

FIRST BANCORP /PR/  
Form 10-Q  
August 15, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 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  
(State or other jurisdiction of  
incorporation or organization)

66-0561882  
(I.R.S. employer  
identification number)

1519 Ponce de León Avenue, Stop 23  
Santurce, Puerto Rico  
(Address of principal executive offices)

00908  
(Zip Code)

(787) 729-8200

(Registrant's telephone number, including area code)

Not applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 ☐

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 Exchange Act).

Yes ☐ No ☒

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock: 21,303,669 outstanding as of July 31, 2011.

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**Forward Looking Statements**

This Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this Form 10-Q 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 meant to 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 collectively 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 attain certain capital levels and reduce its special mention, classified, delinquent and non-performing assets;

uncertainty as to whether the Corporation's stockholders will approve the proposal being presented at the Special Meeting of Stockholders to be held on August 23, 2011 to issue shares of common stock to institutional investors (the capital raise), which will enable the Corporation to compel the United States Department of the Treasury (the U.S. Treasury) to convert into common stock the shares of the Corporation's Fixed Rate Cumulative Mandatorily Convertible Preferred Stock, Series G (the Series G Preferred Stock), that the Corporation issued to the U.S. Treasury;

uncertainty as to whether the Corporation will be able to complete any other future capital-raising efforts;

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 Order;

the risk of not being able to fulfill the Corporation's cash obligations or resume paying dividends to the Corporation's stockholders due to the Corporation's inability to receive approval from the FED to receive dividends from FirstBank;

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 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 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;

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uncertainty about regulatory and legislative changes for financial services companies in Puerto Rico, the United States and the U.S. and British Virgin Islands, 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;

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 British Virgin Islands;

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 expense;

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

the impact on the Corporation's results of operations and financial condition associated with acquisitions and dispositions;

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

risks that further downgrades in the credit ratings of the Corporation's long-term senior debt will adversely affect the Corporation's ability to make future borrowings;

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

general competitive factors and industry consolidation; and

the possible future dilution to holders of the Corporation's common stock resulting from additional issuances of common stock or securities convertible into common stock.

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 refer to the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010, as well as, Part II, Item 1A, Risk Factors in this quarterly report on form 10-Q for a discussion of such factors and certain risks and uncertainties to which the Corporation is subject.

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**FIRST BANCORP**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**(Unaudited)**

| (In thousands, except for share information)                                    | <b>June 30, 2011</b> | <b>December 31, 2010</b> |
|---------------------------------------------------------------------------------|----------------------|--------------------------|
| <b>ASSETS</b>                                                                   |                      |                          |
| Cash and due from banks                                                         | \$ 239,488           | \$ 254,723               |
| Money market investments:                                                       |                      |                          |
| Federal funds sold                                                              | 5,369                | 6,236                    |
| Time deposits with other financial institutions                                 | 855                  | 1,346                    |
| Other short-term investments                                                    | 107,985              | 107,978                  |
| Total money market investments                                                  | 114,209              | 115,560                  |
| Investment securities available for sale, at fair value:                        |                      |                          |
| Securities pledged that can be replugged                                        | 1,371,887            | 1,344,873                |
| Other investment securities                                                     | 1,462,199            | 1,399,580                |
| Total investment securities available for sale                                  | 2,834,086            | 2,744,453                |
| Investment securities held to maturity, at amortized cost:                      |                      |                          |
| Securities pledged that can be replugged                                        |                      | 239,553                  |
| Other investment securities                                                     |                      | 213,834                  |
| Total investment securities held to maturity (2010-fair value of \$476,516)     |                      | 453,387                  |
| Other equity securities                                                         | 42,252               | 55,932                   |
| Investment in unconsolidated entities                                           | 46,092               |                          |
| Loans, net of allowance for loan and lease losses of \$540,878 (2010 \$553,025) | 10,224,647           | 11,102,411               |
| Loans held for sale, at lower of cost or market                                 | 20,781               | 300,766                  |
| Total loans, net                                                                | 10,245,428           | 11,403,177               |
| Premises and equipment, net                                                     | 203,140              | 209,014                  |
| Other real estate owned                                                         | 96,618               | 84,897                   |
| Accrued interest receivable on loans and investments                            | 51,719               | 59,061                   |
| Due from customers on acceptances                                               | 696                  | 1,439                    |
| Other assets                                                                    | 240,245              | 211,434                  |
| Total assets                                                                    | \$ 14,113,973        | \$ 15,593,077            |

**LIABILITIES**

## Deposits:

|                                                                                                                                |            |            |
|--------------------------------------------------------------------------------------------------------------------------------|------------|------------|
| Non-interest-bearing deposits                                                                                                  | \$ 720,573 | \$ 668,052 |
| Interest-bearing deposits                                                                                                      | 10,352,155 | 11,391,058 |
| Total deposits                                                                                                                 | 11,072,728 | 12,059,110 |
| Securities sold under agreements to repurchase                                                                                 | 1,200,000  | 1,400,000  |
| Advances from the Federal Home Loan Bank (FHLB)                                                                                | 420,440    | 653,440    |
| Notes payable (including \$12,374 and \$11,842 measured at fair value as of June 30, 2011 and December 31, 2010, respectively) | 19,715     | 26,449     |
| Other borrowings                                                                                                               | 231,959    | 231,959    |
| Bank acceptances outstanding                                                                                                   | 696        | 1,439      |
| Accounts payable and other liabilities                                                                                         | 158,857    | 162,721    |
| Total liabilities                                                                                                              | 13,104,395 | 14,535,118 |

## Commitments and Contingencies (Note 22)

**STOCKHOLDERS EQUITY**

Preferred stock, authorized 50,000,000 shares: issued 22,828,174; outstanding 2,946,046; aggregate liquidation value of \$487,221:

|                                                                                                                    |               |               |
|--------------------------------------------------------------------------------------------------------------------|---------------|---------------|
| Fixed Rate Cumulative Mandatorily Convertible Preferred Stock: issued and outstanding 424,174 shares               | 365,656       | 361,962       |
| Non-cumulative Perpetual Monthly Income Preferred Stock: issued 22,004,000 shares and outstanding 2,521,872 shares | 63,047        | 63,047        |
| Common stock, \$0.10 par value, authorized 2,000,000,000 shares; issued 21,963,522 shares                          | 2,196         | 2,196         |
| Less: Treasury stock (at par value)                                                                                | (66)          | (66)          |
| Common stock outstanding, 21,303,669 shares outstanding                                                            | 2,130         | 2,130         |
| Additional paid-in capital                                                                                         | 319,505       | 319,459       |
| Retained earnings                                                                                                  | 246,605       | 293,643       |
| Accumulated other comprehensive income, net of tax expense of \$4,618 (December 31, 2010 \$5,351)                  | 12,635        | 17,718        |
| Total stockholders' equity                                                                                         | 1,009,578     | 1,057,959     |
| Total liabilities and stockholders' equity                                                                         | \$ 14,113,973 | \$ 15,593,077 |

The accompanying notes are an integral part of these statements.

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**FIRST BANCORP**  
**CONSOLIDATED STATEMENTS OF LOSS**  
(Unaudited)

|                                                                                                                            | Quarter Ended    |                  | Six-Month Period Ended |                  |
|----------------------------------------------------------------------------------------------------------------------------|------------------|------------------|------------------------|------------------|
|                                                                                                                            | June 30,<br>2011 | June 30,<br>2010 | June 30,<br>2011       | June 30,<br>2010 |
| (In thousands, except per share information)                                                                               |                  |                  |                        |                  |
| <b>Interest income:</b>                                                                                                    |                  |                  |                        |                  |
| Loans                                                                                                                      | \$ 146,314       | \$ 175,070       | \$ 304,285             | \$ 352,503       |
| Investment securities                                                                                                      | 16,687           | 39,170           | 39,310                 | 82,289           |
| Money market investments                                                                                                   | 417              | 624              | 726                    | 1,060            |
| Total interest income                                                                                                      | 163,418          | 214,864          | 344,321                | 435,852          |
| <b>Interest expense:</b>                                                                                                   |                  |                  |                        |                  |
| Deposits                                                                                                                   | 49,525           | 63,766           | 103,584                | 129,732          |
| Loans payable                                                                                                              |                  | 1,265            |                        | 3,442            |
| Securities sold under agreements to repurchase                                                                             | 13,022           | 25,035           | 26,158                 | 50,317           |
| Advances from FHLB                                                                                                         | 4,219            | 7,587            | 8,964                  | 15,281           |
| Notes payable and other borrowings                                                                                         | 2,217            | (1,851)          | 4,901                  | 1,155            |
| Total interest expense                                                                                                     | 68,983           | 95,802           | 143,607                | 199,927          |
| Net interest income                                                                                                        | 94,435           | 119,062          | 200,714                | 235,925          |
| <b>Provision for loan and lease losses</b>                                                                                 | 59,184           | 146,793          | 147,916                | 317,758          |
| Net interest income (loss) after provision for loan and lease losses                                                       | 35,251           | (27,731)         | 52,798                 | (81,833)         |
| <b>Non-interest income:</b>                                                                                                |                  |                  |                        |                  |
| Other service charges on loans                                                                                             | 1,456            | 1,486            | 3,174                  | 3,242            |
| Service charges on deposit accounts                                                                                        | 3,054            | 3,501            | 6,386                  | 6,969            |
| Mortgage banking activities                                                                                                | 9,336            | 2,140            | 15,927                 | 4,640            |
| Net gain on sale of investments                                                                                            | 21,949           | 24,240           | 41,290                 | 55,604           |
| Other-than-temporary impairment losses on investment securities:                                                           |                  |                  |                        |                  |
| Total other-than-temporary impairment losses                                                                               |                  | (3)              |                        | (603)            |
| Noncredit-related impairment portion on debt securities not expected to be sold (recognized in other comprehensive income) | (607)            |                  | (607)                  |                  |
| Net impairment losses on investment securities                                                                             | (607)            | (3)              | (607)                  | (603)            |
| Loss on early extinguishment of borrowings                                                                                 | (1,823)          |                  | (1,823)                |                  |
| Equity in losses of unconsolidated entities                                                                                | (1,536)          |                  | (1,536)                |                  |
| Other non-interest income                                                                                                  | 7,033            | 8,161            | 16,536                 | 14,999           |

|                                                     |             |             |             |              |
|-----------------------------------------------------|-------------|-------------|-------------|--------------|
| Total non-interest income                           | 38,862      | 39,525      | 79,347      | 84,851       |
| <b>Non-interest expenses:</b>                       |             |             |             |              |
| Employees compensation and benefits                 | 29,407      | 30,958      | 59,846      | 62,686       |
| Occupancy and equipment                             | 15,603      | 14,451      | 30,853      | 29,302       |
| Business promotion                                  | 3,628       | 3,340       | 6,292       | 5,545        |
| Professional fees                                   | 6,072       | 5,604       | 11,209      | 10,891       |
| Taxes, other than income taxes                      | 3,278       | 3,817       | 6,533       | 7,638        |
| Insurance and supervisory fees                      | 14,404      | 16,606      | 29,581      | 35,124       |
| Net loss on real estate owned (REO) operations      | 5,971       | 10,816      | 11,471      | 14,509       |
| Other non-interest expenses                         | 8,068       | 13,019      | 13,512      | 24,278       |
| Total non-interest expenses                         | 86,431      | 98,611      | 169,297     | 189,973      |
| <b>Loss before income taxes</b>                     | (12,318)    | (86,817)    | (37,152)    | (186,955)    |
| <b>Income tax expense</b>                           | (2,606)     | (3,823)     | (6,192)     | (10,684)     |
| <b>Net loss</b>                                     | \$ (14,924) | \$ (90,640) | \$ (43,344) | \$ (197,639) |
| <b>Net loss attributable to common stockholders</b> | \$ (22,205) | \$ (96,810) | \$ (57,642) | \$ (209,961) |
| <b>Net loss per common share:</b>                   |             |             |             |              |
| Basic                                               | \$ (1.04)   | \$ (15.70)  | \$ (2.71)   | \$ (34.04)   |
| Diluted                                             | \$ (1.04)   | \$ (15.70)  | \$ (2.71)   | \$ (34.04)   |
| <b>Dividends declared per common share</b>          | \$          | \$          | \$          | \$           |

The accompanying notes are an integral part of these statements.

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**FIRST BANCORP**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**  
**(Unaudited)**

|                                                                                                                          | <b>Quarter Ended</b>     |                          | <b>Six-Month Period Ended</b> |                          |
|--------------------------------------------------------------------------------------------------------------------------|--------------------------|--------------------------|-------------------------------|--------------------------|
|                                                                                                                          | <b>June 30,<br/>2011</b> | <b>June 30,<br/>2010</b> | <b>June 30,<br/>2011</b>      | <b>June 30,<br/>2010</b> |
| (In thousands)                                                                                                           |                          |                          |                               |                          |
| Net loss                                                                                                                 | \$ (14,924)              | \$ (90,640)              | \$ (43,344)                   | \$ (197,639)             |
| Unrealized losses on available-for-sale debt securities on which an other-than-temporary impairment has been recognized: |                          |                          |                               |                          |
| Noncredit-related impairment losses on debt securities not expected to be sold                                           | (607)                    |                          | (607)                         |                          |
| Reclassification adjustment for other-than-temporary impairment on debt securities included in net income                | 607                      |                          | 607                           |                          |
| All other unrealized gains and losses on available-for-sale securities:                                                  |                          |                          |                               |                          |
| All other unrealized holding gains arising during the period                                                             | 18,573                   | 70,999                   | 13,344                        | 88,528                   |
| Reclassification adjustments for net gain included in net income                                                         | (21,949)                 | (24,240)                 | (21,949)                      | (44,936)                 |
| Reclassification adjustments for other-than-temporary impairment on equity securities                                    |                          | 3                        |                               | 353                      |
| Net unrealized gains on securities reclassified from held to maturity to available for sale                              |                          |                          | 2,789                         |                          |
| Income tax benefit (expense) related to items of other comprehensive income                                              | 587                      | (6,399)                  | 733                           | (7,127)                  |
| Other comprehensive (loss) income for the period, net of tax                                                             | (2,789)                  | 40,363                   | (5,083)                       | 36,818                   |
| Total comprehensive loss                                                                                                 | \$ (17,713)              | \$ (50,277)              | \$ (48,427)                   | \$ (160,821)             |

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**FIRST BANCORP**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

| (In thousands)                                                                   | <b>Six-Month Period Ended</b> |                          |
|----------------------------------------------------------------------------------|-------------------------------|--------------------------|
|                                                                                  | <b>June 30,<br/>2011</b>      | <b>June 30,<br/>2010</b> |
| <b>Cash flows from operating activities:</b>                                     |                               |                          |
| Net loss                                                                         | \$ (43,344)                   | \$ (197,639)             |
| Adjustments to reconcile net loss to net cash provided by operating activities:  |                               |                          |
| Depreciation                                                                     | 12,082                        | 9,863                    |
| Amortization of core deposit intangible                                          | 1,177                         | 1,297                    |
| Provision for loan and lease losses                                              | 147,916                       | 317,758                  |
| Deferred income tax expense                                                      | 3,565                         | 5,047                    |
| Stock-based compensation recognized                                              | 46                            | 47                       |
| Gain on sale of investments, net                                                 | (40,611)                      | (55,604)                 |
| Loss on early extinguishment of borrowings                                       | 1,823                         |                          |
| Other-than-temporary impairments on investment securities                        | 607                           | 603                      |
| Equity in losses of unconsolidated entities                                      | 1,536                         |                          |
| Derivatives instruments and hedging activities loss (gain)                       | 1,448                         | (1,676)                  |
| Gain on sale of assets FB Insurance VI                                           | (2,845)                       |                          |
| Net gain on sale of loans and impairments                                        | (12,955)                      | (526)                    |
| Net amortization of premiums and discounts on deferred loan fees and costs       | (873)                         | 802                      |
| Net decrease (increase) in mortgage loans held for sale                          | 2,381                         | (8,845)                  |
| Amortization of broker placement fees                                            | 9,542                         | 10,787                   |
| Net amortization of premium and discounts on investment securities               | 2,038                         | 3,293                    |
| Increase in accrued income tax payable                                           | 1,816                         | 909                      |
| Decrease in accrued interest receivable                                          | 7,342                         | 12,132                   |
| Increase (decrease) in accrued interest payable                                  | 1,948                         | (276)                    |
| Increase in other assets                                                         | (14,503)                      | (298)                    |
| (Decrease) increase in other liabilities                                         | (5,382)                       | 13,727                   |
| Total adjustments                                                                | 118,098                       | 309,040                  |
| Net cash provided by operating activities                                        | 74,754                        | 111,401                  |
| <b>Cash flows from investing activities:</b>                                     |                               |                          |
| Principal collected on loans                                                     | 1,186,329                     | 2,118,978                |
| Loans originated                                                                 | (985,980)                     | (1,141,868)              |
| Purchases of loans                                                               | (70,459)                      | (87,436)                 |
| Proceeds from sale of loans                                                      | 670,230                       | 19,187                   |
| Proceeds from sale of repossessed assets                                         | 49,363                        | 47,440                   |
| Proceeds from sale of available-for-sale securities                              | 487,054                       | 733,887                  |
| Proceeds from sale of held-to-maturity securities                                | 348,750                       |                          |
| Purchases of securities available for sale                                       | (532,727)                     | (1,921,842)              |
| Proceeds from principal repayments and maturities of securities held to maturity | 33,726                        | 75,054                   |

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|                                                                                         |             |             |
|-----------------------------------------------------------------------------------------|-------------|-------------|
| Proceeds from principal repayments of securities available for sale                     | 150,049     | 1,278,313   |
| Additions to premises and equipment                                                     | (6,359)     | (19,338)    |
| Proceeds from sale of other investment securities                                       |             | 10,668      |
| Proceeds from sale of assets FB Insurance VI                                            | 2,940       |             |
| Proceeds from securities litigations settlement                                         | 679         |             |
| Decrease (increase) in other equity securities                                          | 13,680      | (163)       |
| Net cash provided by investing activities                                               | 1,347,275   | 1,112,880   |
| <b>Cash flows from financing activities:</b>                                            |             |             |
| Net (decrease) increase in deposits                                                     | (996,792)   | 46,919      |
| Net decrease in loans payable                                                           |             | (900,000)   |
| Net repayments and cancellation costs of securities sold under agreements to repurchase | (201,575)   | (492,193)   |
| Net FHLB advances paid and cancellation costs                                           | (233,248)   | (38,000)    |
| Repayment of medium-term notes                                                          | (7,000)     |             |
| Net cash used in financing activities                                                   | (1,438,615) | (1,383,274) |
| Net decrease in cash and cash equivalents                                               | (16,586)    | (158,993)   |
| Cash and cash equivalents at beginning of period                                        | 370,283     | 704,084     |
| Cash and cash equivalents at end of period                                              | \$ 353,697  | \$ 545,091  |
| Cash and cash equivalents include:                                                      |             |             |
| Cash and due from banks                                                                 | \$ 239,488  | \$ 523,047  |
| Money market instruments                                                                | 114,209     | 22,044      |
|                                                                                         | \$ 353,697  | \$ 545,091  |

The accompanying notes are an integral part of these statements.

