance procedures based on legal and regulatory requirements that are designed to ensure compliance with all applicable statutory and regulatory requirements. The Corporation has a Compliance Director who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of an enterprise-wide compliance risk assessment process. The Compliance division has officer roles in each major business areas with direct reporting relationships to the Corporate Compliance Group.

**Concentration Risk**

The Corporation conducts its operations in a geographically concentrated area, as its main market is Puerto Rico. However, the Corporation has diversified its geographical risk as evidenced by its operations in the Virgin Islands and in Florida.

The Corporation s primary lending area is Puerto Rico. The Corporation s Puerto Rico banking subsidiary, FirstBank, also lends in the U.S. and British Virgin Islands markets and in the United States (principally in the state of Florida). Of the total gross loans held for investment portfolio of $10.6 billion as of December 31, 2011, approximately 84% have credit risk concentration in Puerto Rico, 8% in the United States and 8% in the Virgin Islands.

As of December 31, 2011, the Corporation had $360.1 million outstanding of credit facilities granted to the Puerto Rico Government and/or its political subdivisions, up from $325.1 million as of December 31, 2010, and $139.4 million granted to the Virgin Islands government, up from $84.3 million as of December 31, 2010. A substantial portion of these credit facilities are obligations that have a specific source of income or revenues identified for their repayment, such as property taxes collected by the central Government and/or municipalities. Another portion of these obligations consists of loans to public corporations that obtain revenues from rates charged for services or products, such as electric power and water utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it. The Corporation also has loans to various municipalities in Puerto Rico for which the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment.

Aside from loans extended to the Puerto Rico Government and its political subdivisions, the largest loan to one borrower as of December 31, 2011 in the amount of $273.8 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual real-estate loans, mostly 1-4 residential mortgage loans.

In addition, more than 83%, or $1.6 billion, of the Corporation s investment portfolio consisted of U.S. Government sponsored agency MBS or debt securities and U.S. Treasury Securities. Thus, a substantial portion of our investment portfolio is backed by mortgages, a guarantee of a U.S. government sponsored entity or the full faith and credit of the U.S. government.

***Impact of Inflation and Changing Prices***

The financial statements and related data presented herein have been prepared in conformity with GAAP, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a greater impact on a financial institution s performance than the effects of general levels of inflation. Interest rate movements are not necessarily correlated with changes in the prices of goods and services.

**Basis of Presentation**

The Corporation has included in this Form 10-K the following financial measures that are not recognized under generally accepted accounting principles, which are referred to as non-GAAP financial measures: (i) the calculation of net interest income, interest rate spread and net interest margin rate on a tax- equivalent basis and excluding changes in the fair value of derivative instruments and certain financial liabilities, (ii) the calculation of the tangible common equity ratio and the tangible book value per common share, (iii) the Tier 1 common equity to risk-weighted assets ratio, and (iv) certain other financial measures adjusted to exclude amounts associated with loans transferred to held for sale resulting from the execution of an agreement providing for the strategic sale of loans. Substantially all of the loans transferred to held for sale were sold in February 2011. Investors should be aware that non-GAAP measures have inherent limitations and should be read only in conjunction with the Corporation s consolidated financial data prepared in accordance with GAAP.

Net interest income, interest rate spread and net interest margin are reported on a tax-equivalent basis and excluding changes in the fair value of derivative instruments and financial liabilities elected to be measured at fair value ( valuations ). The presentation of net interest income excluding valuations provides additional information about the Corporation s net interest income and facilitates comparability and analysis. The changes in the fair value of derivative instruments and unrealized gains and losses on liabilities measured at fair value have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively. The tax-equivalent adjustment to net interest income recognizes the income tax savings when comparing taxable and tax-exempt assets and assumes a marginal income tax rate. Income from tax-exempt earning assets is increased by an amount equivalent to the taxes that would have been paid if this income had been taxable at statutory rates. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax equivalent basis. This adjustment puts all earning assets, most notably tax-exempt securities and certain loans, on a common basis that facilitates comparison of results to results of peers. Refer to *Net Interest Income* discussion above for the table that reconciles the non-GAAP financial measure net interest income on a tax-equivalent basis and excluding fair value changes with net interest income calculated and presented in accordance with GAAP. The table also reconciles the non-GAAP financial measures net interest spread and margin on a tax-equivalent basis and excluding fair value changes with net interest spread and margin calculated and presented in accordance with GAAP.

The tangible common equity ratio and tangible book value per common share are non-GAAP measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill and core deposit intangibles. Tangible assets are total assets less goodwill and core deposit intangibles. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase accounting method of accounting for mergers and acquisitions. Neither tangible common equity nor tangible assets, or related measures should be considered in isolation or as a substitute for stockholders equity, total assets or any other measure calculated in accordance with GAAP. Moreover, the manner in which the Corporation calculates its tangible common equity, tangible assets and any other related measures may differ from that of other companies reporting measures with similar names. Refer to Section *Liquidity and Capital Adequacy, Interest Rate Risk, Credit Risk, Operational, Legal and Regulatory Risk Management- Capital* above for a reconciliation of the Corporation s tangible common equity and tangible assets.

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The Tier 1 common equity to risk-weighted assets ratio is calculated by dividing (a) tier 1 capital less non-common elements including qualifying perpetual preferred stock and qualifying trust preferred securities by (b) risk-weighted assets, which assets are calculated in accordance with applicable bank regulatory requirements. The Tier 1 common equity ratio is not required by GAAP or on a recurring basis by applicable bank regulatory requirements. However, this ratio was used by the Federal Reserve in connection with its stress test administered to the 19 largest U.S. bank holding companies under the Supervisory Capital Assessment Program, the results of which were announced on May 7, 2009. Management is currently monitoring this ratio, along with the other ratios discussed above, in evaluating the Corporation s capital levels and believes that, at this time, the ratio may be of interest to investors. Refer to Section *Liquidity and Capital Adequacy, Interest Rate Risk, Credit Risk, Operational, Legal and Regulatory Risk Management- Capital* above for a reconciliation of stockholders equity (GAAP) to Tier 1 common equity.

To supplement the Corporation s financial statements presented in accordance with GAAP, the Corporation provides additional measures of net income (loss), provision for loan and lease losses, provision for loan and lease losses to net charge-offs, net charge-offs, and net charge-offs to average loans to exclude amounts associated with the transfer of $447 million of loans to held for sale. In connection with the transfer, the Corporation charged-off $165.1 million and recognized an additional provision for loan and lease losses of $102.9 million. Management believes that these non-GAAP measures enhance the ability of analysts and investors to analyze trends in the Corporation s business and to better understand the performance of the Corporation. In addition, the Corporation may utilize these non-GAAP financial measures as a guide in its budgeting and long-term planning process. Any analysis of these non-GAAP financial measures should be used only in conjunction with results presented in accordance with GAAP. A reconciliation of these non-GAAP measures with the most directly comparable financial measures calculated in accordance with GAAP follows:

| (In thousands, except per share information) | Net Loss (Non-GAAP to GAAP reconciliation) Year ended December 31, 2010 Net Loss |
|---|---|
| Net loss, excluding special items (Non-GAAP) | $ (421,370) |
| *Special items:* | |
| Loans transferred to held for sale (1) | (102,938) |
| Exchange transactions | |
| Net Income (loss) | $ (524,308) |

1- In the fourth quarter 2010, the Corporation recorded a charge of $102.9 million to the provision for loan and lease losses associated with $447 million of loans transferred to held for sale.

| (In thousands) | Provision for Loan and Lease Losses, Net Charge-Offs, Provision for Loans and Lease Losses to Net Charge-Offs, and Net Charge-Offs to Average Loans (Non-GAAP to GAAP reconciliation) Year ended December 31, 2010 | |
|---|---|---|
| | Provision for Loan and Lease Losses | Net Charge-Offs |
| Provision for loan and lease losses and net charge-offs, excluding special items (Non-GAAP) | $ 531,649 | $ 444,625 |
| *Special items:* | | |
| Loans transferred to held for sale (1) | 102,938 | 165,057 |
| Provision for loan and lease losses and net charge-offs (GAAP) | $ 634,587 | $ 609,682 |
| Provision for loan and lease losses to net charge-offs, excluding special items (Non-GAAP) | 119.57% | |
| Provision for loan and lease losses to net charge-offs (GAAP) | 104.08% | |
| Net charge-offs to average loans, excluding special items (Non-GAAP) | 3.60% | |
| Net charge-offs to average loans (GAAP) | 4.76% | |

1- In the fourth quarter 2010, the Corporation recorded a charge of $102.9 million to the provision for loan and lease losses and charge-offs of $165.1 million associated with $447 million of loans transferred to held for sale.

**Selected Quarterly Financial Data**

Financial data showing results of the 2011 and 2010 quarters is presented below. In the opinion of management, all adjustments necessary for a fair presentation have been included. These results are unaudited.

| | 2011 | | | |
|---|---|---|---|---|
| | March 31 | June 30 | September 30 | December 31 |
| | (In thousands, except for per share results) | | | |
| Interest income | $ 180,903 | $ 163,418 | $ 158,542 | $ 156,752 |
| Net interest income | 106,279 | 94,435 | 94,255 | 98,543 |
| Provision for loan losses | 88,732 | 59,184 | 46,446 | 41,987 |
| Net loss | (28,420) | (14,924) | (24,046) | (14,842) |
| Net (loss) income attributable to common stockholders basic | (35,437) | (22,205) | (31,143) | 262,011 |
| Net (loss) income attributable to common stockholders diluted | (35,437) | (22,205) | (31,143) | 263,153 |
| (Loss) earnings per common share-basic | $ (1.66) | $ (1.04) | $ (1.46) | $ 1.36 |
| (Loss) earnings per common share-diluted | $ (1.66) | $ (1.04) | $ (1.46) | $ 1.35 |

**2010**

| | March 31 | June 30 | September 30 | December 31 |
|---|---|---|---|---|
| | (In thousands, except for per share results) | | | |
| Interest income | $ 220,988 | $ 214,864 | $ 204,028 | $ 192,806 |
| Net interest income | 116,863 | 119,062 | 113,702 | 112,048 |
| Provision for loan losses | 170,965 | 146,793 | 120,482 | 196,347 |
| Net loss | (106,999) | (90,640) | (75,233) | (251,436) |
| Net (loss) income attributable to common stockholders-basic | (113,151) | (96,810) | 357,787 | (269,871) |
| Net (loss) income attributable to common stockholders-diluted | (113,151) | (96,810) | 363,413 | (269,871) |
| (Loss) earnings per common share-basic | $ (18.34) | $ (15.70) | $ 31.30 | $ (12.67) |
| (Loss) earnings per common share-diluted | $ (18.34) | $ (15.70) | $ 4.20 | $ (12.67) |

Some infrequent transactions that significantly affected quarterly periods of 2011 and 2010 include:

During the fourth quarter of 2011, the conversion of the 424,174 shares of Series G Preferred Stock into 32.9 million shares of common stock resulted in a favorable impact to net income available to common stockholders of $278.0 million.

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During the third quarter of 2010, the successful completion of the issuance of Series G Preferred Stock in exchange for the $400 million Series F preferred stock held by the U.S. Treasury, and the issuance of common stock in exchange for $487 million of Series A through E Preferred Stock resulted in a favorable impact to net income available to common stockholders of $440.5 million.

During the fourth quarter of 2010, the transfer of $447 million of loans, including $263 million of non-performing loans, to held for sale, resulted in the charge off of $165.1 million and the recognition of an additional provision for loan and lease losses of $102.9 million. On February 16, 2011, the Corporation sold substantially all of these loans.

During the fourth quarter of 2010, the exchange agreement with the U.S. Treasury was amended and a non-cash adjustment of $11.3 million was recorded as an acceleration of the Series G Preferred Stock discount accretion, which adversely affected the loss per share during the fourth quarter.

During the fourth quarter of 2010, an incremental $93.7 million non-cash charge to record a full valuation allowance on the Bank s deferred tax asset.

**Changes in Internal Control over Financial Reporting**

Refer to Item 9A.

***CEO and CFO Certifications***

First BanCorp s Chief Executive Officer and Chief Financial Officer have filed with the Securities and Exchange Commission the certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibit 31.1 and 31.2 to this Annual Report on Form 10-K and the certifications required by Section III(b)(4) of the Emergency Stabilization Act of 2008 as Exhibit 99.1 and 99.2 to this Annual Report on Form 10-K.

In addition, in 2011, First BanCorp s Chief Executive Officer certified to the New York Stock Exchange that he was not aware of any violation by the Corporation of the NYSE corporate governance listing standards.

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

The information required herein is incorporated by reference to the information included under the sub caption Interest Rate Risk Management in the Management s Discussion and Analysis of Financial Condition and Results of Operations section in this Form 10-K.

**Item 8. Financial Statements and Supplementary Data**

The consolidated financial statements of First BanCorp, together with the report thereon of PricewaterhouseCoopers LLP, First BanCorp s independent registered public accounting firm, are included herein beginning on page F-1 of this Form 10-K.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

**Disclosure Controls and Procedures**

First BanCorp s management, under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of First BanCorp s disclosure controls and procedures as such term is defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities and Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our CEO and CFO concluded that, as of December 31, 2011, the Corporation s disclosure controls and procedures were effective and provide reasonable assurance that the information required to be disclosed by the Corporation in reports that the Corporation files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and reported to the Corporation s management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

**Management s Report on Internal Control over Financial Reporting**

Our management s report on Internal Control over Financial Reporting is set forth in Item 8 and incorporated herein by reference.

The effectiveness of the Corporation s internal control over financial reporting as of December 31, 2011 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report as set forth in Item 8.

**Changes in Internal Control over Financial Reporting**

There have been no changes to the Corporation s internal control over financial reporting during our most recent quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

**Item 9B. Other Information.**

None.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance

Information in response to this Item is incorporated herein by reference to the sections entitled Information with Respect to Nominees for Director of First BanCorp and Executive Officers of the Corporation , Corporate Governance and Related Matters and Section 16(a) Beneficial Ownership Reporting Compliance contained in First BanCorp s definitive Proxy Statement for use in connection with its 2012 Annual Meeting of stockholders (the Proxy Statement ) to be filed with the Securities and Exchange Commission within 120 days of the close of First BanCorp s 2011 fiscal year.

### Item 11. Executive Compensation.

Information in response to this Item is incorporated herein by reference to the sections entitled Compensation Committee Interlocks and Insider Participation , Compensation of Directors , Compensation Discussion and Analysis , Compensation Committee Report and Tabular Executive Compensation Disclosure in First BanCorp s Proxy Statement.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information in response to this Item is incorporated herein by reference to the section entitled Beneficial Ownership of Securities in First BanCorp s Proxy Statement.

### Item 13. Certain Relationships and Related Transactions, and Director Independence

Information in response to this Item is incorporated herein by reference to the sections entitiled Certain Relationships and Related Person Transactions and Corporate Governance and Related Matters in First BanCorp s Proxy Statement.

### Item 14. Principal Accounting Fees and Services.

**Audit Fees**

Information in response to this Item is incorporated herein by reference to the section entitled Audit Fees in First BanCorp s Proxy Statement.

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## PART IV

**Item 15. Exhibits, Financial Statement Schedules**

(a) List of documents filed as part of this report.

(1) *Financial Statements.*

The following consolidated financial statements of First BanCorp, together with the report thereon of First BanCorp s independent registered public accounting firm, PricewaterhouseCoopers LLP, dated March 13, 2012, are included herein beginning on page F-1:

Report of Independent Registered Public Accounting Firm.

Consolidated Statements of Financial Condition as of December 31, 2011 and 2010.

Consolidated Statements of Loss for Each of the Three Years in the Period Ended December 31, 2011.

Consolidated Statements of Changes in Stockholders Equity for Each of the Three Years in the Period Ended December 31, 2011.

Consolidated Statements of Comprehensive Loss for each of the Three Years in the Period Ended December 31, 2011.

Consolidated Statements of Cash Flows for Each of the Three Years in the Period Ended December 31, 2011.

Notes to the Consolidated Financial Statements.

(2) Financial statement schedules.
All financial schedules have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

(3) Exhibits listed below are filed herewith as part of this Form 10-K or are incorporated herein by reference.

**EXHIBIT INDEX**

| Exhibit No. | Description |
|---|---|
| 3.1 | Restated Articles of Incorporation, incorporated by reference from Exhibit 3.1 of the Registration Statement on Form S-1/A filed by First BanCorp on October 20, 2011. |
| 3.2 | By-Laws, incorporated by reference from Exhibit 3.2 of the Registration Statement on Form S-1/A filed by First BanCorp on October 20, 2011. |

| | |
|---|---|
| 3.3 | Certificate of Designation creating the 7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A, incorporated by reference from Exhibit 4(B) to the Form S-3 filed by First BanCorp on March 30, 1999. |
| 3.4 | Certificate of Designation creating the 8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B, incorporated by reference from Exhibit 4(B) to Form S-3 filed by First BanCorp on September 8, 2000. |
| 3.5 | Certificate of Designation creating the 7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C, incorporated by reference from Exhibit 4(B) to the Form S-3 filed by First BanCorp on May 18, 2001. |
| 3.6 | Certificate of Designation creating the 7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D, incorporated by reference from Exhibit 4(B) to the Form S-3/A filed by First BanCorp on January 16, 2002. |
| 3.7 | Certificate of Designation creating the 7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E, incorporated by reference from Exhibit 4.2 to the Form 8-K filed by First BanCorp on September 5, 2003. |
| 3.8 | Certificate of Designation creating the fixed-rate cumulative perpetual preferred stock, Series F, incorporated by reference from Exhibit 3.1 of the Form 8-K filed by the Corporation on January 20, 2009. |
| 3.9 | Certificate of Designation creating the fixed-rate cumulative perpetual preferred stock, Series G, incorporated by reference from Exhibit 10.3 to the Form 8-K filed by First BanCorp on July 7, 2010. |

3.10 First Amendment to Certificate of Designation creating the Fixed-Rate Cumulative Mandatorily Convertible Preferred Stock, Series G, incorporated by reference from Exhibit 3.1 to the Form 8-K filed by First BanCorp on December 2, 2010.

3.11 Second Amendment to Certificate of Designation creating the Fixed-Rate Cumulative Mandatorily Convertible Preferred Stock, Series G, incorporated by reference from Exhibit 3.1 to the Form 8-K filed by First BanCorp on April 15, 2011.

4.1 Form of Common Stock Certificate, incorporated by reference from Exhibit 4 of the Registration Statement on Form S-4/A filed by First BanCorp on April 24, 1998.

4.2 Form of Stock Certificate for 7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A, incorporated by reference from Exhibit 4(A) to the Form S-3 filed by First BanCorp on March 30, 1999.

4.3 Form of Stock Certificate for 8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B, incorporated by reference form Exhibit 4(A) to the Form S-3 filed by First BanCorp on September 8, 2000.

4.4 Form of Stock Certificate for 7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C, incorporated by reference from Exhibit 4(A) to the Form S-3 filed by First BanCorp on May 18, 2001.

4.5 Form of Stock Certificate for 7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D, incorporated by reference from Exhibit 4(A) to the Form S-3/A filed by First BanCorp on January 16, 2002.

4.6 Form of Stock Certificate for 7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E, incorporated by reference from Exhibit 4.1 to the Form 8-K filed by First BanCorp on September 5, 2003.

4.7 Warrant dated January 16, 2009 to purchase shares of First BanCorp, incorporated by reference from Exhibit 4.1 to the Form 8-K filed by the Corporation on January 20, 2009.

4.8 Amended and Restated Warrant, Annex A to the Exchange Agreement by and between First BanCorp and the United States Treasury dated as of July 7, 2010, incorporated by reference from Exhibit 10.2 of the Form 8-K filed on July 7, 2010.

4.9 Letter Agreement, dated January 16, 2009, including Securities Purchase Agreement Standard Terms attached thereto as Exhibit A, between First BanCorp and the United States Department of the Treasury, incorporated by reference from Exhibit 10.1 to the Form 8-K filed by the Corporation on January 20, 2009.

10.1 FirstBank s 1997 Stock Option Plan, incorporated by reference from the Form 10-K for the year ended December 31, 1998 filed by First BanCorp on March 26, 1999.

10.2 First BanCorp s 2008 Omnibus Incentive Plan, incorporated by reference from Exhibit 10.1 to the Form 10-Q for the quarter ended March 31, 2008 filed by First BanCorp on May 12, 2008.

10.3 First BanCorp s 2008 Omnibus Incentive Plan, as amended, incorporated by reference from Schedule 14A filed by First BanCorp on November 14, 2011.

10.4 Investment Agreement between The Bank of Nova Scotia and First BanCorp dated February 15, 2007, including the Form of Stockholder Agreement, incorporated by reference from Exhibit 10.01 to the Form 8-K filed by First BanCorp on February 22, 2007.

10.5 Amendment No. 1 to Stockholder Agreement, dated as of October 13, 2010, by and between First BanCorp and The Bank of Nova Scotia, incorporated by reference to Exhibit 10.1 to the Form 8-K filed on November 24, 2010.

10.6 Employment Agreement Aurelio Alemán, incorporated by reference from the Form 10-K for the year ended December 31, 1998 filed by First BanCorp on March 26, 1999.

10.7 Amendment No. 1 to Employment Agreement Aurelio Alemán, incorporated by reference from the Form 10-Q for the quarter ended March 31, 2009 filed by First BanCorp on May 11, 2009.

10.8 Amendment No. 2 to Employment Agreement Aurelio Alemán, incorporated by reference from Exhibit 10.6 of the Form 10-K for the year ended December 31, 2009 filed by First BanCorp on March 2, 2010.

10.9 Employment Agreement Lawrence Odell, incorporated by reference from the Form 10-K for the year ended December 31, 2005 filed by First BanCorp on February 9, 2007.

10.10 Amendment No. 1 to Employment Agreement Lawrence Odell, incorporated by reference from the Form 10-K for the year ended December 31, 2005 filed by First BanCorp on February 9, 2007.

10.11 Amendment No. 2 to Employment Agreement Lawrence Odell, incorporated by reference from the Form 10-Q for the quarter ended March 31, 2009 filed by First BanCorp on May 11, 2009.

10.12

| | |
|---|---|
| | Amendment No. 3 to Employment Agreement Lawrence Odell, incorporated by reference from Exhibit 10.13 of the Form 10-K for the year ended December 31, 2009 filed by First BanCorp on March 2, 2010. |
| 10.13 | Employment Agreement Orlando Berges, incorporated by reference from the Form 10-Q for the quarter ended June 30, 2009 filed by First BanCorp on August 11, 2009. |
| 10.14 | Service Agreement Martinez Odell & Calabria, incorporated by reference from the Form 10-K for the year ended December 31, 2005 filed by First BanCorp on February 9, 2007. |
| 10.15 | Amendment No. 1 to Service Agreement Martinez Odell & Calabria, incorporated by reference from the Form 10-K for the year ended December 31, 2005 filed by First BanCorp on February 9, 2007. |

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|---|---|
| 10.16 | Amendment No. 2 to Service Agreement Martinez Odell & Calabria, incorporated by reference from Exhibit 10.17 of the Form 10-K for the year ended December 31, 2009 filed by First BanCorp on March 2, 2010. |
| 10.17 | Amendment No. 3 to Service Agreement Martinez Odell & Calabria, incorporated by reference from Exhibit 10.20 of the Form 10-K for the year ended December 31, 2010 filed by First BanCorp on April 15, 2011. |
| 10.18 | Consent Order, dated June 2, 1010, incorporated by reference from Exhibit 10.1 of the Form 8-K filed on June 4, 2010. |
| 10.19 | Written Agreement, dated June 3, 2010, incorporated by reference from Exhibit 10.2 of the Form 8-K filed on June 4, 2010. |
| 10.20 | Exchange Agreement by and between First BanCorp and the United States Treasury dated as of July 7, 2010, incorporated by reference from Exhibit 10.1 of the Form 8-K filed on July 7, 2010. |
| 10.21 | First Amendment to Exchange Agreement, dated as of December 1, 2010, by and between First BanCorp and The United States Department of the Treasury, incorporated by reference from Exhibit 10.1 to the Form 8-K filed by First BanCorp on December 2, 2010. |
| 10.22 | Form of Restricted Stock Award Agreement incorporated by reference from Exhibit 10.23 to the Form S-1/A filed by First BanCorp on July 16, 2010. |
| 10.23 | Form of Stock Option Agreement for Officers and Other Employees incorporated by reference from Exhibit 10.24 to the Form S-1/A filed by First BanCorp on July 16, 2010. |
| 10.24 | Letter Agreement, dated as of January 16, 2009, and Securities Purchase Agreement, dated as of January 16, 2009, by and between First BanCorp and the United States Department of the Treasury, incorporated by reference from Exhibit 10.1 of the Form 8-K filed on January 20, 2009. |
| 10.25 | Amended and Restated Investment Agreement between First BanCorp and Thomas H. Lee Partners, L.P., incorporated by reference from Exhibit 10.1 of the Form 8-K filed on July 19, 2011. |
| 10.26 | Agreement Regarding Additional Shares between First BanCorp and Thomas H. Lee Partners, L.P., incorporated by reference from Exhibit 10.25 of the Registration Statement on Form S-1/A filed by First BanCorp on October 20, 2011. |
| 10.27 | Amended and Restated Investment Agreement between First BanCorp and Oaktree Capital Management, L.P., incorporated by reference from Exhibit 10.2 of the Form 8-K filed on July 19, 2011. |
| 10.28 | Agreement Regarding Additional Shares between First BanCorp and Oaktree Capital Management, L.P. dated October 26, 2011 incorporated by reference from Exhibit 10.27 of the Form S-1 filed by First BanCorp on December 20, 2011. |
| 10.29 | Investment Agreement between First BanCorp and funds advised by Wellington Management Company LLP, as amended, incorporated by reference from Exhibit 10.2 of the Form 8-K/A filed on July 19, 2011, and Exhibit 10.3 of the Form 8-K filed on July 19, 2011. |
| 10.30 | Amendment No. 2 to Investment Agreement between First BanCorp and funds advised by Wellington Management Company LLP, incorporated by reference from Exhibit 10.28 to the Form S-1/A filed by First BanCorp on October 20, 2011. |
| 10.31 | Form of Subscription Agreement between First BanCorp and private placement investors, incorporated by reference from Exhibit 10.3 of the Form 8-K filed on June 29, 2011. |
| 10.32 | Expense Reimbursement Agreement between First BanCorp and Oaktree Capital Management, L.P., incorporated by reference from Exhibit 10.4 of the Form 8-K/A filed on July 21, 2011. |
| 10.33 | Expense Reimbursement Agreement between First BanCorp and Thomas H. Lee Partners, L.P., incorporated by reference from Exhibit 10.2 of the Form 8-K/A filed on July 21, 2011. |
| 10.34 | Letter Agreement with the U.S. Department of the Treasury dated as of October 3, 2011, incorporated by reference from Exhibit 10.1 of the Form 8-K filed on October 7, 2011. |
| 10.35 | Letter Agreement between First BanCorp. and Roberto R. Herencia, incorporated by reference from the Form 8-K filed by First BanCorp on November 2, 2011. |
| 10.36 | Stock Purchase Agreement between First BanCorp and Roberto Herencia dated February 17, 2012. |
| 12.1 | Ratio of Earnings to Fixed Charges |
| 12.2 | Ratio of Earnings to Fixed Charges and Preference Dividends |
| 14.1 | |

| | |
|---|---|
| | Code of Ethics for CEO and Senior Financial Officers, incorporated by reference from Exhibit 3.2 of the Form 10-K for the fiscal year ended December 31, 2008 filed by First BanCorp on March 2, 2009. |
| 21.1 | List of First BanCorp s subsidiaries |
| 31.1 | Section 302 Certification of the CEO |
| 31.2 | Section 302 Certification of the CFO |
| 32.1 | Section 906 Certification of the CEO |
| 32.2 | Section 906 Certification of the CFO |
| 99.1 | Certification of the CEO Pursuant to Section III(b)(4) of the Emergency Stabilization Act of 2008 and 31 CFR § 30.15. |

| | |
|---|---|
| 99.2 | Certification of the CFO Pursuant to Section III(b)(4) of the Emergency Stabilization Act of 2008 and 31 CFR § 30.15. |
| 101.1 | Interactive Data File (Annual Report on Form 10-K for the year ended December 31, 2011, furnished in XBRL (eXtensible Business Reporting Language) |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934 the Corporation has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**FIRST BANCORP.**

By: /s/ Aurelio Alemán Date: 3/13/12
Aurelio Alemán
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Aurelio Alemán Date: 3/13/12
Aurelio Alemán
President and Chief Executive Officer

/s/ Orlando Berges Date: 3/13/12
Orlando Berges, CPA
Executive Vice President and Chief Financial Officer

/s/ Roberto R. Herencia Date: 3/12/12
Roberto R. Herencia,
Director and Chairman of the Board

/s/ José Menéndez-Cortada Date: 3/12/12
José Menéndez-Cortada, Director

/s/ Fernando Rodríguez-Amaro Date: 3/13/12
Fernando Rodríguez Amaro,
Director

/s/ Thomas Martin Hagerty Date: 3/12/12
Thomas Martin Hagerty,
Director

/s/ Sharee Ann Umpierre-Catinchi Date: 3/12/12
Sharee Ann Umpierre-Catinchi,
Director

/s/ Michael P. Harmon Date: 3/12/12
Michael P. Harmon,
Director

/s/ Héctor M. Nevares Date: 3/12/12
Héctor M. Nevares,
Director

/s/ José F. Rodríguez Date: 3/12/12
José F. Rodríguez,
Director

/s/ Pedro Romero
Pedro Romero, CPA
Senior Vice President and Chief Accounting Officer

Date: 3/13/12

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**Management s Report on Internal Control Over Financial Reporting**

To the Board of Directors and Stockholders of First BanCorp:

First BanCorp s (the Corporation ) internal control over financial reporting is a process effected by those charged with governance, management, and other personnel and designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and regulatory financial statements prepared in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), which are intended to comply with the requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA).

Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation; (ii) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with GAAP and financial statements for regulatory reporting purposes, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and (iii) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the Corporation s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 and for our assessment of internal control over financial reporting. Management has assessed the effectiveness of the Corporation s internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2011, based on the framework set forth by the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment, management has concluded that, as of December 31, 2011, the Corporation s internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) is effective based on the criteria established in Internal-Control Integrated Framework.

Management s assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2011, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report dated March 13, 2012.

/s/ Aurelio Alemán
Aurelio Alemán
President and Chief Executive Officer
Date: March 13, 2012

/s/ Orlando Berges
Orlando Berges
Executive Vice President and Chief Financial Officer
Date: March 13, 2012

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and

Stockholders of First BanCorp

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of loss, of comprehensive loss, of cash flows, and of changes in stockholders equity present fairly, in all material respects, the financial position of First BanCorp and its subsidiaries (the Corporation ) at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Corporation s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Corporation s internal control over financial reporting based on our integrated 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management s assessment and our audit of First BanCorp s internal control over financial reporting also included controls over the preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) to comply with the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA). A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

San Juan, Puerto Rico

March 13, 2012

CERTIFIED PUBLIC ACCOUNTANTS
(OF PUERTO RICO)
License No. 216 Expires Dec. 1, 2013
Stamp E16131 of the P.R. Society of
Certified Public Accountants has been
affixed to the file copy of this report

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**FIRST BANCORP**

**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| | (In thousands, except for share information) | |
| **ASSETS** | | |
| Cash and due from banks | $ 206,897 | $ 254,723 |
| Money market investments: | | |
| Federal funds sold | 2,603 | 6,236 |
| Time deposits with other financial institutions | 955 | 1,346 |
| Other short-term investments | 236,111 | 107,978 |
| Total money market investments | 239,669 | 115,560 |
| Investment securities available for sale, at fair value: | | |
| Securities pledged that can be repledged | 1,167,265 | 1,344,873 |
| Other investment securities | 756,003 | 1,399,580 |
| Total investment securities available for sale | 1,923,268 | 2,744,453 |
| Investment securities held to maturity, at amortized cost: | | |
| Securities pledged that can be repledged | | 239,553 |
| Other investment securities | | 213,834 |
| Total investment securities held to maturity, fair value of $476,516 in 2010 | | 453,387 |
| Other equity securities | 37,951 | 55,932 |
| Investment in unconsolidated entities | 43,401 | |
| Loans, net of allowance for loan and lease losses of $493,917 (2010 - $553,025) | 10,065,475 | 11,102,411 |
| Loans held for sale, at lower of cost or market | 15,822 | 300,766 |
| Total loans, net | 10,081,297 | 11,403,177 |
| Premises and equipment, net | 194,942 | 209,014 |
| Other real estate owned | 114,292 | 84,897 |
| Accrued interest receivable on loans and investments | 49,957 | 59,061 |
| Due from customers on acceptances | 253 | 1,439 |
| Other assets | 235,348 | 211,434 |
| Total assets | $ 13,127,275 | $ 15,593,077 |
| **LIABILITIES** | | |
| Non-interest-bearing deposits | $ 705,789 | $ 668,052 |
| Interest-bearing deposits | 9,201,965 | 11,391,058 |

| | | |
|---|---|---|
| Total deposits | 9,907,754 | 12,059,110 |
| Securities sold under agreements to repurchase | 1,000,000 | 1,400,000 |
| Advances from the Federal Home Loan Bank (FHLB) | 367,440 | 653,440 |
| Notes payable (including $15,968 and $11,842 measured at fair value as of December 31, 2011 and December 31, 2010, respectively) | 23,342 | 26,449 |
| Other borrowings | 231,959 | 231,959 |
| Bank acceptances outstanding | 253 | 1,439 |
| Accounts payable and other liabilities | 152,383 | 162,721 |
| Total liabilities | 11,683,131 | 14,535,118 |
| Commitments and Contingencies (Note 27 and 30) | | |
| **STOCKHOLDERS EQUITY** | | |
| Preferred stock, authorized 50,000,000 shares: | | |
| Fixed Rate Cumulative Mandatorily Convertible Preferred Stock: issued and outstanding in 2010 - 424,174 shares, liquidation value in 2010 of $424,174 | | 361,962 |
| Non-cumulative Perpetual Monthly Income Preferred Stock: issued 22,004,000 shares, outstanding 2,521,872 shares, aggregate liquidation value of $63,047 | 63,047 | 63,047 |
| Common stock, $0.10 par value, authorized 2,000,000,000 shares; issued 205,794,024 shares (2010 - 21,963,522 shares issued) | 20,579 | 2,196 |
| Less: Treasury stock (at par value) | (66) | (66) |
| Common stock outstanding, 205,134,171 shares outstanding (2010 - 21,303,669 shares outstanding) | 20,513 | 2,130 |
| Additional paid-in capital | 884,002 | 319,459 |
| Retained earnings | 457,384 | 293,643 |
| Accumulated other comprehensive income, net of tax expense of $7,751 (December 31, 2010 - $5,351) | 19,198 | 17,718 |
| Total stockholders equity | 1,444,144 | 1,057,959 |
| Total liabilities and stockholders equity | $ 13,127,275 | $ 15,593,077 |

The accompanying notes are an integral part of these statements.