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**FIRST BANCORP**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**(Unaudited)**

| (In thousands)                                                        | <b>Six-Month Period Ended</b> |                          |
|-----------------------------------------------------------------------|-------------------------------|--------------------------|
|                                                                       | <b>June 30,<br/>2011</b>      | <b>June 30,<br/>2010</b> |
| <b>Preferred Stock:</b>                                               |                               |                          |
| Balance at beginning of period                                        | \$ 425,009                    | \$ 928,508               |
| Accretion of preferred stock discount                                 | 3,694                         | 2,322                    |
| Balance at end of period                                              | 428,703                       | 930,830                  |
| <br><b>Common Stock outstanding</b>                                   | <br>2,130                     | <br>6,169                |
| <br><b>Additional Paid-In-Capital:</b>                                |                               |                          |
| Balance at beginning of period                                        | 319,459                       | 220,596                  |
| Stock-based compensation recognized                                   | 46                            | 47                       |
| Balance at end of period                                              | 319,505                       | 220,643                  |
| <br><b>Retained Earnings:</b>                                         |                               |                          |
| Balance at beginning of period                                        | 293,643                       | 417,297                  |
| Net loss                                                              | (43,344)                      | (197,639)                |
| Accretion of preferred stock discount                                 | (3,694)                       | (2,322)                  |
| Balance at end of period                                              | 246,605                       | 217,336                  |
| <br><b>Accumulated Other Comprehensive Income (Loss), net of tax:</b> |                               |                          |
| Balance at beginning of period                                        | 17,718                        | 26,493                   |
| Other comprehensive (loss) income, net of tax                         | (5,083)                       | 36,818                   |
| Balance at end of period                                              | 12,635                        | 63,311                   |
| <br>Total stockholders' equity                                        | <br>\$ 1,009,578              | <br>\$ 1,438,289         |

The accompanying notes are an integral part of these statements.

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**FIRST BANCORP  
PART I NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

The Consolidated Financial Statements (unaudited) have been prepared in conformity with the accounting policies stated in the Corporation's Audited Consolidated Financial Statements included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010. Certain information and note disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) have been condensed or omitted from these statements pursuant to the rules and regulations of the SEC and, accordingly, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements of the Corporation for the year ended December 31, 2010, included in the Corporation's 2010 Annual Report on Form 10-K. All adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the statement of financial position, results of operations and cash flows for the interim periods have been reflected. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the quarter and six-month period ended June 30, 2011 are not necessarily indicative of the results to be expected for the entire year.

All share and per share amounts of common shares included in the consolidated financial statements have been adjusted to retroactively reflect the 1-for-15 reverse stock split effected January 7, 2011.

***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 first half of 2011 was primarily related to credit losses.

As described in Note 18, Regulatory Matters, FirstBank is currently operating under a Consent Order (the FDIC 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 8% for Leverage (Tier 1 Capital to Average Total Assets), 10% for Tier 1 Capital to Risk-Weighted Assets and 12% for Total Capital to Risk-Weighted Assets. The FDIC Order does not contain a specific date for achieving the minimum capital ratios.

In March 2011, the Corporation submitted an updated Capital Plan (the Capital Plan) to the regulators. The Capital Plan contemplates a \$350 million capital raise through the issuance of new common shares for cash, and other actions to further 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 further reductions of the Corporation's loan portfolio and investment 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.

Among the deleveraging strategies incorporated into the Capital Plan and completed during the first half of 2011 are the following:

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 ) a new joint venture 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% interest in CPG/GS. Approximately 93% of the loans were adversely classified loans and 55% were in non-performing status.

As of June 30, 2011, the Corporation's Total Capital, Tier 1 Capital and Leverage ratios were 12.40%, 11.08% and 8.04%, respectively, compared to 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 June 30, 2011 were 12.15%, 10.83% and 7.87%, respectively, up from 11.57%, 10.28% and 7.25%, respectively, as of December 31, 2010. The improvement in the capital ratios was primarily related to the aforementioned

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deleveraging strategies completed during the first half of 2011 and, in the case of FirstBank, also due to a \$22 million capital contribution from the holding company. Proceeds from the sales of assets were used, in part, to pay down maturing liabilities. Although the Bank expected to meet the minimum capital ratios by June 30, 2011, given the time lag between the sales of the assets and the maturity of liabilities, the average assets for the quarter remained at higher levels, thus affecting temporarily the leverage ratio for the quarter. However, when computed using the ending balance of assets as of June 30, 2011, which already reflects the full effect of the deleverage activities, the leverage ratio would have been 8.38% and 8.20% for First BanCorp and FirstBank, respectively. Since the Bank's leverage ratio exceeded 8% as of June 30, 2011, based on the ending balance of assets, the Bank is technically in compliance with the minimum required capital ratios.

With respect to capital raise efforts, during the second quarter of 2011, the Corporation entered into separate agreements with Thomas H. Lee Partners, L.P. ( THL ) and with two funds managed by Oaktree Capital Management, L.P. ( Oaktree ) under which THL and Oaktree would purchase an aggregate of approximately \$348.2 million (\$174.1 million each investor) of common stock of the Corporation at a per share price of \$3.50 provided the Corporation sells an aggregate of \$500 million of shares of common stock. Each of these two investors' investments will represent approximately 24.36% of the outstanding shares of the Corporation's common stock upon completion of the capital raise and the conversion into common stock of the \$424.2 million of the Series G Preferred Stock held by the U.S. Treasury. The Corporation has also entered into investment agreements with institutional investors and other private equity firms for the issuance of an aggregate of approximately \$176.8 million of the Corporation's common stock, which, together with the THL and Oaktree investments, result in \$525 million in commitments. The completion of this transaction is subject to the approval of the Corporation's stockholders at a Special Meeting of Stockholders on August 23, 2011 and regulators. If approved, the transaction is expected to close during the third quarter of 2011.

If the stockholders and regulators approve the \$525 million capital raise, the Corporation will issue 150 million shares of common stock at \$3.50 per share and will immediately exercise its right to compel the conversion of all of the outstanding Series G Preferred Stock, which is held by the U.S. Treasury, into approximately 32.9 million shares of common stock. Also, the Corporation plans to conduct a rights offering that will enable current stockholders to purchase up to 10.7 million shares of common stock at the same \$3.50 price per share for an aggregate of \$37.3 million. The Corporation is expected to have nearly 229.98 million outstanding following the issuance of common stock to institutional investors and private equity firms, the conversion of the Series G Preferred Stock into common stock, the successful completion of the rights offering and the issuance of shares upon the exercise of anti-dilution rights held by certain of the institutional investors in the capital raise.

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 June 30, 2011, the holding company had \$21.2 million of cash and cash equivalents. Cash and cash equivalents at the Bank as of June 30, 2011 were approximately \$353.7 million. The Bank has \$100 million, \$87 million and \$7.3 million in repurchase agreements, FHLB advances and notes payable, respectively, maturing over the next twelve months. In addition, it had \$5.2 billion in brokered CDs as of June 30, 2011, of which \$3.0 billion mature over the next twelve months. Liquidity at the Bank level is highly dependent on bank deposits, which fund 78.7% of the Bank's assets (or 41.8% 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 September 30, 2011. 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. As of June 30, 2011, the Bank held approximately \$862.3 million of readily pledgeable or sellable investment securities, including \$665 million in U.S. Treasury securities. Based on current and expected liquidity needs and sources, management expects First BanCorp to be able to meet its obligations for a reasonable period of time. During 2010, the Corporation and the Bank suffered credit downgrades. The Bank suffered a further downgrade in April 2011. The Corporation does not have any outstanding debt or derivative agreements that would be affected by the 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 the downgrades. The Corporation's ability to access new non-deposit funding, however, could be adversely affected by these downgrades and any additional downgrades.

If unanticipated market factors emerge, such as a significant increase in the provision for loan and lease losses, or if the Corporation is unable to complete the aforementioned capital raise or complete identified capital preservation initiatives, successfully execute its strategic operating plans, issue a sufficient amount of brokered CDs or comply with the FDIC Order, its banking regulators could take further action, which could include actions that may have a material adverse effect on the Bank's business, results of operations and financial position, including the appointment of a conservator or receiver.

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### **Adoption of new accounting requirements and recently issued but not yet effective accounting requirements**

The Financial Accounting Standards Board ( 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, current GAAP will be 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 is currently evaluating the impact of the adoption of this guidance on the financial statements.

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

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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.

**2 EARNINGS PER COMMON SHARE**

The calculations of earnings per common share for the quarters and six-month periods ended on June 30, 2011 and 2010 are as follows:

|                                                                             | Quarter Ended                                |                  | Six-Month Period Ended |                  |
|-----------------------------------------------------------------------------|----------------------------------------------|------------------|------------------------|------------------|
|                                                                             | June 30,<br>2011                             | June 30,<br>2010 | June 30,<br>2011       | June 30,<br>2010 |
|                                                                             | (In thousands, except per share information) |                  |                        |                  |
| <b>Net Loss:</b>                                                            |                                              |                  |                        |                  |
| Net loss                                                                    | \$ (14,924)                                  | \$ (90,640)      | \$ (43,344)            | \$ (197,639)     |
| Cumulative non-convertible preferred stock dividends (Series F)             |                                              | (5,000)          |                        | (10,000)         |
| Cumulative convertible preferred stock dividends (Series G)                 | (5,302)                                      |                  | (10,604)               |                  |
| Preferred stock discount accretion (Series G and F) <sup>(1)</sup>          | (1,979)                                      | (1,170)          | (3,694)                | (2,322)          |
| Net loss attributable to common stockholders                                | \$ (22,205)                                  | \$ (96,810)      | \$ (57,642)            | \$ (209,961)     |
| <b>Weighted-Average Shares:</b>                                             |                                              |                  |                        |                  |
| Basic weighted-average common shares outstanding <sup>(2)</sup>             | 21,303                                       | 6,168            | 21,303                 | 6,168            |
| Average potential common shares <sup>(2)</sup>                              |                                              |                  |                        |                  |
| Diluted weighted-average number of common shares outstanding <sup>(2)</sup> | 21,303                                       | 6,168            | 21,303                 | 6,168            |
| <b>Loss per common share:</b>                                               |                                              |                  |                        |                  |
| Basic <sup>(2)</sup>                                                        | \$ (1.04)                                    | \$ (15.70)       | \$ (2.71)              | \$ (34.04)       |
| Diluted <sup>(2)</sup>                                                      | \$ (1.04)                                    | \$ (15.70)       | \$ (2.71)              | \$ (34.04)       |

(1) Includes a non-cash adjustment of \$0.2 million for the second quarter and six-month period ended June 30, 2011, as an acceleration of the Series G preferred stock discount accretion pursuant to a second amendment to the exchange agreement with the U.S. Treasury, the sole holder of the Series G Preferred Stock, that provides for a six months extension to the date by when the Corporation is required to complete an equity raise in order to compel the conversion of the Series G Preferred Stock into common stock.

(2) All share and per share data has been adjusted to retroactively reflect the 1-for-15 reverse stock split effected January 7, 2011.

Loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average common shares issued and outstanding. Net loss attributable to common stockholders represents net 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 discount on preferred stock issuances. Basic weighted average common shares outstanding exclude 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. As of June 30, 2011 and 2010, there were 129,934 and 138,165 outstanding stock options, respectively; warrants outstanding to purchase 389,483 shares of common stock and 716 and 1,432 unvested shares of restricted stock, respectively, that were excluded from the computation of diluted earnings per common share because their inclusion would have an antidilutive effect.

### **3 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.

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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 253,333 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, 1,424 vested and, as of June 30, 2011, 720 remain restricted.

For the quarter and six-month period ended June 30, 2011, the Corporation recognized \$23,333 and \$46,666 of stock-based compensation expense related to the aforementioned restricted stock awards. The total unrecognized compensation cost related to the non-vested restricted shares was \$38,890 as of June 30, 2011 which expected to be recognized over the next five months.

There were no stock options granted during 2011 and 2010, therefore no compensation associated with stock options was recorded in those years. No stock options were exercised during the first half of 2011 or in 2010.

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 for the six-month period ended June 30, 2011 is set forth below:

|                     | <b>Six-month Period Ended<br/>June 30, 2011</b> |                                                |                                                                            | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(In<br/>thousands)</b> |
|---------------------|-------------------------------------------------|------------------------------------------------|----------------------------------------------------------------------------|-----------------------------------------------------------------|
|                     | <b>Number<br/>of<br/>Options</b>                | <b>Weighted-Average<br/>Exercise<br/>Price</b> | <b>Weighted-Average<br/>Remaining<br/>Contractual<br/>Term<br/>(Years)</b> |                                                                 |
| Beginning of period | 131,532                                         | \$ 202.91                                      |                                                                            |                                                                 |
| Options cancelled   | (1,598)                                         | 196.51                                         |                                                                            |                                                                 |

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|                                           |         |           |      |    |
|-------------------------------------------|---------|-----------|------|----|
| End of period outstanding and exercisable | 129,934 | \$ 202.99 | 4.02 | \$ |
|-------------------------------------------|---------|-----------|------|----|

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The amortized cost, non-credit loss component of other-than-temporary impairment ( 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 June 30, 2011 and December 31, 2010 were as follows:

|                                                             | June 30, 2011                |                      |                  |        |            |                                                    | December 31, 2010            |                  |        |       |            |                          |
|-------------------------------------------------------------|------------------------------|----------------------|------------------|--------|------------|----------------------------------------------------|------------------------------|------------------|--------|-------|------------|--------------------------|
|                                                             | Non-Credit Loss Component of |                      | Gross            |        | Fair value | Weighted average yield %<br>(Dollars in thousands) | Non-Credit Loss Component of |                  | Gross  |       | Fair value | Weighted average yield % |
|                                                             | Amortized cost               | OTTI Recorded in OCI | Unrealized gains | losses |            |                                                    | OTTI Recorded in OCI         | Unrealized gains | losses |       |            |                          |
|                                                             |                              |                      |                  |        |            |                                                    |                              |                  |        |       |            |                          |
| Treasury securities:                                        |                              |                      |                  |        |            |                                                    |                              |                  |        |       |            |                          |
| within one year                                             | \$ 932,474                   | \$                   | \$ 2,607         | \$     | \$ 935,081 | 0.50                                               | \$                           | \$               | \$     | \$    | \$         |                          |
| 1 to 5 years                                                | 200,200                      |                      | 6,394            |        | 206,594    | 1.95                                               | 599,987                      |                  | 8,727  |       | 608,714    |                          |
| Municipal Governments of Puerto Rico:                       |                              |                      |                  |        |            |                                                    |                              |                  |        |       |            |                          |
| within one year                                             | 300,999                      |                      | 2,231            |        | 303,230    | 1.15                                               |                              |                  |        |       |            |                          |
| 1 to 5 years                                                | 253,014                      |                      |                  | 701    | 252,313    | 1.02                                               | 604,630                      |                  | 2,714  | 3,991 | 603,353    |                          |
| Municipal Governments of the United States:                 |                              |                      |                  |        |            |                                                    |                              |                  |        |       |            |                          |
| within one year                                             | 721                          |                      | 11               |        | 732        | 6.68                                               |                              |                  |        |       |            |                          |
| 1 to 5 years                                                | 38,875                       |                      | 1,456            | 87     | 40,244     | 5.08                                               | 26,768                       |                  | 522    |       | 27,290     |                          |
| 5 to 10 years                                               | 111,397                      |                      | 284              | 232    | 111,449    | 5.21                                               | 104,352                      |                  | 432    |       | 104,784    |                          |
| 10 years                                                    | 9,395                        |                      | 495              |        | 9,890      | 5.88                                               | 4,746                        |                  | 21     |       | 4,767      |                          |
| Municipal Governments of the United States and Puerto Rico: |                              |                      |                  |        |            |                                                    |                              |                  |        |       |            |                          |
| within one year                                             | 1,847,075                    |                      | 13,478           | 1,020  | 1,859,533  | 1.24                                               | 1,340,483                    |                  | 12,416 | 3,991 | 1,348,908  |                          |

Agency-backed securities:

|               |         |  |        |     |         |      |         |  |        |       |         |
|---------------|---------|--|--------|-----|---------|------|---------|--|--------|-------|---------|
| MC            |         |  |        |     |         |      |         |  |        |       |         |
| Certificates: |         |  |        |     |         |      |         |  |        |       |         |
| 1 to 5 years  | 1,606   |  | 21     |     | 1,627   | 3.70 |         |  |        |       |         |
| 6 to 10 years | 1,447   |  | 110    |     | 1,557   | 5.00 | 1,716   |  | 101    |       | 1,817   |
|               | 3,053   |  | 131    |     | 3,184   | 4.32 | 1,716   |  | 101    |       | 1,817   |
| MA            |         |  |        |     |         |      |         |  |        |       |         |
| Certificates: |         |  |        |     |         |      |         |  |        |       |         |
| within one    |         |  |        |     |         |      |         |  |        |       |         |
|               | 10      |  |        |     | 10      | 6.05 | 30      |  |        |       | 30      |
| 1 to 5 years  | 269     |  | 12     |     | 281     | 3.89 |         |  |        |       |         |
| 6 to 10 years | 636     |  | 46     |     | 682     | 4.30 | 1,319   |  | 74     |       | 1,393   |
|               | 766,183 |  | 26,048 | 225 | 792,006 | 3.97 | 962,246 |  | 31,105 | 3,396 | 989,955 |
|               | 767,098 |  | 26,106 | 225 | 792,979 | 3.97 | 963,595 |  | 31,179 | 3,396 | 991,378 |
| MA            |         |  |        |     |         |      |         |  |        |       |         |
| Certificates: |         |  |        |     |         |      |         |  |        |       |         |
| 1 to 5 years  | 1,671   |  | 80     |     | 1,751   | 3.85 |         |  |        |       |         |
| 6 to 10 years | 49,030  |  | 2,215  |     | 51,245  | 3.79 | 75,547  |  | 3,987  |       | 79,534  |
|               | 54,245  |  | 2,865  |     | 57,110  | 5.62 | 126,847 |  | 8,678  |       | 135,525 |
|               | 104,946 |  | 5,160  |     | 110,106 | 4.74 | 202,394 |  | 12,665 |       | 215,059 |
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| Securitized   |         |  |        |     |         |      |         |  |        |       |         |
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| Securitized   |         |  |        |     |         |      |         |  |        |       |         |

|                                                             |             |          |          |         |             |      |             |          |          |         |             |
|-------------------------------------------------------------|-------------|----------|----------|---------|-------------|------|-------------|----------|----------|---------|-------------|
| Equity securities<br>without<br>contractual<br>maturity (1) | 77          |          | 6        |         | 83          |      | 77          |          | 18       |         | 59          |
| Real investment<br>properties                               |             |          |          |         |             |      |             |          |          |         |             |
| Available for sale                                          | \$2,816,833 | \$25,763 | \$44,882 | \$1,866 | \$2,834,086 | 2.15 | \$2,721,384 | \$27,814 | \$58,288 | \$7,405 | \$2,744,453 |

(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 \$50 million of U.S. agency debt securities called during 2011. 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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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 June 30, 2011 and December 31, 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:

|                                                | Less than 12 months |                   | As of June 30, 2011<br>12 months or more |                   | Total      |                   |
|------------------------------------------------|---------------------|-------------------|------------------------------------------|-------------------|------------|-------------------|
|                                                | Fair Value          | Unrealized Losses | Fair Value                               | Unrealized Losses | Fair Value | Unrealized Losses |
|                                                |                     |                   | (In thousands)                           |                   |            |                   |
| <b>Debt securities:</b>                        |                     |                   |                                          |                   |            |                   |
| U.S. Government agencies obligations           | \$ 259,799          | \$ 701            | \$                                       | \$                | \$ 259,799 | \$ 701            |
| Puerto Rico Government obligations             | 109,681             | 319               |                                          |                   | 109,681    | 319               |
| <b>Mortgage-backed securities:</b>             |                     |                   |                                          |                   |            |                   |
| GNMA                                           | 14,311              | 225               |                                          |                   | 14,311     | 225               |
| Other mortgage pass-through trust certificates |                     |                   | 66,621                                   | 25,763            | 66,621     | 25,763            |
| <b>Corporate bonds</b>                         |                     |                   | 1,379                                    | 621               | 1,379      | 621               |
|                                                | \$ 383,791          | \$ 1,245          | \$ 68,000                                | \$ 26,384         | \$ 451,791 | \$ 27,629         |

|                                                | Less than 12 months |                   | As of December 31, 2010<br>12 months or more |                   | Total      |                   |
|------------------------------------------------|---------------------|-------------------|----------------------------------------------|-------------------|------------|-------------------|
|                                                | Fair Value          | Unrealized Losses | Fair Value                                   | Unrealized Losses | Fair Value | Unrealized Losses |
|                                                |                     |                   | (In thousands)                               |                   |            |                   |
| <b>Debt securities:</b>                        |                     |                   |                                              |                   |            |                   |
| U.S. Government agencies obligations           | \$ 249,026          | \$ 3,991          | \$                                           | \$                | \$ 249,026 | \$ 3,991          |
| <b>Mortgage-backed securities:</b>             |                     |                   |                                              |                   |            |                   |
| GNMA                                           | 192,799             | 3,396             |                                              |                   | 192,799    | 3,396             |
| Other mortgage pass-through trust certificates |                     |                   | 72,101                                       | 27,814            | 72,101     | 27,814            |
| <b>Equity securities</b>                       | 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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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:

|                                                         |                           | <b>December 31, 2010</b>              |               |                       |                                         |
|---------------------------------------------------------|---------------------------|---------------------------------------|---------------|-----------------------|-----------------------------------------|
|                                                         | <b>Amortized<br/>cost</b> | <b>Gross<br/>Unrealized<br/>gains</b> | <b>losses</b> | <b>Fair<br/>value</b> | <b>Weighted<br/>average<br/>yield %</b> |
|                                                         |                           | <b>(Dollars in<br/>thousands)</b>     |               |                       |                                         |
| 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<br>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<br>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 Statement of Financial Condition. As of June 30, 2011, the Corporation had \$100 million in held to maturity U.S. Treasury bills with an original maturity of 3 months and a yield of 0.05% 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:

|                        | Less than 12 months |                   | As of December 31, 2010<br>12 months or more |                   | Total      |                   |
|------------------------|---------------------|-------------------|----------------------------------------------|-------------------|------------|-------------------|
|                        | Fair Value          | Unrealized Losses | Fair Value                                   | Unrealized Losses | Fair Value | Unrealized Losses |
|                        |                     |                   | (In thousands)                               |                   |            |                   |
| <b>Corporate bonds</b> | \$                  | \$                | \$ 1,277                                     | \$ 723            | \$ 1,277   | \$ 723            |

***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.

OTTI losses for debt securities 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.

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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) income, 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 92% of the total available-for-sale portfolio as of June 30, 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 mortgage-backed securities ( MBS ) of approximately \$93 million for which the Corporation evaluates credit losses 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 quarter and six-month period ended June 30, 2011, the Corporation recorded OTTI losses on available-for-sale debt securities as follows:

|                                                                         | Private label<br>MBS<br>June 30, 2011 |
|-------------------------------------------------------------------------|---------------------------------------|
| (In thousands)                                                          |                                       |
| Total other-than-temporary impairment losses                            | \$                                    |
| Unrealized other-than-temporary impairment losses recognized in OCI (1) | (607)                                 |
| Net impairment losses recognized in earnings (2)                        | \$ (607)                              |

(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

No OTTI losses on available for sale debt securities were recorded for the first half of 2010.

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:

|                                                                                          | June 30, 2011 |
|------------------------------------------------------------------------------------------|---------------|
| (In thousands)                                                                           |               |
| Credit losses at the beginning of the period                                             | \$ 1,852      |
| Additions:                                                                               |               |
| Credit losses related to debt securities for which an OTTI was not previously recognized |               |

|                                                                                                              |          |
|--------------------------------------------------------------------------------------------------------------|----------|
| Credit losses related to debt securities for which an OTTI was previously recognized                         | 607      |
| Ending balance of credit losses on debt securities held for which a portion of an OTTI was recognized in OCI | \$ 2,459 |

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.

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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 June 30, 2011 and December 31, 2010 were as follow:

|                                | <b>June 30, 2011</b>        |                 | <b>December 31, 2010</b>    |                |
|--------------------------------|-----------------------------|-----------------|-----------------------------|----------------|
|                                | <b>Weighted<br/>Average</b> | <b>Range</b>    | <b>Weighted<br/>Average</b> | <b>Range</b>   |
| Discount rate                  | 14.5%                       | 14.5%           | 14.5%                       | 14.5%          |
| Prepayment rate                | 25%                         | 18.45% - 32.04% | 24%                         | 18.2% - 43.73% |
| Projected Cumulative Loss Rate | 6%                          | 1.52% - 11.37%  | 6%                          | 1.49% - 16.25% |

For the six-month period ended on June 30, 2010, 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, no OTTI losses on equity securities were recognized for the first half of 2011. 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.

Total proceeds from the sale of securities available for sale during the first half of 2011 amounted to approximately \$487.1 million (2010 \$733.9 million excluding \$296.5 million of unsettled securities sold).

## **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 June 30, 2011 and December 31, 2010, the Corporation had investments in FHLB stock with a book value of \$41.0 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 the second quarter and six-month period ended June 30, 2011 amounted to \$0.5 million and \$1.2 million, respectively, compared to \$0.6 million and \$1.4 million, respectively, for the same periods in 2010.

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.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of June 30, 2011 and December 31, 2010 was \$1.3 million. An impairment charge of \$0.25 million was recorded in the first quarter of 2010 related to an investment in a failed financial institution in the United States. During the first quarter of 2010, the Corporation recognized a \$10.7 million gain on the sale of VISA Class C shares. The Corporation no longer holds any VISA shares.

**Table of Contents****6 LOAN PORTFOLIO**

The following is a detail of the loan portfolio held for investment:

|                                                                               | <b>June 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|-------------------------------------------------------------------------------|--------------------------|------------------------------|
|                                                                               | <b>(In thousands)</b>    |                              |
| Residential mortgage loans, mainly secured by first mortgages                 | \$ 2,880,989             | \$ 3,417,417                 |
| Commercial loans:                                                             |                          |                              |
| Construction loans                                                            | 515,934                  | 700,579                      |
| Commercial mortgage loans                                                     | 1,590,633                | 1,670,161                    |
| Commercial and Industrial loans <sup>(1)</sup>                                | 3,883,645                | 3,861,545                    |
| Loans to local financial institutions collateralized by real estate mortgages | 282,003                  | 290,219                      |
| Commercial loans                                                              | 6,272,215                | 6,522,504                    |
| Finance leases                                                                | 263,223                  | 282,904                      |
| Consumer loans                                                                | 1,349,098                | 1,432,611                    |
| Loans receivable                                                              | 10,765,525               | 11,655,436                   |
| Allowance for loan and lease losses                                           | (540,878)                | (553,025)                    |
| Loans receivable, net                                                         | \$ 10,224,647            | \$ 11,102,411                |

1 - As of June 30, 2011, includes \$1.7 billion of commercial loans that are secured by real estate but are not dependent upon the real estate for repayment.

Loans held for investment on which accrual of interest income had been discontinued as of June 30, 2011 and December 31, 2010 were as follows:

|                                                               | <b>June 30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|---------------------------------------------------------------|--------------------------|----------------------------------|
| <i>(Dollars in thousands)</i>                                 |                          |                                  |
| Non-performing loans:                                         |                          |                                  |
| Residential mortgage                                          | \$ 380,165               | \$ 392,134                       |
| Commercial mortgage                                           | 196,037                  | 217,165                          |
| Commercial and Industrial                                     | 309,888                  | 317,243                          |
| Construction                                                  | 280,286                  | 263,056                          |
| Consumer:                                                     |                          |                                  |
| Auto loans                                                    | 19,884                   | 25,350                           |
| Finance leases                                                | 3,208                    | 3,935                            |
| Other consumer loans                                          | 18,973                   | 20,106                           |
| Total non-performing loans held for investment <sup>(1)</sup> | \$ 1,208,441             | \$ 1,238,989                     |

1 -

As of June 30, 2011 and December 31, 2010, excludes \$5.1 million and \$159.3 million, respectively, in non-performing loans held for sale.

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The Corporation's aging of the loans held for investment portfolio as of June 30, 2011 and December 31, 2010, follows:

| <b>As of June 30, 2011</b>                                  | <b>Current</b>      | <b>30-89 days<br/>Past Due</b> | <b>90 days or more<br/>Past Due <sup>(1)</sup><br/>(in thousands)</b> | <b>Total<br/>Portfolio</b> | <b>90 days and still accruing</b> |
|-------------------------------------------------------------|---------------------|--------------------------------|-----------------------------------------------------------------------|----------------------------|-----------------------------------|
| <b>Residential Mortgage:</b>                                |                     |                                |                                                                       |                            |                                   |
| FHA/VA and other government guaranteed loans <sup>(2)</sup> | \$ 152,149          | \$ 14,934                      | \$ 82,898                                                             | \$ 249,981                 | \$ 82,898                         |
| Other residential mortgage loans                            | 2,144,643           | 94,145                         | 392,220                                                               | 2,631,008                  | 12,055                            |
| <b>Commercial:</b>                                          |                     |                                |                                                                       |                            |                                   |
| Commercial & Industrial Loans                               | 3,742,437           | 73,477                         | 349,734                                                               | 4,165,648                  | 39,846                            |
| Commercial Mortgage Loans                                   | 1,341,080           | 47,101                         | 202,452                                                               | 1,590,633                  | 6,415                             |
| Construction Loans                                          | 208,159             | 11,784                         | 295,991                                                               | 515,934                    | 15,705                            |
| <b>Consumer:</b>                                            |                     |                                |                                                                       |                            |                                   |
| Auto                                                        | 848,961             | 91,530                         | 19,884                                                                | 960,375                    |                                   |
| Finance Leases                                              | 242,695             | 17,320                         | 3,208                                                                 | 263,223                    |                                   |
| Other Consumer Loans                                        | 353,906             | 15,844                         | 18,973                                                                | 388,723                    |                                   |
| <b>Total Loans Receivable</b>                               | <b>\$ 9,034,030</b> | <b>\$ 366,135</b>              | <b>\$ 1,365,360</b>                                                   | <b>\$ 10,765,525</b>       | <b>\$ 156,919</b>                 |

(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 June 30, 2011, includes \$53.3 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.

| <b>As of December 31, 2010</b>                              | <b>Current</b>      | <b>30-89 days<br/>Past Due</b> | <b>90 days or more<br/>Past Due <sup>(1)</sup><br/>(in thousands)</b> | <b>Total<br/>Portfolio</b> | <b>90 days and still accruing</b> |
|-------------------------------------------------------------|---------------------|--------------------------------|-----------------------------------------------------------------------|----------------------------|-----------------------------------|
| <b>Residential Mortgage:</b>                                |                     |                                |                                                                       |                            |                                   |
| FHA/VA and other government guaranteed loans <sup>(2)</sup> | \$ 136,412          | \$ 14,780                      | \$ 81,330                                                             | \$ 232,522                 | \$ 81,330                         |
| Other residential mortgage loans                            | 2,654,430           | 116,438                        | 414,027                                                               | 3,184,895                  | 21,893                            |
| <b>Commercial:</b>                                          |                     |                                |                                                                       |                            |                                   |
| Commercial & Industrial Loans                               | 3,701,788           | 98,790                         | 351,186                                                               | 4,151,764                  | 33,943                            |
| Commercial Mortgage Loans                                   | 1,412,943           | 40,053                         | 217,165                                                               | 1,670,161                  |                                   |
| Construction Loans                                          | 418,339             | 12,236                         | 270,004                                                               | 700,579                    | 6,948                             |
| <b>Consumer:</b>                                            |                     |                                |                                                                       |                            |                                   |
| Auto                                                        | 888,720             | 94,906                         | 25,350                                                                | 1,008,976                  |                                   |
| Finance Leases                                              | 258,990             | 19,979                         | 3,935                                                                 | 282,904                    |                                   |
| Other Consumer Loans                                        | 379,566             | 23,963                         | 20,106                                                                | 423,635                    |                                   |
| <b>Total Loans Receivable</b>                               | <b>\$ 9,851,188</b> | <b>\$ 421,145</b>              | <b>\$ 1,383,103</b>                                                   | <b>\$ 11,655,436</b>       | <b>\$ 144,114</b>                 |

- (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.

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 \$10.8 billion as of June 30, 2011, approximately 84% have credit risk concentration in Puerto Rico, 8% in the United States and 8% in the Virgin Islands.

The largest loan to one borrower as of June 30, 2011 in the amount of \$282.0 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 family residential mortgage loans.

As of June 30, 2011, the Corporation had \$216.4 million outstanding of credit facilities granted to the Puerto Rico Government and/or its political subdivisions, down from \$325.1 million as of December 31, 2010, and \$113.2 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.

**Table of Contents****7 ALLOWANCE FOR LOAN AND LEASE LOSSES**

The changes in the allowance for loan and lease losses were as follows:

| (Dollars in thousands)                              | <b>Residential<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>&amp;<br/>Industrial<br/>Loans</b> | <b>Construction<br/>Loans</b> | <b>Consumer<br/>Loans</b> | <b>Total</b>  |
|-----------------------------------------------------|-------------------------------------------|------------------------------------------|------------------------------------------------------|-------------------------------|---------------------------|---------------|
| <b>Quarter ended June 30, 2011</b>                  |                                           |                                          |                                                      |                               |                           |               |
| <b>Allowance for loan and lease losses:</b>         |                                           |                                          |                                                      |                               |                           |               |
| Beginning balance                                   | \$ 63,496                                 | \$ 87,873                                | \$ 177,839                                           | \$ 157,197                    | \$ 75,290                 | \$ 561,695    |
| Charge-offs                                         | (9,091)                                   | (3,160)                                  | (11,811)                                             | (47,310)                      | (12,113)                  | (83,485)      |
| Recoveries                                          | 154                                       | 10                                       | 1,048                                                | 103                           | 2,169                     | 3,484         |
| Provision                                           | 12,845                                    | 6,062                                    | 21,486                                               | 21,354                        | (2,563)                   | 59,184        |
| Ending balance                                      | \$ 67,404                                 | \$ 90,785                                | \$ 188,562                                           | \$ 131,344                    | \$ 62,783                 | \$ 540,878    |
| Ending balance: specific reserve for impaired loans | \$ 52,073                                 | \$ 30,402                                | \$ 92,162                                            | \$ 71,149                     | \$ 678                    | \$ 246,464    |
| Ending balance: general allowance                   | \$ 15,331                                 | \$ 60,383                                | \$ 96,400                                            | \$ 60,195                     | \$ 62,105                 | \$ 294,414    |
| <b>Loans receivables:</b>                           |                                           |                                          |                                                      |                               |                           |               |
| Ending balance                                      | \$ 2,880,989                              | \$ 1,590,633                             | \$ 4,165,648                                         | \$ 515,934                    | \$ 1,612,321              | \$ 10,765,525 |
| Ending balance: impaired loans                      | \$ 567,926                                | \$ 242,294                               | \$ 370,544                                           | \$ 290,859                    | \$ 11,607                 | \$ 1,483,230  |
| Ending balance: loans with general allowance        | \$ 2,313,063                              | \$ 1,348,339                             | \$ 3,795,104                                         | \$ 225,075                    | \$ 1,600,714              | \$ 9,282,295  |

| (Dollars in thousands)                              | <b>Residential<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>&amp;<br/>Industrial<br/>Loans</b> | <b>Construction<br/>Loans</b> | <b>Consumer<br/>Loans</b> | <b>Total</b> |
|-----------------------------------------------------|-------------------------------------------|------------------------------------------|------------------------------------------------------|-------------------------------|---------------------------|--------------|
| <b>Six-month period ended June 30, 2011</b>         |                                           |                                          |                                                      |                               |                           |              |
| <b>Allowance for loan and lease losses:</b>         |                                           |                                          |                                                      |                               |                           |              |
| Beginning balance                                   | \$ 62,330                                 | \$ 105,596                               | \$ 152,641                                           | \$ 151,972                    | \$ 80,486                 | \$ 553,025   |
| Charge-offs                                         | (14,495)                                  | (34,331)                                 | (28,155)                                             | (66,475)                      | (24,082)                  | (167,538)    |
| Recoveries                                          | 397                                       | 77                                       | 1,104                                                | 2,030                         | 3,867                     | 7,475        |
| Provision                                           | 19,172                                    | 19,443                                   | 62,972                                               | 43,817                        | 2,512                     | 147,916      |
| Ending balance                                      | \$ 67,404                                 | \$ 90,785                                | \$ 188,562                                           | \$ 131,344                    | \$ 62,783                 | \$ 540,878   |
| Ending balance: specific reserve for impaired loans | \$ 52,073                                 | \$ 30,402                                | \$ 92,162                                            | \$ 71,149                     | \$ 678                    | \$ 246,464   |

|                                   |    |        |    |        |    |        |    |        |    |        |    |         |
|-----------------------------------|----|--------|----|--------|----|--------|----|--------|----|--------|----|---------|
| Ending balance: general allowance | \$ | 15,331 | \$ | 60,383 | \$ | 96,400 | \$ | 60,195 | \$ | 62,105 | \$ | 294,414 |
|-----------------------------------|----|--------|----|--------|----|--------|----|--------|----|--------|----|---------|

**Loans receivables:**

|                |    |           |    |           |    |           |    |         |    |           |    |            |
|----------------|----|-----------|----|-----------|----|-----------|----|---------|----|-----------|----|------------|
| Ending balance | \$ | 2,880,989 | \$ | 1,590,633 | \$ | 4,165,648 | \$ | 515,934 | \$ | 1,612,321 | \$ | 10,765,525 |
|----------------|----|-----------|----|-----------|----|-----------|----|---------|----|-----------|----|------------|

|                                |    |         |    |         |    |         |    |         |    |        |    |           |
|--------------------------------|----|---------|----|---------|----|---------|----|---------|----|--------|----|-----------|
| Ending balance: impaired loans | \$ | 567,926 | \$ | 242,294 | \$ | 370,544 | \$ | 290,859 | \$ | 11,607 | \$ | 1,483,230 |
|--------------------------------|----|---------|----|---------|----|---------|----|---------|----|--------|----|-----------|

|                                              |    |           |    |           |    |           |    |         |    |           |    |           |
|----------------------------------------------|----|-----------|----|-----------|----|-----------|----|---------|----|-----------|----|-----------|
| Ending balance: loans with general allowance | \$ | 2,313,063 | \$ | 1,348,339 | \$ | 3,795,104 | \$ | 225,075 | \$ | 1,600,714 | \$ | 9,282,295 |
|----------------------------------------------|----|-----------|----|-----------|----|-----------|----|---------|----|-----------|----|-----------|

There were no significant purchases of loans during 2011. The Corporation did sell approximately \$518 million of performing residential mortgage loans to another financial institution and \$55.7 million of performing residential mortgage loans in the secondary market to FNMA and FHLMC during the first half of 2011. Also, the Corporation securitized approximately \$90.3 million of FHA/VA mortgage loans to GNMA mortgage-backed securities during 2011. Refer to Note 8 Loans held for sale for additional information about loans sold during 2011.