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**FIRST BANCORP**

**CONSOLIDATED STATEMENTS OF LOSS**

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| | (In thousands, except per share data) | | |
| **Interest income:** | | | |
| Loans | $ 593,961 | $ 691,897 | $ 741,535 |
| Investment securities | 64,099 | 138,740 | 254,462 |
| Money market investments | 1,555 | 2,049 | 577 |
| Total interest income | 659,615 | 832,686 | 996,574 |
| **Interest expense:** | | | |
| Deposits | 191,727 | 248,716 | 314,487 |
| Loans payable | | 3,442 | 2,331 |
| Securities sold under agreements to repurchase | 45,382 | 83,031 | 114,651 |
| Advances from FHLB | 16,335 | 29,037 | 32,954 |
| Notes payable and other borrowings | 12,659 | 6,785 | 13,109 |
| Total interest expense | 266,103 | 371,011 | 477,532 |
| Net interest income | 393,512 | 461,675 | 519,042 |
| **Provision for loan and lease losses** | 236,349 | 634,587 | 579,858 |
| Net interest income (loss) after provision for loan and lease losses | 157,163 | (172,912) | (60,816) |
| **Non-interest income:** | | | |
| Other service charges on loans | 6,775 | 7,224 | 6,830 |
| Service charges on deposit accounts | 12,472 | 13,419 | 13,307 |
| Mortgage banking activities | 23,320 | 13,615 | 8,605 |
| Net gain on sale of investments | 53,796 | 103,847 | 86,804 |
| Other-than-temporary impairment losses on investment securities: | | | |
| Total other-than-temporary impairment losses | (987) | (603) | (33,400) |
| Noncredit-related impairment portion on debt securities not expected to be sold (recognized in other comprehensive income) | (984) | (582) | 31,742 |
| Net impairment losses on investment securities | (1,971) | (1,185) | (1,658) |
| Rental income | | | 1,346 |
| Loss on early extinguishment of borrowings | (10,835) | (47,405) | |
| Equity in losses of unconsolidated entities | (4,227) | | |
| Other non-interest income | 28,651 | 28,388 | 27,030 |
| Total non-interest income | 107,981 | 117,903 | 142,264 |
| **Non-interest expenses:** | | | |
| Employees compensation and benefits | 118,475 | 121,126 | 132,734 |
| Occupancy and equipment | 61,924 | 59,494 | 62,335 |
| Business promotion | 12,283 | 12,332 | 14,158 |

| | | | |
|---|---|---|---|
| Professional fees | 21,884 | 21,287 | 15,217 |
| Taxes, other than income taxes | 13,395 | 14,228 | 15,847 |
| Insurance and supervisory fees | 57,923 | 67,274 | 45,605 |
| Net loss on real estate owned (REO) operations | 25,025 | 30,173 | 21,863 |
| Other non-interest expenses | 27,145 | 40,244 | 44,342 |
| Total non-interest expenses | 338,054 | 366,158 | 352,101 |
| **Loss before income taxes** | (72,910) | (421,167) | (270,653) |
| **Income tax expense** | (9,322) | (103,141) | (4,534) |
| **Net loss** | $ (82,232) | $ (524,308) | $ (275,187) |
| **Net income (loss) attributable to common stockholders - basic** | $ 173,226 | $ (122,045) | $ (322,075) |
| **Net income (loss) attributable to common stockholders - diluted** | $ 195,763 | $ (122,045) | $ (322,075) |
| **Net income (loss) per common share:** | | | |
| Basic | $ 2.69 | $ (10.79) | $ (52.22) |
| Diluted | $ 2.18 | $ (10.79) | $ (52.22) |
| **Dividends declared per common share** | $ | $ | $ 2.10 |

The accompanying notes are an integral part of these statements.

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**FIRST BANCORP**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | (In thousands) | | |
| Net loss | $ (82,232) | $ (524,308) | $ (275,187) |
| Available-for-sale debt securities on which an other-than-temporary impairment has been recognized: | | | |
| Subsequent unrealized gain (loss) on debt securities on which an other-than-temporary impairment has been recognized | 4,005 | 5,032 | (895) |
| Noncredit-related impairment portion on debt securities not expected to be sold | 984 | 582 | (31,742) |
| Reclassification adjustment for other-than-temporary impairment on debt securities included in net income | (1,418) | (582) | (209) |
| All other unrealized gains and losses on available-for-sale securities: | | | |
| All other unrealized holding gains arising during the period | 31,222 | 80,244 | 88,245 |
| Reclassification adjustments for net gain included in net income | (34,453) | (93,681) | (82,772) |
| Reclassification adjustments for other-than-temporary impairment on equity securities | | 353 | 388 |
| Net unrealized gains on securities reclassified from held to maturity to available for sale | 3,540 | | |
| Income tax expense related to items of other comprehensive income | (2,400) | (723) | (3,911) |
| Other comprehensive income (loss) for the year, net of tax | 1,480 | (8,775) | (30,896) |
| Total comprehensive loss | $ (80,752) | $ (533,083) | $ (306,083) |

The accompanying notes are an integral part of these statements.

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**FIRST BANCORP**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 (In thousands) | 2009 |
| **Cash flows from operating activities:** | | | |
| Net loss | $ (82,232) | $ (524,308) | $ (275,187) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | | |
| Depreciation | 24,543 | 20,942 | 20,774 |
| Amortization and impairment of core deposit intangible | 2,354 | 2,557 | 7,386 |
| Provision for loan and lease losses | 236,349 | 634,587 | 579,858 |
| Deferred income tax expense | 1,426 | 99,206 | 16,054 |
| Stock-based compensation recognized | 50 | 93 | 92 |
| Gain on sale of investments, net | (53,115) | (103,847) | (86,804) |
| Loss on early extinguishment of borrowings | 10,835 | 47,405 | |
| Other-than-temporary impairments on investment securities | 1,971 | 1,185 | 1,658 |
| Equity in losses of unconsolidated entities | 4,227 | | |
| Derivative instruments and hedging activities loss (gain) | 5,883 | (302) | (15,745) |
| Gain on sale of premises and equipment and other assets | (2,733) | | |
| Net gain on sale of loans and impairments | (13,803) | (5,469) | (7,352) |
| Net amortization of premiums and discounts and deferred loan fees and costs | (771) | (2,063) | 606 |
| Net decrease (increase) in mortgage loans held for sale | 3,155 | (11,229) | (21,208) |
| Amortization of broker placement fees | 16,314 | 20,758 | 22,858 |
| Net amortization of premium and discounts on investment securities | 7,085 | 7,230 | 5,221 |
| Increase (decrease) in accrued income tax payable | 6,141 | 4,243 | (19,408) |
| Decrease in accrued interest receivable | 7,074 | 20,806 | 18,699 |
| Decrease in accrued interest payable | (11,510) | (8,174) | (24,194) |
| Decrease in other assets | 5,377 | 20,261 | 28,609 |
| (Decrease) increase in other liabilities | (11,697) | 13,289 | (8,668) |
| Total adjustments | 239,155 | 761,478 | 518,436 |
| Net cash provided by operating activities | 156,923 | 237,170 | 243,249 |
| **Cash flows from investing activities:** | | | |
| Principal collected on loans | 2,421,867 | 3,716,734 | 3,010,435 |
| Loans originated | (2,278,644) | (2,729,787) | (4,429,644) |
| Purchases of loans | (162,173) | (155,593) | (190,431) |
| Proceeds from sale of loans | 719,852 | 223,616 | 43,816 |
| Proceeds from sale of repossessed assets | 100,117 | 101,633 | 78,846 |
| Proceeds from sale of available-for-sale securities | 1,247,069 | 2,358,101 | 1,946,186 |
| Proceeds from sale of held-to-maturity securities | 348,750 | | |
| Purchases of securities available for sale | (1,010,104) | (2,762,929) | (2,781,394) |
| Purchases of securities held to maturity | | (8,475) | (8,460) |
| Proceeds from principal repayments and maturities of securities available for sale | 894,897 | 2,128,897 | 880,384 |
| Proceeds from principal repayments and maturities of securities held to maturity | 33,726 | 153,940 | 1,110,245 |
| Additions to premises and equipment | (13,376) | (31,991) | (40,271) |
| Proceeds from sale/redemption of other investment securities | | 10,668 | 4,032 |
| Proceeds from sale of premises and equipment and other assets | 5,107 | | |
| Proceeds from securities litigation settlement | 679 | | 248 |

| | | | |
|---|---|---|---|
| Decrease (increase) in other equity securities | 17,981 | 13,748 | (5,785) |
| Net cash provided by (used in) investing activities | 2,325,748 | 3,018,562 | (381,793) |
| **Cash flows from financing activities:** | | | |
| Net decrease in deposits | (2,169,439) | (632,382) | (393,636) |
| Net (decrease) increase in loans payable | | (900,000) | 900,000 |
| Net repayments and cancellation costs of securities sold under agreements to repurchase | (410,587) | (1,724,036) | (344,411) |
| Net FHLB advances paid and cancellation costs | (286,248) | (325,000) | (82,000) |
| Repayment of medium-term notes | (7,000) | | |
| Dividends paid | (26,388) | | (43,066) |
| Proceeds from common stock issued, net of costs | 493,274 | | |
| Issuance of preferred stock and associated warrant | | | 400,000 |
| Issuance costs of common stock issued in exchange for preferred stock Series A through E | | (8,115) | |
| Other financing activities | | | 8 |
| Net cash (used in) provided by financing activities | (2,406,388) | (3,589,533) | 436,895 |
| Net increase (decrease) in cash and cash equivalents | 76,283 | (333,801) | 298,351 |
| Cash and cash equivalents at beginning of year | 370,283 | 704,084 | 405,733 |
| Cash and cash equivalents at end of year | $ 446,566 | $ 370,283 | $ 704,084 |
| Cash and cash equivalents include: | | | |
| Cash and due from banks | $ 206,897 | $ 254,723 | $ 679,798 |
| Money market instruments | 239,669 | 115,560 | 24,286 |
| | $ 446,566 | $ 370,283 | $ 704,084 |

The accompanying notes are an integral part of these statements.

**FIRST BANCORP**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| **Preferred Stock:** | | | |
| Balance at beginning of year | $ 425,009 | $ 928,508 | $ 550,100 |
| Issuance of preferred stock - Series F | | | 400,000 |
| Preferred stock discount - Series F | | | (25,820) |
| Accretion of preferred stock discount - Series F | | 2,567 | 4,228 |
| Accretion of preferred stock discount - Series G | 5,634 | 14,576 | |
| Exchange of preferred stock - Series A through E | | (487,053) | |
| Exchange of preferred stock - Series F | | (400,000) | |
| Issuance of preferred stock - Series G | | 424,174 | |
| Preferred stock discount - Series G | | (76,788) | |
| Reversal of unaccreted preferred stock discount - Series F | | 19,025 | |
| Reversal of unaccreted preferred stock discount - Series G | 56,578 | | |
| Conversion of preferred stock - Series G | (424,174) | | |
| Balance at end of year | 63,047 | 425,009 | 928,508 |
| **Common Stock outstanding:** | | | |
| Balance at beginning of year | 2,130 | 6,169 | 6,169 |
| Change in par value (from $1.00 to $0.10) | | (5,552) | |
| Common stock issued | 15,089 | | |
| Common stock issued in exchange of Series A through E preferred stock | | 1,513 | |
| Common stock issued in conversion of Series G preferred stock | 3,294 | | |
| Balance at end of year | 20,513 | 2,130 | 6,169 |
| **Additional Paid-In-Capital:** | | | |
| Balance at beginning of year | 319,459 | 220,596 | 194,676 |
| Issuance of common stock warrants | | | 25,820 |
| Issuance of common stock | 513,022 | | |
| Stock-based compensation recognized | 50 | 93 | 92 |
| Fair value adjustment on amended common stock warrant | | 1,179 | |
| Common stock issued in exchange of Series A through E preferred stock | | 89,293 | |
| Issuance costs of common stock issued in exchange of Series A through E preferred stock | | (8,115) | |
| Reversal of issuance costs of Series A through E preferred stock exchanged | | 10,861 | |
| Change in par value (from $1.00 to $0.10) | | 5,552 | |
| Common stock issued in exchange of Series G preferred stock | 86,308 | | |
| Issuance costs of common stock | (34,837) | | |
| Other | | | 8 |
| Balance at end of year | 884,002 | 319,459 | 220,596 |
| **Retained Earnings:** | | | |
| Balance at beginning of year | 293,643 | 417,297 | 739,783 |
| Net loss | (82,232) | (524,308) | (275,187) |
| Cash dividends declared on common stock | | | (12,965) |
| Cash dividends declared on preferred stock | (26,388) | | (30,106) |
| Accretion of preferred stock discount - Series F | | (2,567) | (4,228) |

| | | | |
|---|---|---|---|
| Stock dividend granted of Series F preferred stock | | (24,174) | |
| Reversal of unaccreted discount - Series F | | (19,025) | |
| Preferred Stock discount - Series G | | 76,788 | |
| Fair value adjustment on amended common stock warrant | | (1,179) | |
| Excess of carrying amount of Series A though E preferred stock exchanged over fair value of new shares of common stock | | 385,387 | |
| Accretion of preferred stock discount - Series G | (5,634) | (14,576) | |
| Excess of carrying amount of Series G preferred stock converted over fair value of new shares of common stock | 277,995 | | |
| Balance at end of year | 457,384 | 293,643 | 417,297 |
| **Accumulated Other Comprehensive Income (Loss), net of tax:** | | | |
| Balance at beginning of year | 17,718 | 26,493 | 57,389 |
| Other comprehensive income (loss), net of tax | 1,480 | (8,775) | (30,896) |
| Balance at end of year | 19,198 | 17,718 | 26,493 |
| Total stockholders equity | $ 1,444,144 | $ 1,057,959 | $ 1,599,063 |

The accompanying notes are an integral part of these statements.

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**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 Nature of Business and Summary of Significant Accounting Policies**

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ( GAAP ). The following is a description of First BanCorp s ( First BanCorp or the Corporation ) most significant policies:

***Nature of business***

First BanCorp is a publicly-owned, Puerto Rico-chartered financial holding company that is subject to regulation, supervision and examination by the Board of Governors of the Federal Reserve System (the FED or Federal Reserve ). The Corporation is a full service provider of financial services and products with operations in Puerto Rico, the United States and the U.S. and British Virgin Islands.

The Corporation provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2011, the Corporation controlled two wholly-owned subsidiaries: FirstBank Puerto Rico ( FirstBank or the Bank ), and FirstBank Insurance Agency, Inc. ( FirstBank Insurance Agency ). FirstBank is a Puerto Rico-chartered commercial bank, and FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency. FirstBank is subject to the supervision, examination and regulation of both the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico ( OCIF ) and the Federal Deposit Insurance Corporation (the FDIC ). Deposits are insured through the FDIC Deposit Insurance Fund. FirstBank also operates in the state of Florida, (USA), subject to regulation and examination by the Florida Office of Financial Regulation and the FDIC, in the U.S. Virgin Islands, subject to regulation and examination by the United States Virgin Islands Banking Board, and in the British Virgin Islands, subject to regulation by the British Virgin Islands Financial Services Commission.

FirstBank Insurance Agency is subject to the supervision, examination and regulation of the Office of the Insurance Commissioner of the Commonwealth of Puerto Rico.

FirstBank conducted its business through its main office located in San Juan, Puerto Rico, forty-eight full service banking branches in Puerto Rico, fourteen branches in the United States Virgin Islands (USVI) and British Virgin Islands (BVI) and ten branches in the state of Florida (USA). FirstBank had five wholly-owned subsidiaries with operations in Puerto Rico: First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance company specializing in the origination of small loans with twenty-six offices in Puerto Rico; First Mortgage, Inc. ( First Mortgage ), a residential mortgage loan origination company with thirty-six offices in FirstBank branches and at stand alone sites; First Management of Puerto Rico, a domestic corporation which holds tax-exempt assets; FirstBank Puerto Rico Securities Corp, a broker-dealer subsidiary engaged in municipal bond underwriting and financial advisory services on structured financings principally provided to government entities in the Commonwealth of Puerto Rico; and FirstBank Overseas Corporation, an international banking entity organized under the International Banking Entity Act of Puerto Rico. FirstBank had one active subsidiary with operations outside of Puerto Rico: First Express, a finance company specializing in the origination of small loans with three offices in the USVI.

***Capital and Liquidity***

The Consolidated Financial Statements have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. Sustained weak economic conditions that have severely affected Puerto Rico and the United States over the last several years have adversely impacted First BanCorp s and FirstBank s results of operations and capital levels. The significant loss in 2010, primarily related to credit losses (including losses associated with adversely classified and non-performing loans transferred to held for sale), the increase in the deposit insurance premium expense and increases to the deferred tax asset valuation allowance, reduced the Corporation s and the Bank s capital levels during 2010. The net loss for the year ended December 31, 2011 was primarily related to credit losses.

As described in Note 30, FirstBank is currently operating under a Consent Order with the FDIC and the OCIF and First BanCorp has entered into a Written Agreement with the Federal Reserve. The minimum capital ratios established by the FDIC Order are 12% for Total Capital to Risk-Weighted Assets, 10% for Tier 1 Capital to Risk-Weighted Assets and 8% for Leverage (Tier 1 Capital to Average Total Assets). As of December 31, 2011, the Corporation s Total Capital, Tier 1 Capital and Leverage ratios were 17.12%, 15.79% and 11.91%, respectively, up from 12.02%, 10.73% and 7.57%, respectively, as of December 31, 2010. Meanwhile, FirstBank s Total Capital, Tier 1 Capital and Leverage ratios as of December 31, 2011 were 16.58%, 15.25% and 11.52%, respectively, up from 11.57%, 10.28% and 7.25%, respectively, as of December 31,

2010. All of the capital ratios as of December 31, 2011 are well above the minimum required under the consent order with the FDIC. The improvement in the capital ratios was primarily related to a $525 million capital raise completed in the fourth quarter of 2011, as further discussed below, coupled with the deleveraging strategies completed during the year.

**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In March 2011, the Corporation submitted an updated Capital Plan (the Capital Plan ) to the regulators. The Capital Plan contemplated a $350 million capital raise through the issuance of new common shares for cash, and other actions to reduce the Corporation s and the Bank s risk-weighted assets, strengthen their capital positions and meet the minimum capital ratios required under the FDIC Order. Among the strategies contemplated in the Capital Plan are reductions of the Corporation s loan and investment securities portfolio. The Capital Plan identified specific targeted Leverage, Tier 1 Capital to Risk-Weighted Assets and Total Capital to Risk-Weighted Assets ratios to be achieved by the Bank each calendar quarter until the capital levels required under the FDIC Order are achieved. Although all of the regulatory capital ratios exceeded the minimum capital ratios for well-capitalized levels, as well as the minimum capital ratios required by the FDIC Order, as of December 31, 2011, FirstBank cannot be treated as a well-capitalized institution under regulatory guidance while operating under the FDIC Order.

On October 7, 2011, the Corporation successfully completed a private placement of $525 million shares of common stock (the capital raise ). The proceeds from the capital raise amounted to approximately $490 million (net of offering costs), of which $435 million have been contributed to the Corporation s wholly owned banking subsidiary, FirstBank. As previously reported, lead investors include funds affiliated with Thomas H. Lee Partners, L.P. ( THL ) and Oaktree Capital Management, L.P. ( Oaktree ) that purchased from the Corporation an aggregate of $348.2 million ($174.1 million each investor) of shares of the Corporation s common stock.

In connection with the closing, the Corporation issued 150 million shares of common stock at $3.50 per share to institutional investors. Upon the completion of this transaction and the conversion into common stock of the Series G Preferred Stock held by the U.S. Treasury, as further discussed below, each of THL and Oaktree became owners of 24.36% of the Corporation s shares of common stock outstanding. Subsequent to the closing, in related transactions, on October 12, 2011 and October 26, 2011, each of THL and Oaktree, respectively, purchased in the aggregate 937,493 shares of common stock from certain of the institutional investors who participated in the capital raise transaction. As of the date of issuance of these financial statements, each of THL and Oaktree owns 24.69% of the total shares of common stock outstanding. THL and Oaktree also have the right to designate a person to serve on the Corporation s Board of Directors. In this regard, the Corporation reconstituted its Board of Directors and Michael P. Harmon, a Managing Director with the Principal Group of Oaktree, and Thomas M. Hagerty, a Managing Director at THL were appointed as directors. In addition, Messrs Harmon and Hagerty have been appointed members of the Bank s Board of Directors. In addition, Mr. Roberto R. Herencia was appointed as the new non-executive chairman of the Bank s and the Corporation s Board of Directors.

The completion of the capital raise allowed the conversion of the 424,174 shares of the Corporation s Series G Preferred Stock, held by the U.S. Treasury, into 32.9 million shares of common stock at a conversion price of $9.66. This conversion required for completion the payment of $26.4 million for past due undeclared cumulative dividends on the Series G Preferred Stock as required by the agreement with the U.S. Treasury.

Furthermore, on December 8, 2011, the Corporation completed a rights offering in which the Corporation issued an additional 888,781 shares of common stock at $3.50 per share, and received proceeds of $3.3 million.

With the $525 million capital infusion, the conversion to common stock of the Series G Preferred Stock held by the U.S. Treasury, and the issuance of an additional $3.3 million of capital in the rights offering (after deducting estimated offering expenses and the $26.4 million payment of cumulative dividends on the Series G Preferred Stock), the Corporation increased its total common equity by approximately $834 million.

Prior to the capital raise, deleveraging strategies incorporated into the Capital Plan and completed during the year ended December 31, 2011 include:

Sales of performing first lien residential mortgage loans The Bank completed sales of approximately $518 million of residential mortgage loans to another financial institution.

Sales of investment securities The Bank completed sales of approximately $632 million of U.S. Agency MBS.

Sale of commercial loan participations  The Bank sold approximately $45 million in loan participations.

Sale of adversely classified and non-performing loans  The Bank sold loans with a book value of $269.3 million to CPG/GS PR NPL, LLC ( CPG/GS ), an entity created by Goldman, Sachs & Co. and Caribbean Property Group in exchange for $88.5 million of cash, an acquisition loan of $136.1 million and a 35% subordinated interest in CPG/GS. Approximately 93% of the loans were adversely classified loans and 55% were in non-performing status.

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**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Both the Corporation and the Bank actively manage liquidity and cash flow needs. The Corporation has suspended common and preferred dividends to stockholders since August 2009. As of December 31, 2011, the holding company had $44.8 million of cash and cash equivalents. Cash and cash equivalents at the Bank level as of December 31, 2011 were approximately $440.1 million. The Bank has $100 million, $159 million and $7.4 million in repurchase agreements, FHLB advances and notes payable, respectively, maturing over the next twelve months. In addition, it had $3.7 billion in brokered CDs as of December 31, 2011, of which $2.5 billion mature over the next twelve months. Liquidity at the Bank level is highly dependent on bank deposits, which fund 75.9% of the Bank s assets (or 47.5% excluding brokered CDs). The Corporation has continued to issue brokered CDs pursuant to approvals received from the FDIC to renew or roll over brokered CDs up to certain amounts through March 31, 2012. Management cannot be certain it will continue to obtain waivers from the restrictions to issue brokered CDs under the FDIC Order to meet its obligations and execute its business plans. In addition to the increased level in cash and cash equivalents, the Bank held approximately $62.4 million of readily pledgeable or sellable investment securities as of December 31, 2011. Based on current and expected liquidity needs and sources, management expects First BanCorp to be able to meet its obligations for the foreseeable future.

Upon the completion of the capital raise, the Corporation s and the Bank s credit ratings were upgraded by Moody s Investor Service ( Moody s ) and Standard & Poor s ( S&P ), and the credit outlook was upgraded by Fitch Ratings Limited ( Fitch ). The Corporation does not have any outstanding debt or derivative agreements that would be directly affected by credit downgrades. Furthermore, given the Corporation s non-reliance on corporate debt or other instruments directly linked in terms of pricing or volume to credit ratings, the liquidity of the Corporation was not affected in any material way by the downgrades experienced during 2010 and early 2011, prior to the completion of the aforementioned capital raise. The Corporation s ability to access new non-deposit funding including unsecured debt, however, could be adversely affected by credit downgrades.

***Principles of consolidation***

The consolidated financial statements include the accounts of the Corporation and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Statutory business trusts that are wholly-owned by the Corporation and are issuers of trust preferred securities, and entities in which the Corporation has a non-controlling interest are not consolidated in the Corporation s consolidated financial statements in accordance with authoritative guidance issued by the Financial Accounting Standards Board ( FASB ) for consolidation of variable interest entities. See Variable Interest Entities section below for further detail of the Corporation s accounting policy for these entities.

***Reclassifications***

For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2011 presentation.

***Use of estimates in the preparation of financial statements***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Cash and cash equivalents***

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and short-term investments with original maturities of three months or less.

***Securities purchased under agreements to resell***

The Corporation purchases securities under agreements to resell the same securities. The counterparty retains control over the securities acquired. Accordingly, amounts advanced under these agreements represent short-term loans and are reflected as assets in the statements of

financial condition. The Corporation monitors the market value of the underlying securities as compared to the related receivable, including accrued interest, and requests additional collateral when deemed appropriate. As of December 31, 2011 and 2010, there were no securities purchased under agreements to resell outstanding.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Investment securities***

The Corporation classifies its investments in debt and equity securities into one of four categories:

*Held-to-maturity* Securities which the entity has the intent and ability to hold to maturity. These securities are carried at amortized cost. The Corporation may not sell or transfer held-to-maturity securities without calling into question its intent to hold other debt securities to maturity, unless a nonrecurring or unusual event that could not have been reasonably anticipated has occurred. During 2011, the Corporation sold $330 million of mortgage-backed securities that were originally intended to be held to maturity, consistent with deleveraging initiatives included in the Corporation s capital plan. After the sale, in line with the Corporation s ongoing capital management strategy, the remaining held-to-maturity securities portfolio was reclassified to the available-for-sale portfolio, thus, as of December 31, 2011, the Corporation did not hold investments securities held-to-maturity.

*Trading* Securities that are bought and held principally for the purpose of selling them in the near term. These securities are carried at fair value, with unrealized gains and losses reported in earnings. As of December 31, 2011 and 2010, the Corporation did not hold investment securities for trading purposes.

*Available-for-sale* Securities not classified as held to maturity or trading. These securities are carried at fair value, with unrealized holding gains and losses, net of deferred tax, reported in other comprehensive income as a separate component of stockholders equity and do not affect earnings until realized or are deemed to be other-than-temporarily impaired.

*Other equity securities* Equity securities that do not have readily available fair values are classified as other equity securities in the consolidated statements of financial condition. These securities are stated at the lower of cost or realizable value. This category is principally composed of stock that is owned by the Corporation to comply with Federal Home Loan Bank (FHLB) regulatory requirements. Their realizable value equals their cost.

Premiums and discounts on investment securities are amortized as an adjustment to interest income on investments over the life of the related securities under the interest method. Net realized gains and losses and valuation adjustments considered other-than-temporary, if any, related to investment securities are determined using the specific identification method and are reported in non-interest income as net gain (loss) on sale of investments and net impairment losses on investment securities, respectively. Purchases and sales of securities are recognized on a trade-date basis.

***Evaluation of other-than-temporary impairment ( OTTI ) on held-to-maturity and available-for-sale securities***

On a quarterly basis, the Corporation performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered OTTI. A security is considered impaired if the fair value is less than its amortized cost basis.

The Corporation evaluates if the impairment is other-than-temporary depending upon whether the portfolio consists of fixed income securities or equity securities as further described below. The Corporation employs a systematic methodology that considers all available evidence in evaluating a potential impairment of its investments.

The impairment analysis of fixed income securities places special emphasis on the analysis of the cash position of the issuer and its cash and capital generation capacity, which could increase or diminish the issuer s ability to repay its bond obligations, the length of time and the extent to which the fair value has been less than the amortized cost basis and changes in the near-term prospects of the underlying collateral, if applicable, such as changes in default rates, loss severity given default and significant changes in prepayment assumptions. The Corporation also takes into consideration the latest information available about the overall financial condition of an issuer, credit ratings, recent legislation and government actions affecting the issuer s industry and actions taken by the issuer to deal with the present economic climate. In April 2009, the FASB amended the OTTI model for debt securities. OTTI losses must be recognized in earnings if the Corporation has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Corporation does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has

occurred. An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI, if any, is recorded as a component of Net impairment losses on investment securities in the statements of (loss) income, while the remaining portion of the impairment loss is recognized in other comprehensive income, net of taxes, provided the Corporation does not intend to sell the underlying debt security and it is more likely than not that the Corporation will not have to sell the debt security prior to recovery. The previous amortized cost basis less the OTTI recognized in earnings is the new amortized cost basis of the investment. The new amortized cost

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

basis is not adjusted for subsequent recoveries in fair value. However, for debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected is accreted as interest income. For further disclosures, refer to Note 4 to the consolidated financial statements.

The impairment model for equity securities was not affected by the aforementioned FASB amendment. The impairment analysis of equity securities is performed and reviewed on an ongoing basis based on the latest financial information and any supporting research report made by a major brokerage firm. This analysis is very subjective and based, among other things, on relevant financial data such as capitalization, cash flow, liquidity, systematic risk, and debt outstanding of the issuer. Management also considers the issuer s industry trends, the historical performance of the stock, credit ratings as well as the Corporation s intent to hold the security for an extended period. If management believes there is a low probability of recovering book value in a reasonable time frame, then an impairment will be recorded by writing the security down to market value. As previously mentioned, equity securities are monitored on an ongoing basis but special attention is given to those securities that have experienced a decline in fair value for six months or more. An impairment charge is generally recognized when the fair value of an equity security has remained significantly below cost for a period of twelve consecutive months or more.

***Variable interest entities ( VIE )***

A VIE is an entity in which the Corporation holds an equity interest. The entity that has a controlling financial interest in a VIE is referred to as the primary beneficiary and consolidates the VIE. The Corporation is deemed to have a controlling financial interest and is the primary beneficiary of a VIE if it has both the power to direct the activities of the VIE that most significantly impact the VIE s economic performance and an obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE.

When evaluating transfers and other transactions with VIE for consolidation under the adopted guidance, the Corporation first determines if the counterparty is an entity for which a variable interest exists. If no scope exception is applicable and a variable interest exists, the Corporation then evaluates if it is the primary beneficiary of the VIE and whether the entity should be consolidated or not.

In connection with the sale of loans with a book value of $269.3 million to CPG/GS completed on February 16, 2011, the Bank received a 35% subordinated interest in CPG/GS, as further discussed in Note 13. The Corporation does not present full or summarized financial statements of this equity investee given that the Corporation s investment in this unconsolidated entity is not considered significant under Rule 4-08(g) of Regulation S-X and Rule 3-09 of Regulation S-X. Both of these SEC rules look to Rule 1-02(w) of Regulation S-X to determine the materiality of the investee. The materiality threshold for Rule 4-08(g) is 10%, for the presentation of summarized financial statements, whereas the materiality threshold for Rule 3-09 is 20%, for the presentation of full financial statements. The Corporation would have to provide summarized or full financial information for unconsolidated subsidiaries and 50%-or-less owned entities accounted for by the equity method if the entities are significant under any of the Regulation S-X, Rule 1-02(w) tests (investment, asset, and income tests).

The Corporation accounted for investments in unconsolidated entities under the equity method and are included as part of Investment in unconsolidated entities in the Consolidated Statements of Financial Condition. When applying the equity method, the Corporation follows the Hypothetical Liquidation Book Value method ( HLBV ) to determine its share in earnings or losses of the unconsolidated entity. Under HLBV, the Corporation determines its share in earnings or losses by determining the difference between its claim on the entity s book value at the end of the period as compared to the beginning of the period. This claim is calculated as the amount the Corporation would receive if the entity were to liquidate all of its assets at recorded amounts determined in accordance with GAAP and distribute the resulting cash to the investors.

***Loans held for investment***

Loans are stated at the principal outstanding balance, net of unearned interest, unamortized deferred origination fees and costs and unamortized premiums and discounts. Fees collected and costs incurred in the origination of new loans are deferred and amortized using the interest method or a method which approximates the interest method over the term of the loan as an adjustment to interest yield. Unearned interest on certain personal, auto loans and finance leases is recognized as income under a method which approximates the interest method. When a loan is paid off or sold, any unamortized net deferred fee (cost) is credited (charged) to income.

Classes are usually disaggregations of a portfolio. For allowance for loan and lease losses purposes, the Corporation s portfolios are: Commercial Mortgage, Construction, Commercial and Industrial, Residential Mortgages, and Consumer loans. The classes

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

within the Residential Mortgage are residential mortgages guaranteed by government organization and other loans. The classes within the Consumer portfolio are: auto, finance leases and other consumer loans. Other consumer loans mainly include unsecured personal loans, home equity lines, lines of credits, and marine financing. The Construction, Commercial Mortgage and Commercial and Industrial are not further segmented into classes.

*Non-Performing and Past Due Loans* **-** Loans on which the recognition of interest income has been discontinued are designated as non-performing. Loans are classified as non-performing when interest and principal have not been received for a period of 90 days or more, with the exception of FHA/VA and other guaranteed residential mortgages which continue to accrue interest. The Corporation continues to accrue interest on government guaranteed loans since principal and interest are guaranteed by the U.S. government, therefore, the risk of loss on these types of loans is very low. Any loan in any portfolio may be placed on non-performing status prior to the policies describe above when there are doubts about the potential to collect all of the principal based on collateral deficiencies or, in other situations, when collection of all of the principal or interest is not expected under the contractual terms due to deterioration in the financial condition of the borrower. For all classes within the loan portfolios, when a loan is placed on non-performing status, any accrued but uncollected interest income is reversed and charged against interest income. Interest income on non-performing loans is recognized only to the extent it is received in cash. However, where there is doubt regarding the ultimate collectability of loan principal, all cash thereafter received is applied to reduce the carrying value of such loans (i.e., the cost recovery method). Loans are restored to accrual status only when future payments of interest and principal are reasonably assured.