Changes in the allowance for the quarter and six-month period ended June 30, 2010 were as follows:

|                                      | <b>Quarter<br/>ended<br/>June 30,<br/>2010</b> | <b>Six-month<br/>period ended<br/>June 30,<br/>2010</b> |
|--------------------------------------|------------------------------------------------|---------------------------------------------------------|
|                                      | (In thousands)                                 |                                                         |
| Balance at beginning of the period   | \$ 575,303                                     | \$ 528,120                                              |
| Provision for loan and lease losses  | 146,793                                        | 317,758                                                 |
| Losses charged against the allowance | (120,516)                                      | (246,822)                                               |
| Recoveries credited to the allowance | 2,724                                          | 5,248                                                   |
| Balance at end of period             | \$ 604,304                                     | \$ 604,304                                              |

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.

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Information regarding impaired loans for the quarter and six-month period ended June 30, 2011 and for the year ended December 31, 2010 was as follows:

| <b>Impaired Loans</b><br>(Dollars in thousands) | <b>Recorded</b>   | <b>Unpaid Principal</b> | <b>Related</b>   | <b>Average Recorded</b> | <b>Interest Income Recognized Quarter to date</b> | <b>Interest Income Recognized Year to date</b> |
|-------------------------------------------------|-------------------|-------------------------|------------------|-------------------------|---------------------------------------------------|------------------------------------------------|
| <b>As of June 30, 2011</b>                      | <b>Investment</b> | <b>Balance</b>          | <b>Allowance</b> | <b>Investment</b>       |                                                   |                                                |
| <b>With no related allowance recorded:</b>      |                   |                         |                  |                         |                                                   |                                                |
| FHA/VA Guaranteed loans                         | \$                | \$                      | \$               | \$                      | \$                                                | \$                                             |
| Other residential mortgage loans                | 170,109           | 189,377                 |                  | 164,348                 | 2,081                                             | 3,297                                          |
| Commercial:                                     |                   |                         |                  |                         |                                                   |                                                |
| Commercial mortgage loans                       | 23,357            | 25,033                  |                  | 24,771                  | 488                                               | 697                                            |
| Commercial & Industrial Loans                   | 59,138            | 68,940                  |                  | 59,033                  | 223                                               | 633                                            |
| Construction Loans                              | 22,533            | 34,090                  |                  | 28,506                  | 45                                                | 77                                             |
| Consumer:                                       |                   |                         |                  |                         |                                                   |                                                |
| Auto loans                                      |                   |                         |                  |                         |                                                   |                                                |
| Finance leases                                  |                   |                         |                  |                         |                                                   |                                                |
| Other consumer loans                            | 1,545             | 2,215                   |                  | 1,115                   | 12                                                | 21                                             |
|                                                 | \$ 276,682        | \$ 319,655              | \$               | \$ 277,773              | \$ 2,849                                          | \$ 4,725                                       |
| <b>With an allowance recorded:</b>              |                   |                         |                  |                         |                                                   |                                                |
| FHA/VA Guaranteed loans                         | \$                | \$                      | \$               | \$                      | \$                                                | \$                                             |
| Other residential mortgage loans                | 397,817           | 432,995                 | 52,073           | 398,995                 | 2,753                                             | 4,985                                          |
| Commercial:                                     |                   |                         |                  |                         |                                                   |                                                |
| Commercial mortgage loans                       | 218,937           | 270,901                 | 30,402           | 194,269                 | 1,957                                             | 4,308                                          |
| Commercial & Industrial Loans                   | 311,406           | 415,101                 | 92,162           | 323,088                 | 1,858                                             | 4,116                                          |
| Construction Loans                              | 268,326           | 368,129                 | 71,149           | 277,933                 | 218                                               | 1,754                                          |
| Consumer:                                       |                   |                         |                  |                         |                                                   |                                                |
| Auto loans                                      | 2,754             | 2,754                   | 42               | 918                     | 69                                                | 98                                             |
| Finance leases                                  | 1,385             | 1,385                   | 32               | 462                     | 33                                                | 42                                             |
| Other consumer loans                            | 5,923             | 6,151                   | 604              | 2,895                   | 125                                               | 145                                            |
|                                                 | \$ 1,206,548      | \$ 1,497,416            | \$ 246,464       | \$ 1,198,560            | \$ 7,013                                          | \$ 15,448                                      |
| <b>Total:</b>                                   |                   |                         |                  |                         |                                                   |                                                |
| FHA/VA Guaranteed loans                         | \$                | \$                      | \$               | \$                      | \$                                                | \$                                             |

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|                                  |              |              |            |              |          |           |
|----------------------------------|--------------|--------------|------------|--------------|----------|-----------|
| Other residential mortgage loans | 567,926      | 622,372      | 52,073     | 563,343      | 4,834    | 8,282     |
| Commercial:                      |              |              |            |              |          |           |
| Commercial mortgage loans        | 242,294      | 295,934      | 30,402     | 219,040      | 2,445    | 5,005     |
| Commercial & Industrial Loans    | 370,544      | 484,041      | 92,162     | 382,121      | 2,081    | 4,749     |
| Construction Loans               | 290,859      | 402,219      | 71,149     | 306,439      | 263      | 1,831     |
| Consumer:                        |              |              |            |              |          |           |
| Auto loans                       | 2,754        | 2,754        | 42         | 918          | 69       | 98        |
| Finance leases                   | 1,385        | 1,385        | 32         | 462          | 33       | 42        |
| Other consumer loans             | 7,468        | 8,366        | 604        | 4,010        | 137      | 166       |
|                                  | \$ 1,483,230 | \$ 1,817,071 | \$ 246,464 | \$ 1,476,333 | \$ 9,862 | \$ 20,173 |

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|                                            | <b>Recorded<br/>Investment</b> | <b>Unpaid<br/>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> |
|--------------------------------------------|--------------------------------|-----------------------------------------|------------------------------|
| <b>As of December 31, 2010</b>             |                                |                                         |                              |
| <b>With no related allowance recorded:</b> |                                |                                         |                              |
| FHA/VA Guaranteed loans                    | \$                             | \$                                      | \$                           |
| Other residential mortgage loans           | 244,648                        | 253,636                                 |                              |
| Commercial:                                |                                |                                         |                              |
| Commercial mortgage loans                  | 32,328                         | 32,868                                  |                              |
| Commercial & Industrial Loans              | 54,631                         | 58,927                                  |                              |
| Construction Loans                         | 25,074                         | 26,557                                  |                              |
| Consumer:                                  |                                |                                         |                              |
| Auto loans                                 |                                |                                         |                              |
| Finance leases                             |                                |                                         |                              |
| Other consumer loans                       | 659                            | 1,015                                   |                              |
|                                            | \$ 357,340                     | \$ 373,003                              | \$                           |
| <b>With an allowance recorded:</b>         |                                |                                         |                              |
| FHA/VA Guaranteed loans                    | \$                             | \$                                      | \$                           |
| Other residential mortgage loans           | 311,187                        | 350,576                                 | 42,666                       |
| Commercial:                                |                                |                                         |                              |
| Commercial mortgage loans                  | 150,442                        | 186,404                                 | 26,869                       |
| Commercial & Industrial Loans              | 325,206                        | 416,919                                 | 65,030                       |
| Construction Loans                         | 237,970                        | 323,127                                 | 57,833                       |
| Consumer:                                  |                                |                                         |                              |
| Auto loans                                 |                                |                                         |                              |
| Finance leases                             |                                |                                         |                              |
| Other consumer loans                       | 1,496                          | 1,496                                   | 264                          |
|                                            | \$ 1,026,301                   | \$ 1,278,522                            | \$ 192,662                   |
| <b>Total:</b>                              |                                |                                         |                              |
| FHA/VA Guaranteed loans                    | \$                             | \$                                      | \$                           |
| Other residential mortgage loans           | 555,835                        | 604,212                                 | 42,666                       |
| Commercial:                                |                                |                                         |                              |
| Commercial mortgage loans                  | 182,770                        | 219,272                                 | 26,869                       |
| Commercial & Industrial Loans              | 379,837                        | 475,846                                 | 65,030                       |
| Construction Loans                         | 263,044                        | 349,684                                 | 57,833                       |
| Consumer:                                  |                                |                                         |                              |
| Auto loans                                 |                                |                                         |                              |
| Finance leases                             |                                |                                         |                              |
| Other consumer loans                       | 2,155                          | 2,511                                   | 264                          |
|                                            | \$ 1,383,641                   | \$ 1,651,525                            | \$ 192,662                   |

Interest income of approximately \$8.2 million and \$15.2 million was recognized on impaired loans for the second quarter and first half of 2010, respectively. The average recorded investment in impaired loans for the first half of

2010 was \$1.8 billion.

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The following tables show the activity for impaired loans and the related specific reserve for the quarter and six-month period ended June 30, 2011 and 2010:

|                                                                                           | <b>Quarter ended<br/>June 30,<br/>2011</b> | <b>June 30,<br/>2010</b> | <b>Six-month period ended<br/>June 30,<br/>2011</b> | <b>June 30,<br/>2010</b> |
|-------------------------------------------------------------------------------------------|--------------------------------------------|--------------------------|-----------------------------------------------------|--------------------------|
|                                                                                           | <b>(In thousands)</b>                      |                          |                                                     |                          |
| <b>Impaired Loans:</b>                                                                    |                                            |                          |                                                     |                          |
| Balance at beginning of period                                                            | \$ 1,562,122                               | \$ 1,846,086             | \$ 1,383,641                                        | \$ 1,656,264             |
| Loans determined impaired during the period                                               | 62,124                                     | 253,195                  | 339,672                                             | 570,528                  |
| Net charge-offs                                                                           | (66,271)                                   | (98,376)                 | (126,891)                                           | (199,635)                |
| Loans sold, net of charge-offs                                                            |                                            | (52,000)                 | (850)                                               | (70,749)                 |
| Loans foreclosed, paid in full and partial payments or no longer considered impaired, net | (74,745)                                   | (78,073)                 | (112,342)                                           | (85,576)                 |
| Balance at end of period                                                                  | \$ 1,483,230                               | \$ 1,870,832             | \$ 1,483,230                                        | \$ 1,870,832             |

|                                | <b>Quarter ended<br/>June 30,<br/>2011</b> | <b>June 30,<br/>2010</b> | <b>Six-month period ended<br/>June 30,<br/>2011</b> | <b>June 30,<br/>2010</b> |
|--------------------------------|--------------------------------------------|--------------------------|-----------------------------------------------------|--------------------------|
|                                | <b>(In thousands)</b>                      |                          |                                                     |                          |
| <b>Specific Reserve:</b>       |                                            |                          |                                                     |                          |
| Balance at beginning of period | \$ 253,476                                 | \$ 245,300               | \$ 192,662                                          | \$ 182,145               |
| Provision for loan losses      | 59,259                                     | 130,718                  | 180,693                                             | 295,132                  |
| Net charge-offs                | (66,271)                                   | (98,376)                 | (126,891)                                           | (199,635)                |
| Balance at end of period       | \$ 246,464                                 | \$ 277,642               | \$ 246,464                                          | \$ 277,642               |

The Corporation's credit quality indicators by loan type as of June 30, 2011 and December 31, 2010 are summarized below:

|                           | <b>Commercial Credit Exposure-Credit risk<br/>Profile based on<br/>Creditworthiness category:</b> |                        |
|---------------------------|---------------------------------------------------------------------------------------------------|------------------------|
| <b>June 30, 2011</b>      | <b>Adversely<br/>Classified <sup>(1)</sup></b>                                                    | <b>Total Portfolio</b> |
|                           | <b>(In thousands)</b>                                                                             |                        |
| Commercial Mortgage       | \$ 305,405                                                                                        | \$ 1,590,633           |
| Construction              | 333,968                                                                                           | 515,934                |
| Commercial and Industrial | 581,068                                                                                           | 4,165,648              |

|                          | <b>Commercial Credit Exposure-Credit risk<br/>Profile based on<br/>Creditworthiness category:</b> |                        |
|--------------------------|---------------------------------------------------------------------------------------------------|------------------------|
| <b>December 31, 2010</b> | <b>Adversely<br/>Classified <sup>(1)</sup></b>                                                    | <b>Total Portfolio</b> |
|                          | <b>(In thousands)</b>                                                                             |                        |
| Commercial Mortgage      | \$ 353,860                                                                                        | \$ 1,670,161           |

|                           |         |           |
|---------------------------|---------|-----------|
| Construction              | 323,880 | 700,579   |
| Commercial and Industrial | 558,937 | 4,151,764 |

- (1) Excludes \$5.1 million (construction) as of June 30, 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 considered 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.

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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.

| <b>June 30, 2011</b> | <b>Consumer Credit Exposure-Credit risk Profile based on payment activity</b> |                    |                 |                |                 |
|----------------------|-------------------------------------------------------------------------------|--------------------|-----------------|----------------|-----------------|
|                      | <b>Residential</b>                                                            | <b>Real-Estate</b> | <b>Consumer</b> |                |                 |
|                      |                                                                               | <b>Other</b>       |                 | <b>Finance</b> | <b>Other</b>    |
|                      | <b>FHA/VA/Guaranteed</b>                                                      | <b>residential</b> | <b>Auto</b>     | <b>Leases</b>  | <b>Consumer</b> |
|                      |                                                                               | <b>loans</b>       | (In thousands)  |                |                 |
| Performing           | \$ 249,981                                                                    | \$ 2,250,843       | \$ 940,491      | \$ 260,015     | \$ 369,750      |
| Non-performing       |                                                                               | 380,165            | 19,884          | 3,208          | 18,973          |
| Total                | \$ 249,981                                                                    | \$ 2,631,008       | \$ 960,375      | \$ 263,223     | \$ 388,723      |

| <b>December 31, 2010</b> | <b>Consumer Credit Exposure-Credit risk Profile based on payment activity</b> |                    |                 |                |                 |
|--------------------------|-------------------------------------------------------------------------------|--------------------|-----------------|----------------|-----------------|
|                          | <b>Residential</b>                                                            | <b>Real-Estate</b> | <b>Consumer</b> |                |                 |
|                          |                                                                               | <b>Other</b>       |                 | <b>Finance</b> | <b>Other</b>    |
|                          | <b>FHA/VA/Guaranteed</b>                                                      | <b>residential</b> | <b>Auto</b>     | <b>Leases</b>  | <b>Consumer</b> |
|                          |                                                                               | <b>loans</b>       | (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      |

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico and through programs sponsored by the Federal Government. 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 June 30, 2011, the Corporation's TDR loans consisted of \$303.0 million of residential mortgage loans, \$49.4 million commercial and industrial loans, \$151.3 million commercial mortgage loans, \$14.1 million of construction loans and \$9.2 million of consumer loans. Outstanding unfunded loan commitments on TDR loans amounted to \$1.1 million as of June 30, 2011.

Included in the \$151.3 million of commercial mortgage TDR loans are certain loan relationships restructured through loan splitting, two in the second quarter of 2011, one in the first quarter of 2011 and one in the fourth quarter of 2010. Each of these loan relationships were restructured into two notes; one that represents the portion of the loan that is expected to be fully collected along with contractual interest and the second note that represents the portion of the original loan that was charged-off. The renegotiations of these loans have been made after analyzing the borrowers and guarantors capacity to repay the debt and ability to perform under the modified terms. For the first relationship restructured in the second quarter, the first note amounting to \$2.1 million was placed on a monthly amortization schedule that amortizes the debt over 30 years and the second note for \$3.6 million represents mainly previously taken charge-offs on this loan. For the second relationship restructured in the second quarter, the first note of \$3.9 million was placed on a 30 year amortization schedule at a market rate of interest, while the second note of \$1.3 million, was charged-off. For the relationship restructured in the first quarter of 2011, the first note of \$57.5 million was placed on a monthly payment that amortize the debt over 30 years at a market rate of interest. The second note, amounting to \$28.3 million was fully charged-off. For the relationship restructured in the fourth quarter of 2010, as part of the renegotiation of the loans, the first note of \$17 million was placed on a monthly payment schedule that amortizes the debt over 30 years at a market rate of interest. The second note for \$2.7 million was fully charged-off. The following tables provide additional information about the volume of this type of loan restructurings and the effect on the allowance for loan and lease losses in 2011.

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|                                                       |           |
|-------------------------------------------------------|-----------|
| Principal balance deemed collectible at end of period | \$ 80,189 |
| Amount charged-off during the first half of 2011      | \$ 29,576 |
| Charges to the provision for loan losses              | \$ 5,989  |
| Allowance for loan losses as of June 30, 2011         | \$ 1,034  |

The loans comprising the \$80.2 million that have been deemed collectible were placed in accruing status as the borrowers have exhibited a period of sustained performance but continue to be individually evaluated for impairment purposes. These loans contributed to a \$110.0 million decrease in non-performing loans over the last three quarters.

As of June 30, 2011, the Corporation maintains a \$5.3 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.

**8 LOANS HELD FOR SALE**

As of June 30, 2011 and December 31, 2010, the Corporation's loans held for sale portfolio was composed of:

|                                 | <b>June<br/>30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|---------------------------------|------------------------------|----------------------------------|
|                                 | (In thousands)               |                                  |
| Residential mortgage loans      | \$ 15,694                    | \$ 19,148                        |
| Construction loans              | 5,087                        | 207,270                          |
| Commercial and Industrial loans |                              | 20,643                           |
| Commercial mortgage loans       |                              | 53,705                           |
| Total                           | \$ 20,781                    | \$ 300,766                       |

Non-performing loans held for sale totaled \$5.1 million (construction) and \$159.3 million (\$140.1 million construction loans and \$19.2 million commercial mortgage loans) as of June 30, 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 \$46.1 million is subordinated to the aggregate amount of its loans to CPG/GS in the amount of \$216.1 million as of June 30, 2011 and to the interest and priority return of CPG/GS majority investor. Further details of this transaction are discussed in Note 11. At June 30, 2011, the only related balance remaining from loans transferred in the fourth quarter of 2010 amounted to \$5.1 million.

**9 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 June 30, 2011 and December 31, 2010, all derivatives held by the Corporation were

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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 \$100 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 June 30, 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) Income.