*Impaired Loans* **-** A loan in any class is considered impaired when, based upon current information and events, it is probable that the Corporation will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the loan agreement. The Corporation measures impairment individually for those loans in the Construction, Commercial Mortgage and Commercial and Industrial portfolios with a principal balance of $1 million or more, including loans for which a charge-off has been recorded based upon the fair value of the underlying collateral. The Corporation also evaluates for impairment purposes certain residential mortgage loans and home equity lines of credit with high delinquency and loan-to-value levels. Generally, consumer loans within any class are not individually evaluated on a regular basis for impairment except for impaired marine financing loans over $1 million and home equity lines with high delinquency and loan-to-value levels.

Impaired loans also include loans that have been modified in troubled debt restructurings ( TDRs ). A restructuring of a loan constitutes a TDR if the creditor for economic or legal reasons related to the debtor s financial difficulties, grants a concession to the debtor that it would not otherwise consider. TDRs typically result from the Corporation s loss mitigation activities and in accordance with guidelines of the government s Home Affordable Mortgage Program, and could include rate reductions, principal forgiveness, forbearance, refinancing of any past due amounts, including interest, escrow and late charges and fees, extensions of maturities and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower s ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Refer to Note 8 for additional qualitative and quantitative information about TDRs.

The Corporation removes loans from TDR classification, consistent with authoritative guidance that allows for a TDR to be removed from this classification in years following the modification only when the following two circumstances are met:

(i) The loan is in compliance with the terms of the restructuring agreement and, therefore, is not considered impaired; and

(ii) The loan yields a market interest rate at the time of the restructuring. In other words, the loan was restructured with an interest rate equal to or greater than what the Corporation would have been willing to accept at the time of the restructuring for a new loan with comparable risk.

If both of the conditions are met, the loan can be removed from the TDR classification in calendar years after the year in which the restructuring took place. A sustained performance period, generally six months, is required prior to removal from TDR classification.

With respect to loan splits, generally, Note A of a loan split is restructured under market terms, and Note B is fully charged-off. If Note A is in compliance with the restructured terms in years following the restructuring, Note A will be removed from the TDR classification.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Interest income on impaired loans in any class is recognized based on the Corporation s policy for recognizing interest on accrual and non-accrual loans.

Loans that are past due 30 days or more as to principal or interest are considered delinquent, with the exception of the residential mortgage, commercial mortgage and construction portfolios that are considered past due when the borrower is in arrears 2 or more monthly payments.

*Charge-off of Uncollectible Loans* - Loan and lease losses are charged-off and recoveries are credited to the allowance for loan and lease losses. Collateral dependent loans in the Construction, Commercial Mortgage and Commercial and Industrial loan portfolios are charged-off to their fair value when loans are considered impaired. Within the consumer loan portfolio, loans in the auto and finance leases classes are reserved at 120 days delinquent and charged-off to their estimated net realizable value when collateral deficiency is deemed uncollectible (i.e. when foreclosure is probable). Within the other consumer loans class, closed-end loans are charged-off when payments are 120 days in arrears and open-end (revolving credit) consumer loans are charged-off when payments are 180 days in arrears. Residential mortgage loans individually evaluated for impairment purposes based on its delinquency and original loan to value levels are charged-off to its fair value when there is a collateral deficiency on a quarterly basis. Any loan in any portfolio may be charged-off or written down to the fair value of the collateral prior to the policies described above if a loss confirming event occurred. Loss confirming events include, but are not limited to, bankruptcy (unsecured), continued delinquency, or receipt of an asset valuation indicating a collateral deficiency and that asset is the sole source of repayment.

***Loans held for sale***

Loans held for sale are stated at the lower-of-cost-or-market. The amount by which cost exceeds market value in the aggregate portfolio of loans held for sale, if any, is accounted for as a valuation allowance with changes therein included in the determination of net income.

***Allowance for loan and lease losses***

The Corporation maintains the allowance for loan and lease losses at a level considered adequate to absorb losses currently inherent in the loan and lease portfolio. The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable losses believed to be inherent in the loan portfolio that have not been specifically identified. The determination of the allowance for loan and lease losses requires significant estimates, including the timing and amounts of expected future cash flows on impaired loans, consideration of current economic conditions, and historical loss experience pertaining to the portfolios and pools of homogeneous loans, all of which may be susceptible to change.

The adequacy of the allowance for loan and lease losses is based on judgments related to the credit quality of the loan portfolio. These judgments consider on-going evaluations of the loan portfolio, including such factors as the economic risks associated to each loan class, the financial condition of specific borrowers, the level of delinquent loans, the value of any collateral and, where applicable, the existence of any guarantees or other documented support. In addition, to the general economic conditions and other factors described above, additional factors also considered include: the impact of changes in the residential real estate value and the internal risk ratings assigned to the loan. Internal risk ratings are assigned to each business loan at the time of approval and are subject to subsequent periodic reviews by the Corporation s senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation s continued evaluation of its asset quality.

The allowance for loan and lease losses is increased through a provision for credit losses that is charged to earnings, based on the quarterly evaluation of the factors previously mentioned, and is reduced by charge-offs, net of recoveries.

The allowance for loan and lease losses consists of specific reserves related to specific valuations for loans considered to be impaired and general reserves. A specific valuation allowance is established for those loans in the Commercial Mortgage, Construction and Commercial and Industrial and Residential Mortgage loan portfolios classified as impaired, primarily when the collateral value of the loan (if the impaired loan is determined to be collateral dependent) or the present value of the expected future cash flows discounted at the loan s effective rate is lower than the carrying amount of that loan. The specific valuation allowance is computed on commercial mortgage, construction, commercial and industrial, and real estate loans with individual principal balances of $1 million or more, TDRs which are individually evaluated, as well as smaller residential mortgage loans and home equity lines of credit considered impaired based on their delinquency and loan-to-value levels.

When foreclosure is probable, the impairment measure is based on the fair value of the collateral. The fair value of the collateral is generally obtained from appraisals. Updated appraisals are obtained when the Corporation determines that loans are impaired and are generally updated annually thereafter. In addition, appraisals and/or broker price opinions are also obtained for residential mortgage loans based on specific characteristics such

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

as delinquency levels, age of the appraisal, and loan-to-value ratios. The excess of the recorded investment in collateral dependent loans over the resulting fair value of the collateral is charged-off when deemed uncollectible. For residential mortgage loans the determination of reserves included the incorporation of updated loss factors applicable to loans expected to liquidate over the next twelve months considering the expected realization of similar asset values at disposition.

For all other loans, which include, small, homogeneous loans, such as auto loans, all classes in the Consumer loans portfolio, residential mortgages in amounts under $1 million, and commercial and construction loans not considered impaired, the Corporation maintains a general valuation allowance. The risk category of these loans is based on the delinquency and the Corporation updates the factors used to compute the reserve factors on a quarterly basis. The general reserve is primarily determined by applying loss factors according to the loan type and assigned risk category (pass, special mention and substandard not impaired; all doubtful loans are considered impaired). The general reserve for consumer loans is based on factors such as delinquency trends, credit bureau score bands, portfolio type, geographical location, bankruptcy trends, recent market transactions, collateral values, and other environmental factors such as economic forecasts. The analyses of the residential mortgage pools are performed at the individual loan level and then aggregated to determine the expected loss ratio. The model applies risk-adjusted prepayment curves, default curves, and severity curves to each loan in the pool. The severity is affected by the expected house price scenario based on recent house price trends. Default curves are used in the model to determine expected delinquency levels. The risk-adjusted timing of liquidation and associated costs is used in the model and is risk-adjusted for the area in which the property is located (Puerto Rico, Florida, or Virgin Islands). For commercial loans, including construction loans, the general reserve is based on historical loss ratios. Loss ratios are based on the moving average of charge-offs over a historical 24-month loss period, applying adjustments, as necessary to each loss rate based on assessments of recent charge-off trends (12 months), collateral values, and economic and business influences impacting expected losses. The methodology of accounting for all probable losses in loans not individually measured for impairment purposes is made in accordance with authoritative accounting guidance that requires that losses be accrued when they are probable of occurring and estimable.

***Transfers and servicing of financial assets and extinguishment of liabilities***

After a transfer of financial assets that qualifies for sale accounting, the Corporation derecognizes the financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

The transfer of financial assets in which the Corporation surrenders control over the assets is accounted for as a sale to the extent that consideration other than beneficial interests is received in exchange. The criteria that must be met to determine that the control over transferred assets has been surrendered include: (1) the assets must be isolated from creditors of the transferor, (2) the transferee must obtain the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the transferor cannot maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. When the Corporation transfers financial assets and the transfer fails any one of the above criteria, the Corporation is prevented from derecognizing the transferred financial assets and the transaction is accounted for as a secured borrowing.

***Servicing Assets***

The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased. The Corporation is actively involved in the securitization of pools of FHA-insured and VA-guaranteed mortgages for the issuance of GNMA mortgage-backed securities. Also, certain conventional conforming-loans are sold to FNMA or FHLMC with servicing retained. When the Corporation securitizes or sells mortgage loans, it recognizes any retained interest, based on its fair value.

Servicing assets ( MSRs ) retained in a sale or securitization arise from contractual agreements between the Corporation and investors in mortgage securities and mortgage loans. The value of MSRs is derived from the net positive cash flows associated with the servicing contracts. Under these contracts, the Corporation performs loan servicing functions in exchange for fees and other remuneration. The servicing functions typically include: collecting and remitting loan payments, responding to borrower inquiries, accounting for principal and interest, holding custodial funds for payment of property taxes and insurance premiums, supervising foreclosures and property dispositions, and generally administering the loans. The servicing rights entitle the Corporation to annual servicing fees based on the outstanding principal balance of the mortgage loans and the contractual servicing rate. The servicing fees are credited to income on a monthly basis when collected and recorded as part of mortgage banking activities in the consolidated statements of (loss) income. In addition, the Corporation generally receives other

remuneration consisting of mortgagor-contracted fees such as late charges and prepayment penalties, which are credited to income when collected.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Considerable judgment is required to determine the fair value of the Corporation s servicing assets. Unlike highly liquid investments, the market value of servicing assets cannot be readily determined because these assets are not actively traded in securities markets. The initial carrying value of the servicing assets is generally determined based on its fair value. The fair value of the MSRs is determined based on a combination of market information on trading activity (MSR trades and broker valuations), benchmarking of servicing assets (valuation surveys) and cash flow modeling. The valuation of the Corporation s MSRs incorporates two sets of assumptions: (1) market derived assumptions for discount rates, servicing costs, escrow earnings rates, floating earnings rates and the cost of funds and (2) market assumptions calibrated to the Company s loan characteristics and portfolio behavior for escrow balances, delinquencies and foreclosures, late fees, prepayments and prepayment penalties.

Once recorded, MSRs are periodically evaluated for impairment. Impairment occurs when the current fair value of the MSRs is less than its carrying value. If MSRs are impaired, the impairment is recognized in current-period earnings and the carrying value of the MSRs is adjusted through a valuation allowance. If the value of the MSRs subsequently increases, the recovery in value is recognized in current period earnings and the carrying value of the MSRs is adjusted through a reduction in the valuation allowance. For purposes of performing the MSR impairment evaluation, the servicing portfolio is stratified on the basis of certain risk characteristics such as region, terms and coupons. An other-than-temporary impairment analysis is prepared to evaluate whether a loss in the value of the MSRs, if any, is other than temporary or not. When the recovery of the value is unlikely in the foreseeable future, a write-down of the MSRs in the stratum to its estimated recoverable value is charged to the valuation allowance.

The servicing assets are amortized over the estimated life of the underlying loans based on an income forecast method as a reduction of servicing income. The income forecast method of amortization is based on projected cash flows. A particular periodic amortization is calculated by applying to the carrying amount of the MSRs the ratio of the cash flows projected for the current period to total remaining net MSR forecasted cash flow.

***Premises and equipment***

Premises and equipment are carried at cost, net of accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful life of each type of asset. Amortization of leasehold improvements is computed over the terms of the leases (contractual term plus lease renewals that are reasonably assured ) or the estimated useful lives of the improvements, whichever is shorter. Costs of maintenance and repairs that do not improve or extend the life of the respective assets are expensed as incurred. Costs of renewals and betterments are capitalized. When assets are sold or disposed of, their cost and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in earnings.

The Corporation has operating lease agreements primarily associated with the rental of premises to support the branch network or for general office space. Certain of these arrangements are non-cancelable and provide for rent escalation and renewal options. Rent expense on non-cancelable operating leases with scheduled rent increases is recognized on a straight-line basis over the lease term.

***Other real estate owned (OREO)***

Other real estate owned, which consists of real estate acquired in settlement of loans, is recorded at the lower of cost (carrying value of the loan) or fair value minus estimated cost to sell the real estate acquired. Subsequent to foreclosure, gains or losses resulting from the sale of these properties and losses recognized on the periodic reevaluations of these properties are credited or charged to income. The cost of maintaining and operating these properties is expensed as incurred.

***Goodwill and other intangible assets***

Business combinations are accounted for using the purchase method of accounting. Assets acquired and liabilities assumed are recorded at estimated fair value as of the date of acquisition. After initial recognition, any resulting intangible assets are accounted for as follows:

Goodwill

The Corporation evaluates goodwill for impairment on an annual basis, generally during the fourth quarter, or more often if events or circumstances indicate there may be impairment. The Corporation evaluated goodwill for impairment as of October 1, 2011. Goodwill impairment testing is performed at the segment (or reporting unit ) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill. The Corporation s goodwill is mainly related to the acquisition of FirstBank Florida in 2005.

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The goodwill impairment analysis is a two-step process. The first step ( Step 1 ) involves a comparison of the estimated fair value of the reporting unit to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is not considered impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of the impairment.

The second step ( Step 2 ) involves calculating an implied fair value of the goodwill for each reporting unit for which the first step indicated a potential impairment. The implied fair value of goodwill is determined in a manner similar to the calculation of the amount of goodwill in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

In determining the fair value of a reporting unit, which is based on the nature of the business and reporting unit s current and expected financial performance, the Corporation uses a combination of methods, including market price multiples of comparable companies, as well as a discounted cash flow analysis ( DCF ). The Corporation evaluates the results obtained under each valuation methodology to identify and understand the key value drivers in order to ascertain that the results obtained are reasonable and appropriate under the circumstances.

The computations require management to make estimates and assumptions. Critical assumptions that are used as part of these evaluations include:

- a selection of comparable publicly traded companies, based on the nature of the business, location and size;
- the discount rate applied to future earnings, based on an estimate of the cost of equity;
- the potential future earnings of the reporting unit; and
- the market growth and new business assumptions.

For purposes of the market comparable approach, valuation was determined by calculating price to tangible equity multiples of the comparable companies and applying these multiples to the reporting unit to derive an implied value of equity.

For purposes of the DCF analysis approach, the valuation is based on estimated future cash flows. The financial projections used in the DCF analysis for the reporting unit are based on the most recent available data. The growth assumptions included in these projections are based on management s expectations of the reporting unit s financial prospects as well as particular plans for the entity (i.e. restructuring plans). The cost of equity was estimated using the capital asset pricing model (CAPM) using comparable companies, an equity risk premium, the rate of return of a riskless asset, a size premium based on the size of the reporting unit and a specific company risk premium. The discount rate was estimated to be 16.5 percent. The resulting discount rate was analyzed in terms of reasonability given current market conditions.

The Step 1 evaluation of goodwill allocated to the Florida reporting unit, which is one level below the United States business segment, indicated potential impairment of goodwill. The Step 1 fair value for the unit under both valuation approaches (market and DCF) was below the carrying amount of its equity book value as of the valuation date (October 1), requiring the completion of Step 2. In accordance with accounting standards, the Corporation performed a valuation of all assets and liabilities of the Florida unit, including any recognized and unrecognized intangible assets, to determine the fair value of net assets. To complete Step 2, the Corporation subtracted from the unit s Step 1 fair value the

determined fair value of the net assets to arrive at the implied fair value of goodwill. The results of the Step 2 analysis indicated that the implied fair value of goodwill of $40.4 million exceeded the goodwill carrying value of $27 million, resulting in no goodwill impairment. The analysis of results for Step 2 indicated that the fair value of the reporting unit was mainly driven by the deteriorated fair value of the loan portfolios and not the fair value of the reporting unit as going concern. The discount in the loan portfolios is mainly attributable to market participants expected rates of returns, which affected the market discount on the Florida commercial mortgage and residential mortgage portfolios. The fair value of the loan portfolio determined for the Florida reporting unit represented a discount of $101 million.

The fair value in the Florida unit Step 1 was offset by a reduction in the fair value of its net assets, resulting in an implied fair value of goodwill that exceeded the recorded book value of goodwill. If the Step 1 fair value of the Florida unit declines further without a

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

corresponding decrease in the fair value of its net assets or if loan discounts improve without a corresponding increase in the Step 1 fair value, the Corporation may be required to record a goodwill impairment charge. The Corporation engaged a third-party valuator to assist management in the annual evaluation of the Florida unit goodwill (including Step 1 and Step 2), including the valuation of loan portfolios as of the October 1 valuation date. In reaching its conclusion on impairment, management analyzed with the valuator the methodologies, assumptions and results supporting the relevant values for the goodwill and determined that they were reasonable.

The goodwill impairment evaluation process requires the Corporation to make estimates and assumptions with regards to the fair value of the reporting units. Actual values may differ significantly from these estimates. Such differences could result in future impairment of goodwill that would, in turn, negatively impact the Corporation s results of operations and the profitability of the reporting unit where goodwill is recorded.

Goodwill was not impaired as of December 31, 2011 or 2010, nor was any goodwill written-off due to impairment during 2011, 2010 and 2009.

Other Intangibles

Definite life intangibles, mainly core deposits, are amortized over their estimated lives, generally on a straight-line basis, and are reviewed periodically for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

The Corporation performed impairment tests for the year ended December 31, 2011 and determined that no impairment was needed to be recognized for other intangible assets. As a result of an impairment evaluation of core deposit intangibles, there was an impairment charge of $4.0 million recorded in 2009 related to core deposits of FirstBank Florida attributable to decreases in the base of acquired core deposits, no impairment charge was required for 2010. For further disclosures, refer to Note 12 to the consolidated financial statements.

***Securities sold under agreements to repurchase***

The Corporation sells securities under agreements to repurchase the same or similar securities. Generally, similar securities are securities from the same issuer, with identical form and type, similar maturity, identical contractual interest rates, similar assets as collateral and the same aggregate unpaid principal amount. The Corporation retains control over the securities sold under these agreements. Accordingly, these agreements are considered financing transactions and the securities underlying the agreements remain in the asset accounts. The counterparty to certain agreements may have the right to repledge the collateral by contract or custom. Such assets are presented separately in the statements of financial condition as securities pledged to creditors that can be repledged.

From time to time, the Corporation modifies repurchase agreements to take advantage of decreasing interest rates. Following applicable GAAP guidance, the Corporation determines if the debt under the modified terms is substantially different from the original terms, then the modification must be accounted for as an extinguishment of debt. Modified terms are considered substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. The new debt instrument shall be initially recorded at fair value, and that amount shall be used to determine the debt extinguishment gain or loss to be recognized through the statement of income (loss) and the effective rate of the new instrument. If the Corporation determines that the debt under the modified terms is not substantially different, then the new effective interest rate shall be determined based on the carrying amount of the original debt instrument. All of the $700 million repurchase agreements that were modified during 2011 were not considered to be substantially different from the original terms, and therefore, were not accounted for as extinguishment of debt.

***Income taxes***

The Corporation uses the asset and liability method for the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Corporation s financial statements or tax returns. Deferred income tax assets and liabilities are determined for differences between financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. The computation is based on enacted tax laws and rates applicable to periods in which the temporary differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. In making such assessment, significant weight is given to evidence that can be objectively verified, including

both positive and negative evidence. The authoritative guidance for accounting for income taxes requires the consideration of all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards,

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

taxable income in carryback years and tax planning strategies. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance, and recognizes tax benefits only when deemed probable. Refer to Note 26 to the consolidated financial statements for additional information.

Under the authoritative accounting guidance, income tax benefits are recognized and measured upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this model and the tax benefit claimed on a tax return is referred to as an Unrecognized Tax Benefit ( UTB ). The Corporation classifies interest and penalties, if any, related to UTBs as components of income tax expense. Refer to Note 26 for required disclosures and further information.

***Treasury stock***

The Corporation accounts for treasury stock at par value. Under this method, the treasury stock account is increased by the par value of each share of common stock reacquired. Any excess paid per share over the par value is debited to additional paid-in capital for the amount per share that was originally credited. Any remaining excess is charged to retained earnings.

***Stock-based compensation***

Compensation cost is recognized in the financial statements for all share-based payments grants. Between 1997 and 2007, the Corporation had a stock option plan ( the 1997 stock option plan ) covering eligible employees. On January 21, 2007, the 1997 stock option plan expired; all outstanding awards grants under this plan continue to be in full force and effect, subject to their original terms. No awards for shares could be granted under the 1997 stock option plan as of its expiration.

On April 29, 2008, the Corporation s stockholders approved the First BanCorp 2008 Omnibus Incentive Plan (the Omnibus Plan ). The Omnibus Plan provides for equity-based compensation incentives (the awards ) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. On December 1, 2008, the Corporation granted 2,412 shares of restricted stock under the Omnibus Plan to the Corporation s independent directors, of which 268 were forfeited in 2009 and 270 were forfeited in 2011. Shares of restricted stock are measured based on the fair market values of the underlying stock at the grant dates. As of December 31, 2011, all shares of restricted stock have vested.

Stock-based compensation accounting guidance requires the Corporation to develop an estimate of the number of share-based awards that will be forfeited due to employee or director turnover. Changes in the estimated forfeiture rate may have a significant effect on share-based compensation, as the effect of adjusting the rate for all expense amortization is recognized in the period in which the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, then an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase to the expense recognized in the financial statements. When unvested options or shares of restricted stock are forfeited, any compensation expense previously recognized on the forfeited awards is reversed in the period of the forfeiture. For additional information regarding the Corporation s equity-based compensation refer to Note 21.

***Comprehensive income***

Comprehensive income for First BanCorp includes net income and the unrealized gain (loss) on available-for-sale securities, net of estimated tax effect.

***Segment Information***

The Corporation reports financial and descriptive information about its reportable segments (see Note 32). Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by management in deciding how to allocate resources and in assessing performance. The Corporation s management determined that the segregation that best fulfills the segment definition described above is by lines of business for its operations in Puerto Rico, the Corporation s principal market, and by geographic areas for its operations outside of Puerto Rico. As of December 31, 2011, the Corporation had six reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments; United States Operations and Virgin Islands Operations. Refer to Note 32 for additional information.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Derivative financial instruments***

As part of the Corporation s overall interest rate risk management, the Corporation utilizes derivative instruments, including interest rate swaps, interest rate caps and options and forward contracts to manage interest rate risk. All derivative instruments are measured and recognized on the consolidated statements of financial condition at their fair value. On the date the derivative instrument contract is entered into, the Corporation may designate the derivative as (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ( fair value hedge), (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ( cash flow hedge) or (3) as a standalone derivative instrument, including economic hedges that the Corporation has not formally documented as a fair value or cash flow hedge. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a fair-value hedge, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk (including gains or losses on firm commitments), are recorded in current-period earnings as interest income or interest expense depending upon whether an asset or liability is being hedged. Similarly, the changes in the fair value of standalone derivative instruments or derivatives not qualifying or designated for hedge accounting are reported in current-period earnings as interest income or interest expense depending upon whether an asset or liability is being economically hedged. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a cash-flow hedge, if any, are recorded in other comprehensive income in the stockholders equity section of the consolidated statements of financial condition until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings). As of December 31, 2011 and 2010, all derivatives held by the Corporation were considered economic undesignated hedges recorded at fair value with the resulting gain or loss recognized in current period earnings.

Prior to entering into an accounting hedge transaction or designating a hedge, the Corporation formally documents the relationship between the hedging instrument and the hedged item, as well as the risk management objective and strategy for undertaking the hedge transaction. This process includes linking all derivative instruments that are designated as fair value or cash flow hedges, if any, to specific assets and liabilities on the statements of financial condition or to specific firm commitments or forecasted transactions along with a formal assessment at both inception of the hedge and on an ongoing basis as to the effectiveness of the derivative instrument in offsetting changes in fair values or cash flows of the hedged item. The Corporation discontinues hedge accounting prospectively when management determines that the derivative is not effective or will no longer be effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative expires, is sold, or terminated, or management determines that designation of the derivative as a hedging instrument is no longer appropriate. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability as a yield adjustment.

The Corporation occasionally purchases or originates financial instruments that contain embedded derivatives. At inception of the financial instrument, the Corporation assesses: (1) if the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the financial instrument (host contract), (2) if the financial instrument that embodies both the embedded derivative and the host contract is measured at fair value with changes in fair value reported in earnings, or (3) if a separate instrument with the same terms as the embedded instrument would not meet the definition of a derivative. If the embedded derivative does not meet any of these conditions, it is separated from the host contract and carried at fair value with changes recorded in current period earnings as part of net interest income. Information regarding derivative instruments is included in Note 31 to the Corporation s consolidated financial statements.

***Valuation of financial instruments***

The measurement of fair value is fundamental to the Corporation s presentation of its financial condition and results of operations. The Corporation holds fixed income and equity securities, derivatives, investments and other financial instruments at fair value. The Corporation holds its investments and liabilities on the statement of financial condition mainly to manage liquidity needs and interest rate risks. A significant part of these assets and liabilities is reflected at fair value on the Corporation s financial statements.

The FASB authoritative guidance for fair value measurements defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs may be used to measure fair value:

**Level 1** Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Level 2** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**Level 3** Valuations are observed from unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following is a description of the valuation methodologies used for instruments measured at fair value:

*Medium-Term Notes (Level 2 inputs)*

The fair value of the medium-term note is computed using a discounted cash flow analysis over the full term of the borrowings computed using the notional amount outstanding. The discount rate used in the valuation considers the 3-month LIBOR forward curve and the credit spread at every cash flow.

*Investment Securities*

The fair value of investment securities is the market value based on quoted market prices (as is the case with equity securities, U.S. Treasury Notes and non-callable U.S. Agency debt securities), when available, or market prices for identical or comparable assets (as is the case with MBS and callable U.S. agency debt) that are based on observable market parameters including benchmark yields, reported trades, quotes from brokers or dealers, issuer spreads, bids, offers and reference data, including market research operations. Observable prices in the market already consider the risk of nonperformance. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument (Level 3), as is the case with certain private label MBS held by the Corporation. Unlike U.S. agency MBS, the fair value of these private label securities cannot be readily determined because they are not actively traded in securities markets. Significant inputs used for fair value determination consist of specific characteristics such as information used in the prepayment model, which follows the amortizing schedule of the underlying loans, which is an unobservable input.

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States; the interest rate on the securities is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread bias on a non-rated security. The market valuation is derived from a model that utilizes relevant assumptions such as prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (i.e. loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, others) in combination with prepayment forecasts obtained from a commercially available prepayment model (ADCO). The variable cash flow of the security is modeled using the 3-month LIBOR forward curve. Loss assumptions were driven by the combination of default and loss severity estimates, taking into account loan credit characteristics (loan-to-value, state, origination date, property type, occupancy loan purpose, documentation type, debt-to-income ratio, other) to provide an estimate of default and loss severity. Refer to Note 4 for additional information about assumptions used in the valuation of private label MBS.

*Derivative Instruments*

The fair value of most of the derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparties when appropriate, except when collateral is pledged. That is, on interest rate swaps, the credit risk of both counterparties is included in the valuation; and on options and caps, only the seller s credit risk is considered. The derivative instruments, namely swaps and caps, were valued using a discounting cash flows approach using US LIBOR and swap rate for each cash flow. Derivatives include interest rate swaps used for protection against rising interest rates and, prior to June 30, 2009, included interest rate swaps to economically hedge brokered CDs and medium-term notes. For these interest rate swaps, a credit component is not considered in the valuation since the Corporation has fully collateralized with investment securities any mark-to-market loss with the counterparty and, if there were market gains, the counterparty had to deliver collateral to the Corporation.

Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full.

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Certain derivatives with limited market activity, as is the case with derivative instruments named as reference caps, were valued using models that consider unobservable market parameters (Level 3). Reference caps were used mainly to hedge interest rate risk inherent in private label MBS, thus were tied to the notional amount of the underlying fixed-rate mortgage loans originated in the United States. The counterparty to these derivative instruments failed on April 30, 2010. The Corporation currently has a claim with the FDIC and the exposure to fair value of $3.0 million was recorded as an accounts receivable. The Corporation no longer accounts for these reference caps as derivative instruments. In the past, significant inputs used for fair value determination consisted of specific characteristics such as information used in the prepayment model which follow the amortizing schedule of the underlying loans, which was an unobservable input. The valuation model used the Black formula, which is a benchmark standard in the financial industry. The Black formula is similar to the Black-Scholes formula for valuing stock options except that the spot price of the underlying is replaced by the forward price. The Black formula uses as inputs the strike price of the cap, forward LIBOR rates, volatility estimates and discount rates to estimate the option value. LIBOR rates and swap rates are obtained from Bloomberg L.P. ( Bloomberg ) every day and are used to build a zero coupon curve based on the Bloomberg LIBOR/Swap curve. The discount factor is then calculated from the zero coupon curve. The cap is the sum of all caplets. For each caplet, the rate is reset at the beginning of each reporting period and payments are made at the end of each period. The cash flow of the caplet is then discounted from each payment date.

***Income recognition Insurance agencies business***

Commission revenue is recognized as of the effective date of the insurance policy or the date the customer is billed, whichever is later. The Corporation also receives contingent commissions from insurance companies as additional incentive for achieving specified premium volume goals and/or the loss experience of the insurance placed by the Corporation. Contingent commissions from insurance companies are recognized when determinable, which is generally when such commissions are received or when the Corporation receives data from the insurance companies that allows the reasonable estimation of these amounts. The Corporation maintains an allowance to cover commissions that management estimates will be returned upon the cancellation of a policy.

***Advertising costs***

Advertising costs for all reporting periods are expensed as incurred.

***Earnings per common share***

Earnings per share-basic is calculated by dividing net income (loss) attributable to common stockholders by the weighted average number of outstanding common shares. Net income (loss) attributable to common stockholders represents net income (loss) adjusted for preferred stock dividends including dividends declared, and cumulative dividends related to the current dividend period that have not been declared as of the end of the period, and the accretion of discounts on preferred stock issuances. For 2011, the net income (loss) attributable to common stockholders also includes the one-time effect of the issuance of common stock in the conversion of the Series G preferred stock, and in 2010 the one-time effect of the issuance of common stock in exchange for shares of the Series A through E preferred stock and the issuance of the Series G Preferred Stock for the Series F preferred stock. These transactions are further discussed in Note 22. The computation of earnings per share-diluted is similar to the computation of earnings per share-basic except that the number of weighted average common shares is increased to include the number of additional common shares that would have been outstanding if the dilutive common shares had been issued.

Potential common shares consist of common stock issuable under the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect in earnings per share.

The dilutive effect of convertible securities is reflected in the computation of diluted earnings per share using the if-converted method. The Series G Preferred Stock converted in the fourth quarter of 2011 was included in the denominator for the period prior to actual conversion and common shares issued upon conversion were included in the weighted average shares outstanding for the period from their date of issuance

through period end. For 2010, the amount of potential common shares was obtained based on the most advantageous conversion rate from the standpoint of the security holder and assumed the Corporation would not be able to compel conversion until the seven-year anniversary, at which date the conversion price would have been based on the Corporation s stock price in the open market and conversion would be based on the full liquidation value of $1,000 per share.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Recently issued accounting pronouncements***

The FASB has issued the following accounting pronouncements and guidance relevant to the Corporation s operations:

In December 2010, the FASB updated the Accounting Standards Codification ( Codification ) to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. As a result, GAAP improved by eliminating an entity s ability to assert that a reporting unit is not required to perform Step 2 because the carrying amount of the reporting unit is zero or negative despite the existence of qualitative factors that indicate the goodwill is more likely than not impaired. As a result, goodwill impairments may be reported sooner than under current practice. The objective of this Update is to address questions about entities with reporting units with zero or negative carrying amounts because some entities concluded that Step 1 of the test is passed in those circumstances because the fair value of their reporting unit will generally be greater than zero. As a result of that conclusion, some constituents raised concerns that Step 2 of the test is not performed despite factors indicating that goodwill may be impaired. The amendments in this Update do not provide guidance on how to determine the carrying amount or measure the fair value of the reporting unit. For public entities, the amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The adoption of this guidance did not have an impact on the Corporation s financial statements.

In December 2010, the FASB updated the Codification to clarify required disclosures of supplementary pro forma information for business combinations. The amendments specify that, if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the year had occurred as of the beginning of the comparable prior annual period only. Additionally, the Update expands disclosures to include a description of the nature and amount of material nonrecurring pro forma adjustments directly attributable to the business combination included in the pro forma revenue and earnings. This guidance is effective for reporting periods beginning after December 15, 2010; early adoption is permitted. The Corporation adopted this guidance with no impact on the financial statements.

In April 2011, the FASB updated the Codification to clarify the guidance on a creditor s evaluation of whether a restructuring constitutes a troubled debt restructuring ( TDR ). Under the amendments, a creditor must separately conclude that a loan modification constitutes a concession and that the debtor is experiencing financial difficulties when evaluating whether a loan modification constitutes a TDR. If a creditor determines that it has granted a concession to a debtor, the creditor must make a separate assessment about whether the debtor is experiencing financial difficulties to determine whether the restructuring constitutes a TDR. The amendments clarify the guidance on a creditor s evaluation of whether it has granted a concession and what constitutes financial difficulty. In addition, the amendments clarify that a creditor is precluded from using the effective interest rate test in the debtor s guidance on restructuring of payables when evaluating whether a restructuring constitutes a TDR. The amendments in this Update are effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The Corporation adopted this guidance during the third quarter of 2011. As a result of adopting the amendments in this Update, the Corporation reassessed all restructurings that occurred on or after the beginning of the current fiscal year (January 1, 2011) for identification as troubled debt restructurings. Upon identifying those receivables as troubled debt restructurings, the Corporations identified them as impaired under the applicable guidance. The amendments in this Update require prospective application of the impairment measurement guidance for those receivables newly identified as TDRs. At the end of the first interim period of adoption (September 30, 2011), the recorded investment in receivables newly identified as TDR under the applicable guidance of this Update was $99.5 million, and the allowance for credit losses associated with those receivables, on the basis of a current evaluation of loss as of September 30, 2011, was $13.0 million. Refer to Note 8 for required disclosures and additional information.