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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The following table summarizes the notional amounts of all derivative instruments as of June 30, 2011 and December 31, 2010:

|                                                                                               | Notional Amounts |            |
|-----------------------------------------------------------------------------------------------|------------------|------------|
|                                                                                               | As of            | As of      |
|                                                                                               | June 30,         | December   |
|                                                                                               | 2011             | 31,        |
|                                                                                               |                  | 2010       |
|                                                                                               | (In thousands)   |            |
| <b>Economic undesignated hedges:</b>                                                          |                  |            |
| Interest rate contracts:                                                                      |                  |            |
| Interest rate swap agreements used to hedge loans                                             | \$ 40,470        | \$ 41,248  |
| Written interest rate cap agreements                                                          | 71,125           | 71,602     |
| Purchased interest rate cap agreements                                                        | 71,125           | 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:                                                                            |                  |            |
| Sales of TBA GNMA MBS pools                                                                   | 17,600           |            |
|                                                                                               | \$ 293,350       | \$ 291,482 |

The following table summarizes the fair value of derivative instruments and the location in the Statement of Financial Condition as of June 30, 2011 and December 31, 2010:

|                  | <b>Asset Derivatives</b> |                 |                  | <b>Liability Derivatives</b> |                 |
|------------------|--------------------------|-----------------|------------------|------------------------------|-----------------|
|                  | <b>June</b>              | <b>December</b> |                  | <b>June</b>                  | <b>December</b> |
|                  | <b>30,</b>               | <b>31,</b>      |                  | <b>30,</b>                   | <b>31,</b>      |
| <b>Statement</b> | <b>2011</b>              | <b>2010</b>     | <b>Statement</b> | <b>2011</b>                  | <b>2010</b>     |
| <b>of</b>        |                          |                 | <b>of</b>        |                              |                 |
| <b>Financial</b> |                          |                 | <b>Financial</b> |                              |                 |
| <b>Condition</b> | <b>Fair</b>              | <b>Fair</b>     | <b>Condition</b> | <b>Fair</b>                  | <b>Fair</b>     |
| <b>Location</b>  | <b>Value</b>             | <b>Value</b>    | <b>Location</b>  | <b>Value</b>                 | <b>Value</b>    |
|                  | <b>(In thousands)</b>    |                 |                  |                              |                 |

**Economic undesignated hedges:**

Interest rate contracts:

|                                                   |              |        |        |                                        |          |          |
|---------------------------------------------------|--------------|--------|--------|----------------------------------------|----------|----------|
| Interest rate swap agreements used to hedge loans | Other assets | \$ 368 | \$ 351 | Accounts payable and other liabilities | \$ 6,051 | \$ 5,192 |
| Written interest rate cap agreements              | Other assets |        |        | Accounts payable and other             |          | 1        |

|                                                                                               |              |          |          |                                        |          |          |
|-----------------------------------------------------------------------------------------------|--------------|----------|----------|----------------------------------------|----------|----------|
| Purchased interest rate cap agreements                                                        | Other assets |          | 1        | 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                          | 988      | 1,508    |
| Purchased options used to manage exposure to the stock market on embedded stock index options | Other assets | 988      | 1,553    | Accounts payable and other liabilities |          |          |
| Forward Contracts:                                                                            |              |          |          |                                        |          |          |
| Sales of TBA GNMA MBS pools                                                                   | Other assets | 53       |          | Accounts payable and other liabilities | 86       |          |
|                                                                                               |              | \$ 1,409 | \$ 1,905 |                                        | \$ 7,125 | \$ 6,701 |

The following table summarizes the effect of derivative instruments on the Statement of Loss for the quarter and six-month period ended June 30, 2011 and 2010:

|                                                                                 |                                                                | Unrealized Gain or (Loss) |         | Unrealized Gain or (Loss) |         |
|---------------------------------------------------------------------------------|----------------------------------------------------------------|---------------------------|---------|---------------------------|---------|
|                                                                                 | Location of Gain or (loss) Recognized in Income on Derivatives | Quarter Ended             |         | Six-Month Period Ended    |         |
|                                                                                 |                                                                | June 30, 2011             | 2010    | June 30, 2011             | 2010    |
| (In thousands)                                                                  |                                                                |                           |         |                           |         |
| ECONOMIC UNDESIGNATED HEDGES:                                                   |                                                                |                           |         |                           |         |
| Interest rate contracts:                                                        |                                                                |                           |         |                           |         |
| Interest rate swap agreements used to hedge fixed-rate:                         |                                                                |                           |         |                           |         |
| Loans                                                                           | Interest income - Loans                                        | \$ (1,185)                | \$ (47) | \$ (840)                  | \$ (60) |
| Written and purchased interest rate cap agreements - mortgage-backed securities | Interest income - Investment securities                        |                           | (440)   |                           | (1,137) |
| Written and purchased interest rate cap agreements - loans                      | Interest income - loans                                        |                           |         |                           | (34)    |
| Equity contracts:                                                               |                                                                |                           |         |                           |         |
| Embedded written and purchased options on stock index deposits                  | Interest expense - Deposits                                    |                           |         |                           | (1)     |

|                                                                           |                                                          |          |          |          |            |
|---------------------------------------------------------------------------|----------------------------------------------------------|----------|----------|----------|------------|
| Embedded written and purchased<br>options on stock index notes<br>payable | Interest expense - Notes<br>payable and other borrowings | (42)     | 81       | (47)     | 51         |
| Forward contracts:<br>Sales of TBA GNMA MBS pools                         | Mortgage Banking Activities                              | 231      |          | (33)     |            |
| Total gain (loss) on derivatives                                          |                                                          | \$ (996) | \$ (406) | \$ (920) | \$ (1,181) |

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.

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A summary of interest rate swaps as of June 30, 2011 and December 31, 2010 follows:

|                                                                      | <b>As of<br/>June<br/>30,<br/>2011</b> | <b>As of<br/>December<br/>31,<br/>2010</b> |
|----------------------------------------------------------------------|----------------------------------------|--------------------------------------------|
|                                                                      | <b>(Dollars in thousands)</b>          |                                            |
| Pay fixed/receive floating :                                         |                                        |                                            |
| Notional amount                                                      | \$ 40,470                              | \$ 41,248                                  |
| Weighted-average receive rate at period end                          | 2.06%                                  | 2.14%                                      |
| Weighted-average pay rate at period end                              | 6.83%                                  | 6.83%                                      |
| Floating rates range from 167 to 252 basis points over 3-month LIBOR |                                        |                                            |

As of June 30, 2011, the Corporation has not entered into any derivative instrument containing credit-risk-related contingent features.

**10 GOODWILL AND OTHER INTANGIBLES**

Goodwill as of June 30, 2011 and December 31, 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 2010. 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, 2010 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 \$12.3 million, resulting in no goodwill impairment. Goodwill was not impaired as of December 31, 2010, nor was any goodwill written-off due to impairment during 2010. There have been no events related to the Florida reporting unit that could indicate potential goodwill impairment since the date of the last evaluation; therefore, no goodwill impairment evaluation was performed during the first half of 2011. Goodwill and other indefinite life intangibles are reviewed at least annually for impairment.

As of June 30, 2011, the gross carrying amount and accumulated amortization of core deposit intangibles was \$41.8 million and \$29.0 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). During the quarter and six-month period ended June 30, 2011, the amortization expense of core deposit intangibles amounted to \$0.6 million and \$1.2 million, respectively, compared to \$0.6 million and \$1.3 million, respectively, for the comparable periods in 2010.

**11 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 June 30, 2011, the Corporation serviced loans securitized through GNMA with principal balance of \$541.9 million.

**Table of Contents****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, 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 June 30, 2011, the outstanding balance of Grantor Trusts amounted to approximately \$92 million with a weighted average yield of 2.28%.

**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 the 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 June 30, 2011, the carrying amount of the loan is \$136.1 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 \$46.1 million as of June 30, 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 will be accounting for 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 first half of 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 June 30, 2011, the carrying value of the advance facility and working capital line were \$80.0 million and \$0, respectively, and are included in the Corporation's C&I loan receivable portfolio.

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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 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. Because 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 \$1.5 million presented in the Statement of Loss, relates to the Bank's investment in CPG/GS. Approximately \$1.9 million of such charges 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

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.

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The changes in servicing assets are shown below:

|                                                          | Quarter ended  |               | Six-month period ended |               |
|----------------------------------------------------------|----------------|---------------|------------------------|---------------|
|                                                          | June 30, 2011  | June 30, 2010 | June 30, 2011          | June 30, 2010 |
|                                                          | (In thousands) |               |                        |               |
| Balance at beginning of period                           | \$ 16,243      | \$ 12,594     | \$ 15,597              | \$ 11,902     |
| Capitalization of servicing assets                       | 1,291          | 1,377         | 2,522                  | 3,063         |
| Amortization                                             | (573)          | (497)         | (1,097)                | (932)         |
| Adjustment to servicing assets for loans repurchased (1) | (84)           | (139)         | (145)                  | (698)         |
| Balance before valuation allowance at end of period      | 16,877         | 13,335        | 16,877                 | 13,335        |
| Valuation allowance for temporary impairment             | (2,239)        | (282)         | (2,239)                | (282)         |
| Balance at end of period                                 | \$ 14,638      | \$ 13,053     | \$ 14,638              | \$ 13,053     |

(1) Amount represents the adjustment to fair value related to the repurchase of \$8.8 million and \$20.8 million for the quarter and six-month period ended June 30, 2011, respectively, and, \$13.9 million and \$67.4 million for the quarter and six-month period ended June 30, 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.

Changes in the impairment allowance were as follows:

|                                | Quarter ended  |               | Six-month period ended |               |
|--------------------------------|----------------|---------------|------------------------|---------------|
|                                | June 30, 2011  | June 30, 2010 | June 30, 2011          | June 30, 2010 |
|                                | (In thousands) |               |                        |               |
| Balance at beginning of period | \$ 1,237       | \$ 180        | \$ 434                 | \$ 745        |
| Temporary impairment charges   | 1,149          | 216           | 2,123                  | 352           |
| Recoveries                     | (147)          | (114)         | (318)                  | (815)         |
| Balance at end of period       | \$ 2,239       | \$ 282        | \$ 2,239               | \$ 282        |

The components of net servicing income are shown below:

|                                       | Quarter ended  |               | Six-month period ended |               |
|---------------------------------------|----------------|---------------|------------------------|---------------|
|                                       | June 30, 2011  | June 30, 2010 | June 30, 2011          | June 30, 2010 |
|                                       | (In thousands) |               |                        |               |
| Servicing fees                        | \$ 1,411       | \$ 1,008      | \$ 2,662               | \$ 1,936      |
| Late charges and prepayment penalties | 123            | 207           | 367                    | 321           |

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|                                                 |          |        |         |          |
|-------------------------------------------------|----------|--------|---------|----------|
| Adjustment for loans repurchased                | (84)     | (140)  | (145)   | (698)    |
| Servicing income, gross                         | 1,450    | 1,075  | 2,884   | 1,559    |
| Amortization and impairment of servicing assets | (1,575)  | (599)  | (2,902) | (469)    |
| Servicing (loss) income, net                    | \$ (125) | \$ 476 | \$ (18) | \$ 1,090 |

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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 ranged as follows:

|                                              | <b>Maximum</b> | <b>Minimum</b> |
|----------------------------------------------|----------------|----------------|
| <b>Six-month period ended June 30, 2011:</b> |                |                |
| <b>Constant prepayment rate:</b>             |                |                |
| Government guaranteed mortgage loans         | 12.3%          | 10.6%          |
| Conventional conforming mortgage loans       | 12.9%          | 12.7%          |
| Conventional non-conforming mortgage loans   | 13.9%          | 11.7%          |
| <b>Discount rate:</b>                        |                |                |
| Government guaranteed mortgage loans         | 11.5%          | 11.3%          |
| Conventional conforming mortgage loans       | 9.5%           | 9.3%           |
| Conventional non-conforming mortgage loans   | 15.0%          | 13.8%          |
| <b>Six-month period ended June 30, 2010:</b> |                |                |
| <b>Constant prepayment rate:</b>             |                |                |
| Government guaranteed mortgage loans         | 12.7%          | 11.3%          |
| Conventional conforming mortgage loans       | 16.2%          | 14.8%          |
| Conventional non-conforming mortgage loans   | 13.4%          | 11.5%          |
| <b>Discount rate:</b>                        |                |                |
| Government guaranteed mortgage loans         | 11.6%          | 10.3%          |
| Conventional conforming mortgage loans       | 9.3%           | 9.2%           |
| Conventional non-conforming mortgage loans   | 13.1%          | 13.1%          |

At June 30, 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 June 30, 2011, were as follows:

|                                                                |    | (Dollars in thousands) |
|----------------------------------------------------------------|----|------------------------|
| Carrying amount of servicing assets                            | \$ | 14,638                 |
| Fair value                                                     | \$ | 15,366                 |
| Weighted-average expected life (in years)                      |    | 8.6                    |
| <b>Constant prepayment rate (weighted-average annual rate)</b> |    | 12.69%                 |
| Decrease in fair value due to 10% adverse change               | \$ | 721                    |
| Decrease in fair value due to 20% adverse change               | \$ | 1,389                  |
| <b>Discount rate (weighted-average annual rate)</b>            |    | 10.58%                 |
| Decrease in fair value due to 10% adverse change               | \$ | 561                    |
| Decrease in fair value due to 20% adverse change               | \$ | 1,084                  |

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.

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The following table summarizes deposit balances:

|                                        | <b>June 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|----------------------------------------|--------------------------|------------------------------|
|                                        | <b>(In thousands)</b>    |                              |
| Type of account and interest rate:     |                          |                              |
| Non-interest bearing checking accounts | \$ 720,573               | \$ 668,052                   |
| Savings accounts                       | 1,890,484                | 1,938,475                    |
| Interest-bearing checking accounts     | 1,017,053                | 1,012,009                    |
| Certificates of deposit                | 2,237,635                | 2,181,205                    |
| Brokered certificates of deposit       | 5,206,983                | 6,259,369                    |
|                                        | <b>\$ 11,072,728</b>     | <b>\$ 12,059,110</b>         |

Brokered CDs mature as follows:

|                              | <b>June 30,<br/>2010</b> |
|------------------------------|--------------------------|
|                              | <b>(In thousands)</b>    |
| One to ninety days           | \$ 772,403               |
| Over ninety days to one year | 2,221,568                |
| One to three years           | 2,196,108                |
| Three to five years          | 5,821                    |
| Over five years              | 11,083                   |
| Total                        | <b>\$ 5,206,983</b>      |

The following are the components of interest expense on deposits:

|                                                                                                                   | <b>Quarter Ended</b>         |                          | <b>Six-Month Period Ended</b> |                          |
|-------------------------------------------------------------------------------------------------------------------|------------------------------|--------------------------|-------------------------------|--------------------------|
|                                                                                                                   | <b>June<br/>30,<br/>2011</b> | <b>June 30,<br/>2010</b> | <b>June 30,<br/>2011</b>      | <b>June 30,<br/>2010</b> |
|                                                                                                                   | <b>(In thousands)</b>        |                          | <b>(In thousands)</b>         |                          |
| Interest expense on deposits                                                                                      | \$ 45,342                    | \$ 58,444                | \$ 94,042                     | \$ 118,944               |
| Amortization of broker placement fees                                                                             | 4,183                        | 5,322                    | 9,542                         | 10,787                   |
| Interest expense on deposits excluding net unrealized loss on derivatives and brokered CDs measured at fair value | 49,525                       | 63,766                   | 103,584                       | 129,731                  |
| Net unrealized loss on derivatives and brokered CDs measured at fair value                                        |                              |                          |                               | 1                        |
| Total interest expense on deposits                                                                                | <b>\$ 49,525</b>             | <b>\$ 63,766</b>         | <b>\$ 103,584</b>             | <b>\$ 129,732</b>        |

**13 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE**

Securities sold under agreements to repurchase (repurchase agreements) consist of the following:

|                                                                                     | <b>June 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|-------------------------------------------------------------------------------------|--------------------------|------------------------------|
|                                                                                     | <b>(In thousands)</b>    |                              |
| Repurchase agreements, interest ranging from 3.35% to 4.51% (2010 - 0.99% to 4.51%) | \$ 1,200,000             | \$ 1,400,000                 |

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Repurchase agreements mature as follows:

|                              | <b>June 30,<br/>2011<br/>(In thousands)</b> |
|------------------------------|---------------------------------------------|
| Over ninety days to one year | \$ 100,000                                  |
| One to three years           | 600,000                                     |
| Three to five years          | 500,000                                     |
| Total                        | \$ 1,200,000                                |

As of June 30, 2011 and December 31, 2010, the securities underlying such agreements were delivered to the dealers with whom the repurchase agreements were transacted.

Repurchase agreements as of June 30, 2011, grouped by counterparty, were as follows:

| Counterparty                 | <b>Amount</b> | <b>Weighted-Average<br/>Maturity (In<br/>Months)</b> |
|------------------------------|---------------|------------------------------------------------------|
| UBS Financial Services, Inc. | \$ 100,000    | 13                                                   |
| Barclays Capital             | 100,000       | 14                                                   |
| Dean Witter / Morgan Stanley | 200,000       | 25                                                   |
| Credit Suisse First Boston   | 300,000       | 32                                                   |
| JP Morgan Chase              | 200,000       | 33                                                   |
| Citigroup Global Markets     | 300,000       | 34                                                   |
|                              | \$ 1,200,000  |                                                      |

As part of the Corporation's deleveraging strategies, approximately \$200 million of repurchase agreements were repaid prior to maturity during the second quarter of 2011, realizing a loss of \$1.6 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 1.06%.

**14 ADVANCES FROM THE FEDERAL HOME LOAN BANK (FHLB)**

Following is a summary of the advances from the FHLB:

|                                                                                                 | <b>June 30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|-------------------------------------------------------------------------------------------------|--------------------------|----------------------------------|
|                                                                                                 | <b>(In thousands)</b>    |                                  |
| Fixed-rate advances from FHLB, with a weighted-average interest rate of 3.67%<br>(2010 - 3.33%) | \$ 420,440               | \$ 653,440                       |

Advances from FHLB mature as follows:

|                    | <b>June 30,<br/>2011<br/>(In<br/>thousands)</b> |
|--------------------|-------------------------------------------------|
| One to thirty days | \$ 11,000                                       |

|                              |            |
|------------------------------|------------|
| Over ninety days to one year | 76,000     |
| One to three years           | 333,440    |
| Total                        | \$ 420,440 |

As of June 30, 2011, the Corporation had additional capacity of approximately \$445.4 million on this credit facility based on collateral pledged at the FHLB, including haircuts reflecting the perceived risk associated with holding the collateral.

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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%.