In April 2011, the FASB updated the Codification to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this Update remove from the assessment of effective control the criterion relating to the transferor s ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. The Board concluded that this criterion is not a determining factor of effective control. Consequently, the amendments in this Update also eliminate the requirement to demonstrate that the transferor possesses adequate collateral to fund substantially all the cost of purchasing replacement financial assets. Eliminating the transferor s ability criterion and related implementation guidance from an entity s assessment of effective control should improve the accounting for repurchase agreements and other similar transactions. The amendments in this Update are effective for the first interim or annual period beginning on or after December 15, 2011, and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Corporation is currently evaluating the impact of the adoption of this guidance on the financial statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In May 2011, the FASB updated the Codification to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards (IFRSs). The amendments in this Update apply to all reporting entities that are required or permitted to measure or disclose the fair value of an asset, a liability, or an instrument classified in a reporting entity s shareholders equity in the financial statements and result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. The amendments in this Update are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted. The Corporation is currently evaluating the impact of the adoption of this guidance on the financial statements.

In June 2011, the FASB updated the Codification to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. Under the amendments, an entity has the option to present the total comprehensive income either in a single continuous statement or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. Additionally, this update requires consecutive presentation of the statement of net income and other comprehensive income and requires an entity to present reclassification adjustments on the face of the financial statements from other comprehensive income to net income. The amendments in this Update should be applied retrospectively and are effective for fiscal years beginning after December 15, 2011. Early adoption is permitted, because compliance with the amendments is already permitted. The amendments do not require any transition disclosures. Beginning with the financial statements for the quarter and six-month period ended June 30, 2011, the Corporation is following the guidance of consecutive presentation of the statement of net income and other comprehensive income.

In September 2011, the FASB updated the Codification to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. The amendments in this Update are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity s financial statements for the most recent annual or interim period have not yet been issued. The Corporation is currently evaluating the impact, if any, of the adoption of this guidance on its financial statements.

In December 2011, the FASB updated the Codification to clarify the guidance on the derecognition of in substance real estate in order to resolve the diversity in practice when a parent ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary s nonrecourse debt. Under the amendments in this Update, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary s nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. That is, even if the reporting entity ceases to have a controlling financial interest, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary s operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. The Corporation is currently evaluating the impact, if any, of the adoption of this guidance on its financial statements.

In December 2011, the FASB updated the Codification to enhance and provided converged disclosures about financial and derivative instruments that are either offset on the balance sheet, or are subject to an enforceable master netting arrangement (or other similar arrangement). Entities are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The amendments in this Update are effective for interim and annual period beginning on or after January 1, 2013. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its financial statements.

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**Note 2 Restrictions on Cash and Due from Banks**

The Corporation s bank subsidiary, FirstBank, is required by law to maintain minimum average weekly reserve balances to cover demand deposits. The amount of those minimum average reserve balances for the week that covered December 31, 2011 was $76.6 million (2010 $67.8 million). As of December 31, 2010 and 2009, the Bank complied with the requirement. Cash and due from banks as well as other short-term, highly liquid securities are used to cover the required average reserve balances.

As of December 31, 2011, and as required by the Puerto Rico International Banking Law, the Corporation maintained $300,000 in time deposits, which were considered restricted assets related to FirstBank Overseas Corporation, an international banking entity acting as a subsidiary of FirstBank.

**Note 3 Money Market Investments**

Money market investments are composed of federal funds sold, time deposits with other financial institutions and short-term investments with original maturities of three months or less.

Money market investments as of December 31, 2011 and 2010 were as follows:

| | 2011 | 2010 |
|---|---|---|
| | Balance (Dollars in thousands) | |
| Federal funds sold, interest rate of 0.05% (2010 - 0.12%) | $ 2,603 | $ 6,236 |
| Time deposits with other financial institutions, weighted-average interest rate 0.65% (2010-interest 0.62%) | 955 | 1,346 |
| Other short-term investments, weighted-average interest rate of 0.34% (2010-weighted-average interest rate of 0.34%) | 236,111 | 107,978 |
| | $ 239,669 | $ 115,560 |

As of both December 31, 2011 and 2010, $0.45 million of the Corporation s money market investments was pledged as collateral for interest rate swaps.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

## Note 4 Investment Securities

### *Investment Securities Available for Sale*

The amortized cost, non-credit loss component of OTTI on securities recorded in other comprehensive income ( OCI ), gross unrealized gains and losses recorded in OCI, approximate fair value, weighted-average yield and contractual maturities of investment securities available for sale as of December 31, 2011 and 2010 were as follows:

| | December 31, 2011 | | | | | | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Non-Credit Loss Component of | Gross Unrealized | | | Weighted | | Non-Credit Loss Component of | Gross Unrealized | | | Weighted |
| | Amortized cost | OTTI Recorded in OCI | gains | losses | Fair value | average yield% | Amortized cost | OTTI Recorded in OCI | gains | losses | Fair value | average yield% |
| | | | | | | | (Dollars in thousands) | | | | | |
| U.S. Treasury securities: | | | | | | | | | | | | |
| Due within one year | $ 476,665 | $ | $ 327 | $ | $ 476,992 | 0.34 | $ | $ | $ | $ | $ | |
| After 1 to 5 years | | | | | | | 599,987 | | 8,727 | | 608,714 | 1.34 |
| Obligations of U.S. Government sponsored agencies: | | | | | | | | | | | | |
| Due within one year | 300,381 | | 1,204 | | 301,585 | 1.15 | | | | | | |
| After 1 to 5 years | | | | | | | 604,630 | | 2,714 | 3,991 | 603,353 | 1.17 |
| Puerto Rico Government obligations: | | | | | | | | | | | | |
| Due within one year | 8,560 | | 110 | | 8,670 | 4.20 | | | | | | |
| After 1 to 5 years | 70,590 | | 171 | 1 | 70,760 | 2.63 | 26,768 | | 522 | | 27,290 | 4.70 |
| After 5 to 10 years | 118,186 | | 76 | 13 | 118,249 | 5.07 | 104,352 | | 432 | | 104,784 | 5.18 |
| After 10 years | 24,154 | | 781 | 1 | 24,934 | 5.74 | 4,746 | | 21 | | 4,767 | 6.22 |
| United States and Puerto Rico Government obligations | 998,536 | | 2,669 | 15 | 1,001,190 | 1.47 | 1,340,483 | | 12,416 | 3,991 | 1,348,908 | 1.65 |
| Mortgage-backed securities: | | | | | | | | | | | | |
| FHLMC certificates: | | | | | | | | | | | | |
| After 1 to 5 years | 928 | | 8 | | 936 | 3.67 | | | | | | |
| After 10 years | 24,974 | | 238 | | 25,212 | 2.59 | 1,716 | | 101 | | 1,817 | 5.00 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 25,902 | | 246 | | 26,148 | 2.62 | 1,716 | | 101 | | 1,817 | 5.00 |
| GNMA certificates: | | | | | | | | | | | | |
| Due within one year | | | | | | | 30 | | | | 30 | 6.49 |
| After 1 to 5 years | 179 | | 9 | | 188 | 3.88 | | | | | | |
| After 5 to 10 years | 596 | | 47 | | 643 | 4.09 | 1,319 | | 74 | | 1,393 | 4.80 |
| After 10 years | 717,237 | | 43,938 | | 761,175 | 3.98 | 962,246 | | 31,105 | 3,396 | 989,955 | 4.25 |
| | 718,012 | | 43,994 | | 762,006 | 3.98 | 963,595 | | 31,179 | 3,396 | 991,378 | 4.25 |
| FNMA certificates: | | | | | | | | | | | | |
| After 1 to 5 years | 1,019 | | 42 | | 1,061 | 3.82 | | | | | | |
| After 5 to 10 years | 18,826 | | 1,007 | | 19,833 | 3.97 | 75,547 | | 3,987 | | 79,534 | 4.50 |
| After 10 years | 47,485 | | 3,285 | | 50,770 | 5.46 | 126,847 | | 8,678 | | 135,525 | 5.51 |
| | 67,330 | | 4,334 | | 71,664 | 5.02 | 202,394 | | 12,665 | | 215,059 | 5.13 |
| Collateralized Mortgage Obligations issued or guaranteed by FHLMC, FNMA and GNMA: | | | | | | | | | | | | |
| After 10 years | | | | | | | 112,989 | | 1,926 | | 114,915 | 0.99 |
| Other mortgage pass-through trust certificates: | | | | | | | | | | | | |
| After 10 years | 85,014 | 31,951 | 8,143 | | 61,206 | 2.19 | 100,130 | 31,951 | 4,138 | | 72,317 | 2.31 |
| Total mortgage-backed securities | 896,258 | 31,951 | 56,717 | | 921,024 | 3.85 | 1,380,824 | 31,951 | 50,009 | 3,396 | 1,395,486 | 3.97 |
| Corporate bonds: | | | | | | | | | | | | |
| After 10 years | 1,447 | 434 | | | 1,013 | 5.80 | | | | | | |
| Equity securities (without contractual maturity) (1) | 77 | | | 36 | 41 | | 77 | | | 18 | 59 | |
| Total investment securities available for sale | $ 1,896,318 | $ 32,385 | $ 59,386 | $ 51 | $ 1,923,268 | 2.60 | $ 2,721,384 | $ 31,951 | $ 62,425 | $ 7,405 | $ 2,744,453 | 2.83 |

(1) Represents common shares of other financial institutions in Puerto Rico.

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options as was the case with approximately $303.3 million and $1.6 billion of investment securities (mainly U.S. agency debt securities) called during 2011 and 2010, respectively. The weighted-average yield on investment securities available for sale is based on amortized cost and, therefore, does not give effect to changes in fair value. The net unrealized gain or loss on securities available for sale and the non-credit loss component of OTTI are presented as part of

OCI.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The aggregate amortized cost and approximate market value of investment securities available for sale as of December 31, 2011, by contractual maturity, are shown below:

| | Amortized Cost | Fair Value |
|---|---|---|
| | (In thousands) | |
| Within 1 year | $ 785,606 | $ 787,247 |
| After 1 to 5 years | 72,716 | 72,945 |
| After 5 to 10 years | 137,608 | 138,725 |
| After 10 years | 900,311 | 924,310 |
| Total | 1,896,241 | 1,923,227 |
| Equity securities | 77 | 41 |
| Total investment securities available for sale | $ 1,896,318 | $ 1,923,268 |

The following tables show the Corporation s available-for-sale investments fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2011 and 2010. It also includes debt securities for which an OTTI was recognized and only the amount related to a credit loss was recognized in earnings:

| | As of December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | | | |
| **Debt securities:** | | | | | | |
| Puerto Rico Government obligations | $ 15,982 | $ 15 | $ | $ | $ 15,982 | $ 15 |
| **Mortgage-backed securities:** | | | | | | |
| Other mortgage pass-through trust certificates | | | 61,017 | 23,809 | 61,017 | 23,809 |
| **Corporate bonds** | | | 1,013 | 434 | 1,013 | 434 |
| **Equity securities** | 41 | 36 | | | 41 | 36 |
| | $ 16,023 | $ 51 | $ 62,030 | $ 24,243 | $ 78,053 | $ 24,294 |

| | As of December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | | | |
| **Debt securities** | | | | | | |
| U.S. Government agencies obligations | $ 249,026 | $ 3,991 | $ | $ | $ 249,026 | $ 3,991 |
| **Mortgage-backed securities** | | | | | | |
| GNMA | 192,799 | 3,396 | | | 192,799 | 3,396 |
| Other mortgage pass-through trust certificates | | | 72,101 | 27,814 | 72,101 | 27,814 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Equity securities** | 59 | 18 | | | 59 | 18 |
| | $ 441,884 | $ 7,405 | $ 72,101 | $ 27,814 | $ 513,985 | $ 35,219 |

***Investments Held to Maturity***

On March 7, 2011, the Corporation sold $330 million of mortgage-backed securities that were originally intended to be held to maturity, consistent with deleveraging initiatives included in the Corporation s Capital Plan. The Corporation realized a gain of $18.7 million associated with this transaction. After the sale, in line with the Corporation s ongoing capital management strategy, the remaining $89 million of investment securities held in the held-to-maturity portfolio was reclassified to the available-for-sale portfolio.

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**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The amortized cost, gross unrealized gains and losses, approximate fair value, weighted-average yield and contractual maturities of investment securities held to maturity as of December 31, 2010 were as follows:

| | December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Amortized cost | Gross Unrealized gains | Gross Unrealized losses | Fair value | Weighted average yield% |
| | (Dollars in thousands) | | | | |
| U.S. Treasury securities: | | | | | |
| Due within 1 year | $ 8,487 | $ 5 | $ | $ 8,492 | 0.30 |
| Puerto Rico Government obligations: | | | | | |
| After 5 to 10 years | 19,284 | 795 | | 20,079 | 5.87 |
| After 10 years | 4,665 | 49 | | 4,714 | 5.50 |
| United States and Puerto Rico Government obligations | 32,436 | 849 | | 33,285 | 4.36 |
| Mortgage-backed securities: | | | | | |
| FHLMC certificates: | | | | | |
| After 1 to 5 years | 2,569 | 42 | | 2,611 | 3.71 |
| FNMA certificates: | | | | | |
| After 1 to 5 years | 2,525 | 130 | | 2,655 | 3.86 |
| After 5 to 10 years | 391,328 | 21,946 | | 413,274 | 4.48 |
| After 10 years | 22,529 | 885 | | 23,414 | 5.33 |
| Mortgage-backed securities | 418,951 | 23,003 | | 441,954 | 4.52 |
| Corporate bonds: | | | | | |
| After 10 years | 2,000 | | 723 | 1,277 | 5.80 |
| Total investment securities held-to-maturity | $ 453,387 | $ 23,852 | $ 723 | $ 476,516 | 4.51 |

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options.

From time to time the Corporation has securities held to maturity with an original maturity of three months or less that are considered cash and cash equivalents and classified as money market investments in the consolidated statements of financial condition. As of December 31, 2011 and 2010, the Corporation had no outstanding securities held to maturity that were classified as cash and cash equivalents.

The following tables show the Corporation s held-to-maturity investments fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2010:

| As of December 31, 2010 | | |
|---|---|---|
| Less than 12 months | 12 months or more | Total |

| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
|---|---|---|---|---|---|---|
| | | | (In thousands) | | | |
| **Corporate bonds** | $ | $ | $ 1,277 | $ 723 | $ 1,277 | $ 723 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Assessment for OTTI***

On a quarterly basis, the Corporation performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered OTTI. A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. The accounting literature requires the Corporation to assess whether the unrealized loss is other-than-temporary.

In April 2009, the FASB amended the OTTI model for debt securities. OTTI losses must be recognized in earnings if an investor has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if an investor does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI, if any, is recorded as a component of Net impairment losses on investment securities in the accompanying consolidated statements of loss, while the remaining portion of the impairment loss is recognized in OCI, provided the Corporation does not intend to sell the underlying debt security and it is more likely than not that the Corporation will not have to sell the debt security prior to recovery.

Debt securities issued by U.S. government agencies, government-sponsored entities and the U.S. Treasury accounted for more than 83% of the total available-for-sale portfolio as of December 31, 2011 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation s assessment was concentrated mainly on private label MBS with an amortized cost of $85 million and in the Corporation s $1.4 million investment in a collateralized debt obligation transaction for which credit losses are evaluated on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis.

- Changes in the near term prospects of the underlying collateral of a security such as changes in default rates, loss severity given default and significant changes in prepayment assumptions;

- The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities; and

- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation and government actions affecting the issuer s industry and actions taken by the issuer to deal with the present economic climate.

For the years ended December 31, 2011 and 2010, the Corporation recorded OTTI losses on available-for-sale debt securities as follows:

| | Corporate Bonds | Private label MBS | |
|---|---|---|---|
| | **2011** | **2011** | **2010** |
| (In thousands) | | | |

| | | | |
|---|---|---|---|
| Total other-than-temporary impairment losses | $ (987) | $ | $ |
| Unrealized other-than-temporary impairment losses recognized in OCI (1) | 434 | (1,418) | (582) |
| Net impairment losses recognized in earnings (2) | $ (553) | $ (1,418) | $ (582) |

(1) Represents the noncredit component impact of the OTTI on available-for-sale debt securities
(2) Represents the credit component of the OTTI on available-for-sale debt securities

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the roll-forward of credit losses on debt securities held by the Corporation for which a portion of an OTTI is recognized in OCI:

| (In thousands) | 2011 | 2010 |
|---|---|---|
| Credit losses at the beginning of the period | $ 1,852 | $ 1,270 |
| Additions: | | |
| Credit losses related to debt securities for which an OTTI was not previously recognized | 553 | |
| Credit losses related to debt securities for which an OTTI was previously recognized | 1,418 | 582 |
| Ending balance of credit losses on debt securities held for which a portion of an OTTI was recognized in OCI | $ 3,823 | $ 1,852 |

Private label MBS are collateralized by fixed-rate mortgages on single family residential properties in the United States. The interest rate on these private-label MBS is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The underlying mortgages are fixed-rate single family loans with original high FICO scores (over 700) and moderate original loan-to-value ratios (under 80%), as well as moderate delinquency levels.

Based on the expected cash flows derived from the model, and since the Corporation does not have the intention to sell the securities and has sufficient capital and liquidity to hold these securities until a recovery of the fair value occurs, only the credit loss component was reflected in earnings. Significant assumptions in the valuation of the private label MBS as of December 31, 2011 and 2010 were as follow:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Weighted Average | Range | Weighted Average | Range |
| Discount rate | 14.5% | 14.5% | 14.5% | 14.5% |
| Prepayment rate | 27% | 21.33% - 37.97% | 24% | 18.2% - 43.73% |
| Projected Cumulative Loss Rate | 6% | 1.94% - 11.89% | 6% | 1.49% - 16.25% |

Corporate bonds are collateralized by an agency-zero coupon bond and a synthetic Collateralized Debt Obligation of 125 corporate bonds rated investment grade at the time of structuring. At the time of issue, the bonds were rated AAA based on the bond s structure, while they are currently rated CCC-. The value of the bond is tied to the level of credit default swap spreads.

For each of the years ended December 31, 2010 and 2009, the Corporation recorded OTTI of approximately $0.4 million on certain equity securities held in its available-for-sale investment portfolio related to financial institutions in Puerto Rico. Management concluded that the declines in value of the securities were other-than-temporary; as such, the cost basis of these securities was written down to the market value as of the date of the analysis and is reflected in earnings as a realized loss.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Total proceeds from the sale of securities available for sale during 2011 amounted to approximately $1.2 billion (2010 - $2.4 billion, 2009 - $1.9 billion). The following table summarizes the realized gains and losses on sales of securities available for sale for the years indicated:

| (In thousands) | Year ended December 31, | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| Realized gains [1] | $ 34,449 | $ 93,719 | $ 82,772 |
| Realized losses | | (540) | |
| Net realized security gains | $ 34,449 | $ 93,179 | $ 82,772 |

(1) Includes a $3.5 million gain attributable to a tender offer by the Puerto Rico Housing Finance Authority to purchase certain of its outstanding bonds. Bonds held by the Corporation with a book value of $19.8 million were exchanged for cash as part of the tender offer and the difference between the cash received and the book value of such instruments was recorded as part of Gain on sale of investment in the Statement of (loss) income.

As part of its balance sheet restructuring strategies, the Corporation sold during 2011 approximately $500 million of low-yielding U.S. Treasury Notes and $105 million of floating rate U.S. Agency collateralized mortgage obligations ( CMOs ) and used the proceeds, in part, to prepay $400 million of repurchase agreements that carried an average rate of 2.74%. The prepayment penalties of $10.6 million were offset with gains of $11.0 million from the sale of U.S. Treasury Notes and floating rates U.S. Agency CMOs. This transaction contributed to improvements in the net interest margin.

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

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | **Amortized Cost** | **Fair Value** | **Amortized Cost** | **Fair Value** |
| | **(In thousands)** | | **(In thousands)** | |
| FHLMC | $ 25,902 | $ 26,148 | $ 71,283 | $ 71,784 |
| GNMA | 718,012 | 762,006 | 1,020,076 | 1,048,739 |
| FNMA | 367,711 | 373,249 | 972,573 | 1,011,393 |
| FHLB | | | 240,343 | 236,560 |

**Note 5 Other Equity Securities**

Institutions that are members of the FHLB system are required to maintain a minimum investment in FHLB stock. Such minimum is calculated as a percentage of aggregate outstanding mortgages, and an additional investment is required that is calculated as a percentage of total FHLB advances, letters of credit, and the collateralized portion of interest-rate swaps outstanding. The stock is capital stock issued at $100 par value. Both stock and cash dividends may be received on FHLB stock.

As of December 31, 2011 and 2010, the Corporation had investments in FHLB stock with a book value of $36.7 million and $54.6 million, respectively. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for 2011,

2010 and 2009 amounted to $1.9 million, $2.9 million and $3.1 million, respectively.

The FHLB stocks owned by the Corporation are issued by the FHLB of New York and by the FHLB of Atlanta. Both Banks are part of the Federal Home Loan Bank System, a national wholesale banking network of 12 regional, stockholder-owned congressionally chartered banks. The Federal Home Loan Banks are all privately capitalized and operated by their member stockholders. The system is supervised by the Federal Housing Finance Agency, which ensures that the Home Loan Banks operate in a financially safe and sound manner, remain adequately capitalized and able to raise funds in the capital markets, and carry out their housing finance mission.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of both December 31, 2011 and 2010 was $1.3 million. An impairment charge of $0.25 million was recorded in 2010 related to an investment in a failed financial institution in the United States.

During 2010 and 2009, the Corporation recognized gains of $10.7 million and $3.8 million, respectively, on the sale of VISA shares. As of December 31, 2011, the Corporation no longer held any VISA shares.

**Note 6 Interest and Dividend on Investments**

A detail of interest on investments and FHLB dividend income follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| | (In thousands) | | |
| Interest on money market investments: | | | |
| Taxable | $ 1,107 | $ 1,772 | $ 568 |
| Exempt | 448 | 277 | 9 |
| | 1,555 | 2,049 | 577 |
| Mortgage-backed securities: | | | |
| Taxable | 32,599 | 42,722 | 30,854 |
| Exempt | 10,511 | 63,754 | 172,923 |
| | 43,110 | 106,476 | 203,777 |
| PR Government obligations, U.S. Treasury securities and U.S. Government agencies: | | | |
| Taxable | 3,705 | 7,572 | 2,694 |
| Exempt | 15,282 | 21,667 | 44,510 |
| | 18,987 | 29,239 | 47,204 |
| Equity securities: | | | |
| Taxable | 1 | 15 | 69 |
| Exempt | | | 37 |
| | 1 | 15 | 106 |
| Other investment securities (including FHLB dividends): | | | |
| Taxable | 2,001 | 3,010 | 3,375 |
| Exempt | | | |
| | 2,001 | 3,010 | 3,375 |

| | | | |
|---|---|---|---|
| Total interest and dividends on investments | $ 65,654 | $ 140,789 | $ 255,039 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the components of interest and dividend income on investments:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | | (In thousands) | |
| Interest income on investment securities and money market investments | $ 63,769 | $ 139,031 | $ 248,563 |
| Dividends on FHLB stock | 1,885 | 2,894 | 3,082 |
| Interest income excluding unrealized (loss) gain on derivatives (economic hedges) | 65,654 | 141,925 | 251,645 |
| Unrealized (loss) gain on derivatives (economic hedges) from interest rate caps | | (1,136) | 3,394 |
| Total interest income and dividends on investments | $ 65,654 | $ 140,789 | $ 255,039 |

**Note 7 Loans Receivable**

The following is a detail of the loan portfolio held for investment:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (In thousands) | |
| Residential mortgage loans, mainly secured by first mortgages | $ 2,873,785 | $ 3,417,417 |
| Commercial loans: | | |
| Construction loans | 427,863 | 700,579 |
| Commercial mortgage loans | 1,565,411 | 1,670,161 |
| Commercial and Industrial loans [(1)] | 3,856,695 | 3,861,545 |
| Loans to a local financial institution collateralized by real estate mortgages | 273,821 | 290,219 |
| Commercial loans | 6,123,790 | 6,522,504 |
| Finance leases | 247,003 | 282,904 |
| Consumer loans | 1,314,814 | 1,432,611 |
| Loans receivable | 10,559,392 | 11,655,436 |
| Allowance for loan and lease losses | (493,917) | (553,025) |
| Loans receivable, net | $ 10,065,475 | $ 11,102,411 |

1 - As of December 31, 2011, includes $2.1 billion of commercial loans that are secured by real estate but are not dependent upon the real estate for repayment.

As of December 31, 2011 and 2010, the Corporation had net deferred origination fees on its loan portfolio amounting to $6.2 million and $0.7 million, respectively. Total loan portfolio is net of unearned income of $39.7 million and $42.7 million as of December 31, 2011 and 2010, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Loans held for investment on which accrual of interest income had been discontinued as of December 31, 2011 and 2010 were as follows:

| *(Dollars in thousands)* | **December 31, 2011** | **2010** |
|---|---|---|
| Non-performing loans: | | |
| Residential mortgage | $ 338,208 | 392,134 |
| Commercial mortgage | 240,414 | 217,165 |
| Commercial and Industrial | 270,171 | 317,243 |
| Construction | 250,022 | 263,056 |
| Consumer: | | |
| Auto loans | 19,641 | 25,350 |
| Finance leases | 3,485 | 3,935 |
| Other consumer loans | 16,421 | 20,106 |
| Total non-performing loans held for investment [1] | $ 1,138,362 | $ 1,238,989 |

1 -As of December 31, 2011 and 2010, excludes $4.8 million and $159.3 million, respectively, in non-performing loans held for sale.

If these loans were accruing interest, the additional interest income realized would have been $64.0 million (2010 $52.7 million; 2009 $57.9 million).

The Corporation s aging of the loans held for investment portfolio as of December 31, 2011 and 2010, follows:

| **As of December 31, 2011** (Dollars in thousands) | **30-59 Days Past Due** | **60-89 Days Past Due** | **90 days or more Past Due [1]** | **Total Past Due** | **Current** | **Total loans held for investment** | **90 days past due and still accruing** |
|---|---|---|---|---|---|---|---|
| Residential mortgage: | | | | | | | |
| FHA/VA and other government guaranteed loans [2] [3] | $ | $ 17,548 | $ 85,188 | $ 102,736 | $ 165,417 | $ 268,153 | $ 85,188 |
| Other residential mortgage loans [3] | | 90,274 | 350,495 | 440,769 | 2,164,863 | 2,605,632 | 12,287 |
| Commercial: | | | | | | | |
| Commercial & Industrial loans | 27,674 | 10,714 | 294,723 | 333,111 | 3,797,405 | 4,130,516 | 24,552 |
| Commercial mortgage loans [3] | | 8,891 | 240,414 | 249,305 | 1,316,106 | 1,565,411 | |
| Construction loans [3] | | 8,211 | 258,811 | 267,022 | 160,841 | 427,863 | 8,789 |
| Consumer: | | | | | | | |
| Auto loans | 61,265 | 18,963 | 19,641 | 99,869 | 837,697 | 937,566 | |
| Finance leases | 11,110 | 4,172 | 3,485 | 18,767 | 228,236 | 247,003 | |
| Other consumer loans | 10,170 | 4,699 | 16,421 | 31,290 | 345,958 | 377,248 | |
| Total loans held for investment | $ 110,219 | $ 163,472 | $ 1,269,178 | $ 1,542,869 | $ 9,016,523 | $ 10,559,392 | $ 130,816 |

(1) Includes non-performing loans and accruing loans which are contractually delinquent 90 days or more (i.e. FHA/VA and other guaranteed loans).

(2) As of December 31, 2011, includes $66.4 million of defaulted loans collateralizing Ginnie Mae ( GNMA ) securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans

(3) According to the Corporation s delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve, residential mortgage, commercial mortgage and construction loans are considered past due when the borrower is in arrears 2 or more monthly payments.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| As of December 31, 2010<br>(Dollars in thousands) | 30-59 Days Past Due | 60-89 Days Past Due | 90 days or more Past Due [1] | Total Past Due | Current | Total loans held for investment | 90 days past due and still accruing |
|---|---|---|---|---|---|---|---|
| Residential mortgage: | | | | | | | |
| FHA/VA and other government guaranteed loans [2] [3] | $ | $ 14,780 | $ 81,330 | $ 96,110 | $ 136,412 | $ 232,522 | $ 81,330 |
| Other residential mortgage loans [3] | | 116,438 | 414,027 | 530,465 | 2,654,430 | 3,184,895 | 21,893 |
| Commercial: | | | | | | | |
| Commercial & Industrial loans | 41,906 | 56,884 | 351,186 | 449,976 | 3,701,788 | 4,151,764 | 33,943 |
| Commercial mortgage loans [3] | | 40,053 | 217,165 | 257,218 | 1,412,943 | 1,670,161 | |
| Construction loans [3] | | 12,236 | 270,004 | 282,240 | 418,339 | 700,579 | 6,948 |
| Consumer: | | | | | | | |
| Auto loans | 72,657 | 22,249 | 25,350 | 120,256 | 888,720 | 1,008,976 | |
| Finance leases | 14,851 | 5,128 | 3,935 | 23,914 | 258,990 | 282,904 | |
| Other consumer loans | 15,389 | 8,574 | 20,106 | 44,069 | 379,566 | 423,635 | |
| Total loans held for investment | $ 144,803 | $ 276,342 | $ 1,383,103 | $ 1,804,248 | $ 9,851,188 | $ 11,655,436 | $ 144,114 |

(1) Includes non-performing loans and accruing loans which are contractually delinquent 90 days or more (i.e. FHA/VA and other guaranteed loans).

(2) As of December 31, 2010, includes $54.2 million of defaulted loans collateralizing GNMA securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans

(3) According to the Corporation s delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve, residential mortgage, commercial mortgage and construction loans are considered past due when the borrower is in arrears 2 or more monthly payments.

As of December 31, 2011, the Corporation was servicing residential mortgage loans owned by others aggregating $1.6 billion (2010 $1.4 billion) and construction and commercial loans owned by others aggregating $3.0 million (2010 $7.8 million).

In addition, as of December 31, 2011, the Corporation was servicing commercial loan participations owned by others aggregating $343.3 million (2010 $269.9 million).

Various loans secured by first mortgages were assigned as collateral for CDs, individual retirement accounts and advances from the Federal Home Loan Bank. The mortgages pledged as collateral amounted to $1.3 billion as of December 31, 2011 (2010 $2.2 billion).

The Corporation s primary lending area is Puerto Rico. The Corporation s Puerto Rico banking subsidiary, FirstBank, also lends in the U.S. and British Virgin Islands markets and in the United States (principally in the state of Florida). Of the total gross loans held for investment portfolio of $10.6 billion as of December 31, 2011, approximately 84% have credit risk concentration in Puerto Rico, 8% in the United States and 8% in the Virgin Islands.

As of December 31, 2011, the Corporation had $360.1 million outstanding of credit facilities granted to the Puerto Rico Government and/or its political subdivisions, up from $325.1 million as of December 31, 2010, and $139.4 million granted to the Virgin Islands government, up from $84.3 million as of December 31, 2010. A substantial portion of these credit facilities are obligations that have a specific source of income or revenues identified for their repayment, such as property taxes collected by the central Government and/or municipalities. Another portion of these obligations consists of loans to public corporations that obtain revenues from rates charged for services or products, such as electric power and water utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it. The Corporation also has loans to various municipalities in Puerto Rico for which the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment.

Aside from loans extended to the Puerto Rico Government and its political subdivisions, the largest loan to one borrower as of December 31, 2011 in the amount of $273.8 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual real-estate loans, mostly 1-4 residential mortgage loans.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 8 Allowance for Loan and Lease Losses and Impaired Loans**

The changes in the allowance for loan and lease losses for the year ended December 31, 2011 and 2010 were as follows:

| (Dollars in thousands) | Residential Mortgage Loans | Commercial Mortgage Loans | Commercial & Industrial Loans | Construction Loans | Consumer Loans | Total |
|---|---|---|---|---|---|---|
| **December 31, 2011** | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | |
| Beginning balance | $ 62,330 | $ 105,596 | $ 152,641 | $ 151,972 | $ 80,486 | $ 553,025 |
| Charge-offs | (39,826) | (51,207) | (69,783) | (103,131) | (45,478) | (309,425) |
| Recoveries | 835 | 90 | 2,921 | 2,371 | 7,751 | 13,968 |
| Provision | 45,339 | 54,513 | 78,711 | 40,174 | 17,612 | 236,349 |
| Ending balance | $ 68,678 | $ 108,992 | $ 164,490 | $ 91,386 | $ 60,371 | $ 493,917 |
| Ending balance: specific reserve for impaired loans | $ 48,566 | $ 59,167 | $ 58,652 | $ 44,768 | $ 3,749 | $ 214,902 |
| Ending balance: general allowance | $ 20,112 | $ 49,824 | $ 105,838 | $ 46,618 | $ 56,623 | $ 279,015 |
| **Loans receivables:** | | | | | | |
| Ending balance | $ 2,873,785 | $ 1,565,411 | $ 4,130,516 | $ 427,863 | $ 1,561,817 | $ 10,559,392 |
| Ending balance: impaired loans | $ 604,421 | $ 368,751 | $ 264,025 | $ 247,147 | $ 23,032 | $ 1,507,376 |
| Ending balance: loans with general allowance | $ 2,269,364 | $ 1,196,660 | $ 3,866,491 | $ 180,716 | $ 1,538,785 | $ 9,052,016 |

| (Dollars in thousands) | Residential Mortgage Loans | Commercial Mortgage Loans | Commercial & Industrial Loans | Construction Loans | Consumer Loans | Total |
|---|---|---|---|---|---|---|
| **December 31, 2010** | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | |
| Beginning balance | $ 31,165 | $ 67,201 | $ 182,778 | $ 164,128 | $ 82,848 | $ 528,120 |
| Charge-offs | (62,839) | (82,708) | (99,724) | (313,511) | (64,219) | (623,001) |
| Recoveries | 121 | 1,288 | 1,251 | 358 | 10,301 | 13,319 |
| Provision | 93,883 | 119,815 | 68,336 | 300,997 | 51,556 | 634,587 |
| Ending balance | $ 62,330 | $ 105,596 | $ 152,641 | $ 151,972 | $ 80,486 | $ 553,025 |
| Ending balance: specific reserve for impaired loans | $ 42,666 | $ 26,869 | $ 65,030 | $ 57,833 | $ 264 | $ 192,662 |
| Ending balance: general allowance | $ 19,664 | $ 78,727 | $ 87,611 | $ 94,139 | $ 80,222 | $ 360,363 |
| **Loans receivables:** | | | | | | |
| Ending balance | $ 3,417,417 | $ 1,670,161 | $ 4,151,764 | $ 700,579 | $ 1,715,515 | $ 11,655,436 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Ending balance: impaired loans | $ 555,835 | $ 182,770 | $ 379,837 | $ 263,044 | $ 2,155 | $ 1,383,641 |
| Ending balance: loans with general allowance | $ 2,861,582 | $ 1,487,391 | $ 3,771,927 | $ 437,535 | $ 1,713,360 | $ 10,271,795 |

There were no significant purchases of loans during 2011, purchases of $180.7 million in 2011 were consistent with a strategic program established by the Corporation in 2005 to purchase ongoing residential mortgage loan production from mortgage bankers in Puerto Rico. Generally, the loans purchased from mortgage bankers were conforming residential mortgage loans. Purchases of conforming residential mortgage loans provide the Corporation the flexibility to retain or sell the loans, including through securitization transactions depending upon whether the Corporation wants to retain high yielding loans and improve net interest margins or generate profits by selling loans. When the Corporation sells such loans, it generally keeps the servicing of the loans. The Corporation sold approximately $518 million of performing residential mortgage loans to another financial institution, $118.8 million of performing residential mortgage loans in the secondary market to FNMA and FHLMC and sold its participation in a syndicated commercial and industrial loan with a book value of $37.2 million during 2011. Also, the Corporation securitized approximately $214.4 million of FHA/VA mortgage loans into GNMA mortgage-backed securities during 2011. Refer to Note 9 Loans held for sale for additional information about loans sold during 2011.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in the allowance for 2009 were as follows:

| | | Year Ended December 31, 2009 (In thousands) |
|---|---|---|
| Balance at beginning of year | $ | 281,526 |
| Provision for loan and lease losses | | 579,858 |
| Losses charged against the allowance | | (344,422) |
| Recoveries credited to the allowance | | 11,158 |
| Balance at end of year | $ | 528,120 |

The allowance for impaired loans is part of the allowance for loan and lease losses. The allowance for impaired loans covers those loans for which management has determined that it is probable that the debtor will be unable to pay all the amounts due in accordance with the contractual terms of the loan agreement, and does not necessarily represent loans for which the Corporation will incur a loss.

Information regarding impaired loans for the year ended December 31, 2011 and 2010 was as follows:

| (Dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **As of December 31, 2011** | | | | | |
| **With no related allowance recorded:** | | | | | |
| FHA/VA Guaranteed loans | $ | $ | $ | $ | $ |
| Other residential mortgage loans | 181,081 | 192,757 | | 141,412 | 8,704 |
| Commercial: | | | | | |
| Commercial mortgage loans | 13,797 | 15,283 | | 22,540 | 469 |
| Commercial & Industrial Loans | 40,453 | 45,948 | | 51,238 | 544 |
| Construction Loans | 33,759 | 45,931 | | 27,438 | 47 |
| Consumer: | | | | | |
| Auto loans | | | | | |
| Finance leases | | | | | |
| Other consumer loans | 2,840 | 3,846 | | 1,775 | 54 |
| | $ 271,930 | $ 303,765 | $ | $ 244,403 | $ 9,818 |
| **With an allowance recorded:** | | | | | |
| FHA/VA Guaranteed loans | $ | $ | $ | $ | $ |
| Other residential mortgage loans | 423,340 | 465,495 | 48,566 | 430,411 | 12,195 |
| Commercial: | | | | | |
| Commercial mortgage loans | 354,954 | 383,890 | 59,167 | 249,595 | 6,576 |
| Commercial & Industrial Loans | 223,572 | 316,641 | 58,652 | 302,559 | 2,653 |
| Construction Loans | 213,388 | 344,035 | 44,768 | 257,842 | 456 |
| Consumer: | | | | | |
| Auto loans | 8,710 | 8,710 | 1,039 | 4,644 | 527 |

| | | | | | |
|---|---|---|---|---|---|
| Finance leases | 1,804 | 1,804 | 41 | 1,179 | 125 |
| Other consumer loans | 9,678 | 9,678 | 2,669 | 5,492 | 1,105 |
| | $ 1,235,446 | $ 1,530,253 | $ 214,902 | $ 1,251,722 | $ 23,637 |
| **Total:** | | | | | |
| FHA/VA Guaranteed loans | $ | $ | $ | $ | $ |
| Other residential mortgage loans | 604,421 | 658,252 | 48,566 | 571,823 | 20,899 |
| Commercial: | | | | | |
| Commercial mortgage loans | 368,751 | 399,173 | 59,167 | 272,135 | 7,045 |
| Commercial & Industrial Loans | 264,025 | 362,589 | 58,652 | 353,797 | 3,197 |
| Construction Loans | 247,147 | 389,966 | 44,768 | 285,280 | 503 |
| Consumer: | | | | | |
| Auto loans | 8,710 | 8,710 | 1,039 | 4,644 | 527 |
| Finance leases | 1,804 | 1,804 | 41 | 1,179 | 125 |
| Other consumer loans | 12,518 | 13,324 | 2,669 | 7,267 | 1,159 |
| | $ 1,507,376 | $ 1,834,018 | $ 214,902 | $ 1,496,125 | $ 33,455 |

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FIRST BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| (Dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **As of December 31, 2010** | | | | | |
| **With no related allowance recorded:** | | | | | |
| FHA/VA Guaranteed loans | $ | $ | $ | $ | $ |
| Other residential mortgage loans | 244,648 | 253,636 | | 302,565 | 8,103 |
| Commercial: | | | | | |
| Commercial mortgage loans | 32,328 | 32,868 | | 32,117 | 1,180 |
| Commercial & Industrial Loans | 54,631 | 58,927 | | 74,554 | 892 |
| Construction Loans | 25,074 | 26,557 | | 126,841 | 59 |
| Consumer: | | | | | |
| Auto loans | | | | | |
| Finance leases | | | | | |
| Other consumer loans | 659 | 1,015 | | 165 | 2 |
| | $ 357,340 | $ 373,003 | $ | $ 536,242 | $ 10,236 |
| **With an allowance recorded:** | | | | | |
| FHA/VA Guaranteed loans | $ | $ | $ | $ | $ |
| Other residential mortgage loans | 311,187 | 350,576 | 42,666 | 215,985 | 5,801 |
| Commercial: | | | | | |
| Commercial mortgage loans | 150,442 | 186,404 | 26,869 | 180,504 | 4,179 |
| Commercial & Industrial Loans | 325,206 | 416,919 | 65,030 | 330,433 | 5,606 |
| Construction Loans | 237,970 | 323,127 | 57,833 | 481,871 | 1,015 |
| Consumer: | | | | | |
| Auto loans | | | | | |
| Finance leases | | | | | |
| Other consumer loans | 1,496 | 1,496 | 264 | 374 | 28 |
| | $ 1,026,301 | $ 1,278,522 | $ 192,662 | $ 1,209,167 | $ 16,629 |
| **Total:** | | | | | |
| FHA/VA Guaranteed loans | $ | $ | $ | $ | $ |
| Other residential mortgage loans | 555,835 | 604,212 | 42,666 | 518,550 | 13,904 |
| Commercial: | | | | | |
| Commercial mortgage loans | 182,770 | 219,272 | 26,869 | 212,621 | 5,359 |
| Commercial & Industrial Loans | 379,837 | 475,846 | 65,030 | 404,987 | 6,498 |
| Construction Loans | 263,044 | 349,684 | 57,833 | 608,712 | 1,074 |
| Consumer: | | | | | |
| Auto loans | | | | | |
| Finance leases | | | | | |
| Other consumer loans | 2,155 | 2,511 | 264 | 539 | 30 |
| | $ 1,383,641 | $ 1,651,525 | $ 192,662 | $ 1,745,409 | $ 26,865 |

The following tables show the activity for impaired loans and the related specific reserve during 2011:

| | 2011 (In thousands) |
|---|---|
| **Impaired Loans:** | |
| Balance at beginning of year | $ 1,383,641 |
| Loans determined impaired during the year | 873,486 |
| Net charge-offs | (233,692) |
| Loans sold, net of charge-offs | (36,898) |
| Increases to impaired loans (disbursements) | 16,692 |
| Foreclosures | (69,400) |
| Loans no longer considered impaired | (252,519) |
| Paid in full or partial payments | (173,934) |
| Balance at end of year | $ 1,507,376 |

**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

| | 2011 | 2010 |
|---|---|---|
| | (In thousands) | |
| **Specific Reserve:** | | |
| Balance at beginning of year | $ 192,662 | $ 182,145 |
| Provision for loan losses | 255,932 | 577,251 |
| Net charge-offs | (233,692) | (566,734) |
| Balance at end of year | $ 214,902 | $ 192,662 |

The Corporation s credit quality indicators by loan type as of December 31, 2011 and 2010 are summarized below:

| | Commercial Credit Exposure-Credit risk Profile based on Creditworthiness category: | | | | |
|---|---|---|---|---|---|
| **December 31, 2011** | **Substandard** | **Doubtful** | **Loss** | **Total Adversely Classified (1)** | **Total Portfolio** |
| | | | (In thousands) | | |
| Commercial Mortgage | $ 414,355 | $ 8,462 | $ | $ 422,817 | $ 1,565,411 |
| Construction | 247,560 | 32,059 | 2,916 | 282,535 | 427,863 |
| Commercial and Industrial | 457,927 | 31,100 | 1,373 | 490,400 | 4,130,516 |

| | Commercial Credit Exposure-Credit risk Profile based on Creditworthiness category: | | | | |
|---|---|---|---|---|---|
| **December 31, 2010** | **Substandard** | **Doubtful** | **Loss** | **Total Adversely Classified (1)** | **Total Portfolio** |
| | | | (In thousands) | | |
| Commercial Mortgage | $ 351,671 | $ 2,168 | $ 21 | $ 353,860 | $ 1,670,161 |
| Construction | 310,071 | 13,204 | 605 | 323,880 | 700,579 |
| Commercial and Industrial | 537,618 | 17,123 | 4,197 | 558,938 | 4,151,764 |

(1) Excludes $4.8 million (construction) as of December 31, 2011 and $261.8 million as of December 31, 2010 ($205.7 million construction; $35.4 million commercial mortgage; $20.7 million commercial and industrial) of adversely classified loans held for sale.

The Corporation considers a loan as adversely classified if its risk rating is Substandard, Doubtful or Loss. These categories are defined as follows:

Substandard- A Substandard Asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful- Doubtful classifications have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. A Doubtful classification may be appropriate in cases where significant risk exposures are perceived, but Loss cannot be determined because of specific reasonable pending factors which may strengthen the credit in the near term.

Loss- Assets classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. There is little or no prospect for near term

improvement and no realistic strengthening action of significance pending.

| December 31, 2011 | Consumer Credit Exposure-Credit risk Profile based on payment activity | | | | |
|---|---|---|---|---|---|
| | Residential Real-Estate | | | Consumer | |
| | FHA/VA/Guaranteed | Other residential loans | Auto | Finance Leases | Other Consumer |
| | | | (In thousands) | | |
| Performing | $ 268,153 | $ 2,267,424 | $ 917,925 | $ 243,518 | $ 360,827 |
| Non-performing | | 338,208 | 19,641 | 3,485 | 16,421 |
| Total | $ 268,153 | $ 2,605,632 | $ 937,566 | $ 247,003 | $ 377,248 |

| December 31, 2010 | Consumer Credit Exposure-Credit risk Profile based on payment activity | | | | |
|---|---|---|---|---|---|
| | Residential Real-Estate | | | Consumer | |
| | FHA/VA/Guaranteed | Other residential loans | Auto | Finance Leases | Other Consumer |
| | | | (In thousands) | | |
| Performing | $ 232,522 | $ 2,792,761 | $ 983,626 | $ 278,969 | $ 403,529 |
| Non-performing | | 392,134 | 25,350 | 3,935 | 20,106 |
| Total | $ 232,522 | $ 3,184,895 | $ 1,008,976 | $ 282,904 | $ 423,635 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico and in accordance with the government s Home Affordable Modification Program guidelines. Depending upon the nature of borrowers financial condition, restructurings or loan modifications through this program as well as other restructurings of individual commercial, commercial mortgage, construction and residential mortgage loans in the U.S. mainland fit the definition of TDR. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor s financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of December 31, 2011, the Corporation s total TDR loans of $820.5 million consisted of $372.8 million of residential mortgage loans, $100.5 million of commercial and industrial loans, $218.1 million of commercial mortgage loans, $109.3 million construction loans and $19.8 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to $5.9 million as of December 31, 2011.

The Corporation s loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments for a significant period of time, and reduction of interest rates either permanently (up to 2010) or for a period of up to two years (step-up rates). Additionally, in remote cases, the restructuring may provide for the forgiveness of contractually due principal or interest. Uncollected interest is added to the end of the loan term at the time of the restructuring and not recognized as income until collected or when the loan is paid off. These programs are available to only those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in foreclosure action absent some lender concession. Notwithstanding, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

In addition to residential loans modified in TDRs described above, the Corporation also enters into trial modifications with certain borrowers. Trial modifications generally represent a three month period whereby the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Trial modifications lasting more than three months are considered TDRs. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification where the terms of the loan are formally modified. Approximately 60% of all loans that entered into a trial modification during 2011 became permanent modifications as of December 31, 2011. Substantially all permanent modifications are considered TDRs and are included in the TDR disclosures herein. As of December 31, 2011, the Corporation had 108 loans that were in trial modifications and were not considered TDRs, with an unpaid principal balance of $13.0 million and a carrying value of $12.6 million.

For the commercial real estate, commercial and industrial, and the construction portfolios, at the time of the restructuring, the Corporation determines, on a loan by loan basis, whether a concession was granted for economic or legal reasons related to the borrower s financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waiving of borrower covenants; forgiveness of principal or interest; or other contract changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collections function. The function s objective is to minimize both early stage delinquencies and losses upon default of commercial loans. The group utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third party consultants. In the case of residential construction projects and large commercial loans, the function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and restructuring of large commercial loans. In addition, the Corporation extends, renews and restructures loans with satisfactory credit profiles. Many commercial loan facilities are structured as lines of credit, which are mainly one year in term and therefore are required to be renewed annually. Other facilities may be restructured or extended from time to time based upon changes in the borrower s business needs, use of funds, timing of completion of projects and other factors. If the borrower is not deemed to have financial difficulties, extensions, renewals and restructurings are done in the normal course of business and not considered concessions, and the loans continue to be recorded as performing.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Selected information on TDRs that includes the recorded investment by loan class and modification type is summarized in the following table. This information reflects all TDRs at December 31, 2011:

| | December 31, 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Interest rate below market | Maturity or term extension | Combination of reduction in interest rate and extension of maturity | Forgiveness of Principal and/or interest | Forbearance Agreement (1) | Other (2) | Total |
| Troubled Debt Restructurings | | | | | | | |
| Non- FHA/VA Residential Mortgage loans | $ 15,781 | $ 3,559 | $ 323,971 | $ 446 | $ | $ 29,026 | $ 372,783 |
| Commercial Mortgage Loans | 58,214 | 17,525 | 119,719 | 885 | | 21,784 | 218,127 |
| Commercial & Industrial Loans | 32,604 | 12,175 | 20,808 | 7,696 | 6,417 | 20,806 | 100,506 |
| Construction Loans | 6,301 | | 4,422 | | 85,552 | 12,998 | 109,273 |
| Consumer Loans - Auto | | | 7,778 | | | 932 | 8,710 |
| Finance Leases | | 1,804 | | | | | 1,804 |
| Consumer Loans - Other | 3,146 | 1,883 | 1,058 | 28 | | 3,181 | 9,296 |
| Total Troubled Debt Restructurings | 116,046 | $ 36,946 | $ 477,756 | $ 9,055 | $ 91,969 | $ 88,727 | $ 820,499 |

(1) Mainly related to one construction relationship amounting to $74.6 million.

(2) Other concessions granted by the Corporation include deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation or a combination of the concessions listed in the table above.

The following table presents the Corporation s TDR activity for the year ended December 31, 2011:

| | Year ended December 31, 2011 |
|---|---|
| Beginning Balance of TDRs | $ 434,243 |
| New TDRs | 518,712 |
| Increases to existing TDRs (disbursements) | 37,246 |
| Net charge offs | (29,623) |
| Sales | (24,214) |
| Foreclosures | (3,207) |
| Removed from TDR classification | (49,155) |
| Paid-off and partial payments | (63,503) |
| Ending balance of TDRs | $ 820,499 |

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower s ability to meet the revised payment schedule is uncertain, the

loan remains classified as a nonaccrual loan. Loan modifications increase Corporation s interest income by returning a non-performing loan to performing status, if applicable, and increase cash flows by providing for payments to be made by the borrower, and avoid increases in foreclosure and real estate owned ( REO ) costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses. A TDR loan that specifies an interest rate that at the time of the restructuring is greater than or equal to the rate the Corporation is willing to accept for a new loan with comparable risk may not be reported as a TDR or an impaired loan in the calendar years subsequent to the restructuring if it is in compliance with its modified terms. For the year ended December 31, 2011, $49.2 million were removed from the TDR classification, as reflected in the table above.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table provides a breakdown between accrual and nonaccrual status of TDRs as of December 31, 2011:

| | December 31, 2011 | | |
|---|---|---|---|
| | Accrual | Nonaccrual [(1)] | Total TDRs |
| Non- FHA/VA Residential Mortgage loans | $ 282,519 | $ 90,264 | $ 372,783 |
| Commercial Mortgage Loans | 130,874 | 87,253 | 218,127 |
| Commercial & Industrial Loans | 22,301 | 78,205 | 100,506 |
| Construction Loans | 1,467 | 107,806 | 109,273 |
| Consumer Loans - Auto | 5,096 | 3,614 | 8,710 |
| Finance Leases | 1,774 | 30 | 1,804 |
| Consumer Loans - Other | 7,118 | 2,178 | 9,296 |
| Total Troubled Debt Restructurings | $ 451,149 | $ 369,350 | $ 820,499 |

(1) Included in non-accrual loans are $138.1 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability.

TDRs exclude restructured mortgage loans that are government guaranteed (i.e. FHA/VA loans) totaling $81.7 million. The Corporation excludes government guaranteed loans from TDRs given that in the event that the borrower defaults on the loan, the principal and interest are guaranteed by the U.S. government, therefore, the risk of loss on these types of loans is very low. The Corporation does not consider loans with government guarantees to be impaired loans for the purpose of calculating the allowance for loan and lease losses.

Loan modifications that are considered TDRs completed during the year ended December 31, 2011 were as follows:

| | Year ended December 31, 2011 | | |
|---|---|---|---|
| | Number of contracts | Pre-modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Troubled Debt Restructurings | | | |
| Non- FHA/VA Residential Mortgage loans | 880 | $ 137,265 | $ 143,217 |
| Commercial Mortgage Loans | 104 | 213,791 | 171,563 |
| Commercial & Industrial Loans | 70 | 113,467 | 68,131 |
| Construction Loans | 28 | 114,550 | 114,172 |
| Consumer Loans - Auto | 771 | 9,428 | 9,458 |
| Finance Leases | 109 | 1,899 | 1,912 |
| Consumer Loans - Other | 1,253 | 10,165 | 10,259 |
| Total Troubled Debt Restructurings | 3,215 | $ 600,565 | $ 518,712 |

Recidivism, or the borrower defaulting on its obligation pursuant to a modified loan, results in the loan once again becoming a non-performing loan. Recidivism occurs at a notably higher rate than do defaults on new origination loans, so modified loans present a higher risk of loss than do new origination loans. The Corporation considers a loan to have defaulted if the borrower has failed to make payments of either principal,

interest, or both for a period of 90 days or more.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Loan modifications considered troubled debt restructurings that defaulted during the year ended December 31, 2011 and had been modified in a TDR during the 12-months preceding the default date were as follows:

| | Year ended December 31, 2011 | |
|---|---|---|
| | Number of contracts | Recorded Investment |
| Non- FHA/VA Residential Mortgage loans | 199 | $ 36,106 |
| Commercial Mortgage Loans | 33 | 18,603 |
| Commercial & Industrial Loans | 5 | 926 |
| Construction Loans | 17 | 76,089 |
| Consumer Loans - Auto | 318 | 3,614 |
| Consumer Loans - Other | 4 | 40 |
| Finance Leases | 70 | 2,395 |
| Total | 646 | $ 137,773 |

The Corporation reevaluated all loans that have been restructured during 2011 in order to reassess if these loans had been properly classified as TDRs at the restructuring date according to Accounting Standards Update 2011-02. As a result of adopting the amendments in this Update, the Corporation reassessed all restructurings that occurred on or after the beginning of the current fiscal year (January 1, 2011) for identification as TDRs. Upon identifying those loans as TDRs, the Corporations identified them as impaired under the applicable guidance. The amendments in this Update require prospective application of the impairment measurement guidance for those loans newly identified as TDRs. At the end of the first interim period of adoption (September 30, 2011), the recorded investment in these loans newly identified as TDR under the applicable guidance of this Update was $99.5 million, and the allowance for credit losses associated with those loans, on the basis of a current evaluation of loss as of September 30, 2011, was $13.0 million.

For certain TDRs, the Corporation splits the loans into two new notes, A and B notes. The A note is restructured to comply with the Corporation s lending standards at current market rates, and is tailored to suit the customer s ability to make timely interest and principal payments. The B note includes the granting of the concession to the borrower and varies by situation. The B note is charged-off but the obligation is not forgiven to the borrower, and any payments collected are accounted for as recoveries. At the time of restructuring, the A note is identified and classified as a TDR. If the loan performs for at least six months according to the modified terms, the A note may be returned to accrual status. The borrower s payment performance prior to the restructuring are included in assessing whether the borrower can meet the new terms and may result in that the loans be returned to accrual status at the time of restructuring. In the periods following the calendar year in which a loan was restructured, the Note A may no longer be reported as a TDR if it is on accrual, is in compliance with its modified terms, and yields a market rate (as determined and documented at the time of the restructure)

The recorded investment in loans restructured using the A/B note restructure workout strategy was approximately $117.9 million at December 31, 2011. The following table provides additional information about the volume of this type of loan restructuring and the effect on the allowance for loan and lease losses in 2011:

| | (In thousands) |
|---|---|
| Principal balance deemed collectible at end of period | $ 117,931 |
| Amount charged-off | $ 35,850 |
| Charges to the provision for loan losses | $ 13,237 |

| | | |
|---|---|---|
| Allowance for loan losses as of December 31, 2011 | $ | 2,929 |

Of the loans comprising the $117.9 million that have been deemed collectible, approximately $106.0 million were placed in accruing status as the borrowers have exhibited a period of sustained performance. These loans continue to be individually evaluated for impairment purposes.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of December 31, 2011, the Corporation maintains a $2.8 million reserve for unfunded loan commitments mainly related to outstanding construction loans commitments. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included as part of accounts payable and other liabilities in the consolidated statement of financial condition.

**Note 9 Loans Held for Sale**

As of December 21, 2011 and 2010, the Corporation s loans held-for-sale portfolio was composed of:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (In thousands) | |
| Residential mortgage loans | $ 11,058 | $ 19,148 |
| Construction loans | 4,764 | 207,270 |
| Commercial and Industrial loans | | 20,643 |
| Commercial Mortgage loans | | 53,705 |
| Total | $ 15,822 | $ 300,766 |

Non-performing loans held for sale totaled $4.8 million (construction) and $159.3 million ($140.1 million construction loans and $19.2 million commercial mortgage loans) as of December 31, 2011 and December 31, 2010, respectively.

At the end of the fourth quarter of 2010, the Corporation transferred $447 million of loans to held for sale at a value of $281.6 million. This resulted in charge-offs at the time of transfer of $165.1 million. During the first quarter of 2011, these loans with a book value of $269.3 million were sold to CPG/GS in exchange for $88.5 million of cash, an acquisition loan of $136.1 million and a 35%, equity interest in CPG/GS. The Bank s 35% interest in CPG/GS is subordinated to the interest of the majority investor in CPG/GS, which is entitled to recover its investment and receive a priority 12% return on its invested capital. The Corporation s equity interest of $43.4 million as of December 31, 2011 is subordinated to the aggregate amount of its loans to CPG/GS in the amount of $201.2 million as of December 31, 2011 and to the interest and priority return of CPG/GS s majority investor. Further details of this transaction are discussed in Note 13. At December 31, 2011, the only related balance remaining from loans transferred in the fourth quarter of 2010 amounted to $4.8 million.

**Note 10 Related Party Transactions**

The Corporation granted loans to its directors, executive officers and certain related individuals or entities in the ordinary course of business. The movement and balance of these loans were as follows:

| | Amount (In thousands) |
|---|---|
| **Balance at December 31, 2009** | $ 24,170 |
| New loans | 9,842 |
| Payments | (3,618) |
| Other changes | (408) |

| | | |
|---|---|---|
| **Balance at December 31, 2010** | | 29,986 |
| New loans | | 1,539 |
| Payments | | (2,028) |
| Other changes | | (23,342) |
| **Balance at December 31, 2011** | $ | 6,155 |

These loans do not involve more than normal risk of collectability and management considers that they present terms that are no more favorable than those that would have been obtained if transactions had been with unrelated parties. The amounts reported as

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

other changes include changes in the status of those who are considered related parties, which, for 2011 are mainly due to the resignation of three independent directors of the Corporation and in 2010 was mainly due to the departure of an officer of the Corporation.

From time to time, the Corporation, in the ordinary course of its business, obtains services from related parties or makes contributions to non-profit organizations that have some association with the Corporation. Management believes the terms of such arrangements are consistent with arrangements entered into with independent third parties.

**Note 11 Premises and Equipment**

Premises and equipment is comprised of:

| | Useful Life In Years | As of December 31, 2011 | As of December 31, 2010 |
|---|---|---|---|
| | | (Dollars in thousands) | |
| Buildings and improvements | 10 - 40 | $ 141,706 | $ 144,599 |
| Leasehold improvements | 1 - 15 | 58,540 | 57,034 |
| Furniture and equipment | 3 - 10 | 137,338 | 142,407 |
| | | 337,584 | 344,040 |
| Accumulated depreciation | | (175,591) | (173,801) |
| | | 161,993 | 170,239 |
| Land | | 29,200 | 29,395 |
| Projects in progress | | 3,749 | 9,380 |
| Total premises and equipment, net | | $ 194,942 | $ 209,014 |

Depreciation and amortization expense amounted to $24.5 million, $20.9 million and $20.8 million for the years ended December 31, 2011, 2010 and 2009, respectively.

**Note 12 Goodwill and Other Intangibles**

Goodwill as of December 31, 2011 and 2010 amounted to $28.1 million, recognized as part of Other Assets . The Corporation conducted its annual evaluation of goodwill and intangibles during the fourth quarter of 2011. The evaluation was a two step process. The Step 1 evaluation of goodwill allocated to the Florida reporting unit indicated potential impairment of goodwill. The Step 1 fair value for the unit was below the carrying amount of its equity book value as of the October 1, 2011 valuation date, requiring the completion of Step 2. The Step 2 required a valuation of all assets and liabilities of the Florida unit, including any recognized and unrecognized intangible assets, to determine the fair value of net assets. To complete Step 2, the Corporation subtracted from the unit s Step 1 fair value the determined fair value of the net assets to arrive at the implied fair value of goodwill. The results of the Step 2 analysis indicated that the implied fair value of goodwill exceeded the goodwill carrying value by $13.7 million, resulting in no goodwill impairment. Goodwill was not impaired as of December 31, 2011 or 2010, nor was any goodwill written-off due to impairment during 2011, 2010 and 2009. Refer to Note 1 for additional details about the methodology used for the goodwill impairment analysis.

As of December 31, 2011, the gross carrying amount and accumulated amortization of core deposit intangibles was $41.8 million and $30.1 million, respectively, recognized as part of Other Assets in the consolidated statements of financial condition (December 31, 2010 $41.8 million and $27.8 million, respectively). For the year ended December 31, 2011, the amortization expense of core deposit intangibles amounted to

$2.4 million (2010 $2.6 million; 2009 $3.4 million). As a result of an impairment evaluation of core deposit intangibles, there was an impairment charge of $4.0 million recognized during 2009 related to core deposits in FirstBank Florida attributable to decreases in the base of core deposits acquired, which was recorded as part of other non-interest expenses in the statement of loss.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents the estimated aggregate annual amortization expense of the core deposit intangible:

| | Amount (In thousands) |
|---|---|
| 2012 | $ 2,354 |
| 2013 | 2,354 |
| 2014 | 2,354 |
| 2015 | 1,048 |
| 2016 and after | 3,579 |

**Note 13 Non-consolidated Variable Interest Entities and Servicing Assets**

The Corporation transfers residential mortgage loans in sale or securitization transactions in which it has continuing involvement, including servicing responsibilities and guarantee arrangements. All such transfers have been accounted for as sales as required by applicable accounting guidance.

When evaluating transfers and other transactions with Variable Interest Entities ( VIEs ) for consolidation under the recently adopted guidance, the Corporation first determines if the counterparty is an entity for which a variable interest exists. If no scope exception is applicable and a variable interest exists, the Corporation then evaluates if it is the primary beneficiary of the VIE and whether the entity should be consolidated or not.

Below is a summary of transfers of financial assets to VIEs for which the Corporation has retained some level of continuing involvement:

Ginnie Mae

The Corporation typically transfers first lien residential mortgage loans in conjunction with Ginnie Mae securitization transactions whereby the loans are exchanged for cash or securities that are readily redeemed for cash proceeds and servicing rights. The securities issued through these transactions are guaranteed by the issuer and, as such, under seller/servicer agreements the Corporation is required to service the loans in accordance with the issuers servicing guidelines and standards. As of December 31, 2011, the Corporation serviced loans securitized through GNMA with principal balance of $643.1 million.

Trust Preferred Securities

In 2004, FBP Statutory Trust I, a financing subsidiary of the Corporation, sold to institutional investors $100 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.1 million of FBP Statutory Trust I variable rate common securities, were used by FBP Statutory Trust I to purchase $103.1 million aggregate principal amount of the Corporation s Junior Subordinated Deferrable Debentures. Also in 2004, FBP Statutory Trust II, a statutory trust that is wholly-owned by the Corporation, sold to institutional investors $125 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.9 million of FBP Statutory Trust II variable rate common securities, were used by FBP Statutory Trust II to purchase $128.9 million aggregate principal amount of the Corporation s Junior Subordinated Deferrable Debentures. The trust preferred debentures are presented in the Corporation s Consolidated Statement of Financial Condition as Other Borrowings, net of related issuance costs. The variable rate trust preferred securities are fully and unconditionally guaranteed by the Corporation. The $100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the $125 million issued in September 2004 mature on September 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust preferred securities). The trust preferred securities, subject to certain limitations, qualify as Tier I regulatory capital under current Federal Reserve rules and regulations. The Collins Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act eliminates certain trust preferred securities from Tier 1 Capital, but TARP preferred securities are exempted from this treatment. These regulatory capital deductions for trust preferred securities are to

be phased in incrementally over a period of 3 years beginning on January 1, 2013.

Grantor Trusts

During 2004 and 2005, a third party to the Corporation, from now on identified as the seller, established a series of statutory trusts to effect the securitization of mortgage loans and the sale of trust certificates. The seller initially provided the servicing for a fee,

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

which is senior to the obligations to pay trust certificate holders. The seller then entered into a sales agreement through which it sold and issued the trust certificates in favor of the Corporation s banking subsidiary. Currently, the Bank is the sole owner of the trust certificates; the servicing of the underlying residential mortgages that generate the principal and interest cash flows, is performed by another third party, which receives a fee compensation for services provided, the servicing fee. The securities are variable rate securities indexed to 90 day LIBOR plus a spread. The principal payments from the underlying loans are remitted to a paying agent (servicer) who then remits interest to the Bank; interest income is shared to a certain extent with the FDIC, that has an interest only strip ( IO ) tied to the cash flows of the underlying loans, whereas it is entitled to received the excess of the interest income less a servicing fee over the variable rate income that the Bank earns on the securities. This IO is limited to the weighted average coupon of the securities. The FDIC became the owner of the IO upon the intervention of the seller, a failed financial institution. No recourse agreement exists and the risk from losses on non accruing loans and repossessed collateral are absorbed by the Bank as the sole holder of the certificates. As of December 31, 2011, the amortized balance of Grantor Trusts amounted to approximately $85 million with a weighted average yield of 2.19%.

Investment in unconsolidated entities

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage and C&I loans with an aggregate book value of $269.3 million to CPG/GS PR NPL, LLC ( CPG/GS or the Joint Venture ) organized under the Laws of the Commonwealth of Puerto Rico and majority owned by PRLP Ventures LLC ( PRLP ), a company created by Goldman, Sachs & Co. and Caribbean Property Group. In connection with the sale, the Corporation received $88.5 million in cash and a 35% interest in CPG/GS, and made a loan in the amount of $136.1 million representing seller financing provided by FirstBank. The loan has a 7-year maturity and bears variable interest at 30-day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity s assets as well as the PRLP s 65% ownership interest in CPG/GS. As of December 31, 2011, the carrying amount of the loan is $126.7 million and is included in the Corporation s C&I loan receivable portfolio; the carrying value of FirstBank s equity interest in CPG/GS is $43.4 million as of December 31, 2011, accounted under the equity method and included as part of Investment in unconsolidated entities in the Consolidated Statements of Financial Condition. When applying the equity method, the Bank follows the Hypothetical Liquidation Book Value method ( HLBV ) to determine its share in CPG/GS earnings or losses. Under HLBV, the Bank determines its share in CPG/GS earnings or losses by determining the difference between its claim on CPG/GS s book value at the end of the period as compared to the beginning of the period. This claim is calculated as the amount the Bank would receive if CPG/GS were to liquidate all of its assets at recorded amounts determined in accordance with GAAP and distribute the resulting cash to the investors, PRLP and FirstBank, according to their respective priorities as provided in the contractual agreement. CPG/GS records its loans receivable under the fair value option.

FirstBank also provided an $80 million advance facility to CPG/GS to fund unfunded commitments and costs to complete projects under construction, which was fully disbursed in the year ended December 31, 2011, and a $20 million working capital line of credit to fund certain expenses of CPG/GS. These loans bear variable interest at 30-day LIBOR plus 300 basis points. As of December 31, 2011, the carrying value of the advance facility and working capital line were $74.5 million and $0, respectively, and are included in the Corporation s C&I loan receivable portfolio.