**15 NOTES PAYABLE**

Notes payable consist of:

|                                                                                                                                                                                       | <b>June<br/>30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|----------------------------------|
|                                                                                                                                                                                       | (Dollars in thousands)       |                                  |
| Callable step-rate notes, bearing step increasing interest from 5.00% to 7.00% (6.00% as of June 30, 2011 and December 31, 2010) maturing on October 18, 2019, measured at fair value | \$ 12,374                    | \$ 11,842                        |
| Dow Jones Industrial Average (DJIA) linked principal protected notes:                                                                                                                 |                              |                                  |
| Series A maturing on February 28, 2012                                                                                                                                                | 7,341                        | 6,865                            |
| Series B maturing on May 27, 2011                                                                                                                                                     |                              | 7,742                            |
|                                                                                                                                                                                       | \$ 19,715                    | \$ 26,449                        |

**16 OTHER BORROWINGS**

Other borrowings consist of:

|                                                                                                                                                                           | <b>June 30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------|----------------------------------|
|                                                                                                                                                                           | (Dollars in thousands)   |                                  |
| Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.75% over 3-month LIBOR (3.00% as of June 30, 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 (2.75% as of June 30, 2011 and 2.80% as of December 31, 2010) | 128,866                  | 128,866                          |
|                                                                                                                                                                           | \$ 231,959               | \$ 231,959                       |

**17 STOCKHOLDERS' EQUITY*****Common Stock***

As of June 30, 2011, the Corporation had 2,000,000,000 authorized shares of common stock with a par value of \$0.10 per share. As of both June 30, 2011 and December 31, 2010, there were 21,963,522 shares issued and 21,303,669 shares outstanding. The Corporation stopped paying common and preferred stock dividends in August 2009.

As of June 30, 2011, there were 716 shares of restricted stock outstanding that are expected to vest in the fourth quarter of 2011. 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 holder of restricted stock, 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.

Effective January 7, 2011, the Corporation implemented a one-for-fifteen reverse stock split of all outstanding shares of its common stock. At the Corporation's Special Meeting of Stockholders held on August 24, 2010, stockholders approved an amendment to the

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Corporation's Restated Articles of Incorporation to implement a reverse stock split at a ratio, to be determined by the board in its sole discretion, within the range of one new share of common stock for 10 old shares and one new share for 20 old shares. As authorized, the Board elected to effect a reverse stock split at a ratio of one-for-fifteen. The reverse stock split allowed the Corporation to regain compliance with listing standards of the New York Stock Exchange. The one-for-fifteen reverse stock split reduced the number of outstanding shares of common stock from 319,557,932 shares to 21,303,669 shares of common stock. All share and per share amounts included in these financial statements have been adjusted to retroactively reflect the 1-for-15 reverse stock split.

***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 June 30, 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. The Corporation is currently in the process of voluntarily delisting the Series A through E preferred stock from the New York Stock Exchange.

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 for 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 to the Corporation was obtaining the right, under the terms of the 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. The Series G Preferred Stock is also convertible by the Treasury and any subsequent holder at any time and, unless earlier converted, is automatically convertible into common stock on the seventh anniversary of issuance. On the seventh anniversary of issuance, each share of the Series G Preferred Stock will mandatorily convert into a number of shares of the Corporation's common stock equal to a fraction, the numerator of which is \$1,000 and the denominator of which is the market price of the Corporation's common stock on the second trading day preceding the mandatory conversion date, provided, however, holders of the Series G Preferred Stock will not be entitled to convert shares until the converting holder has first received any applicable regulatory approvals. 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 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.

During the fourth quarter of 2010, the U.S. Treasury agreed to a reduction from \$500 million to \$350 million in the size of the capital raise required to satisfy the remaining substantive condition to compel the conversion of the Series G Preferred Stock owned by the U.S. Treasury into shares of common stock. Additionally, in April 2011, the U.S. Treasury agreed to extend to October 7, 2011, the date by when the Corporation is required to complete an equity raise in order to compel conversion of the Series G Preferred Stock into shares of common stock. In connection with the negotiation of this reduction, the Corporation agreed to a reduction in the previously agreed upon discount of the liquidation preference of the Series G Preferred Stock from 35% to 25%, thus, increasing the number of shares of common stock into which the Series G Preferred Stock is convertible. Based on an initial conversion rate of 68.9465 shares of common stock for each share of Series G Preferred Stock (calculated by dividing \$750, or a discount of 25% from the \$1,000 liquidation preference per share of Series G Preferred Stock, by the initial conversion price of \$10.878 per share, which is subject to adjustment), the number of shares into which the Series G Preferred Stock

would be convertible increased from 25.3 million to 29.2 million shares of common stock. As a result of the change in the discount and the extension of the date to compel the conversion, non-cash adjustments of \$11.3 million and \$0.2 million were recorded in the fourth quarter of 2010 and second quarter of 2011, respectively, as an acceleration of the Series G Preferred Stock discount accretion.

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 is accreted to preferred stock over 7 years using the interest method with a corresponding adjustment to preferred dividends.

The Series G Preferred Stock qualifies as Tier 1 regulatory capital. Cumulative dividends on the Series G Preferred Stock accrue on the liquidation preference on a quarterly basis at a rate of 5% per annum for the first five years, and thereafter at a rate of 9% per annum, but will only be paid when, as and if declared by the Corporation's Board of Directors out of assets legally available therefore.

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The Series G Preferred Stock ranks pari passu with the Corporation's existing Series A through E preferred stock in terms of dividend payments and distributions upon liquidation, dissolution and winding up of the Corporation. The exchange agreement relating to the issuance of the Series G Preferred Stock limits the payment of dividends on common stock, including limiting regular quarterly cash dividends to an amount not exceeding the last quarterly cash dividend paid per share, or the amount publicly announced (if lower), on common stock prior to October 14, 2008, which is \$1.05 per share.

Additionally, 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 Warrant has a 10-year term and is 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 2% of the Corporation's shares of common stock as of June 30, 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 on the Corporation's then outstanding Series F Preferred Stock and the Corporation's common stock. Prior to any resumption of the payment of dividends on or repurchases of any of the remaining outstanding noncumulative preferred stock or common stock, the Corporation must comply with the terms of the Series G Preferred Stock. In addition, prior to the repurchase of any stock for cash, the Corporation must obtain the consent of the U.S. Treasury under certain circumstances.

Refer to Note 1, Capital and Liquidity, for information about Investment agreements entered by the Corporation with institutional investors and private equity firms for the issuance of an aggregate \$525 million of the Corporation's common stock, subject to the approval of the Corporation's stockholders and regulators. If approved, the transaction is expected to close during the third quarter of 2011.

### ***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 the first half of 2011 and 2010 by the Corporation. As of June 30, 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. FirstBank's statutory reserve fund amounted to \$299.0 million as of June 30, 2011 and December 31, 2010.

## **18 REGULATORY MATTERS**

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

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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 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 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 at June 30, 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 investments 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 September 30, 2011. FirstBank will request approvals for future periods.

## **19 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 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.

Under the Puerto Rico Internal Revenue Code of 1994, as amended (the "1994 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 1994 PR Code). The 1994 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

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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 1994 PR Code, First BanCorp is subject to a maximum statutory tax rate of 39%. In 2009, the Puerto Rico Government approved Act No. 7 (the Act) to stimulate Puerto Rico's economy and to reduce the Puerto Rico Government's fiscal deficit. The Act imposes a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which is 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 the capital gain statutory tax rate from 15% to 15.75%. These temporary measures are effective for tax years that commenced after December 31, 2008 and before January 1, 2012. The 1994 PR Code also includes an alternative minimum tax of 22% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements.

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 Entities (IBEs) of the Bank (FirstBank IBE) 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. Under the Act, all IBE are subject to the special 5% tax on their net income not otherwise subject to tax pursuant to the 1994 PR Code. This temporary measure is effective for tax years that commenced after December 31, 2008 and before January 1, 2012. FirstBank IBE 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.

On January 31, 2011, the Puerto Rico Government approved Act No. 1, which repealed the 1994 PR Code and replaced it with the Puerto Rico Internal Revenue Code of 2010 (the 2010 PR Code). The provisions of the 2010 Code are generally applicable to taxable years commencing after December 31, 2010. The matters discussed above are equally applicable under the 2010 PR Code except that the maximum corporate tax rate has been reduced from 39% (40.95% for calendar years 2009 and 2010) to 30% (25% for taxable years commencing after December 31, 2013 if certain economic conditions are met by the Puerto Rico economy); and the net operating losses carryforward period has been extended from 7 years to 10 years. Corporations are entitled to elect to continue to determine their Puerto Rico income tax responsibility for such a 5-year period starting in 2011 to determine income tax responsibility under the provisions of the 1994 PR Code.

For the quarter and six-month period ended June 30, 2011, the Corporation recorded an income tax expense of \$2.6 million and \$6.2 million, respectively, compared to an income tax expense of \$3.8 million and \$10.7 million for the same periods in 2010. The decrease in the tax expense for the second quarter of 2011, compared to the same period in 2010, was mainly related to lower income derived from the operations of FirstBank Overseas and the reduction in the statutory income tax rates applicable to subsidiaries. The decrease in the income tax expense for the first half of 2011, compared to the same period in 2010, reflects the impact in the first half of 2010 of a \$3.5 million charge to increase the valuation allowance related to deferred tax assets created prior to 2010 and lower income derived from the operations of FirstBank Overseas. As of June 30, 2011, the deferred tax asset, net of a valuation allowance of \$361.1 million, amounted to \$6.4 million compared to \$9.3 million as of December 31, 2010. The Corporation continued to reserve 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 in the valuation allowance was that the Corporation's banking subsidiary, FirstBank Puerto Rico, continued in a three-year historical cumulative loss position as of the end of the second quarter of 2011, and has projected to be in a loss position for the remaining of 2011. As of June 30, 2011, management concluded that \$6.4 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.

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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.

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 Unrecognized Tax Benefit ( UTB ).

The Corporation classified all interest and penalties, if any, related to tax uncertainties as income tax expense. 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. There were no UTBs outstanding as of June 30, 2011 and December 31, 2010.

**20 FAIR VALUE*****Fair Value Option***

FASB authoritative guidance permits the measurement of selected eligible financial instruments at fair value.

***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 June 30, 2011 and December 31, 2010, these medium-term notes with a principal balance of \$15.4 million, had a fair value of \$12.4 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.

***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:

- |                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Level 1</b> | 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.                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| <b>Level 2</b> | 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.

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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.

The following table presents the estimated fair value and carrying value of financial instruments as of June 30, 2011 and December 31, 2010.

|                                                | <b>Total<br/>Carrying<br/>Amount in<br/>Statement<br/>of<br/>Financial<br/>Condition<br/>6/30/2011</b> | <b>Fair Value<br/>Estimated<br/>6/30/2011</b> | <b>Total<br/>Carrying<br/>Amount in<br/>Statement of<br/>Financial<br/>Condition<br/>12/31/2010</b> | <b>Fair Value<br/>Estimated<br/>12/31/2010</b> |
|------------------------------------------------|--------------------------------------------------------------------------------------------------------|-----------------------------------------------|-----------------------------------------------------------------------------------------------------|------------------------------------------------|
| <b>(In thousands)</b>                          |                                                                                                        |                                               |                                                                                                     |                                                |
| <b>Assets:</b>                                 |                                                                                                        |                                               |                                                                                                     |                                                |
| Cash and due from banks and money              |                                                                                                        |                                               |                                                                                                     |                                                |
| market investments                             | \$ 353,697                                                                                             | \$ 353,697                                    | \$ 370,283                                                                                          | \$ 370,283                                     |
| Investment securities available for sale       | 2,834,086                                                                                              | 2,834,086                                     | 2,744,453                                                                                           | 2,744,453                                      |
| Investment securities held to maturity         |                                                                                                        |                                               | 453,387                                                                                             | 476,516                                        |
| Other equity securities                        | 42,252                                                                                                 | 42,252                                        | 55,932                                                                                              | 55,932                                         |
| Loans held for sale                            | 20,781                                                                                                 | 20,781                                        | 300,766                                                                                             | 300,766                                        |
| Loans, held for investment                     | 10,765,525                                                                                             |                                               | 11,655,436                                                                                          |                                                |
| Less: allowance for loan and lease losses      | (540,878)                                                                                              |                                               | (553,025)                                                                                           |                                                |
| Loans held for investment, net of allowance    | 10,224,647                                                                                             | 9,813,271                                     | 11,102,411                                                                                          | 10,581,221                                     |
| Derivatives, included in assets                | 1,409                                                                                                  | 1,409                                         | 1,905                                                                                               | 1,905                                          |
| <b>Liabilities:</b>                            |                                                                                                        |                                               |                                                                                                     |                                                |
| Deposits                                       | 11,072,728                                                                                             | 11,179,891                                    | 12,059,110                                                                                          | 12,207,613                                     |
| Securities sold under agreements to repurchase | 1,200,000                                                                                              | 1,306,715                                     | 1,400,000                                                                                           | 1,513,338                                      |
| Advances from FHLB                             | 420,440                                                                                                | 441,600                                       | 653,440                                                                                             | 677,866                                        |
| Notes Payable                                  | 19,715                                                                                                 | 18,647                                        | 26,449                                                                                              | 24,909                                         |
| Other borrowings                               | 231,959                                                                                                | 86,401                                        | 231,959                                                                                             | 71,488                                         |
| Derivatives, included in liabilities           | 7,125                                                                                                  | 7,125                                         | 6,701                                                                                               | 6,701                                          |
|                                                | 43                                                                                                     |                                               |                                                                                                     |                                                |

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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 June 30, 2011           |           |         |                                             | As of December 30, 2010       |           |         |                                             |
|-------------------------------------------------------------------------------------------------|-------------------------------|-----------|---------|---------------------------------------------|-------------------------------|-----------|---------|---------------------------------------------|
|                                                                                                 | Fair Value Measurements Using |           |         |                                             | Fair Value Measurements Using |           |         |                                             |
| (In thousands)                                                                                  | Level 1                       | Level 2   | Level 3 | Assets /<br>Liabilities<br>at Fair<br>Value | Level 1                       | Level 2   | Level 3 | Assets /<br>Liabilities<br>at Fair<br>Value |
| Assets:                                                                                         |                               |           |         |                                             |                               |           |         |                                             |
| Securities available for sale :                                                                 |                               |           |         |                                             |                               |           |         |                                             |
| Equity securities                                                                               | \$ 83                         | \$        | \$      | \$ 83                                       | \$ 59                         | \$        | \$      | \$ 59                                       |
| U.S. Treasury Securities                                                                        | 1,141,675                     |           |         | 1,141,675                                   | 608,714                       |           |         | 608,714                                     |
| Non-callable U.S. agency debt                                                                   | 343,554                       |           |         | 343,554                                     | 304,257                       |           |         | 304,257                                     |
| Callable U.S. agency debt and MBS                                                               |                               | 1,118,258 |         | 1,118,258                                   |                               | 1,622,265 |         | 1,622,265                                   |
| Puerto Rico Government Obligations                                                              |                               | 159,104   | 3,211   | 162,315                                     |                               | 134,165   | 2,676   | 136,841                                     |
| Private label MBS                                                                               |                               |           | 66,822  | 66,822                                      |                               |           | 72,317  | 72,317                                      |
| Corporate bonds                                                                                 |                               |           | 1,379   | 1,379                                       |                               |           |         |                                             |
| Derivatives, included in assets:                                                                |                               |           |         |                                             |                               |           |         |                                             |
| Interest rate swap agreements                                                                   |                               | 368       |         | 368                                         |                               | 351       |         | 351                                         |
| Purchased interest rate cap agreements                                                          |                               |           |         |                                             |                               | 1         |         | 1                                           |
| Purchased options used to manage exposure to the stock market on embedded stock indexed options |                               | 988       |         | 988                                         |                               | 1,553     |         | 1,553                                       |
| Forward Contracts                                                                               |                               | 53        |         | 53                                          |                               |           |         |                                             |

|                                                                    |        |        |        |        |
|--------------------------------------------------------------------|--------|--------|--------|--------|
| Liabilities:                                                       |        |        |        |        |
| Medium-term notes                                                  | 12,374 | 12,374 | 11,842 | 11,842 |
| Derivatives, included in liabilities:                              |        |        |        |        |
| Interest rate swap agreements                                      | 6,051  | 6,051  | 5,192  | 5,192  |
| Written interest rate cap agreements                               |        |        | 1      | 1      |
| Embedded written options on stock index deposits and notes payable | 988    | 988    | 1,508  | 1,508  |
| Forward Contracts                                                  | 86     | 86     |        |        |

**Changes in Fair Value for the Quarter Ended June 30, 2011, for items Measured at Fair Value Pursuant to Election of the Fair Value Option Unrealized Loss and Interest Expense included in Current-Period Earnings**

**Changes in Fair Value for the Six-Month Period Ended June 30, 2011, for items Measured at Fair Value Pursuant to Election of the Fair Value Option Unrealized Loss and Interest Expense included in Current-Period Earnings <sup>(1)</sup>**

|                   |     |         |     |         |
|-------------------|-----|---------|-----|---------|
| (In thousands)    | (1) |         | (1) |         |
| Medium-term notes |     | (\$169) |     | (\$993) |

- (1) Changes in fair value for the quarter and six-month period ended June 30, 2011 include interest expense on medium-term notes of \$0.2 million and \$0.5 million, respectively. Interest expense on medium-term notes that have been elected to be carried at fair value is recorded in interest expense in the Consolidated Statement of Loss based on their contractual coupons.

**Changes in Fair Value for the Quarter Ended June 30, 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**

**Changes in Fair Value for the Six-Month Period Ended June 30, 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 <sup>(1)</sup>**

|                   |     |          |     |          |
|-------------------|-----|----------|-----|----------|
| (In thousands)    | (1) |          | (1) |          |
| Medium-term notes |     | \$ 3,602 |     | \$ 2,432 |

|    |       |    |       |
|----|-------|----|-------|
| \$ | 3,602 | \$ | 2,432 |
|----|-------|----|-------|

- (1) Changes in fair value for the quarter and six-month period ended June 30, 2010 include interest expense on medium-term notes of \$0.2 million and \$0.4 million, respectively. Interest expense on medium-term notes that have been elected to be carried at fair value is recorded in interest expense in the Consolidated Statement of (Loss) Income based on their contractual coupons.

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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 quarter and six-month period ended June 30, 2011 and 2010.

|                                                                              | <b>Total Fair Value<br/>Measurements<br/>(Quarter Ended<br/>June 30, 2011)<br/>Securities Available<br/>For Sale<sup>(1)</sup></b> |         | <b>Total Fair Value<br/>Measurements<br/>(Six-Month Period<br/>Ended June 30, 2011)<br/>Securities Available For<br/>Sale<sup>(1)</sup></b> |         |
|------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------|---------|---------------------------------------------------------------------------------------------------------------------------------------------|---------|
| <b>Level 3 Instruments Only</b>                                              |                                                                                                                                    |         |                                                                                                                                             |         |
| (In thousands)                                                               |                                                                                                                                    |         |                                                                                                                                             |         |
| Beginning balance                                                            | \$                                                                                                                                 | 72,733  | \$                                                                                                                                          | 74,993  |
| Total gains or (losses) (realized / unrealized):                             |                                                                                                                                    |         |                                                                                                                                             |         |
| Included in earnings                                                         |                                                                                                                                    | (607)   |                                                                                                                                             | (607)   |
| Included in other comprehensive income                                       |                                                                                                                                    | 1,825   |                                                                                                                                             | 1,871   |
| Held-to-Maturity investment securities reclassified to<br>Available-for-Sale |                                                                                                                                    |         |                                                                                                                                             | 2,000   |
| Principal repayments and amortization                                        |                                                                                                                                    | (2,539) |                                                                                                                                             | (6,845) |
| Ending balance                                                               | \$                                                                                                                                 | 71,412  | \$                                                                                                                                          | 71,412  |

(1) Amounts mostly related to certain private label mortgage-backed securities.

|                                                     | <b>Total Fair Value<br/>Measurements<br/>(Quarter Ended June 30,<br/>2010)<br/>Securities<br/>Available For<br/>Sale<sup>(2)</sup></b> |           | <b>Total Fair Value Measurements<br/>(Six-Month Period Ended June<br/>30, 2010)<br/>Securities<br/>Available For<br/>Sale<sup>(2)</sup></b> |           |
|-----------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------|-----------|---------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| <b>Level 3 Instruments Only</b>                     | <b>Derivatives<br/>(1)</b>                                                                                                             |           | <b>Derivatives<br/>(1)</b>                                                                                                                  |           |
| (In thousands)                                      |                                                                                                                                        |           |                                                                                                                                             |           |
| Beginning balance                                   | \$ 3,487                                                                                                                               | \$ 80,883 | \$ 4,199                                                                                                                                    | \$ 84,354 |
| Total gains or (losses) (realized /<br>unrealized): |                                                                                                                                        |           |                                                                                                                                             |           |
| Included in earnings                                | (440)                                                                                                                                  |           | (1,152)                                                                                                                                     |           |
| Included in other comprehensive income              |                                                                                                                                        | 3,647     |                                                                                                                                             | 3,970     |
| Purchases                                           |                                                                                                                                        | 2,584     |                                                                                                                                             | 2,584     |
| Principal repayments and amortization               |                                                                                                                                        | (3,672)   |                                                                                                                                             | (7,466)   |
| Other (1)                                           | (3,047)                                                                                                                                |           | (3,047)                                                                                                                                     |           |
| Ending balance                                      | \$                                                                                                                                     | \$ 83,442 | \$                                                                                                                                          | \$ 83,442 |

(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 in an FDIC assisted transaction. The Corporation currently has a claim with the FDIC.

(2) Amounts mostly related to private label mortgage-backed securities.

The table below summarizes changes in unrealized gains and losses recorded in earnings for the quarter and six-month period ended June 30, 2011 and 2010 for Level 3 assets and liabilities that are still held at the end of such periods.

|                                                                                             | Changes in<br>Unrealized<br>Gains (Losses) | Changes in<br>Unrealized<br>Gains (Losses) |
|---------------------------------------------------------------------------------------------|--------------------------------------------|--------------------------------------------|
|                                                                                             | Quarter Ended<br>June 30, 2011             | Six-Month Period<br>Ended<br>June 30, 2011 |
| Level 3 Instruments Only                                                                    | Securities Available<br>for Sale           | Securities Available<br>for Sale           |
| (In thousands)                                                                              |                                            |                                            |
| <b>Changes in unrealized gains (losses) relating to assets still held at reporting date</b> |                                            |                                            |
| Net impairment losses on investment securities                                              | \$ (607)                                   | \$ (607)                                   |

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, investments in unconsolidated entities).

As of June 30, 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 June 30, 2011 |         |           | Losses recorded<br>for<br>the Quarter<br>Ended<br>June 30, 2011 | Losses recorded<br>for<br>the Six-month<br>period<br>ended June 30,<br>2011 |
|----------------------------------------|------------------------------------|---------|-----------|-----------------------------------------------------------------|-----------------------------------------------------------------------------|
|                                        | Level<br>1                         | Level 2 | Level 3   |                                                                 |                                                                             |
| (In thousands)                         |                                    |         |           |                                                                 |                                                                             |
| Loans receivable <sup>(1)</sup>        | \$                                 | \$      | \$947,185 | \$ (40,293)                                                     | \$ (127,364)                                                                |
| Other Real Estate Owned <sup>(2)</sup> |                                    |         | 96,618    | (3,532)                                                         | (5,350)                                                                     |
| Loans held for sale <sup>(3)</sup>     |                                    | 20,781  |           | (30)                                                            | (372)                                                                       |

- (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) Fair value is primarily derived from quotations based on the mortgage-backed securities market.

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As of June 30, 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 June 30,<br>2010 |         |              | (Losses) gains<br>recorded for<br>the Quarter Ended<br>June 30, 2010 | Losses recorded<br>for<br>the Six-month<br>period<br>ended June 30,<br>2010 |
|----------------------------------------|---------------------------------------|---------|--------------|----------------------------------------------------------------------|-----------------------------------------------------------------------------|
| (In thousands)                         | Level<br>1                            | Level 2 | Level 3      |                                                                      |                                                                             |
| Loans receivable <sup>(1)</sup>        | \$                                    | \$      | \$ 1,443,045 | \$ (126,622)                                                         | \$ (272,859)                                                                |
| Other Real Estate Owned <sup>(2)</sup> |                                       |         | 72,358       | (7,631)                                                              | (8,669)                                                                     |
| Loans held for sale <sup>(3)</sup>     |                                       | 100,626 |              | 3                                                                    | (137)                                                                       |

(1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value. The fair values are derived from appraisals of the collateral, 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.

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 might 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.

*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 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.

**Table of Contents***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.

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 valuation of embedded call options used a Hull-White Interest Rate Tree approach option valuation and estimated a duration and convexity adjusted update based on market rate movement. 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 June 30, 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.

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 \$0.6 million as of June 30, 2011.

**Table of Contents***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 valuation of embedded call options used a Hull-White Interest Rate Tree approach option valuation and estimated a duration and convexity adjusted update based on market rate movement. The model assumes that the embedded options are exercised economically. The fair value of medium-term notes is computed using the notional amount outstanding. The discount rates used in the valuations are based on estimated US dollar CCC Financials yield curve. The net loss 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 recorded for the first half of 2011 amounted to \$0.5 million, compared to an unrealized gain of \$2.7 million for the first half of 2010. The cumulative mark-to-market unrealized gain on the medium-term notes since measured at fair value attributable to credit risk amounted to \$3.2 million as of June 30, 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.

**21 SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental cash flow information follows:

|                                                                                                               | <b>Six-Month Period Ended June 30,</b> |             |
|---------------------------------------------------------------------------------------------------------------|----------------------------------------|-------------|
|                                                                                                               | <b>2011</b>                            | <b>2010</b> |
|                                                                                                               | (In thousands)                         |             |
| Cash paid for:                                                                                                |                                        |             |
| Interest on borrowings                                                                                        | \$ 130,674                             | \$ 192,323  |
| Income tax                                                                                                    | 871                                    |             |
| Non-cash investing and financing activities:                                                                  |                                        |             |
| Additions to other real estate owned                                                                          | 94,023                                 | 48,507      |
| Additions to auto and other repossessed assets                                                                | 32,691                                 | 37,614      |
| Capitalization of servicing assets                                                                            | 2,522                                  | 3,063       |
| Loan securitizations                                                                                          | 90,328                                 | 105,112     |
| Loans sold to a joint venture in exchange for an acquisition loan and an equity interest in the joint venture | 183,709                                |             |
| Reclassification of Held-to-Maturity investment securities to Available-for-Sale                              | 88,751                                 |             |

**22 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 June 30, 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.

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

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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 referred to in Note 1 to the Corporation's financial statements for the year ended December 31, 2010 contained in the Corporation's Annual Report or 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.

The following table presents information about the reportable segments (in thousands):

|                        | <b>Mortgage</b> | <b>Consumer</b> | <b>Commercial</b> | <b>Treasury</b>    | <b>United</b>     | <b>Virgin</b>     |               |
|------------------------|-----------------|-----------------|-------------------|--------------------|-------------------|-------------------|---------------|
| (In thousands)         | <b>Banking</b>  | <b>(Retail)</b> | <b>and</b>        | <b>and</b>         | <b>States</b>     | <b>Islands</b>    | <b>Total</b>  |
| <b>For the quarter</b> |                 | <b>Banking</b>  | <b>Corporate</b>  | <b>Investments</b> | <b>Operations</b> | <b>Operations</b> |               |
| <b>ended June 30,</b>  |                 |                 |                   |                    |                   |                   |               |
| <b>2011:</b>           |                 |                 |                   |                    |                   |                   |               |
| Interest income        | \$ 28,394       | \$ 42,377       | \$ 50,607         | \$ 16,812          | \$ 11,104         | 14,124            | \$ 163,418    |
| Net                    |                 |                 |                   |                    |                   |                   |               |
| (charge) credit        |                 |                 |                   |                    |                   |                   |               |
| for transfer of        |                 |                 |                   |                    |                   |                   |               |
| funds                  | (15,285)        | 2,554           | (2,784)           | 11,370             | 4,145             |                   |               |
| Interest expense       |                 | (10,609)        |                   | (46,650)           | (10,052)          | (1,672)           | (68,983)      |
| Net interest           |                 |                 |                   |                    |                   |                   |               |
| income (loss)          | 13,109          | 34,322          | 47,823            | (18,468)           | 5,197             | 12,452            | 94,435        |
| Provision for          |                 |                 |                   |                    |                   |                   |               |
| loan and lease         |                 |                 |                   |                    |                   |                   |               |
| losses                 | (11,064)        | 2,289           | (49,517)          |                    | (2,229)           | 1,337             | (59,184)      |
| Non-interest           |                 |                 |                   |                    |                   |                   |               |
| income                 | 8,283           | 7,059           | 2,609             | 20,289             | 170               | 1,988             | 40,398        |
| Direct                 |                 |                 |                   |                    |                   |                   |               |
| non-interest           |                 |                 |                   |                    |                   |                   |               |
| expenses               | (8,407)         | (23,257)        | (11,724)          | (1,208)            | (8,216)           | (9,347)           | (62,159)      |
| Segment income         |                 |                 |                   |                    |                   |                   |               |
| (loss)                 | \$ 1,921        | \$ 20,413       | \$ (10,809)       | \$ 613             | \$ (5,078)        | \$ 6,430          | \$ 13,490     |
| Average                |                 |                 |                   |                    |                   |                   |               |
| earnings assets        | \$ 2,095,358    | \$ 1,454,513    | \$ 5,167,454      | \$ 3,521,836       | \$ 861,903        | \$ 881,459        | \$ 13,982,523 |

**Mortgage      Consumer**

|                                                     |              |                     | Commercial<br>and | Treasury<br>and | United<br>States | Virgin<br>Islands |               |
|-----------------------------------------------------|--------------|---------------------|-------------------|-----------------|------------------|-------------------|---------------|
| (In thousands)                                      | Banking      | (Retail)<br>Banking | Corporate         | Investments     | Operations       | Operations        | Total         |
| <b>For the quarter<br/>ended June 30,<br/>2010:</b> |              |                     |                   |                 |                  |                   |               |
| Interest income                                     | \$ 39,634    | \$ 47,127           | \$ 57,691         | \$ 39,208       | \$ 13,308        | 17,896            | \$ 214,864    |
| Net<br>(charge) credit<br>for transfer of<br>funds  | (24,185)     | 2,681               | (6,484)           | 27,988          |                  |                   |               |
| Interest expense                                    |              | (13,549)            |                   | (69,123)        | (11,561)         | (1,569)           | (95,802)      |
| Net interest<br>income (loss)                       | 15,449       | 36,259              | 51,207            | (1,927)         | 1,747            | 16,327            | 119,062       |
| Provision for<br>loan and lease<br>losses           | (29,424)     | (10,923)            | (71,651)          |                 | (33,611)         | (1,184)           | (146,793)     |
| Non-interest<br>income                              | 2,166        | 7,461               | 3,003             | 24,288          | 161              | 2,446             | 39,525        |
| Direct<br>non-interest<br>expenses                  | (10,193)     | (25,151)            | (19,576)          | (1,413)         | (12,692)         | (10,500)          | (79,525)      |
| Segment<br>(loss) income                            | \$ (22,002)  | \$ 7,646            | \$ (37,017)       | \$ 20,948       | \$ (44,395)      | \$ 7,089          | \$ (67,731)   |
| Average<br>earnings assets                          | \$ 2,714,807 | \$ 1,625,859        | \$ 6,001,446      | \$ 5,428,208    | \$ 1,148,631     | \$ 1,031,373      | \$ 17,950,324 |

|                                                                  |                     |                                 | Commercial<br>and | Treasury<br>and | United<br>States | Virgin<br>Islands |            |
|------------------------------------------------------------------|---------------------|---------------------------------|-------------------|-----------------|------------------|-------------------|------------|
|                                                                  | Mortgage<br>Banking | Consumer<br>(Retail)<br>Banking | Corporate         | Investments     | Operations       | Operations        | Total      |
| <b>For the<br/>six-month<br/>period ended<br/>June 30, 2011:</b> |                     |                                 |                   |                 |                  |                   |            |
| Interest income                                                  | \$ 63,274           | \$ 85,790                       | \$ 102,997        | \$ 39,442       | \$ 23,446        | \$ 29,372         | \$ 344,321 |
| Net<br>(charge) credit<br>for transfer of<br>funds               | (33,977)            | 4,392                           | (6,014)           | 26,875          | 8,724            |                   |            |
| Interest expense                                                 |                     | (22,114)                        |                   | (97,341)        | (20,849)         | (3,303)           | (143,607)  |
| Net interest<br>income (loss)                                    | 29,297              | 68,068                          | 96,983            | (31,024)        | 11,321           | 26,069            | 200,714    |

|                                     |           |           |             |          |             |            |           |
|-------------------------------------|-----------|-----------|-------------|----------|-------------|------------|-----------|
| Provision for loan and lease losses | (11,739)  | (2,903)   | (100,641)   |          | (10,129)    | (22,504)   | (147,916) |
| Non-interest income                 | 15,070    | 13,988    | 4,829       | 39,432   | 313         | 7,251      | 80,883    |
| Direct non-interest expenses        | (16,222)  | (45,612)  | (20,877)    | (2,684)  | (16,818)    | (19,416)   | (121,629) |
| Segment income (loss)               | \$ 16,406 | \$ 33,541 | \$ (19,706) | \$ 5,724 | \$ (15,313) | \$ (8,600) | \$ 12,052 |

|                         |              |              |              |              |            |            |               |
|-------------------------|--------------|--------------|--------------|--------------|------------|------------|---------------|
| Average earnings assets | \$ 2,264,703 | \$ 1,473,605 | \$ 5,278,191 | \$ 3,541,401 | \$ 883,008 | \$ 895,727 | \$ 14,336,635 |
|-------------------------|--------------|--------------|--------------|--------------|------------|------------|---------------|

|                                                      | <b>Mortgage<br/>Banking</b> | <b>Consumer<br/>(Retail)<br/>Banking</b> | <b>Commercial<br/>and<br/>Corporate</b> | <b>Treasury<br/>and<br/>Investments</b> | <b>United<br/>States<br/>Operations</b> | <b>Virgin<br/>Islands<br/>Operations</b> | <b>Total</b>  |
|------------------------------------------------------|-----------------------------|------------------------------------------|-----------------------------------------|-----------------------------------------|-----------------------------------------|------------------------------------------|---------------|
| <b>For the six-month period ended June 30, 2010:</b> |                             |                                          |                                         |                                         |                                         |                                          |               |
| Interest income                                      | \$ 79,660                   | \$ 94,689                                | \$ 116,533                              | \$ 81,982                               | \$ 27,238                               | \$ 35,750                                | \$ 435,852    |
| Net (charge) credit for transfer of funds            | (49,512)                    | 4,821                                    | (13,310)                                | 58,001                                  |                                         |                                          |               |
| Interest expense                                     |                             | (27,117)                                 |                                         | (146,863)                               | (22,828)                                | (3,119)                                  | (199,927)     |
| Net interest income (loss)                           | 30,148                      | 72,393                                   | 103,223                                 | (6,880)                                 | 4,410                                   | 32,631                                   | 235,925       |
| Provision for loan and lease losses                  | (45,438)                    | (23,416)                                 | (131,099)                               |                                         | (104,813)                               | (12,992)                                 | (317,758)     |
| Non-interest income                                  | 4,417                       | 14,768                                   | 4,605                                   | 54,873                                  | 315                                     | 5,873                                    | 84,851        |
| Direct non-interest expenses                         | (18,288)                    | (49,151)                                 | (37,162)                                | (3,025)                                 | (22,009)                                | (21,509)                                 | (151,144)     |
| Segment (loss) income                                | \$ (29,161)                 | \$ 14,594                                | \$ (60,433)                             | \$ 44,968                               | \$ (122,097)                            | \$ 4,003                                 | \$ (148,126)  |
|                                                      | \$ 2,712,067                | \$ 1,646,337                             | \$ 6,225,334                            | \$ 5,447,358                            | \$ 1,204,921                            | \$ 1,036,541                             | \$ 18,272,558 |

Average  
earnings assets

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The following table presents a reconciliation of the reportable segment financial information to the consolidated totals:

|                                                 | Quarter Ended<br>June 30, |               | Six-month Period Ended<br>June 30, |               |
|-------------------------------------------------|---------------------------|---------------|------------------------------------|---------------|
|                                                 | 2011                      | 2010          | 2011                               | 2010          |
| <b>Net loss:</b>                                |                           |               |                                    |               |
| Total income (loss) for segments and other      | \$ 13,490                 | \$ (67,731)   | \$ 12,052                          | \$ (148,126)  |
| Other non-interest income (loss) <sup>(1)</sup> | (1,536)                   |               | (1,536)                            |               |
| Other operating expenses                        | (24,272)                  | (19,086)      | (47,668)                           | (38,829)      |
| Loss before income taxes                        | (12,318)                  | (86,817)      | (37,152)                           | (186,955)     |
| Income tax expense                              | (2,606)                   | (3,823)       | (6,192)                            | (10,684)      |
| Total consolidated net loss                     | \$ (14,924)               | \$ (90,640)   | \$ (43,344)                        | \$ (197,639)  |
| <b>Average assets:</b>                          |                           |               |                                    |               |
| Total average earning assets for segments       | \$ 13,982,523             | \$ 17,950,324 | \$ 14,336,635                      | \$ 18,272,558 |
| Other average earning assets <sup>(1)</sup>     | 47,629                    |               | 35,524                             |               |
| Average non-earning assets                      | 671,549                   | 770,618       | 668,184                            | 745,439       |
| Total consolidated average assets               | \$ 14,701,701             | \$ 18,720,942 | \$ 15,040,343                      | \$ 19,017,997 |

(1) The activities related to the Bank's equity interest in CPG/GS are presented as an Other non-interest income (loss) and other average earning assets reconciliation in the table above.

**23 COMMITMENTS AND CONTINGENCIES**

The Corporation enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments may include commitments to extend credit and commitments to sell mortgage loans at fair value. As of June 30, 2011, commitments to extend credit amounted to approximately \$723.6 million and commercial standby letters of credit amounted to approximately \$70.3 million. 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. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. In the case of credit cards and personal lines of credit, the Corporation can at any time and without cause, cancel the unused credit facility. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with prospective borrowers.

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 June 30, 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 there under was required. The book value of pledged securities with Lehman as of June 30, 2011 amounted to approximately \$64.5 million.

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.

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Discovery has commenced pursuant to that case management plan and is currently scheduled for completion by September 15, 2011, 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 Bankruptcy Court, 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 investments classified as non-performing since the second quarter of 2009.

As of June 30, 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, results of operations or cash flows.