Cash proceeds received by CPG/GS are first used to cover operating expenses and debt service payments, including the note receivable, the advanced facility and the working capital line, described above, which must be fully repaid before proceeds can be used for other purposes, including the return of capital to both PRLP and FirstBank. FirstBank will not receive any return on its equity interest until PRLP receives an aggregate amount equivalent to its initial investment and a priority return of at least 12%, resulting in FirstBank s interest in CPG/GS being subordinate to PRLP s interest. CPG/GS will then begin to make payments pro rata to PRLP and FirstBank, 35% and 65%, respectively, until FirstBank has achieved a 12% return on its invested capital and the aggregate amount of distributions is equal to FirstBank s capital contributions to CPG/GS. FirstBank may experience further losses associated with this transaction due to this subordination in an amount equal to up to the value of its interest in CPG/GS. Factors that could impact FirstBank s recoverability of its equity interest include lower than expected sale prices of units underlying CPG/GS assets and/or lower than projected liquidation value of the underlying collateral and changes in the expected timing of cash flows, among others.

The Bank has determined that CPG/GS is a VIE in which the Bank is not the primary beneficiary. In determining the primary beneficiary of CPG/GS, the Bank considered applicable guidance that requires the Bank to qualitatively assess the determination of the primary beneficiary (or consolidator) of CPG/GS based on whether it has both the power to direct the activities of CPG/GS that most significantly impact the entity s economic performance and the obligation to absorb losses of CPG/GS that could potentially be significant to the VIE or the right to receive

benefits from the entity that could potentially be significant to the VIE. The Bank determined that it does not have the power to direct the activities that most significantly impact the economic performance of CPG/GS as it does not have the right to manage the loan portfolio, impact foreclosure proceedings, or manage the construction and sale of the property; therefore, the Bank concluded that it is not the primary beneficiary of CPG/GS. As a creditor to CPG/GS, the Bank has

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

certain rights related to CPG/GS, however, these are intended to be protective in nature and do not provide the Bank with the ability to manage the operations of CPG/GS. Since CPG/GS is not a consolidated subsidiary of the Bank and given that the transaction met the criteria for sale accounting under authoritative guidance, the Bank accounted for this transaction as a true sale, recognizing the cash received, the notes receivable and the interest in CPG/GS and derecognizing the loan portfolio sold.

Equity in losses of unconsolidated entities of approximately $4.2 million for the year ended December 31, 2011, presented in the Statement of Loss, relate to the Bank s investment in CPG/GS. Approximately $1.9 million of such charges, recorded in the second quarter of 2011, represents an out of period adjustment to correct an overstatement of the carrying value of the Bank s investment CPG/GS recognized as of March 31, 2011. The overstatement was the result of the use of a discount factor in calculating the initial fair value of investment in unconsolidated entity of 16.24% based on the expected rate of return at the transaction date whereas, upon further consideration and additional information considered during the second quarter of 2011, the Corporation believes that a discount factor of 17.57% is more appropriate. In accordance with the Corporation s policy, which is based on the principles of Staff Accounting Bulletin ( SAB ) 99 and SAB 108, management concluded, with the agreement of the Corporation s Audit Committee, that the overstatement of the carrying value of the investment in CPG/GS was not individually or in the aggregate material to the first quarter or the second quarter of 2011.

The initial fair value of the investment in CPG/GS was determined using techniques with significant unobservable (Level 3) inputs. The valuation inputs included an estimate of future cash flows, expectations about possible variations in the amount and timing of cash flows, and a discount factor based on a rate of return. The Corporation researched available market data and internal information (i.e. proposals received for the servicing of distressed assets and public disclosures and information of similar structures and/or of distressed asset sales) and determined reasonable ranges of expected returns for FirstBank s equity interest.

The rate of return of 17.57% was used as the discount factor used to estimate the value of the FirstBank s equity interest and validated from a market participants perspective. A reasonable range of equity returns was assessed considering the range of company specific risk premiums. The valuation of this type of equity interest is highly subjective and somewhat dependent on non-observable market assumptions, which may result in variations from market participant to market participant.

*Servicing Assets*

As disclosed in Note 1, the Corporation is actively involved in the securitization of pools of FHA-insured and VA-guaranteed mortgages for issuance of GNMA mortgage-backed securities. Also, certain conventional conforming-loans are sold to FNMA or FHLMC with servicing retained. The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased.

The changes in servicing assets are shown below:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | | (In thousands) | |
| Balance at beginning of year | $ 15,597 | $ 11,902 | $ 8,151 |
| Capitalization of servicing assets | 5,150 | 6,607 | 6,072 |
| Amortization | (2,491) | (2,099) | (2,321) |
| Adjustment to servicing assets for loans repurchased (1) | (305) | (813) | |
| Balance before valuation allowance at end of year | 17,951 | 15,597 | 11,902 |
| Valuation allowance for temporary impairment | (2,725) | (434) | (745) |
| Balance at end of year | $ 15,226 | $ 15,163 | $ 11,157 |

(1) Amount represents the adjustment to fair value related to the repurchase of $38.7 million and $79.3 million for 2011 and 2010, respectively, in principal balance of loans serviced for others.

Impairment charges are recognized through a valuation allowance for each individual stratum of servicing assets. The valuation allowance is adjusted to reflect the amount, if any, by which the cost basis of the servicing asset for a given stratum of loans being serviced exceeds its fair value. Any fair value in excess of the cost basis of the servicing asset for a given stratum is not recognized. Other-than-temporary impairments, if any, are recognized as a direct write-down of the servicing assets.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Changes in the impairment allowance were as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | | (In thousands) | |
| Balance at beginning of year | $ 434 | $ 745 | $ 751 |
| Temporary impairment charges | 2,732 | 1,261 | 2,537 |
| Recoveries | (441) | (1,572) | (2,543) |
| Balance at end of year | $ 2,725 | $ 434 | $ 745 |

The components of net servicing income are shown below:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | | (In thousands) | |
| Servicing fees | $ 5,268 | $ 4,119 | $ 3,082 |
| Late charges and prepayment penalties | 751 | 624 | 581 |
| Adjustment for loans repurchased | (305) | (813) | |
| Servicing income, gross | 5,714 | 3,930 | 3,663 |
| Amortization and impairment of servicing assets | (4,782) | (1,788) | (2,315) |
| Servicing income, net | $ 932 | $ 2,142 | $ 1,348 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Corporation s servicing assets are subject to prepayment and interest rate risks. Key economic assumptions used in determining the fair value at the time of sale of the loans were as follows:

| | Maximum | Minimum |
|---|---|---|
| **2011:** | | |
| **Constant prepayment rate:** | | |
| Government guaranteed mortgage loans | 12.9% | 10.6% |
| Conventional conforming mortgage loans | 14.3% | 12.7% |
| Conventional non-conforming mortgage loans | 13.9% | 11.7% |
| **Discount rate:** | | |
| Government guaranteed mortgage loans | 12.0% | 11.3% |
| Conventional conforming mortgage loans | 11.5% | 9.3% |
| Conventional non-conforming mortgage loans | 15.0% | 13.8% |
| **2010:** | | |
| **Constant prepayment rate:** | | |
| Government guaranteed mortgage loans | 12.7% | 11.2% |
| Conventional conforming mortgage loans | 18.0% | 14.8% |
| Conventional non-conforming mortgage loans | 14.8% | 11.5% |
| **Discount rate:** | | |
| Government guaranteed mortgage loans | 11.7% | 10.3% |
| Conventional conforming mortgage loans | 9.3% | 9.2% |
| Conventional non-conforming mortgage loans | 13.1% | 13.1% |
| **2009:** | | |
| **Constant prepayment rate:** | | |
| Government guaranteed mortgage loans | 24.8% | 14.3% |
| Conventional conforming mortgage loans | 21.9% | 16.4% |
| Conventional non-conforming mortgage loans | 20.1% | 12.8% |
| **Discount rate:** | | |
| Government guaranteed mortgage loans | 13.6% | 11.8% |
| Conventional conforming mortgage loans | 9.3% | 9.2% |
| Conventional non-conforming mortgage loans | 13.2% | 13.1% |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

At December 31, 2011, fair values of the Corporation s servicing assets were based on a valuation model that incorporates market driven assumptions, adjusted by the particular characteristics of the Corporation s servicing portfolio, regarding discount rates and mortgage prepayment rates. The weighted-averages of the key economic assumptions used by the Corporation in its valuation model and the sensitivity of the current fair value to immediate 10 percent and 20 percent adverse changes in those assumptions for mortgage loans at December 31, 2011, were as follows:

| (Dollars in thousands) | |
|---|---|
| Carrying amount of servicing assets | $ 15,226 |
| Fair value | $ 15,919 |
| Weighted-average expected life (in years) | 7.78 |
| **Constant prepayment rate (weighted-average annual rate)** | 12.5% |
| Decrease in fair value due to 10% adverse change | $ 722 |
| Decrease in fair value due to 20% adverse change | $ 1,392 |
| **Discount rate (weighted-average annual rate)** | 11.10% |
| Decrease in fair value due to 10% adverse change | $ 596 |
| Decrease in fair value due to 20% adverse change | $ 1,151 |

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 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 servicing asset 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 may magnify or counteract the sensitivities.

**Note 14 Deposits and Related Interest**

Deposits and related interest consist of the following:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (In thousands) | |
| Type of account and interest rate: | | |
| Non-interest bearing checking accounts | $ 705,789 | $ 668,052 |
| Savings accounts - 0.25% to 1.61% (2010 - 0.50% to 2.27%) | 2,145,625 | 1,938,475 |
| Interest bearing checking accounts - 0.25% to 1.97% (2010 - 0.50% to 2.27%) | 1,066,753 | 1,012,009 |
| Certificates of deposit - 0.10% to 6.50% (2010 - 0.15% to 6.50%) | 2,258,216 | 2,181,205 |
| Brokered certificates of deposit - 0.30% to 5.05% (2010 - 0.20% to 5.05% ) | 3,731,371 | 6,259,369 |
| | $ 9,907,754 | $ 12,059,110 |

The weighted average interest rate on total interest-bearing deposits as of December 31, 2011 and 2010 was 1.57% and 1.80%, respectively.

As of December 31, 2010, the aggregate amount of overdrafts in demand deposits that were reclassified as loans amounted to $21.4 million (2010 $25.9 million).

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents a summary of CDs, including brokered CDs, with a remaining term of more than one year as of December 31, 2011:

| | Total<br>(In thousands) |
|---|---|
| Over one year to two years | $ 1,782,361 |
| Over two years to three years | 192,308 |
| Over three years to four years | 42,910 |
| Over four years to five years | 25,600 |
| Over five years | 13,353 |
| Total | $ 2,056,532 |

As of December 31, 2011, CDs in denominations of $100,000 or higher amounted to $5.0 billion (2010 $7.5 billion) including brokered CDs of $3.7 billion (2010 $6.3 billion) at a weighted average rate of 1.89% (2010 1.85%) issued to deposit brokers in the form of large ($100,000 or more) certificates of deposit that are generally participated out by brokers in shares of less than $100,000. As of December 31, 2011, unamortized broker placement fees amounted to $9.2 million (2010 $22.8 million), which are amortized over the contractual maturity of the brokered CDs under the interest method.

Brokered CDs mature as follows:

| | December 31, 2011<br>(In thousands) |
|---|---|
| One to ninety days | $ 680,970 |
| Over ninety days to one year | 1,782,469 |
| One to three years | 1,251,016 |
| Three to five years | 5,827 |
| Over five years | 11,089 |
| Total | $ 3,731,371 |

As of December 31, 2011, deposit accounts issued to government agencies with a carrying value of $480.9 million (2010 $470.0 million) were collateralized by securities and loans with an amortized cost of $661.8 million (2010 $555.6 million) and estimated market value of $679.0 million (2010 $569.6 million).

A table showing interest expense on deposits follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | (In thousands) | | |
| Interest-bearing checking accounts | $ 13,760 | $ 19,060 | $ 19,995 |

| | | | |
|---|---|---|---|
| Savings | 20,530 | 24,238 | 19,032 |
| Certificates of deposit | 45,960 | 44,790 | 50,939 |
| Brokered certificates of deposit | 111,477 | 160,628 | 224,521 |
| Total | $ 191,727 | $ 248,716 | $ 314,487 |

The interest expense on deposits includes the market valuation of interest rate swaps that economically hedge brokered CDs, the related interest exchanged, the amortization of broker placement fees related to brokered CDs not measured at fair value and changes in the fair value of callable brokered CDs measured at fair value. During 2009, all of the $1.1 billion of brokered CDs measured at fair value that were outstanding as of December 31, 2008 were called. The Corporation exercised its call option on swapped-to-floating brokered CDs after the cancellation of interest rate swaps by counterparties due to lower levels of 3-month LIBOR.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following are the components of interest expense on deposits:

| | Year Ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| | (In thousands) | | |
| Interest expense on deposits | $ 175,413 | $ 227,956 | $ 295,004 |
| Amortization of broker placement fees[1] | 16,314 | 20,758 | 22,858 |
| Interest expense on deposits excluding net unrealized loss (gain) on derivatives and brokered CDs measured at fair value | 191,727 | 248,714 | 317,862 |
| Net unrealized loss (gain) on derivatives and brokered CDs measured at fair value | | 2 | (3,375) |
| Total interest expense on deposits | $ 191,727 | $ 248,716 | $ 314,487 |

(1) Related to brokered CDs not measured at fair value.

Total interest expense on deposits includes net cash settlements on interest rate swaps that economically hedge brokered CDs that for the year ended December 31, 2009 amounted to net interest realized of $5.5 million.

**Note 15 Loans Payable**

Loans payable consisted of short-term borrowings under the FED Discount Window Program. During the second quarter of 2010, the Corporation repaid the remaining balance under the Discount Window. As the capital markets recovered from the crisis witnessed in 2009, the FED gradually reversed its stance back to lender of last resort. Advances from the Discount Window are once again discouraged, and as such, the Corporation no longer uses FED Advances for regular funding needs.

**Note 16 Securities Sold Under Agreements to Repurchase**

Securities sold under agreements to repurchase (repurchase agreements) consist of the following:

| | December, 31 2011 | 2010 |
|---|---|---|
| | (Dollars in thousands) | |
| Repurchase agreements, interest ranging from 2.50% to 4.40% (2010 - 0.99% to 4.51%) [1] | $ 1,000,000 | $ 1,400,000 |

(1) As of December 31, 2011, includes $900.0 million with an average rate of 3.36%, which lenders have the right to call before their contractual maturities at various dates beginning on January 19, 2012.

The weighted-average interest rates on repurchase agreements as of December 31, 2011 and 2010 were 3.27% and 3.74%, respectively. Accrued interest payable on repurchase agreements amounted to $5.6 million and $8.7 million as of December 31, 2011 and 2010, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Repurchase agreements mature as follows:

| | December 31, 2011 (In thousands) |
|---|---|
| Over ninety days to one year | $ 100,000 |
| One to three years | 200,000 |
| Three to five years | 400,000 |
| Over five years | 300,000 |
| Total | $ 1,000,000 |

The following securities were sold under agreements to repurchase:

| Underlying Securities | Amortized Cost of Underlying Securities | Balance of Borrowing | Approximate Fair Value of Underlying Securities | Weighted Average Interest Rate of Security |
|---|---|---|---|---|
| | December 31, 2011 (Dollars in thousands) | | | |
| U.S. Treasury securities and obligations of other U.S. Government Sponsored Agencies | $ 701,767 | $ 611,903 | $ 703,273 | 0.70% |
| Mortgage-backed securities | 445,093 | 388,097 | 463,992 | 3.61% |
| Total | $ 1,146,860 | $ 1,000,000 | $ 1,167,265 | |
| Accrued interest receivable | $ 4,296 | | | |

| Underlying Securities | Amortized Cost of Underlying Securities | Balance of Borrowing | Approximate Fair Value of Underlying Securities | Weighted Average Interest Rate of Security |
|---|---|---|---|---|
| | December 31, 2010 (Dollars in thousands) | | | |
| U.S. Treasury securities and obligations of other U.S. Government Sponsored Agencies | $ 980,103 | $ 877,008 | $ 989,424 | 1.29% |
| Mortgage-backed securities | 584,472 | 522,992 | 608,273 | 4.31% |
| Total | $ 1,564,575 | $ 1,400,000 | $ 1,597,697 | |
| Accrued interest receivable | $ 5,166 | | | |

The maximum aggregate balance outstanding at any month-end during 2011 was $1.4 billion (2010 $2.9 billion). The average balance during 2011 was $1.2 billion (2010 $2.2 billion). The weighted average interest rate during 2011 and 2010 was 3.77% and 3.82%, respectively.

As of December 31, 2011 and 2010, the securities underlying such agreements were delivered to the dealers with which the repurchase agreements were transacted.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Repurchase agreements as of December 31, 2011, grouped by counterparty, were as follows:

| (Dollars in thousands)<br>Counterparty | Amount | Weighted-Average Maturity (In Months) |
|---|---|---|
| JP Morgan Chase | $ 200,000 | 27 |
| Dean Witter / Morgan Stanley | 200,000 | 37 |
| Citigroup Global Markets | 300,000 | 58 |
| Credit Suisse First Boston | 300,000 | 72 |
| | $ 1,000,000 | |

As part of the Corporation s balance sheet restructuring strategies, approximately $400 million of repurchase agreements were repaid prior to maturity during 2011, realizing a loss of $10.6 million on the early extinguishment. The repaid repurchase agreements were scheduled to mature at various dates between September 2011 and September 2012 and had a weighted average cost of 2.74%. Prepayment penalties of $10.6 million for the early termination of the repurchase agreements were offset with gains of $11.0 million from the sale of low-yielding investment securities. This transaction contributed to improvements in the net interest margin.

In addition, during 2011, the Corporation restructured $700 million of repurchase agreements through amendments that include three to four year maturity extensions and are expected to result in additional reductions in the average cost of funding.

**Note 17 Advances from the Federal Home Loan Bank (FHLB)**

Following is a summary of the advances from the FHLB:

| | December, 31 2011 | December, 31 2010 |
|---|---|---|
| | (Dollars in thousands) | |
| Fixed-rate advances from FHLB with a weighted-average interest rate of 3.59% (2010 - 3.33%) | $ 367,440 | $ 653,440 |

Advances from FHLB mature as follows:

| | December, 31 2011 (In thousands) |
|---|---|
| Over thirty to ninety days | $ 14,000 |
| Over ninety days to one year | 145,000 |
| One to two years | 208,440 |
| Total | $ 367,440 |

Advances are received from the FHLB under an Advances, Collateral Pledge and Security Agreement (the Collateral Agreement ). Under the Collateral Agreement, the Corporation is required to maintain a minimum amount of qualifying mortgage collateral with a market value of generally 125% or higher than the outstanding advances. As of December 31, 2011, the estimated value of specific mortgage loans pledged as collateral amounted to $766.6 million (2010 $1.2 billion), as computed by the FHLB for collateral purposes. The carrying value of such loans as of December 31, 2011 amounted to $1.2 billion (2010 $1.9 billion). In addition, securities with an approximate estimated value of $109.0 million (2010 $3.4 million) and a carrying value of $112.4 million (2010 $3.6 million) were pledged to the FHLB. As of December 31, 2011, the Corporation had additional capacity of approximately $506 million on this credit facility based on collateral pledged at the FHLB, including a haircut reflecting the perceived risk associated with holding the collateral. Haircut refers to the percentage by which an asset s market value is reduced for purpose of collateral levels. Advances may be repaid prior to maturity, in whole or in part, at the option of the borrower upon payment of any applicable fee specified in the contract governing such advance. In calculating the fee, due consideration is given to (i)

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

all relevant factors, including but not limited to, any and all applicable costs of repurchasing and/or prepaying any associated liabilities and/or hedges entered into with respect to the applicable advance; and (ii) the financial characteristics, in their entirety, of the advance being prepaid; and (iii), in the case of adjustable-rate advances, the expected future earnings of the replacement borrowing as long as the replacement borrowing is at least equal to the original advance s par amount and the replacement borrowing s tenor is at least equal to the remaining maturity of the prepaid advance.

Also as part of the Corporation s deleveraging strategies, $100 million of advances from FHLB was repaid prior to maturity during the second quarter of 2011, which resulted in a $0.2 million loss on early extinguishment. The $100 million was scheduled to mature in July 2011 and had an interest rate of 1.62%.

**Note 18 Notes Payable**

Notes payable consist of:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (Dollars in thousands) | |
| Callable step-rate notes, bearing step increasing interest from 5.00% to 7.00% (6.00% as of December 31, 2011 and 2010) maturing on October 18, 2019, measured at fair value | $ 15,968 | $ 11,842 |
| Dow Jones Industrial Average (DJIA) linked principal protected notes: | | |
| Series A maturing on February 28, 2012 | 7,374 | 6,865 |
| Series B maturing on May 27, 2011 | | 7,742 |
| | $ 23,342 | $ 26,449 |

**Note 19 Other Borrowings**

Other borrowings consist of:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (Dollars in thousands) | |
| Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.75% over 3-month LIBOR (3.31% as of December 31, 2011 and 3.05% as of December 31, 2010) | $ 103,093 | $ 103,093 |
| Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.50% over 3-month LIBOR (3.06% as of December 31, 2011 and 2.80% as of December 31, 2010) | 128,866 | 128,866 |
| | $ 231,959 | $ 231,959 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

## Note 20 Earnings per Common Share

The calculations of earnings per common share for the years ended December 31, 2011, 2010 and 2009 follow:

| (In thousands, except per share information) | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Net loss | $ (82,232) | $ (524,308) | $ (275,187) |
| Non-cumulative preferred stock dividends (Series A through E) | | | (23,494) |
| Cumulative non-convertible preferred stock dividends (Series F) | | (11,618) | (19,167) |
| Cumulative convertible preferred stock dividend (Series G) | (16,903) | (9,485) | |
| Preferred stock discount accretion (Series G and F) [1] | (5,634) | (17,143) | (4,227) |
| Favorable impact from issuing common stock in exchange for Series G mandatorily convertible preferred stock (Refer to Note 22) [2] | 277,995 | | |
| Favorable impact from issuing common stock in exchange for Series A through E preferred stock net of issuance costs [3] (Refer to Note 22) | | 385,387 | |
| Favorable impact from issuing Series G mandatorily convertible preferred stock in exchange for Series F preferred stock [4] (Refer to Note 22) | | 55,122 | |
| Net income (loss) attributable to common stockholders - basic | 173,226 | (122,045) | (322,075) |
| Convertible preferred stock dividends and accretion | 22,537 | | |
| Net income (loss) attributable to common stockholders - diluted | 195,763 | (122,045) | (322,075) |
| Average common shares outstanding | 64,466 | 11,310 | 6,167 |
| Average potential common shares | 25,192 | | |
| Average common shares outstanding - assuming dilution | 89,658 | 11,310 | 6,167 |
| Basic earnings (loss) per common share | $ 2.69 | $ (10.79) | $ (52.22) |
| Diluted earnings (loss) per common share | $ 2.18 | $ (10.79) | $ (52.22) |

(1) Includes a non-cash adjustment of $0.2 million for the year ended December 31, 2011 and of $11.3 million for 2010 as an acceleration of the Series G preferred stock discount accretion pursuant to amendments to the exchange agreement with the U.S. Treasury, the sole holder of the Series G preferred stock.
(2) Excess of carrying amount of the Series G Preferred Stock exchanged over the fair value of new common shares issued in 2011.
(3) Excess of carrying amount of Series A through E preferred stock exchanged over the fair value of new common shares issued in 2010.
(4) Excess of carrying amount of Series F preferred stock exchanged and original warrant over the fair value of new Series G preferred stock issued in 2010 and amended warrant.

Earnings (loss) per common share is computed by dividing net income (loss) attributable to common stockholders by the weighted average common shares issued and outstanding. Net income (loss) attributable to common stockholders represents net (loss) income adjusted for preferred stock dividends including dividends declared, and cumulative dividends related to the current dividend period that have not been

declared as of the end of the period, and the accretion of discount on preferred stock issuances. For 2011, the net income attributable to common stockholders also includes the one-time effect of the issuance of common stock in the conversion of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the Series G preferred stock and in 2010, the one-time effect of the issuance of common stock in exchange for shares of the Series A through E preferred stock and the issuance of the Series G Preferred Stock in exchange for the Series F Preferred Stock. These transactions are discussed in Note 22 to the consolidated financial statements. Basic weighted average common shares outstanding exclude any unvested shares of restricted stock.

Potential common shares consist of common stock issuable under the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect on earnings per share. For the years ended December 31, 2011 and 2010, there were 129,934 and 131,532 outstanding stock options, respectively and 716 unvested shares of restricted stock in 2010, none in 2011, which were excluded from the computation of diluted earnings per common share because their inclusion would have an antidilutive effect.

The dilutive effect of convertible securities is reflected in the computation of diluted earnings per share using the if-converted method. The Series G Preferred Stock converted in the fourth quarter of 2011 was included in the denominator for the period prior to actual conversion and 32,941,797 common shares issued upon conversion were included in the weighted average shares outstanding for the period from their date of issuance through period end. For 2010, the amount of potential common shares was obtained based on the most advantageous conversion rate from the standpoint of the security holder and assumed the Corporation would not be able to compel conversion until the seven-year anniversary, at which date the conversion price would have been based on the Corporation s stock price in the open market and conversion would be based on the full liquidation value of $1,000 per share.

**Note 21 Stock Option Plan**

Between 1997 and January 2007, the Corporation had a stock option plan ( the 1997 stock option plan ) that authorized the granting of up to 579,740 options on shares of the Corporation s common stock to eligible employees. The options granted under the plan could not exceed 20% of the number of common shares outstanding. Each option provides for the purchase of one share of common stock at a price not less than the fair market value of the stock on the date the option was granted. Stock options were fully vested upon grant. The maximum term to exercise the options is ten years. The stock option plan provides for a proportionate adjustment in the exercise price and the number of shares that can be purchased in the event of a stock dividend, stock split, reclassification of stock, merger or reorganization and certain other issuances and distributions such as stock appreciation rights.

Under the 1997 stock option plan, the Compensation and Benefits Committee (the Compensation Committee ) had the authority to grant stock appreciation rights at any time subsequent to the grant of an option. Pursuant to stock appreciation rights, the optionee surrenders the right to exercise an option granted under the plan in consideration for payment by the Corporation of an amount equal to the excess of the fair market value of the shares of common stock subject to such option surrendered over the total option price of such shares. Any option surrendered is cancelled by the Corporation and the shares subject to the option are not eligible for further grants under the option plan. On January 21, 2007, the 1997 stock option plan expired; all outstanding awards granted under this plan continue in full force and effect, subject to their original terms. No awards for shares could be granted under the 1997 stock option plan as of its expiration.

On April 29, 2008, the Corporation s stockholders approved the First BanCorp 2008 Omnibus Incentive Plan (the Omnibus Plan ). The Omnibus Plan provides for equity-based compensation incentives (the awards ) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. This plan allows the issuance of up to 8,169,807 shares of common stock, subject to adjustments for stock splits, reorganizations and other similar events. The Corporation s Board of Directors, upon receiving the relevant recommendation of the Compensation Committee, has the power and authority to determine those eligible to receive awards and to establish the terms and conditions of any awards subject to various limits and vesting restrictions that apply to individual and aggregate awards. During the fourth quarter of 2008, the Corporation granted 2,412 shares of restricted stock with a fair value of $130.35 under the Omnibus Plan to the Corporation s independent directors. Of the original 2,412 shares of restricted stock, 268 were forfeited in the second half of 2009 and 270 were forfeited in the second half of 2011. All remaining shares of restricted stock have vested as of December 31, 2011.

For the years ended December 31, 2011, 2010 and 2009, the Corporation recognized $50,294, $93,332 and $92,361, respectively, of stock-based compensation expense related to the aforementioned restricted stock awards. As of December 31, 2011, the Corporation has recognized all compensation expense related to restricted shares.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

There were no stock options granted during 2011, 2010 and 2009, therefore no compensation associated with stock options was recorded in those years.

Stock-based compensation accounting guidance requires the Corporation to develop an estimate of the number of share-based awards that will be forfeited due to employee or director turnover. Quarterly changes in the estimated forfeiture rate may have a significant effect on share-based compensation, as the effect of adjusting the rate for all expense amortization is recognized in the period in which the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, then an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase to the expense recognized in the financial statements. When unvested options or shares of restricted stock are forfeited, any compensation expense previously recognized on the forfeited awards is reversed in the period of the forfeiture.

The activity of stock options during the year ended December 31, 2011 is set forth below:

| | For the Year Ended December 31, 2011 | | | |
|---|---|---|---|---|
| | Number of Options | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value (In thousands) |
| Beginning of year | 131,532 | $ 202.91 | | |
| Options cancelled | (1,598) | 196.51 | | |
| End of period outstanding and exercisable | 129,934 | $ 202.99 | 3.52 | $ |

No stock options were exercised during 2011, 2010 or 2009.

**Note 22 Stockholders Equity**

***Common Stock***

As of December 31, 2011 and 2010, the Corporation had 2,000,000,000 authorized shares of common stock with a par value of $0.10 per share. As of December 31, 2011 and 2010, there were 205,794,024 and 21,963,522 shares issued, respectively, and 205,134,171 and 21,303,669 shares outstanding, respectively. The increase in common shares is the result of the completion of the $525 million capital raise, the conversion of the Series G Preferred Stock into common stock and the completion of the Rights offering, all discussed below. In February 2009, the Corporation s Board of Directors declared a first quarter cash dividend of $1.05 per common share which was paid on March 31, 2009 to common stockholders of record on March 15, 2009 and in May 2009 declared a second quarter dividend of $1.05 per common share which was paid on June 30, 2009 to common stockholders of record on June 15, 2009. On July 30, 2009, the Corporation announced the suspension of common and preferred stock dividends effective with the preferred dividend for the month of August 2009.

As of December 31, 2011, all shares of restricted stock outstanding have vested. The shares of restricted stock may vest more quickly in the event of death, disability, retirement, or a change in control. Based on particular circumstances evaluated by the Compensation Committee as they may relate to the termination of a restricted stock holder, the Corporation s Board of Directors may, with the recommendation of the Compensation Committee, grant the full vesting of the restricted stock held upon termination of employment. Holders of restricted stock have the right to dividends or dividend equivalents, as applicable, during the restriction period. Such dividends or dividend equivalents will accrue during the restriction period, but will not be paid until restrictions lapse. The holder of restricted stock has the right to vote the shares.

The Corporation s stockholders approved on August 24, 2010 a decrease in the par value of the common stock from $1 per share to $0.10 per share. The decrease in the par value of the Corporation s common stock had no effect on the total dollar value of the Corporation s stockholders equity. For the year ended December 31, 2010, the Corporation transferred $5.6 million from common stock to additional paid-in capital, which is the product of the number of shares issued and outstanding and the difference between the old par value of $1 and new par value of $0.10, or $0.90.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On October 7, 2011, the Corporation successfully completed a private placement of $525 million in shares of common stock. In connection with the closing, the Corporation issued 150 million shares of common stock at $3.50 per share to institutional investors. The proceeds from the capital raise amounted to approximately $490 million (net of offering costs), of which $435 million have been contributed to the Corporation s wholly owned banking subsidiary, FirstBank. As previously reported, lead investors include funds affiliated with THL and Oaktree that purchased from the Corporation an aggregate of $348.2 million ($174.1 million each investor) of shares of the Corporation s common stock.

Upon the completion of this transaction and the conversion into common stock of the Series G Preferred Stock held by the U.S. Treasury, as further discussed below, each of THL and Oaktree became owners of 24.36% of the Corporation s shares of common stock outstanding. Subsequent to the closing, in related transactions, on October 12, 2011 and October 26, 2011, each of THL and Oaktree, respectively, purchased in the aggregate 937,493 shares of common stock from certain of the institutional investors who participated in the capital raise transaction. As of December 31, 2011, each of THL and Oaktree owns 24.71% of the total shares of common stock outstanding.

On December 8, 2011, the Corporation completed a rights offering in which the Corporation issued an additional 888,781 shares of common stock at $3.50 per share.

***Preferred Stock***

The Corporation has 50,000,000 authorized shares of preferred stock with a par value of $1, redeemable at the Corporation s option subject to certain terms. This stock may be issued in series and the shares of each series shall have such rights and preferences as shall be fixed by the Board of Directors when authorizing the issuance of that particular series. As of December 31, 2011, the Corporation has five outstanding series of non-convertible non-cumulative preferred stock: 7.125% non-cumulative perpetual monthly income preferred stock, Series A; 8.35% non-cumulative perpetual monthly income preferred stock, Series B; 7.40% non-cumulative perpetual monthly income preferred stock, Series C; 7.25% non-cumulative perpetual monthly income preferred stock, Series D; and 7.00% non-cumulative perpetual monthly income preferred stock, Series E. The liquidation value per share is $25. Effective January 17, 2012, the Corporation delisted all of the series of non-convertible, non-cumulative preferred stock from the New York Stock Exchange. The Corporation has not arranged for listing and/or registration on another national securities exchange or for quotation of the preferred stock in a quotation medium. The Corporation initially announced its intention to delist the non-convertible, non-cumulative preferred stock at the time it made an offer to issue shares of its common stock in exchange for any and all outstanding shares of the non-convertible, non-cumulative preferred stock (the Exchange Offer ). Approximately 89% of the outstanding non-convertible, non-cumulative preferred stock was exchanged for the Corporation s common stock in the Exchange Offer.

In January 2009, in connection with the TARP Capital Purchase Program, established as part of the Emergency Economic Stabilization Act of 2008, the Corporation issued to the U.S. Treasury 400,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series F, $1,000 liquidation preference value per share. The Series F Preferred Stock had a call feature after three years. In connection with this investment, the Corporation also issued to the U.S. Treasury a 10-year warrant (the Warrant ) to purchase 389,483 shares of the Corporation s common stock at an exercise price of $154.05 per share. The Corporation registered the Series F Preferred Stock, the Warrant and the shares of common stock underlying the Warrant for sale under the Securities Act of 1933. The Corporation recorded in 2009 the total $400 million of the preferred shares and the Warrant at their relative fair values of $374.2 million and $25.8 million, respectively. On July 20, 2010, the Corporation issued 424,174 shares of a new series of preferred stock with a liquidation preference of $1,000 per share, Series G Preferred Stock, to the U.S. Treasury in exchange for all 400,000 shares of the Corporation s Series F Preferred Stock, beneficially owned and held by the U.S. Treasury, and accrued dividends, as discussed below. The completion of the Capital Raise allowed for the conversion of the 424,174 shares of the Corporation s Series G preferred stock, held by the U.S. Treasury, into 32.9 million shares of common stock at a conversion price of $9.66 per share, as further discussed below.

*Exchange Offer*

On August 30, 2010, the Corporation completed its offer to issue shares of its common stock in exchange for its outstanding Series A through E Preferred Stock, which resulted in the issuance of 15,134,347 new shares of common stock in exchange for 19,482,128 shares of preferred stock with an aggregate liquidation amount of $487 million, or 89% of the outstanding Series A through E preferred stock. In accordance with the terms of the Exchange Offer, the Corporation used a relevant price of $17.70 per share of its common stock and an exchange ratio of 55% of the preferred stock liquidation preference to determine the number of shares of its common stock issued in exchange for the tendered shares of

Series A through E preferred stock. The fair value of the common stock was $6.00 per share, which was the price as of the expiration date of the exchange offer. The carrying (liquidation) value of the Series A through E preferred stock exchanged, or $487.1 million, was reduced and common stock and additional paid-in capital increased in

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the amount of the fair value of the common stock issued. The Corporation recorded the par amount of the shares issued as common stock ($0.10 per common share) or $1.5 million. The excess of the common stock fair value over the par amount, or $89.3 million, was recorded in additional paid-in capital. The excess of the carrying amount of the shares of preferred stock over the fair value of the shares of common stock, or $385.4 million, was recorded as a reduction to accumulated deficit and an increase in earnings per common share computation.

The results of the exchange offer with respect to Series A through E preferred stock were as follows:

| Title of Securities | Liquidation preference per share | Shares of preferred stock outstanding prior to exchange | Shares of preferred stock exchanged | Shares of preferred stock outstanding after exchange | Aggregate liquidation preference after exchange (In thousands) | Shares of common stock issued |
|---|---|---|---|---|---|---|
| 7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A | $ 25 | 3,600,000 | 3,149,805 | 450,195 | $ 11,255 | 2,446,872 |
| 8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B | $ 25 | 3,000,000 | 2,524,013 | 475,987 | 11,900 | 1,960,736 |
| 7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C | $ 25 | 4,140,000 | 3,679,389 | 460,611 | 11,515 | 2,858,265 |
| 7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D | $ 25 | 3,680,000 | 3,169,408 | 510,592 | 12,765 | 2,462,098 |
| 7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E | $ 25 | 7,584,000 | 6,959,513 | 624,487 | 15,612 | 5,406,376 |
| | | 22,004,000 | 19,482,128 | 2,521,872 | $ 63,047 | 15,134,347 |

Dividends declared on the non-convertible non-cumulative preferred stock in 2009 amounted to $23.5 million, respectively. Consistent with the Corporation s announcement in July 2009, no dividends have been declared during 2011 or 2010. As explained above, the Corporation voluntarily delisted the remaining Series A through E preferred stock from the New York Stock Exchange.

*Exchange Agreement with the U.S. Treasury*

On July 20, 2010, the Corporation issued $424.2 million Fixed Rate Cumulative Mandatorily Convertible Preferred Stock, Series G (the Series G Preferred Stock ), in exchange of the $400 million of Fixed Rate Cumulative Perpetual Preferred Stock, Series F (the Series F Preferred Stock ), that the U.S. Treasury had acquired pursuant to the TARP Capital Purchase Program, and dividends accrued on such stock. A key benefit of this transaction was obtaining the right, under the terms of the new Series G Preferred Stock, to compel the conversion of this stock into shares of the Corporation s common stock, provided that the Corporation meets a number of conditions. On August, 24, 2010, the Corporation obtained its stockholders approval to increase the number of authorized shares of common stock from 750 million to 2 billion and decrease the par value of its common stock from $1.00 to $0.10 per share. These approvals and the issuance in 2010 of approximately 227 million shares of common stock in exchange for Series A through E preferred stock satisfy all but one of the substantive conditions to the Corporation s ability to compel the conversion of the 424,174 shares of the new series of Series G Preferred Stock, issued to the U.S. Treasury. The other substantive condition to the Corporation s ability to compel the conversion of the Series G Preferred Stock is the issuance of a minimum amount of additional capital, subject to terms, other than the price per share, reasonably acceptable to the U.S. Treasury in its sole discretion which was completed on October 7, 2011, as further discussed below.

The Corporation accounted for this transaction in 2010 as an extinguishment of the previously issued Series F Preferred Stock. As a result, the Corporation recorded $424.2 million of the new Series G Preferred Stock, net of a $76.8 million discount and derecognized the carrying value of the Series F Preferred Stock. The excess of the carrying value of the Series F Preferred Stock over the fair value of the Series G Preferred Stock,

or $33.6 million, was recorded as a reduction to accumulated deficit.

The value of the base preferred stock component of the Series G Preferred Stock was determined using a discounted cash flow method and applying a discount rate. The cash flows, which consist of the sum of the discounted quarterly dividends plus the principal repayment, were discounted considering the Corporation s credit rating. The short and long call options were valued using a Cox-Rubinstein binomial option pricing model-based methodology. The valuation methodology considered the likelihood of option conversions under different scenarios, and the valuation interactions of the various components under each scenario. The difference from the par amount of the Series G Preferred Stock was accreted to preferred stock using the interest method with a corresponding adjustment to preferred dividends.

The completion of the capital raise on October 7, 2011 enabled the Corporation to compel the conversion of the 424,174 shares of the Corporation s Series G Preferred Stock, held by the U.S. Treasury, into 32.9 million shares of common stock at a conversion price of $9.66. In connection with the conversion, the Corporation paid to the U.S. Treasury $26.4 million for past due undeclared

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

cumulative dividends on the Series G Preferred Stock. The book value of the Series G Preferred Stock was approximately $277 million greater than the $89.6 million fair value of the common stock issued to the U.S. Treasury in the exchange. Although the excess book value of approximately $277 million was treated as a non-cash increase in income available to common stockholders in the fourth quarter of 2011, it has no effect on the Corporation s overall equity or its regulatory capital.

Additionally, in 2010, the Corporation issued an amended 10-year warrant (the Warrant ) to the U.S. Treasury to purchase 389,483 shares of the Corporation s common stock at an initial exercise price of $10.878 per share instead of the exercise price on the original warrant of $154.05 per share. The Corporation evaluated the fair market value of the new warrant and recognized in 2010 a $1.2 million increase in value due to the difference between the fair market value of the new and the old warrant as an increase to additional paid-in capital and an increase to the accumulated deficit. The Cox-Rubinstein binomial model was used to estimate the value of the Warrant. The Warrant was adjusted as a result of the Capital Raise to provide for the issuance of approximately 1,285,899 shares of common stock at an exercise price of $3.29 per share for a 10 year term, exercisable at any time. The exercise price and the number of shares issuable upon exercise of the Warrant are subject to certain anti-dilution adjustments.

The possible future issuance of equity securities through the exercise of the Warrant could affect the Corporation s current stockholders in a number of ways, including by:

- diluting the voting power of the current holders of common stock (the shares underlying the warrant represent approximately 0.69% of the Corporation s shares of common stock outstanding as of December 31, 2011);
- diluting the earnings per share and book value per share of the outstanding shares of common stock; and
- making the payment of dividends on common stock more expensive.

As mentioned above, the Corporation stopped paying dividends for common and all its outstanding series of preferred stock. This suspension was effective with the dividends for the month of August 2009 on the Corporation s five outstanding series of non-cumulative preferred stock and dividends or the Corporation s then outstanding Series F Preferred Stock and the Corporation s common stock.

***Stock repurchase plan and treasury stock***

The Corporation has a stock repurchase program under which, from time to time, it repurchases shares of common stock in the open market and holds them as treasury stock. No shares of common stock were repurchased during 2011 and 2010 by the Corporation. As of December 31, 2011 and December 31, 2010, of the total amount of common stock repurchased in prior years, 659,853 shares were held as treasury stock and were available for general corporate purposes.

***FirstBank Statutory Reserve***

The Banking Act of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank s net income for the year be transferred to legal surplus until such surplus equals the total of paid-in-capital on common and preferred stock. Amounts transferred to the legal surplus account from the retained earnings account are not available for distribution to the stockholders without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The net loss experienced in 2011 exhausted the FirstBank s statutory reserve fund. The Bank cannot pay dividends until it can replenish the reserve fund to an amount of at least 20% of the original capital contributed.

**Note 23 Employees Benefit Plan**

FirstBank provides contributory retirement plans pursuant to Section 1165(e) of the Puerto Rico Internal Revenue Code for Puerto Rico employees and Section 401(k) of the U.S. Internal Revenue Code for U.S. Virgin Islands and U.S. employees (the Plans ). All employees are eligible to participate in the Plans after three months of service for purposes of making elective deferral contributions and one year of service for purposes of sharing in the Bank s matching, qualified matching and qualified nonelective contributions. Under the provisions of the Plans, the Bank contributes 25% of the first 4% of the participant s compensation contributed to the Plans on a pre-tax basis. Participants are permitted to contribute up to $9,000 for 2009 and 2010, $10,000 for 2011, $13,000 for 2012 and $15,000 beginning on January 1, 2013 ($16,500 for 2011 and $17,000 for 2012 for U.S.V.I. and U.S. employees). Additional contributions to the Plans are voluntarily made by the Bank as determined by its Board of Directors. The Bank had a total plan expense of $0.6 million for the year ended December 31, 2011, $0.6 million for 2010 and $1.6 million for 2009.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In the past, FirstBank Florida provided a contributory retirement plan pursuant to Section 401(k) of the U.S. Internal Revenue Code for its U.S. employees (the Plan ). All employees were eligible to participate in the Plan after six months of service. Under the provisions of the Plan, FirstBank Florida contributed 100% of the first 3% of the participant s contribution and 50% of the next 2% of a participant s contribution up to a maximum of 4% of the participant s compensation. Effective July 1, 2009, the operations conducted by FirstBank Florida as a separate entity were merged with and into FirstBank Puerto Rico, the Plan sponsor. As a result of the merger, the retirement plan provided by FirstBank Florida was merged with and into the FirstBank Plan on April 29, 2010 and all assets of the FirstBank Florida 401(k) plan totaling approximately $2.2 million were transferred to the FirstBank Plan. FirstBank Florida had total plan expenses of approximately $151,000 for 2009.

**Note 24 Other Non-interest Income**

A detail of other non-interest income follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | (In thousands) | | |
| Commissions and fees- broker-dealer related | $ 1,735 | $ 2,544 | $ 469 |
| Insurance income | 4,456 | 7,752 | 8,668 |
| Gain on sale of assets FB Insurance VI | 2,845 | | |
| Other | 19,615 | 18,092 | 17,893 |
| Total | $ 28,651 | $ 28,388 | $ 27,030 |

**Note 25 Other Non-interest Expenses**

A detail of other non-interest expenses follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | (In thousands) | | |
| Servicing and processing fees | $ 9,145 | $ 8,984 | $ 10,174 |
| Communications | 7,117 | 7,979 | 8,283 |
| Supplies and printing | 2,168 | 2,307 | 3,073 |
| Core deposit intangible impairment | | | 3,988 |
| Other [1] | 8,715 | 20,974 | 18,824 |
| Total | $ 27,145 | $ 40,244 | $ 44,342 |

(1) The decrease in Other expenses in 2011 was mainly related to a decrease in the provision for off-balance sheet exposures, mainly unfunded loan commitments.

**Note 26 Income Taxes**

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes, The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the; conduct of a trade or business within the United States. Any such tax paid is also creditable against the Corporation s Puerto Rico tax liability, subject to certain conditions and limitations.

On January 31, 2011, the Puerto Rico Government approved Act No. 1, which repealed the 1994 Code ( 1994 PR Code ) and replaces it with the Puerto Rico Internal Revenue Code of 2011 ( 2011 PR Code ) .The provisions of the 2011 PR Code are generally applicable to taxable years commencing after December 31, 2010. Under the 2011 PR Code, the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carry forward period (7 years under the 2011 PR Code for losses incurred during tax year, except for losses incurred during tax years commenced after December 31, 2004 and before December 31, 2012, that the carry forward period is extended to 10 years). The 2011 PR Code provides a dividend received deduction of 100% on dividends received from controlled subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations. Dividend payments from a U.S. subsidiary to the Corporation are subject to a 10% withholding tax based on the provisions of the U.S. Internal Revenue Code.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Under the 2011 PR Code, First BanCorp is subject to a maximum statutory tax rate of 30% (25% for taxable years commencing after December 31, 2013 if certain economic conditions are met by the Puerto Rico economy). The 2011 PR Code also includes an alternative minimum tax of 20% that applies if the Corporation s regular income tax liability is less than the alternative minimum tax requirements. Prior to the 2011 PR Code, First BanCorp maximum statutory tax rate was 39% except for tax years commenced after December 31, 2008 and before January 1, 2012 which was 40.95% due to the approval by the Puerto Rico Government of Act No. 7 (the Act ), to stimulate Puerto Rico s economy and to reduce the Puerto Rico Government s fiscal deficit. The Act imposed a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which was applicable to corporations, among others, whose combined income exceeds $100,000,effectively resulting in an increase in the maximum statutory tax rate from 39% to 40.95% and an increase in capital gain statutory tax rate from 15% to 15.75%.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through International Banking Entity ( IBE ) of the Bank and through the Bank s subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation except for tax yeas that commenced after December 31, 2008 and before January 1, 2012, for which the Act No. 7 imposed a special 5% tax to all IBEs. The IBEs and FirsBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IRES operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs net income exceeds 20% of the bank s total net taxable income.

The components of income tax expense for the years ended December 31 are summarized below:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | | (In thousands) | |
| Current income tax (expense) benefit | $ (7,896) | $ (3,935) | $ 11,520 |
| Deferred income tax expense | (1,426) | (99,206) | (16,054) |
| Total income tax expense | $ (9,322) | $ (103,141) | $ (4,534) |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The differences between the income tax expense applicable to income before provision for income taxes and the amount computed by applying the statutory tax rate in Puerto Rico were as follows:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2009 | |
| | Amount | % of Pre-Tax Income | Amount | % of Pre-Tax Income | Amount | % of Pre-Tax Income |
| | (Dollars in thousands) | | | | | |
| Computed income tax at statutory rate | $ 21,873 | 30.00% | $ 172,468 | 40.95% | $ 110,832 | 40.95% |
| Federal and state taxes | (179) | (0.3)% | (286) | 0.0% | (311) | (0.1)% |
| Adjustment in deferred tax due to change in tax rate | (1,988) | (2.7)% | | 0.0% | | 0.0% |
| Benefit of net exempt income | 2,466 | 3.4% | 10,130 | 2.4% | 52,293 | 19.3% |
| Deferred tax valuation allowance | (21,958) | (30.1)% | (265,501) | (63.0)% | (184,397) | (68.1)% |
| (Recognition)/reversal of Unrecognized Tax Benefits | (3,247) | (4.5)% | | 0.0% | 18,515 | 6.8% |
| Non-tax deductible expenses | (4,092) | (5.6)% | (6,302) | (1.5)% | (7,648) | (2.8)% |
| Other-net | (2,197) | (3.0)% | (13,650) | (3.3)% | 6,182 | 2.3% |
| Total income tax provision | $ (9,322) | (12.8)% | $ (103,141) | (24.5)% | $ (4,534) | (1.7)% |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Significant components of the Corporation s deferred tax assets and liabilities as of December 31, 2011 and 2010 were as follows:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (In thousands) | |
| Deferred tax asset: | | |
| Allowance for loan and lease losses | $ 149,208 | $ 213,048 |
| Unrealized losses on derivative activities | 1,967 | 1,870 |
| Legal reserve | 240 | 312 |
| Reserve for insurance premium cancellations | 361 | 490 |
| Net operating loss and donation carryforward available | 207,539 | 219,963 |
| Impairment on investments | 4,575 | 4,492 |
| Tax credits available for carryforward | 3,491 | 3,629 |
| Unrealized net loss on equity investments | 993 | |
| Settlement payment - closing agreement | 5,625 | 7,313 |
| Unrealized loss on REO valuation | 8,143 | 9,652 |
| Other | 5,183 | 8,813 |
| Deferred tax asset | 387,325 | 469,582 |
| Deferred tax liability: | | |
| Unrealized gain on available-for-sale securities, net | 6,617 | 5,348 |
| Differences between the assigned values and tax bases of assets and liabilities recognized in purchase business combinations | 2,292 | 2,762 |

| | | |
|---|---|---|
| Unrealized gain on other investments | 360 | 468 |
| Other | 3,732 | 5,976 |
| Deferred tax liability | 13,001 | 14,554 |
| Valuation allowance | (368,882) | (445,759) |
| Deferred income taxes, net | $ 5,442 | $ 9,269 |

For 2011, the Corporation recorded an income tax expense of $9.3 million compared to an income tax expense of $103.1 million for 2010. The lower income tax expense for 2011 is mainly related to the impact in 2010 of an incremental $93.7 million non-cash charge to the valuation allowance of the Bank s deferred tax asset. The income tax expense for 2011 includes unrecognized tax benefits ( UTBs ) of $3.2 million, including accrued interest, as further discussed below. As of December 31, 2011, the deferred tax

**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

asset, net of a valuation allowance of $368.9 million, amounted to $5.4 million compared to $9.3 million as of December 31, 2010. The Corporation continued to increase the valuation allowance related to deferred tax assets created in connection with the operations of its banking subsidiary, FirstBank.

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on the consideration of all available evidence, using a more likely than not realization standard. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. In making such assessment, significant weight is to be given to evidence that can be objectively verified, including both positive and negative evidence. Consideration must be given to all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of the reversal of temporary differences and carryforwards, taxable income in carryback years and tax planning strategies. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance, and recognizes tax benefits only when deemed probable of realization.

In assessing the weight of positive and negative evidence, a significant negative factor that resulted in increases of the valuation allowance was that the Corporation s banking subsidiary, FirstBank Puerto Rico, continues in a three-year historical cumulative loss position as of the end of the year 2011, mainly due to charges to the provision for loan and lease losses as a result of the economic downturn. As of December 31, 2011, management concluded that $5.4 million of the deferred tax asset will be realized. The Corporation s deferred tax assets for which it has not established a valuation allowance relate to profitable subsidiaries and to amounts that can be realized through future reversals of existing taxable temporary differences. To the extent the realization of a portion, or all, of the tax asset becomes more likely than not based on changes in circumstances (such as, improved earnings, changes in tax laws or other relevant changes), a reversal of that portion of the deferred tax asset valuation allowance will then be recorded.

The tax effect of the unrealized holding gain or loss on securities available-for-sale, excluding that on securities held by the Corporation s international banking entities which is exempt, was computed based on a 15% capital gain tax rate, and is included in accumulated other comprehensive income as part of stockholders equity.

At December 31, 2011, the Corporation s gross deferred tax asset related to loss and other carry-forwards was $212.3 million. This was comprised of net operating loss carry-forward of $206.7 million, which will begin expiring in 2019, an alternative minimum tax credit carry-forward of $1.3 million, an extraordinary tax credit carryover of $3.5 million, and a charitable contribution carry-forward of $0.8 million which will begin expiring in 2013.

The authoritative accounting guidance prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under this guidance, income tax benefits are recognized and measured based upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this model and the tax benefit claimed on a tax return is referred to as an UTB.

During the third quarter of 2011, the Corporation recorded new UTBs of $2.4 million and related accrued interest of $0.8 million, all of which would, if recognized, affect the Corporations effective tax rate. The Corporation classified all interest and penalties, if any, related to tax uncertainties as income tax expense. As of December 31, 2011, the Corporation s accrued interest that relates to tax uncertainties amounted to $0.8 million and there is no need to accrue for the payment of penalties. The amount of UTBs may increase or decrease for various reasons, including changes in the amounts for current tax year positions, the expiration of open income tax returns due to the expiration of statutes of limitations, changes in management s judgment about the level of uncertainty, the status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions. The years 2007 through 2009 have been examined by the United States Internal Revenue Service ( IRS ) and disputed issues have been taken to administrative appeals. Although the timing of the resolution and/or closure of audits is highly uncertain, the Corporation believes it is reasonably possible that the IRS will conclude this audit within the next twelve months. If any issues addressed in the IRS audit are resolved in a manner not consistent with the Corporation s expectations, the Corporation could be required to adjust its provision for income taxes in the period such resolution occurs. The Corporation currently cannot reasonbaly estimate a range of possible changes to existing reserves

During the second quarter of 2009, the Corporation reversed UTBs of $10.8 million and related accrued interest of $5.3 million due to the lapse of the statute of limitations for the 2004 taxable year. Also, in July 2009, the Corporation entered into an agreement with the Puerto Rico Department of the Treasury to conclude an income tax audit and to eliminate all possible income and withholding tax deficiencies related to taxable years 2005, 2006, 2007 and 2008. As a result of such agreement, the Corporation reversed during the third quarter of 2009 the remaining UTBs and related interest by approximately $2.9 million, net of the payment made to the Puerto Rico Department of the Treasury in connection with the conclusion of the tax audit. For the year ended on December 31, 2009, the total amount of accrued interest reversed by the Corporation through income tax expense was $6.8 million.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table reconciles the balances of UTBs:

**Reconciliation of the Change in Unrecognized Tax Benefits**
(In thousands)

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Balance at beginning of year | $ | $ | $ 15,600 |
| Increases related to positions taken during prior years | 2,374 | | 173 |
| Decreases related to positions taken during prior years | | | (317) |
| Expiration of statute of limitations | | | (10,733) |
| Audit settlement | | | (4,723) |
| Balance at end of year | $ 2,374 | $ | $ |

The Corporation s liability for income taxes includes the liability for UTBs, and interest which relates to tax years still subject to review by taxing authorities. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the PR Code is 4 years; and for Virgin Islands and U.S. income tax purposes is 3 years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation s liability for income taxes. Any such adjustment could be material to results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. All tax years subsequent to 2009 remain open to examination under the PR Code, taxable years from 2008 remain open to examination for Virgin Islands and U.S. income tax purpose.

**Note 27 Lease Commitments**

As of December 31, 2010, certain premises are leased with terms expiring through the year 2036. The Corporation has the option to renew or extend certain leases beyond the original term. Some of these leases require the payment of insurance, increases in property taxes and other incidental costs. As of December 31, 2011, the obligation under various leases follows:

| | Amount (In thousands) |
|---|---|
| 2012 | $ 8,527 |
| 2013 | 6,764 |
| 2014 | 5,803 |
| 2015 | 4,940 |
| 2016 | 4,487 |
| 2017 and later years | 19,357 |
| Total | $ 49,878 |

Rental expense included in occupancy and equipment expense was $10.0 million in 2011 (2010 $10.8 million; 2009 $11.8 million).

**Note 28 Fair Value**

***Fair Value Option***

FASB authoritative guidance permits the measurement of selected eligible financial instruments at fair value.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Medium-Term Notes*

The Corporation elected the fair value option for certain medium term notes that were hedged with interest rate swaps that were previously designated for fair value hedge accounting. As of December 31, 2011 and 2010, these medium-term notes with a principal balance of $15.4 million, had a fair value of $16.0 million and $11.8 million, respectively, recorded in notes payable. Interest paid/accrued on these instruments is recorded as part of interest expense and the accrued interest is part of the fair value of the notes. Electing the fair value option allows the Corporation to eliminate the burden of complying with the requirements for hedge accounting (e.g., documentation and effectiveness assessment) without introducing earnings volatility.

Medium-term notes for which the Corporation elected the fair value option were priced using observable market data in the institutional markets.

*Callable brokered CDs*

In the past, the Corporation also measured at fair value callable brokered CDs. All of the brokered CDs measured at fair value were called during 2009.

***Fair Value Measurement***

The FASB authoritative guidance for fair value measurement defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs may be used to measure fair value:

**Level 1** Valuations of Level 1 assets and liabilities are obtained from readily available pricing sources for market transactions involving identical assets or liabilities. Level 1 assets and liabilities include equity securities that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. government and agency securities and corporate debt securities that are traded by dealers or brokers in active markets.

**Level 2** Valuations of Level 2 assets and liabilities are based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on the value of identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments and (iii) derivative contracts and financial liabilities (e.g., medium-term notes elected to be measured at fair value) whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

**Level 3** Valuations of Level 3 assets and liabilities are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models for which the determination of fair value requires significant management judgment or estimation.

For 2011, there have been no transfers into or out of Level 1 and Level 2 measurement of the fair value hierarchy.

***Estimated Fair Value of Financial Instruments***

The information about the estimated fair value of financial instruments required by GAAP is presented hereunder. The aggregate fair value amounts presented do not necessarily represent management s estimate of the underlying value of the Corporation.

The estimated fair value is subjective in nature and involves uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. 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.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents the estimated fair value and carrying value of financial instruments as of December 31, 2011 and December 31, 2010.

| | Total Carrying Amount in Statement of Financial Condition December 31, 2011 | Fair Value Estimated December 31, 2011 | Total Carrying Amount in Statement of Financial Condition December 31, 2010 | Fair Value Estimated December 31, 2010 |
|---|---|---|---|---|
| | | (In thousands) | | |
| **Assets:** | | | | |
| Cash and due from banks and money market investments | $ 446,566 | $ 446,566 | $ 370,283 | $ 370,283 |
| Investment securities available for sale | 1,923,268 | 1,923,268 | 2,744,453 | 2,744,453 |
| Investment securities held to maturity | | | 453,387 | 476,516 |
| Other equity securities | 37,951 | 37,951 | 55,932 | 55,932 |
| Loans held for sale | 15,822 | 16,038 | 300,766 | 300,766 |
| Loans, held for investment | 10,559,392 | | 11,655,436 | |
| Less: allowance for loan and lease losses | (493,917) | | (553,025) | |
| Loans held for investment, net of allowance | 10,065,475 | 9,618,267 | 11,102,411 | 10,581,221 |
| Derivatives, included in assets | 1,277 | 1,277 | 1,905 | 1,905 |
| **Liabilities:** | | | | |
| Deposits | 9,907,754 | 9,974,119 | 12,059,110 | 12,207,613 |
| Securities sold under agreements to repurchase | 1,000,000 | 1,102,263 | 1,400,000 | 1,513,338 |
| Advances from FHLB | 367,440 | 379,730 | 653,440 | 677,866 |
| Notes Payable | 23,342 | 22,476 | 26,449 | 24,909 |
| Other borrowings | 231,959 | 160,603 | 231,959 | 71,488 |
| Derivatives, included in liabilities | 7,834 | 7,834 | 6,701 | 6,701 |

Assets and liabilities measured at fair value on a recurring basis, including financial liabilities for which the Corporation has elected the fair value option, are summarized below:

| | As of December 31, 2011 Fair Value Measurements Using | | | | As of December 31, 2010 Fair Value Measurements Using | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | Level 1 | Level 2 | Level 3 | Assets / Liabilities at Fair Value | Level 1 | Level 2 | Level 3 | Assets / Liabilities at Fair Value |
| Assets: | | | | | | | | |
| Securities available for sale : | | | | | | | | |
| Equity securities | $ 41 | $ | $ | $ 41 | $ 59 | $ | $ | $ 59 |
| U.S. Treasury Securities | 476,992 | | | 476,992 | 608,714 | | | 608,714 |
| Non-callable U.S. agency debt | 301,585 | | | 301,585 | 304,257 | | | 304,257 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Callable U.S. agency debt and MBS | 859,818 | | 859,818 | 1,622,265 | | 1,622,265 |
| Puerto Rico Government Obligations | 219,369 | 3,244 | 222,613 | 134,165 | 2,676 | 136,841 |
| Private label MBS | | 61,206 | 61,206 | | 72,317 | 72,317 |
| Corporate bonds | | 1,013 | 1,013 | | | |
| Derivatives, included in assets: | | | | | | |
| Interest rate swap agreements | 378 | | 378 | 351 | | 351 |
| Purchased interest rate cap agreements | | | | 1 | | 1 |
| Purchased options used to manage exposure to the stock market on embeded stock indexed options | 899 | | 899 | 1,553 | | 1,553 |
| Liabilities: | | | | | | |
| Medium-term notes | 15,968 | | 15,968 | 11,842 | | 11,842 |
| Derivatives, included in liabilities: | | | | | | |
| Interest rate swap agreements | 6,767 | | 6,767 | 5,192 | | 5,192 |
| Written interest rate cap agreements | | | | 1 | | 1 |
| Embedded written options on stock index deposits and notes payable | 899 | | 899 | 1,508 | | 1,508 |
| Forward Contracts | 168 | | 168 | | | |

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**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

| (In thousands) | Changes in Fair Value for the Year Ended December 31, 2011, for items Measured at Fair Value Pursuant to Election of the Fair Value Option Unrealized (Losses) and Interest Expense included in Current-Period Earnings (1) |
| --- | --- |
| Medium-term notes | ($ 5,050) |

(1) Changes in fair value for the year ended December 31, 2011 include interest expense on medium-term notes of $0.9 million. Interest expense on medium-term notes that have been elected to be carried at fair value are recorded in interest expense in the Consolidated Statement of Loss based on their contractual coupons.

| (In thousands) | Changes in Fair Value for the Year Ended December 31, 2010, for items Measured at Fair Value Pursuant to Election of the Fair Value Option Unrealized Gains and Interest Expense included in Current-Period Earnings (1) |
| --- | --- |
| Medium-term notes | $ 670 |

(1)

Changes in fair value for the year ended December 31, 2010 include interest expense on medium-term notes of $0.8 million. Interest expense on medium-term notes that have been elected to be carried at fair value are recorded in interest expense in the Consolidated Statement of Loss based on their contractual coupons.

| | Changes in Fair Value for the Year Ended December 31, 2009, for items Measured at Fair Value Pursuant to Election of the Fair Value Option | | |
|---|---|---|---|
| (In thousands) | Unrealized Gains and Interest Expense included in Interest Expense on Deposits(1) | Unrealized Losses and Interest Expense included in Interest Expense on Notes Payable(1) | Total Changes in Fair Value Unrealized Losses and Interest Expense included in Current-Period Earnings(1) |
| Callable brokered CDs | $ (2,068) | $ | $ (2,068) |
| Medium-term notes | | (4,069) | (4,069) |
| | $ (2,068) | $ (4,069) | $ (6,137) |

(1) Changes in fair value for the year ended December 31, 2009 include interest expense on callable brokered CDs of $10.8 million and interest expense on medium-term notes of $0.8 million. Interest expense on callable brokered CDs and medium-term notes that have been elected to be carried at fair value are recorded in interest expense in the Consolidated Statements of Income based on such instruments contractual coupons.

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**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2011, 2010 and 2009. No level 3 assets were sold in 2011, 2010 or 2009.

| **Level 3 Instruments Only** | **Total Fair Value Measurements (Year Ended December 31, 2011)** | **Total Fair Value Measurements (Year Ended December 31, 2010)** | | **Total Fair Value Measurements (Year Ended December 31, 2009)** | |
|---|---|---|---|---|---|
| *(In thousands)* | **Securities Available For Sale[(2)]** | **Derivatives[(1)]** | **Securities Available For Sale[(2)]** | **Derivatives[(1)]** | **Securities Available For Sale[(2)]** |
| Beginning balance | $ 74,993 | $ 4,199 | $ 84,354 | $ 760 | $ 113,983 |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings | (1,971) | (1,152) | (582) | 3,439 | (1,270) |
| Included in other comprehensive income | 3,946 | | 5,613 | | (2,610) |
| New instruments acquired | | | 2,584 | | |
| Held-to-Maturity investment securities reclassified to Available-for-Sale | 2,000 | | | | |
| Principal repayments and amortization | (13,505) | | (16,976) | | (25,749) |
| Other [(1)] | | (3,047) | | | |
| Ending balance | $ 65,463 | $ | $ 74,993 | $ 4,199 | $ 84,354 |

(1) Amounts related to the valuation of interest rate cap agreements. The counterparty to these interest rate cap agreements failed on April 30, 2010 and was acquired by another financial institution through an FDIC assisted transaction. The Corporation currently has a claim with the FDIC.

(2) Amounts mostly related to certain private label mortgage-backed securities.

The table below summarizes changes in unrealized gains and losses recorded in earnings for the years ended December 31, 2011, 2010 and 2009 for Level 3 assets and liabilities that are still held at the end of each year.

| **Level 3 Instruments Only** | **Changes in Unrealized Losses (Year Ended December 31, 2011)** | **Changes in Unrealized Losses (Year Ended December 31, 2010)** | **Changes in Unrealized Gains (Losses) (Year Ended December 31, 2009)** | |
|---|---|---|---|---|
| *(In thousands)* | **Securities Available For Sale** | **Securities Available For Sale** | **Derivatives** | **Securities Available For Sale** |
| **Changes in unrealized losses relating to assets still held at reporting date[(1)] :** | | | | |
| Interest income on loans | $ | $ | $ 45 | $ |
| Interest income on investment securities | | | 3,394 | |
| | (1,971) | (582) | | (1,270) |

| | | | | |
|---|---|---|---|---|
| Net impairment losses on investment securities (credit component) | | | | |
| | $ (1,971) | $ (582) | $ 3,439 | $ (1,270) |

(1) Unrealized gain of $3.9 million was recognized on Level 3 available-for-sale securities as part of other comprehensive income for the year ended December 31, 2011, while unrealized losses of $5.6 million and $2.6 million were recognized for the years ended December 31, 2010 and 2009, respectively.

Additionally, fair value is used on a non-recurring basis to evaluate certain assets in accordance with GAAP. Adjustments to fair value usually result from the application of lower-of-cost-or-market accounting (e.g., loans held for sale carried at the lower of cost or fair value and repossessed assets) or write-downs of individual assets (e.g., goodwill, loans).

As of December 31, 2011, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:

| | Carrying value as of December 31, 2011 | | | Losses recorded for the Year Ended December 31, 2011 |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | |
| | | | (In thousands) | |
| Loans receivable (1) | $ | $ | $ 703,855 | $ 200,263 |
| Other Real Estate Owned (2) | | | 114,292 | 10,855 |

(1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair values are derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.

(2) The fair value is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates), which are not market observable. Losses are related to market valuation adjustments after the transfer from the loan to the Other real estate owned ( OREO ) portfolio.

FIRST BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of December 31, 2010, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:

| | Carrying value as of December 31, 2010 | | | Losses recorded for the Year Ended December 31, 2010 |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | |
| | | | (In thousands) | |
| Loans receivable (1) | $ | $ | $ 1,261,612 | $ 273,243 |
| Other Real Estate Owned (2) | | | 114,292 | 15,661 |
| Loans held for sale (3) | | 19,148 | 281,618 | 103,536 |

(1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair values are derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.

(2) The fair value is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates), which are not market observable. Losses are related to market valuation adjustments after the transfer from the loan to the OREO portfolio.

(3) Fair value is primarily derived from quotations based on the mortgage-backed securities market for level 2 assets. Level 3 loans held for sale are associated with the $447 million loans transferred to held for sale during the fourth quarter of 2010 recorded at a value of $281.6 million, or the sales price established for these loans by agreement entered into in February 2011. The Corporation completed the sale of substantially all of these loans on February 16, 2011.

As of December 31, 2009, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:

| | Carrying value as of December 31, 2009 | | | Losses recorded for the Year Ended December 31, 2009 |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | |
| | | | (In thousands) | |
| Loans receivable (1) | $ | $ | $ 1,103,069 | $ 144,024 |
| Other Real Estate Owned (2) | | | 69,304 | 8,419 |
| Core deposit intangible (3) | | | 6,683 | 3,988 |
| Loans held for sale (4) | | 20,775 | | 58 |

(1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair values are derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.

(2) The fair value is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates), which are not market observable. Losses are related to market valuation adjustments after the transfer from the loan to the Other Real Estate Owned ( OREO ) portfolio.

(3)

Amount represents core deposit intangible of First Bank Florida. The impairment was generally measured based on internal information about decreases in the base of core deposits acquired upon the acquisition of First Bank Florida.

(4) Fair value is primarily derived from quotations based on the mortgage-backed securities market.

The following is a description of the valuation methodologies used for instruments for which an estimated fair value is presented as well as for instruments for which the Corporation has elected the fair value option. The estimated fair value was calculated using certain facts and assumptions, which vary depending on the specific financial instrument.

*Cash and due from banks and money market investments*

The carrying amounts of cash and due from banks and money market investments are reasonable estimates of their fair value. Money market investments include held-to-maturity U.S. Government obligations, which have a contractual maturity of three months or less. The fair value of these securities is based on quoted market prices in active markets that incorporate the risk of nonperformance.

**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Investment securities available for sale and held to maturity*

The fair value of investment securities is the market value based on quoted market prices (as is the case with equity securities, U.S. Treasury notes and non-callable U.S. Agency debt securities), when available, or market prices for identical or comparable assets (as is the case with MBS and callable U.S. agency debt) that are based on observable market parameters including benchmark yields, reported trades, quotes from brokers or dealers, issuer spreads, bids, offers and reference data including market research operations. Observable prices in the market already consider the risk of nonperformance. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument, as is the case with certain private label mortgage-backed securities held by the Corporation.

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States; the interest rate on the securities is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread bias on a nonrated security. The market valuation is derived from a model that utilizes relevant assumptions such as prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (i.e. loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, others) in combination with prepayment forecasts obtained from a commercially available prepayment model (ADCO). The variable cash flow of the security is modeled using the 3-month LIBOR forward curve. Loss assumptions were driven by the combination of default and loss severity estimates, taking into account loan credit characteristics (loan-to-value, state, origination date, property type, occupancy loan purpose, documentation type, debt-to-income ratio, other) to provide an estimate of default and loss severity. Refer to Note 1 and Note 4 for additional information about assumptions used in the valuation of private label MBS.

*Other equity securities*

Equity or other securities that do not have a readily available fair value are stated at the net realizable value, which management believes is a reasonable proxy for their fair value. This category is principally composed of stock that is owned by the Corporation to comply with FHLB regulatory requirements. Their realizable value equals their cost as these shares can be freely redeemed at par.

*Loans receivable, including loans held for sale*

The fair value of loans held for investment and for mortgage loans held for sale was estimated using discounted cash flow analyses, based on interest rates currently being offered for loans with similar terms and credit quality and with adjustments that the Corporation s management believes a market participant would consider in determining fair value. Loans were classified by type such as commercial, residential mortgage, and automobile. These asset categories were further segmented into fixed- and adjustable-rate categories. The fair values of performing fixed-rate and adjustable-rate loans were calculated by discounting expected cash flows through the estimated maturity date. Loans with no stated maturity, like credit lines, were valued at book value. Prepayment assumptions were considered for non-residential loans. For residential mortgage loans, prepayment estimates were based on recent historical prepayment experience of the Corporation s residential mortgage portfolio. Discount rates were based on the Treasury and LIBOR/Swap Yield Curves at the date of the analysis, and included appropriate adjustments for expected credit losses and liquidity. For impaired collateral dependent loans, the impairment was primarily measured based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observable transactions involving similar assets in similar locations. For construction, commercial mortgage and commercial loans transferred to held for sale during the fourth quarter of 2010, the fair value equals the established sales price of these loans. The Corporation completed the sale of substantially all of these loans on February 16, 2011.

*Deposits*

The estimated fair value of demand deposits and savings accounts, which are deposits with no defined maturities, equals the amount payable on demand at the reporting date. The fair values of retail fixed-rate time deposits, with stated maturities, are based on the present value of the future cash flows expected to be paid on the deposits. The cash flows were based on contractual maturities; no early repayments are assumed. Discount rates were based on the LIBOR yield curve.

**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The estimated fair value of total deposits excludes the fair value of core deposit intangibles, which represent the value of the customer relationship measured by the value of demand deposits and savings deposits that bear a low or zero rate of interest and do not fluctuate in response to changes in interest rates.

The fair value of brokered CDs, which are included within deposits, is determined using discounted cash flow analyses over the full term of the CDs. The fair value of the CDs is computed using the outstanding principal amount. The discount rates used are based on brokered CD market rates as of December 31, 2011. The fair value does not incorporate the risk of nonperformance, since interests in brokered CDs are generally sold by brokers in amounts of less than $250,000 and, therefore, insured by the FDIC.

*Securities sold under agreements to repurchase*

Some repurchase agreements reprice at least quarterly, and their outstanding balances are estimated to be their fair value. Where longer commitments are involved, fair value is estimated using exit price indications of the cost of unwinding the transactions as of the end of the reporting period. Securities sold under agreements to repurchase are fully collateralized by investment securities.

*Advances from FHLB*

The fair value of advances from FHLB with fixed maturities is determined using discounted cash flow analyses over the full term of the borrowings, using indications of the fair value of similar transactions. The cash flows assume no early repayment of the borrowings. Discount rates are based on the LIBOR yield curve. For advances from FHLB that reprice quarterly, their outstanding balances are estimated to be their fair value. Advances from FHLB are fully collateralized by mortgage loans and, to a lesser extent, investment securities.

*Derivative instruments*

The fair value of most of the derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparties when appropriate, except when collateral is pledged. That is, on interest rate swaps, the credit risk of both counterparties is included in the valuation; and, on options and caps, only the seller s credit risk is considered. The derivative instruments, namely swaps and caps, were valued using a discounted cash flow approach using the related US LIBOR and swap rate for each cash flow. Derivatives include interest rate swaps used for protection against rising interest rates. For these interest rate swaps, a credit component was not considered in the valuation since the Corporation has fully collateralized with investment securities any mark to market loss with the counterparty and, if there were market gains, the counterparty had to deliver collateral to the Corporation.

Certain derivatives with limited market activity, as is the case with derivative instruments named as reference caps, were valued using models that consider unobservable market parameters (Level 3). Reference caps were used mainly to hedge interest rate risk inherent in private label MBS, thus were tied to the notional amount of the underlying fixed-rate mortgage loans originated in the United States. The counterparty to these derivative instruments failed on April 30, 2010. The Corporation currently has a claim with the FDIC and the exposure to fair value of $3.0 million was recorded as an accounts receivable. The Corporation no longer accounts for these reference caps as derivative instruments. In the past, significant inputs used for the fair value determination consisted of specific characteristics such as information used in the prepayment model which follow the amortizing schedule of the underlying loans, which is an unobservable input. The valuation model uses the Black formula, which is a benchmark standard in the financial industry. The Black formula is similar to the Black-Scholes formula for valuing stock options except that the spot price of the underlying is replaced by the forward price. The Black formula uses as inputs the strike price of the cap, forward LIBOR rates, volatility estimates and discount rates to estimate the option value. LIBOR rates and swap rates are obtained from Bloomberg L.P. ( Bloomberg ) every day and build a zero coupon curve based on the Bloomberg LIBOR/Swap curve. The discount factor is then calculated from the zero coupon curve. The cap is the sum of all caplets. For each caplet, the rate is reset at the beginning of each reporting period and payments are made at the end of each period. The cash flow of each caplet is then discounted from each payment date.

Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments resulted in an unrealized gain of approximately $0.8 million as of December 31, 2011.

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**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Term notes payable*

The fair value of term notes is determined using a discounted cash flow analysis over the full term of the borrowings. The model assumes that the embedded options are exercised economically. The fair value of medium-term notes is determined using a discounted cash flow analysis over the full term of the borrowings computed using the notional amount outstanding. The discount rates used in the valuations consider 3-month LIBOR forward curves and the credit spread at every cash flow. The net gain from fair value changes attributable to the Corporation s own credit to the medium-term notes for which the Corporation has elected the fair value option amounted to $0.8 million for 2011, compared to an unrealized gain of $1.1 million for 2010 and an unrealized loss of $3.1 million for 2009. The cumulative mark-to-market unrealized gain on the medium-term notes, since measured at fair value, attributable to credit risk amounted to $2.9 million as of December 31, 2011.

*Other borrowings*

Other borrowings consist of junior subordinated debentures. Projected cash flows from the debentures were discounted using the LIBOR yield curve plus a credit spread. This credit spread was estimated using the difference in yield curves between Swap rates and a yield curve that considers the industry and credit rating of the Corporation as issuer of the note at a tenor comparable to the time to maturity of the debentures.

**Note 29 Supplemental Cash Flow Information**

Supplemental cash flow information follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | | (In thousands) | |
| Cash paid for: | | | |
| Interest on borrowings | $ 255,363 | $ 358,294 | $ 494,628 |
| Income tax | 2,852 | 1,248 | 7,391 |
| Non-cash investing and financing activities: | | | |
| Additions to other real estate owned | 155,621 | 113,997 | 98,554 |
| Additions to auto and other repossessed assets | 65,049 | 77,754 | 80,568 |
| Capitalization of servicing assets | 5,150 | 6,607 | 6,072 |
| Loan securitizations | 214,399 | 217,257 | 305,378 |
| Non-cash acquisition of mortgage loans that previously served as collateral of a commercial loan to a local financial institution | | | 205,395 |
| Loans held for investment transferred to held for sale | | 281,618 | |
| Change in par value of common stock | | 5,552 | |
| Preferred Stock exchanged for new common stock issued: | | | |
| Preferred stock exchanged (Series A through E) | | 476,192 | |
| New common stock issued | | 90,806 | |
| Series F preferred stock exchanged for Series G preferred stock: | | | |
| Preferred stock exchanged (Series F) | | 378,408 | |
| New Series G preferred stock issued | | 347,386 | |
| Fair value adjustment on amended common stock warrant | | 1,179 | |
| Preferred Stock exchanged for new common stock issued: | | | |
| Preferred stock exchanged (Series G) | 361,962 | | |
| New common stock issued | 89,602 | | |
| Loans sold to CPG/GS in exchange for an acquisition loan and an equity interest in CPG/GS | 183,709 | | |
| Reclassification of Held-to-Maturity investment securities to Available-for-Sale | 88,751 | | |

**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 30 Regulatory Matters, Commitments and Contingencies**

The Corporation is subject to various regulatory capital requirements imposed by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation must meet specific capital guidelines that involve quantitative measures of the Corporation s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation s capital amounts and classification are also subject to qualitative judgment by the regulators about components, risk weightings and other factors.

Capital standards established by regulations require the Corporation to maintain minimum amounts and ratios for Leverage (Tier 1 capital to average total assets) and ratios of Tier 1 Capital to Risk-Weighted Assets and Total Capital to Risk-Weighted Assets as defined in the regulations. The total amount of risk-weighted assets is computed by applying risk-weighting factors to the Corporation s assets and certain off-balance sheet items, which generally vary from 0% to 100% depending on the nature of the asset.

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into the FDIC Order with the FDIC and OCIF. This Order provides for various things, including (among other things) the following: (1) having and retaining qualified management; (2) increased participation in the affairs of FirstBank by its board of directors; (3) development and implementation by FirstBank of a capital plan to attain a leverage ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 10% and a total risk-based capital ratio of at least 12%; (4) adoption and implementation of strategic, liquidity and fund management and profit and budget plans and related projects within certain timetables set forth in the FDIC Order and on an ongoing basis; (5) adoption and implementation of plans for reducing FirstBank s positions in certain classified assets and delinquent and non-accrual loans within timeframes set forth in the FDIC Order; (6) refraining from lending to delinquent or classified borrowers already obligated to FirstBank on any extensions of credit so long as such credit remains uncollected, except where FirstBank s failure to extend further credit to a particular borrower would be detrimental to the best interests of FirstBank, and any such additional credit is approved by the FirstBank s Board of Directors; (7) refraining from accepting, increasing, renewing or rolling over brokered CDs without the prior written approval of the FDIC; (8) establishment of a comprehensive policy and methodology for determining the allowance for loan and lease losses and the review and revision of FirstBank s loan policies, including the non-accrual policy; and (9) adoption and implementation of adequate and effective programs of independent loan review, appraisal compliance and an effective policy for managing FirstBank s sensitivity to interest rate risk. The foregoing summary is not complete and is qualified in all respects by reference to the actual language of the FDIC Order. Although all the regulatory capital ratios exceeded the established well capitalized levels and the minimum capital ratio requirements of the FDIC Order at December 31, 2011, because of the FDIC Order with the FDIC, FirstBank cannot be treated as a well capitalized institution under regulatory guidance.

Effective June 3, 2010, First BanCorp entered into the Written Agreement with the FED. The Agreement provides, among other things, that the holding company must serve as a source of strength to FirstBank, and that, except upon consent of the FED, (1) the holding company may not pay dividends to stockholders or receive dividends from FirstBank, (2) the holding company and its nonbank subsidiaries may not make payments on trust preferred securities or subordinated debt, and (3) the holding company cannot incur, increase or guarantee debt or repurchase any capital securities. The Written Agreement also requires that the holding company submit a capital plan which reflects sufficient capital at First BanCorp on a consolidated basis, which must be acceptable to the FED, and follow certain guidelines with respect to the appointment or change in responsibilities of senior officers. The foregoing summary is not complete and is qualified in all respects by reference to the actual language of the Written Agreement.

The Corporation submitted its capital plan setting forth how it plans to improve capital positions to comply with the FDIC Order and the Written Agreement over time. Additional information about the Corporation s achievement of various aspects of the Capital Plan and the terms of the Capital Plan are described above in Note 1.

In addition to the Capital Plan, the Corporation has submitted to its regulators a liquidity and brokered CD plan, including a contingency funding plan, a non-performing asset reduction plan, a budget and profit plan, a strategic plan and a plan for the reduction of classified and special mention assets. Further, the Corporation has reviewed and enhanced the Corporation s loan review program, various credit policies, the Corporation s treasury and investment policy, the Corporation s asset classification and allowance for loan and lease losses and non-accrual policies, the Corporation s charge-off policy and the Corporation s appraisal program. The Agreements also require the submission to the regulators of quarterly progress reports.

The FDIC Order imposes no other restrictions on FirstBank s products or services offered to customers, nor does it or the Written Agreement impose any type of penalties or fines upon FirstBank or the Corporation. Concurrent with the FDIC Order, the FDIC has granted FirstBank temporary waivers to enable it to continue accessing the brokered CD market through March 31, 2012. FirstBank will request approvals for future periods.

**FIRST BANCORP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Corporation s and its banking subsidiary s regulatory capital positions as of December 31, 2011 and 2010 were as follows:

| | | | Regulatory Requirements | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Actual | | For Capital Adequacy Purposes | | To be Well-Capitalized-Regular Thresholds | | Consent Order Capital requirements | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (Dollars in thousands) | | | | | | | |
| **At December 31, 2011** | | | | | | | | |
| Total Capital (to Risk-Weighted Assets) | | | | | | | | |
| First BanCorp | $ 1,742,357 | 17.12% | $ 814,418 | 8% | N/A | N/A | N/A | N/A |
| FirstBank | $ 1,688,496 | 16.58% | $ 814,789 | 8% | $ 1,018,486 | 10% | $ 1,222,184 | 12% |
| Tier I Capital (to Risk-Weighted Assets) | | | | | | | | |
| First BanCorp | $ 1,607,191 | 15.79% | $ 407,209 | 4% | N/A | N/A | N/A | N/A |
| FirstBank | $ 1,553,374 | 15.25% | $ 407,395 | 4% | $ 611,092 | 6% | $ 1,018,486 | 10% |
| Leverage ratio | | | | | | | | |
| First BanCorp | $ 1,607,191 | 11.91% | $ 539,942 | 4% | N/A | N/A | N/A | N/A |
| FirstBank | $ 1,553,374 | 11.52% | $ 539,500 | 4% | $ 674,375 | 5% | $ 1,078,999 | 8% |
| **At December 31, 2010** | | | | | | | | |
| Total Capital (to Risk-Weighted Assets) | | | | | | | | |
| First BanCorp | $ 1,366,951 | 12.02% | $ 909,828 | 8% | N/A | N/A | N/A | N/A |
| FirstBank | $ 1,315,580 | 11.57% | $ 909,575 | 8% | $ 1,136,969 | 10% | $ 1,364,363 | 12% |
| Tier I Capital (to Risk-Weighted Assets) | | | | | | | | |
| First BanCorp | $ 1,219,854 | 10.73% | $ 454,914 | 4% | N/A | N/A | N/A | N/A |
| FirstBank | $ 1,168,523 | 10.28% | $ 454,788 | 4% | $ 682,181 | 6% | $ 1,136,969 | 10% |
| Leverage ratio | | | | | | | | |
| First BanCorp | $ 1,219,854 | 7.57% | $ 644,805 | 4% | N/A | N/A | N/A | N/A |
| FirstBank | $ 1,168,523 | 7.25% | $ 644,283 | 4% | $ 805,354 | 5% | $ 1,288,567 | 8% |

The following table presents a detail of commitments to extend credit, standby letters of credit and commitments to sell loans:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| | (In thousands) | |
| Financial instruments whose contract amounts represent credit risk: | | |
| Commitments to extend credit: | | |
| To originate loans | $ 129,271 | $ 189,437 |
| Unused personal lines of credit | 31,134 | 32,230 |
| Commercial lines of credit | 409,297 | 390,171 |
| Commercial letters of credit | 52,340 | 71,641 |
| Standby letters of credit | 25,448 | 84,338 |
| Commitments to sell loans | 20,226 | 92,147 |

The Corporation s exposure to credit loss in the event of nonperformance by the other party to the financial instrument on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. Management uses the same credit policies and approval process in entering into commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. There have been no significant or unexpected draws on existing commitments. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility, at any time and without cause. Generally, the Corporation s mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers. The amount of any collateral obtained if deemed necessary by the Corporation upon an extension of credit is based on management s credit evaluation of the borrower. Rates charged on loans that are finally disbursed are the rates being offered at the time the loans are closed; therefore, no fee is charged on these commitments.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In general, commercial and standby letters of credit are issued to facilitate foreign and domestic trade transactions. Normally, commercial and standby letters of credit are short-term commitments used to finance commercial contracts for the shipment of goods. The collateral for these letters of credit includes cash or available commercial lines of credit. The fair value of commercial and standby letters of credit is based on the fees currently charged for such agreements, which, as of December 31, 2011 and 2010, was not significant.

The Corporation obtained from GNMA, Commitment Authority to issue GNMA mortgage-backed securities. Under this program, for 2011, the Corporation securitized approximately $214.4 million of FHA/VA mortgage loan production into GNMA mortgage-backed securities.

Lehman Brothers Special Financing, Inc. ( Lehman ) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which constituted an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement due as of December 31, 2011 under the swap agreements, the Corporation has an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately $1.4 million. This exposure was reserved in the third quarter of 2008. The Corporation had pledged collateral of $63.6 million with Lehman to guarantee its performance under the swap agreements in the event payment thereunder was required. As of December 31, 2011, the Corporation maintained a non-performing account receivable of $64.5 million related to the collateral pledged with Lehman.

The Corporation believes that the securities pledged as collateral should not be part of the Lehman bankruptcy estate given the fact that the posted collateral constituted a performance guarantee under the swap agreements and was not part of a financing agreement, and that ownership of the securities was never transferred to Lehman. Upon termination of the interest rate swap agreements, Lehman s obligation was to return the collateral to the Corporation. During the fourth quarter of 2009, the Corporation discovered that Lehman Brothers, Inc., acting as agent of Lehman, had deposited the securities in a custodial account at JP Morgan Chase, and that, shortly before the filing of the Lehman bankruptcy proceedings, it had provided instructions to have most of the securities transferred to Barclays Capital ( Barclays ) in New York. After Barclays s refusal to turn over the securities, during December 2009, the Corporation filed a lawsuit against Barclays in federal court in New York demanding the return of the securities.

During February 2010, Barclays filed a motion with the court requesting that the Corporation s claim be dismissed on the grounds that the allegations of the complaint are not sufficient to justify the granting of the remedies therein sought. Shortly thereafter, the Corporation filed its opposition motion. A hearing on the motions was held in court on April 28, 2010. The court, on that date, after hearing the arguments by both sides, concluded that the Corporation s equitable-based causes of action, upon which the return of the investment securities is being demanded, contain allegations that sufficiently plead facts warranting the denial of Barclays motion to dismiss the Corporation s claim. Accordingly, the judge ordered the case to proceed to trial. Subsequent to the court decision, the district court judge transferred the case to the Lehman bankruptcy court for trial. Upon such transfer, the bankruptcy court began to entertain the pre-trial procedures including discovery of evidence. In this regard, an initial scheduling conference was held before the United States Bankruptcy Court for the Southern District of New York on November 17, 2010, at which time a proposed case management plan was approved. Discovery has commenced pursuant to that case management plan and is currently scheduled for completion by March 31, 2012, but this timing is subject to adjustment. While the Corporation believes it has valid reasons to support its claim for the return of the securities, the Corporation may not succeed in its litigation against Barclays to recover all or a substantial portion of the securities.

Additionally, the Corporation continues to pursue its claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to Lehman Brothers Incorporated in the United States Bankruptcy Court for the Southern District of New York. An estimated loss was not accrued as the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value. If additional relevant negative facts become available in future periods, a need to recognize a partial or full reserve of this claim may arise. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the Corporation has maintained such collateral as a non-performing asset since the second quarter of 2009.

As of December 31, 2011, First BanCorp and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. Management believes that the final disposition of these matters will not have a material adverse effect on the Corporation s financial position or results of operations.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 31 Derivative Instruments and Hedging Activities**

One of the market risks facing the Corporation is interest rate risk, which includes the risk that changes in interest rates will result in changes in the value of the Corporation s assets or liabilities and the risk that net interest income from its loan and investment portfolios will be adversely affected by changes in interest rates. The overall objective of the Corporation s interest rate risk management activities is to reduce the variability of earnings caused by changes in interest rates.

The Corporation designates a derivative as a fair value hedge, cash flow hedge or as an economic undesignated hedge when it enters into the derivative contract. As of December 31, 2011 and 2010, all derivatives held by the Corporation were considered economic undesignated hedges. These undesignated hedges are recorded at fair value with the resulting gain or loss recognized in current earnings.

The following summarizes the principal derivative activities used by the Corporation in managing interest rate risk:

*Interest rate cap agreements* - Interest rate cap agreements provide the right to receive cash if a reference interest rate rises above a contractual rate. The value increases as the reference interest rate rises. The Corporation enters into interest rate cap agreements for protection from rising interest rates. Specifically, the interest rate on certain of the Corporation s commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the referenced residential mortgage collateral, less a contractual servicing fee. During the second quarter of 2010, the counterparty for interest rate caps for certain private label MBS was taken over by the FDIC, which resulted in the immediate cancelation of all outstanding commitments, and as a result, interest rate caps with a notional amount of $90.4 million are no longer considered to be derivative financial instruments. The total exposure to fair value of $3.0 million related to such contracts was reclassified to an account receivable.

*Interest rate swaps* - Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of December 31, 2011, most of the interest rate swaps outstanding are used for protection against rising interest rates. Similar to unrealized gains and losses arising from changes in fair value, net interest settlements on interest rate swaps are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being economically hedged.

*Indexed options* - Indexed options are generally over-the-counter (OTC) contracts that the Corporation enters into in order to receive the appreciation of a specified Stock Index (e.g., Dow Jones Industrial Composite Stock Index) over a specified period in exchange for a premium paid at the contract s inception. The option period is determined by the contractual maturity of the notes payable tied to the performance of the Stock Index. The credit risk inherent in these options is the risk that the exchange party may not fulfill its obligation.

*Forward Contracts* - Forward contracts are sales of to-be-announced ( TBA ) mortgage-backed securities that will settle over the standard delivery date and do not qualify as regular way security trades. Regular-way security trades are contracts with no net settlement provision and no market mechanism to facilitate net settlement and they provide for delivery of a security within the time generally established by regulations or conventions in the market-place or exchange in which the transaction is being executed. The forward sales are considered derivative instruments that need to be marked-to-market. These securities are used to hedge the FHA/VA residential mortgage loans securitizations of the mortgage-banking operations. Unrealized gains (losses) are recognized as part of mortgage banking activities in the Consolidated Statement of Loss.

To satisfy the needs of its customers, the Corporation may enter into non-hedging transactions. On these transactions, generally, the Corporation participates as a buyer in one of the agreements and as a seller in the other agreement under the same terms and conditions.

In addition, the Corporation enters into certain contracts with embedded derivatives that do not require separate accounting as these are clearly and closely related to the economic characteristics of the host contract. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated, carried at fair value, and designated as a trading or non-hedging derivative instrument.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the notional amounts of all derivative instruments as of December 31, 2011 and December 31, 2010:

| | Notional Amounts | |
|---|---|---|
| | As of December 31, 2011 | As of December 31, 2010 |
| | (In thousands) | |
| **Economic undesignated hedges:** | | |
| Interest rate contracts: | | |
| Interest rate swap agreements used to hedge loans | $ 39,786 | $ 41,248 |
| Written interest rate cap agreements | 67,894 | 71,602 |
| Purchased interest rate cap agreements | 67,894 | 71,602 |
| Equity contracts: | | |
| Embedded written options on stock index deposits and notes payable | 46,515 | 53,515 |
| Purchased options used to manage exposure to the stock market on embedded stock index options | 46,515 | 53,515 |
| Forward Contracts | | |
| Sale of TBA GNMA MBS pools | 19,000 | |
| | $ 287,604 | $ 291,482 |

The following table summarizes the fair value of derivative instruments and the location in the statement of financial condition as of December 31, 2011 and 2010:

| | Asset Derivatives | | | Liability Derivatives | | |
|---|---|---|---|---|---|---|
| | | As of December 31, | | | As of December 31, | |
| | | 2011 | 2010 | | 2011 | 2010 |
| | Statement of Financial Condition Fair Location | Fair Value | Fair Value | Statement of Financial Condition Location | Fair Value | Fair Value |
| | | (In thousands) | | | | |
| **Economic undesignated hedges:** | | | | | | |
| Interest rate contracts: | | | | | | |
| Interest rate swap agreements used to hedge loans | Other assets | $ 378 | $ 351 | Accounts payable and other liabilities | $ 6,767 | $ 5,192 |
| Written interest rate cap agreements | Other assets | | | Accounts payable and other liabilities | | 1 |
| Purchased interest rate cap agreements | Other assets | | 1 | Accounts payable and other liabilities | | |
| Equity contracts: | | | | | | |
| Embedded written options on stock index deposits | Other assets | | | Interest-bearing deposits | | |
| Embedded written options on stock index notes payable | Other assets | | | Notes payable | 899 | 1,508 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Purchased options used to manage exposure to the stock market on embedded stock index options | Other assets | 899 | 1,553 | Accounts payable and other liabilities | | |
| Forward Contracts: | | | | | | |
| Sales of TBA GNMA MBS pools | Other assets | | | Accounts payable and other liabilities | 168 | |
| | | $ 1,277 | $ 1,905 | | $ 7,834 | $ 6,701 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the effect of derivative instruments on the statement of loss for the years ended December 31, 2011, 2010 and 2009:

| | Location of Gain or (Loss) Recognized in Income on Derivatives | Gain or (Loss) Year Ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|---|
| | | (In thousands) | | |
| **ECONOMIC UNDESIGNATED HEDGES:** | | | | |
| Interest rate contracts: | | | | |
| Interest rate swap agreements used to hedge fixed-rate: | | | | |
| Brokered CDs | Interest expense - Deposits | $ | $ | $ (5,236) |
| Notes payable | Interest expense - Notes payable and other borrowings | | | 3 |
| Loans | Interest income - Loans | (1,548) | (92) | 2,023 |
| Written and purchased interest rate cap agreements - mortgage-backed securities | Interest income - Investment securities | | (1,136) | 3,394 |
| Written and purchased interest rate cap agreements - loans | Interest income - loans | | (38) | 102 |
| Equity contracts: | | | | |
| Embedded written and purchased options on stock index deposits | Interest expense - Deposits | | (2) | (85) |
| Embedded written and purchased options on stock index notes payable | Interest expense - Notes payable and other borrowings | (45) | 51 | (202) |
| Forward contracts: | | | | |
| Sales of TBA GNMA MBS pools | Mortgage banking activities | (168) | | |
| Total (loss) gain on derivatives | | $ (1,761) | $ (1,217) | $ (1) |

Derivative instruments, such as interest rate swaps, are subject to market risk. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market s expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future.

A summary of interest rate swaps as of December 31, 2011 and 2010 follows:

| | As of December 31, 2011 | As of December 31, 2010 |
|---|---|---|
| | (Dollars in thousands) | |
| Pay fixed/receive floating: | | |
| Notional amount | $ 39,786 | $ 41,248 |
| Weighted-average receive rate at period end | 2.13% | 2.14% |
| Weighted-average pay rate at period end | 6.82% | 6.83% |
| Floating rates range from 167 to 252 basis points over 3-month LIBOR | | |

As of December 31, 2011, the Corporation has not entered into any derivative instrument containing credit-risk-related contingent features.

***Credit and Market Risk of Derivatives***

The Corporation uses derivative instruments to manage interest rate risk. By using derivative instruments, the Corporation is exposed to credit and market risk. If the counterparty fails to perform, credit risk is equal to the extent of the Corporation s fair value gain in the derivative. When the fair value of a derivative instrument contract is positive, this generally indicates that the counterparty owes the Corporation and, therefore, creates a credit risk for the Corporation. When the fair value of a derivative instrument contract is negative, the Corporation owes the counterparty and, therefore, it has no credit risk. The Corporation minimizes the credit risk in derivative instruments by entering into transactions with reputable broker dealers (financial institutions) that are reviewed periodically by the Corporation s Management s Investment and Asset Liability Committee (MIALCO) and by the Board of Directors. The Corporation also maintains a policy of requiring that all derivative instrument contracts be governed by an International Swaps and Derivatives Association Master Agreement, which includes a provision for netting; most of the Corporation s agreements with derivative counterparties include bilateral collateral arrangements. The bilateral collateral arrangement permits the counterparties to perform margin calls in the form of cash or securities in the event that the fair market value of the derivative favors either

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

counterparty. The book value and aggregate market value of securities pledged as collateral for interest rate swaps as of December 31, 2011 was $6.6 million and $7.1 million, respectively (2010 $40.6 million and $42.4 million, respectively). The Corporation has a policy of diversifying derivatives counterparties to reduce the risk that any counterparty will default.

The Corporation has credit risk of $1.3 million (2010 $1.9 million) related to derivative instruments with positive fair values. The credit risk does not consider the value of any collateral and the effects of legally enforceable master netting agreements. There were no credit losses associated with derivative instruments recognized in 2011, 2010 or 2009. As of December 31, 2011, the Corporation had a total net interest settlement payable of $0.2 million (2010 net interest settlement payable of $0.1 million) related to the swap transactions. The net settlements receivable and net settlements payable on interest rate swaps are included as part of Other Assets and Accounts payable and other liabilities , respectively, on the Consolidated Statements of Financial Condition.

Market risk is the adverse effect that a change in interest rates or implied volatility rates has on the value of a financial instrument. The Corporation manages the market risk associated with interest rate contracts by establishing and monitoring limits as to the types and degree of risk that may be undertaken.

The Corporation s derivative activities are monitored by the MIALCO as part of its risk-management oversight of the Corporation s treasury functions.

**Note 32 Segment Information**

Based upon the Corporation s organizational structure and the information provided to the Chief Executive Officer of the Corporation and, to a lesser extent, the Board of Directors, the operating segments are driven primarily by the Corporation s lines of business for its operations in Puerto Rico, the Corporation s principal market, and by geographic areas for its operations outside of Puerto Rico. As of December 31, 2011, the Corporation had six reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments; United States operations and Virgin Islands operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation s organizational chart, nature of the products, distribution channels and the economic characteristics of the products were also considered in the determination of the reportable segments.

The Commercial and Corporate Banking segment consists of the Corporation s lending and other services for large customers represented by specialized and middle-market clients and the public sector. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings as well as other products such as cash management and business management services. The Mortgage Banking segment s operations consist of the origination, sale and servicing of a variety of residential mortgage loans. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. In addition, the Mortgage Banking segment includes mortgage loans purchased from other local banks and mortgage bankers. The Consumer (Retail) Banking segment consists of the Corporation s consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. The Treasury and Investments segment is responsible for the Corporation s investment portfolio and treasury functions executed to manage and enhance liquidity. This segment lends funds to the Commercial and Corporate Banking, Mortgage Banking and Consumer (Retail) Banking segments to finance their lending activities and borrows from those segments and from the United States Operations segment. The Consumer (Retail) Banking and the United States Operations segments also lend funds to other segments. The interest rates charged or credited by Treasury and Investments, the Consumer (Retail) Banking and the United States Operations segments are allocated based on market rates. The difference between the allocated interest income or expense and the Corporation s actual net interest income from centralized management of funding costs is reported in the Treasury and Investments segment. The United States operations segment consists of all banking activities conducted by FirstBank in the United States mainland, including commercial and retail banking services. The Virgin Islands operations segment consists of all banking activities conducted by the Corporation in the U.S. and British Virgin Islands, including commercial and retail banking services and insurance activities.

The accounting policies of the segments are the same as those described in Note 1 Nature of Business and Summary of Significant Accounting Policies .

The Corporation evaluates the performance of the segments based on net interest income, the estimated provision for loan and lease losses, non-interest income and direct non-interest expenses. The segments are also evaluated based on the average volume of their interest-earning assets less the allowance for loan and lease losses.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents information about the reportable segments (in thousands):

| (In thousands) | Mortgage Banking | Consumer (Retail) Banking | Commercial and Corporate | Treasury and Investments | United States Operations | Virgin Islands Operations | Total |
|---|---|---|---|---|---|---|---|
| **For the year ended December 31, 2011:** | | | | | | | |
| Interest income | $ 118,346 | $ 168,520 | $ 206,494 | $ 64,536 | $ 45,095 | $ 56,624 | $ 659,615 |
| Net (charge) credit for transfer of funds | (61,466) | 11,769 | (16,002) | 49,430 | 16,269 | | |
| Interest expense | | (41,902) | | (177,599) | (39,906) | (6,696) | (266,103) |
| Net interest income | 56,880 | 138,387 | 190,492 | (63,633) | 21,458 | 49 | |