**24 FIRST BANCORP (Holding Company Only) Financial Information**

The following condensed financial information presents the financial position of the Holding Company only as of June 30, 2011 and December 31, 2010 and the results of its operations for the quarter and six-month period ended June 30, 2011 and 2010.

|                                                      | <b>As of June<br/>30,<br/>2011</b> | <b>As of December<br/>31,<br/>2010</b> |
|------------------------------------------------------|------------------------------------|----------------------------------------|
|                                                      | (In thousands)                     |                                        |
| <b>Assets</b>                                        |                                    |                                        |
| Cash and due from banks                              | \$ 21,241                          | \$ 42,430                              |
| Money market investments                             |                                    |                                        |
| Investment securities available for sale, at market: |                                    |                                        |
| Equity investments                                   | 83                                 | 59                                     |
| Other investment securities                          | 1,300                              | 1,300                                  |
| Investment in First Bank Puerto Rico, at equity      | 1,208,061                          | 1,231,603                              |
| Investment in First Bank Insurance Agency, at equity | 4,105                              | 6,275                                  |
| Investment in FBP Statutory Trust I                  | 3,093                              | 3,093                                  |
| Investment in FBP Statutory Trust II                 | 3,866                              | 3,866                                  |
| Other assets                                         | 7,216                              | 5,395                                  |
| <b>Total assets</b>                                  | <b>\$ 1,248,965</b>                | <b>\$ 1,294,021</b>                    |
| <b>Liabilities &amp; Stockholders' Equity</b>        |                                    |                                        |
| <b>Liabilities:</b>                                  |                                    |                                        |
| Other borrowings                                     | \$ 231,959                         | \$ 231,959                             |
| Accounts payable and other liabilities               | 7,428                              | 4,103                                  |
| <b>Total liabilities</b>                             | <b>239,387</b>                     | <b>236,062</b>                         |
| <b>Stockholders' equity</b>                          | <b>1,009,578</b>                   | <b>1,057,959</b>                       |

|                                            |              |              |
|--------------------------------------------|--------------|--------------|
| Total liabilities and stockholders' equity | \$ 1,248,965 | \$ 1,294,021 |
|--------------------------------------------|--------------|--------------|

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|                                                                                             | <b>Quarter Ended</b>     |                          | <b>Six-Month Period Ended</b> |                          |
|---------------------------------------------------------------------------------------------|--------------------------|--------------------------|-------------------------------|--------------------------|
|                                                                                             | <b>June 30,<br/>2011</b> | <b>June 30,<br/>2010</b> | <b>June 30,<br/>2011</b>      | <b>June 30,<br/>2010</b> |
|                                                                                             | (In thousands)           |                          |                               |                          |
| <b>Income:</b>                                                                              |                          |                          |                               |                          |
| Dividends from other subsidiaries                                                           | \$ 3,000                 | \$                       | \$ 3,000                      | \$                       |
| Dividends from FirstBank Puerto Rico                                                        |                          | 771                      |                               | 1,522                    |
| Other income                                                                                | 52                       | 51                       | 104                           | 101                      |
|                                                                                             | 3,052                    | 822                      | 3,104                         | 1,623                    |
| <b>Expense:</b>                                                                             |                          |                          |                               |                          |
| Notes payable and other borrowings                                                          | 1,748                    | 1,697                    | 3,466                         | 3,369                    |
| Other operating expenses                                                                    | 537                      | 821                      | 1,047                         | 1,510                    |
|                                                                                             | 2,285                    | 2,518                    | 4,513                         | 4,879                    |
| Investment related proceeds and impairments on equity securities                            |                          | (3)                      | 679                           | (603)                    |
| <b>Income (loss) before income taxes and equity in undistributed losses of subsidiaries</b> | 767                      | (1,699)                  | (730)                         | (3,859)                  |
| <b>Equity in undistributed losses of subsidiaries</b>                                       | (15,691)                 | (88,941)                 | (42,614)                      | (193,780)                |
| <b>Net loss</b>                                                                             | <b>\$ (14,924)</b>       | <b>\$ (90,640)</b>       | <b>\$ (43,344)</b>            | <b>\$ (197,639)</b>      |

**25 SUBSEQUENT EVENTS**

The Corporation has performed an evaluation of events occurring subsequent to June 30, 2011; management has determined that there are no additional events occurring in this period that required disclosure in or adjustment to the accompanying financial statements.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)**

|                                                                                 | Quarter ended<br>June 30, |            | Six-month period ended<br>June 30, |            |
|---------------------------------------------------------------------------------|---------------------------|------------|------------------------------------|------------|
|                                                                                 | 2011                      | 2010       | 2011                               | 2010       |
| <b>Condensed Income Statements:</b>                                             |                           |            |                                    |            |
| Total interest income                                                           | \$ 163,418                | \$ 214,864 | \$ 344,321                         | \$ 435,852 |
| Total interest expense                                                          | 68,983                    | 95,802     | 143,607                            | 199,927    |
| Net interest income                                                             | 94,435                    | 119,062    | 200,714                            | 235,925    |
| Provision for loan and lease losses                                             | 59,184                    | 146,793    | 147,916                            | 317,758    |
| Non-interest income                                                             | 38,862                    | 39,525     | 79,347                             | 84,851     |
| Non-interest expenses                                                           | 86,431                    | 98,611     | 169,297                            | 189,973    |
| Loss before income taxes                                                        | (12,318)                  | (86,817)   | (37,152)                           | (186,955)  |
| Income tax expense                                                              | (2,606)                   | (3,823)    | (6,192)                            | (10,684)   |
| Net loss                                                                        | (14,924)                  | (90,640)   | (43,344)                           | (197,639)  |
| Net loss attributable to common stockholders                                    | (22,205)                  | (96,810)   | (57,642)                           | (209,961)  |
| <b>Per Common Share Results <sup>(1)</sup>:</b>                                 |                           |            |                                    |            |
| Net loss per share basic                                                        | \$ (1.04)                 | \$ (15.70) | \$ (2.71)                          | \$ (34.04) |
| Net loss per share diluted                                                      | \$ (1.04)                 | \$ (15.70) | \$ (2.71)                          | \$ (34.04) |
| Cash dividends declared                                                         | \$                        | \$         | \$                                 | \$         |
| Average shares outstanding                                                      | 21,303                    | 6,168      | 21,303                             | 6,168      |
| Average shares outstanding diluted                                              | 21,303                    | 6,168      | 21,303                             | 6,168      |
| Book value per common share                                                     | \$ 27.27                  | \$ 82.25   | \$ 27.27                           | \$ 82.25   |
| Tangible book value per common share <sup>(2)</sup>                             | \$ 25.34                  | \$ 75.22   | \$ 25.34                           | \$ 75.22   |
| <b>Selected Financial Ratios (In Percent):</b>                                  |                           |            |                                    |            |
| <b>Profitability:</b>                                                           |                           |            |                                    |            |
| Return on Average Assets                                                        | (0.41)                    | (1.94)     | (0.58)                             | (2.10)     |
| Interest Rate Spread <sup>(3)</sup>                                             | 2.42                      | 2.38       | 2.53                               | 2.41       |
| Net Interest Margin <sup>(3)</sup>                                              | 2.68                      | 2.66       | 2.79                               | 2.70       |
| Return on Average Total Equity                                                  | (5.81)                    | (24.52)    | (8.45)                             | (25.85)    |
| Return on Average Common Equity                                                 | (14.77)                   | (70.31)    | (19.11)                            | (69.13)    |
| Average Total Equity to Average Total Assets                                    | 7.01                      | 7.92       | 6.88                               | 8.11       |
| Tangible common equity ratio <sup>(2)</sup>                                     | 3.84                      | 2.57       | 3.84                               | 2.57       |
| Dividend payout ratio                                                           |                           |            |                                    |            |
| Efficiency ratio <sup>(4)</sup>                                                 | 64.84                     | 62.18      | 60.45                              | 59.22      |
| <b>Asset Quality:</b>                                                           |                           |            |                                    |            |
| Allowance for loan and lease losses to loans held for investment                | 5.02                      | 4.83       | 5.02                               | 4.83       |
| Net charge-offs (annualized) to average loans                                   | 2.91                      | 3.62       | 2.82                               | 3.63       |
| Provision for loan and lease losses to net charge-offs                          | 73.98                     | 124.62     | 92.41                              | 131.54     |
| Non-performing assets to total assets                                           | 9.85 <sup>(5)</sup>       | 9.39       | 9.85 <sup>(5)</sup>                | 9.39       |
| Non-performing loans held for investment to total loans held for investment     | 11.23                     | 12.40      | 11.23                              | 12.40      |
| Allowance to total non-performing loans held for investment                     | 44.76                     | 38.97      | 44.76                              | 38.97      |
| Allowance to total non-performing loans excluding residential real estate loans | 65.30                     | 54.81      | 65.30                              | 54.81      |



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The following Management's Discussion and Analysis of Financial Condition and Results of Operations relates to the accompanying consolidated unaudited financial statements of First BanCorp (the Corporation or First BanCorp) and should be read in conjunction with such financial statements and the notes thereto.

## **DESCRIPTION OF BUSINESS**

### **Description of Business**

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 Note 18, Regulatory Matters, FirstBank is currently operating under a Consent Order (the Order) with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico (OCIF) 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 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 a reasonable period of time. If unanticipated market factors emerge, or if the Corporation is unable to raise additional capital or complete identified capital preservation initiatives, 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 Update**

As previously announced, during the second quarter of 2011 the Corporation entered into separate agreements with Thomas H. Lee Partners, L.P. (THL) and with two funds managed by Oaktree Capital Management, L.P. (Oaktree) under which THL and Oaktree would purchase an aggregate of approximately \$348.2 million (\$174.1 million each investor) of common stock of the Corporation at a per share price of \$3.50 provided the Corporation sells an aggregate of \$500 million of shares of common stock. Each of these two investors' investment will represent approximately 24.36% of the outstanding shares of the Corporation's common stock upon completion of the capital raise and the conversion into common stock of the \$424.2 million of the Series G Preferred Stock held by the U.S. Treasury. The Corporation has also entered into investment agreements with institutional investors and other private equity firms for the issuance of an aggregate of approximately \$176.8 million of the Corporation's common stock, which, together with the THL and Oaktree investments, result in \$525 million in commitments. The completion of this transaction is subject to the approval of the Corporation's stockholders and regulators. If approved, the transaction is expected to close during the third quarter of 2011.

If the stockholders and regulators approve the \$525 million capital raise, the Corporation will issue 150 million shares of common stock at \$3.50 per share and will immediately exercise its right to compel the conversion of all of the outstanding Series G Preferred Stock, which is held by the U.S. Treasury, into approximately 32.9 million shares of common stock. Also, the Corporation plans to raise \$37.3 million through a rights offering that will enable current stockholders to purchase up to 10.7 million shares of common stock at the same \$3.50 price per share. The Corporation is expected to have nearly 229.98 million shares outstanding following the issuance of common stock to institutional investors and private equity firms, the conversion of the Series G Preferred Stock into common stock, the successful completion of the rights offering and the issuance of common stock upon the exercise of anti-dilution rights held by certain of the institutional investors that will buy shares in the capital raise.

## **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 two 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.

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Net loss for the quarter ended June 30, 2011 amounted to \$14.9 million or \$1.04 per diluted common share, compared to a net loss of \$90.6 million or \$15.70 per diluted common share for the quarter ended June 30, 2010. The Corporation's financial results for the second quarter of 2011, as compared to the second quarter of 2010, were principally impacted by (i) a decrease of \$87.6 million in the provision for loan and lease losses primarily related to lower charges to specific reserves on a reduced level of adversely classified and non-performing loans as well as lower historical loss rates and the overall reduction of the loan portfolio, and (ii) a decrease of \$12.2 million in non-interest expenses also mainly due to credit-related expenses such as a \$4.4 million decrease in the provision for unfunded loan commitments and letters of credit, aligned with the sale during the first quarter of 2011 of non-performing construction loans to a joint venture on which the Corporation has an investment, and a \$4.8 million decrease in the loss on real estate owned (REO) operations due to lower write-downs and losses on the sale of repossessed properties. These factors were partially offset by a \$24.6 million decrease in net interest income driven by the decline in average earning assets consistent with the Corporation's deleveraging strategies included in the capital plan submitted to regulators and the maintenance of high levels of liquidity.

The key drivers of the Corporation's financial results for the quarter ended June 30, 2011 include the following:

Net interest income for the quarter ended June 30, 2011 was \$94.4 million, compared to \$119.1 million for the same period in 2010. The decrease is mainly associated with the Corporation's deleveraging initiatives included in the capital plan submitted to regulators in order to preserve and improve its capital position. Average interest-earning assets decreased by \$4.0 billion when compared to the second quarter of 2010, reflecting a \$2.0 billion reduction in average total loans and leases mainly due to loan sales combined with repayments of commercial credit facilities, including government loans, and charge-offs. Average investment securities decreases by \$1.9 billion primarily related to sales and prepayments of U.S. agency MBS. Net interest income has been adversely affected also by the maintenance of high liquidity levels. While the asset sales during the first and second quarter of 2011 were substantial, the full de-leverage associated with them could not be achieved since it was subject to the maturity schedule of funding sources (mainly brokered CDs). As a result, the Corporation kept during the second quarter approximately \$725 million in short-term U.S. Treasury bills with maturities ranging from 3 to 6 months at an average yield of 0.08%. The excess liquidity held in the form of low yield, highly liquid instruments (US Treasury Bills) at a negative spread contributed to approximately \$3.0 million of the decrease in net interest income during the quarter. The earnings drag due to the elevated liquidity levels is perceived as temporary. Refer to the Net Interest Income discussion below for additional information.

For the second quarter of 2011, the Corporation's provision for loan and lease losses amounted to \$59.2 million, compared to \$146.8 million for the same period in 2010. The decrease in the provision for 2011 was primarily due to lower charges to specific reserves on a reduced level of non-performing and adversely classified loans, commensurate with reductions in charges to general reserves due to reductions in historical loss rates and the overall decrease of the loan portfolio. Refer to the discussions under Provision for loan and lease losses and

Risk Management below for an analysis of the allowance for loan and lease losses and non-performing assets and related ratios.

The Corporation's net charge-offs for the second quarter of 2011 were \$80.0 million or 2.91% of average loans on an annualized basis, compared to \$117.8 million or 3.62% of average loans on an annualized basis for the same period in 2010, a reduction mainly related to the commercial and industrial (C&I) and the commercial mortgage loan portfolio. Refer to the Provision for Loan and Lease Losses and Risk Management Non-performing assets and Allowance for Loan and Lease Losses sections below for additional information.

For the quarter ended June 30, 2011, the Corporation's non-interest income amounted to \$38.9 million, compared to \$39.5 million for the quarter ended June 30, 2010. The decrease was mainly due to lower gains on sales of investments, as the Corporation recorded a net gain on sale of U.S. agency fixed-rate MBS of \$19.9 million for the second quarter of 2011 compared to \$22.2 million for the same period in 2010. Also, in 2010 the Corporation recorded a \$2.0 million gain on the sale of approximately \$250 million of U.S. Treasury Notes. The lower non-interest income was also driven by non-cash charges of \$1.5 million related to FirstBank's equity interest in the joint venture to which it sold loans in the first quarter of 2011, a \$1.1 million

decrease in income from insurance activities, a \$0.6 million other-than-temporary impairment ( OTTI ) charge related to estimated credit losses on private label MBS and a \$0.5 million decrease in service charges on deposit accounts, partially offset by the \$7.2 million increase in income from mortgage banking activities driven by the \$6.8 million gain recorded on the bulk sale of \$282 million of performing residential mortgage loans. Refer to the Non Interest Income discussion below for additional information.

Non-interest expenses for the second quarter of 2011 amounted to \$86.4 million, compared to \$98.6 million for the same period in 2010. The decrease was mainly related to: (i) a \$4.4 million decrease in the provision for unfunded loan commitments and letters of credit, aligned with the sale during the first quarter of 2011 of non-performing construction loans to a joint venture on which the Corporation has an investment, (ii) a \$4.8 million decrease in the loss on REO operations due to lower write-downs and losses on the sale of repossessed properties, (iii) a \$1.6 million decrease in employees compensation and benefits expenses driven by a lower headcount, and (iv) a \$1.6 million decrease in local regulatory

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examination fees driven by the reduction of the Bank's total assets in Puerto Rico. Refer to the Non Interest Expenses discussion below for additional information.

For the second quarter of 2011, the Corporation recorded an income tax expense of \$2.6 million, compared to \$3.8 million for the same period in 2010. The variance is mainly due to lower revenues derived from the operations of FirstBank Overseas Corporation and the impact of lower statutory tax rates on profitable subsidiaries. Refer to the Income Taxes discussion below for additional information.

Total assets as of June 30, 2011 amounted to \$14.1 billion, a decrease of \$1.5 billion compared to total assets as of December 31, 2010. The Corporation continued to execute deleveraging initiatives and total loans decreased \$1.2 billion driven by loan sales completed during the first half of 2011, including \$518 million of performing residential mortgage loans to another financial institution and the previously reported sale of a pool of loans, mainly adversely classified loans, amounting to approximately \$269 million to the joint venture. Charge-offs, principal repayments of commercial credit facilities, commercial loans participated and sales of troubled assets in Florida, loan securitizations and foreclosures also contributed to a lower loan portfolio. Total investment securities decreased by \$377.4 million driven by sales and prepayments of U.S. agency mortgage-backed securities ( MBS ), partially offset by purchases of highly liquid U.S. Treasury Bills. Refer to the Financial Condition and Operating Data discussion below for additional information.

As of June 30, 2011, total liabilities amounted to \$13.1 billion, a decrease of approximately \$1.4 billion, as compared to \$14.5 billion as of December 31, 2010. The decrease is mainly attributable to a \$1.1 billion decrease in brokered CDs, a \$233.0 million decrease in advances from FHLB, and a \$200 million decrease in repurchase agreements repaid prior to its schedule maturity and for which a \$1.8 million loss on the early extinguishment was recorded in the second quarter of 2011. Refer to the Risk Management Liquidity and Capital Adequacy discussion below for additional information about the Corporation's funding sources.

The Corporation's stockholders' equity amounted to \$1.0 billion as of June 30, 2011, a decrease of \$48.4 million compared to the balance as of December 31, 2010, driven by the net loss of \$43.3 million for the first half of 2011 and the decrease of \$5.1 million in accumulated other comprehensive income. Refer to the Risk Management Capital section below for additional information, including information about investment agreements for the issuance of new capital amounting to \$525 million entered into with institutional investors and private equity firms.

Total loan production, including purchases, refinancings and draws from existing commitments, for the quarter ended June 30, 2011 was \$569 million, compared to \$651 million for the comparable period in 2010. The decrease in loan production during 2011, as compared to the second quarter of 2010, was mainly reflected in construction and credit facilities to government.

Total non-performing loans as of June 30, 2011 were \$1.21 billion, compared to \$1.40 billion as of December 31, 2010. The completion of the previously reported loan sale transaction with the joint venture removed approximately \$153.6 million of non-performing loans from the balance sheet. Excluding the impact of this loan sale transaction, non-performing loans decreased approximately \$30.5 million, reflecting decreases in almost all loan categories, with the exception of the construction loan portfolio. Although non-performing loans decreased as a result of the transaction with the joint venture, the Corporation's investment in the joint venture is subordinate to the interests of the other investors in the joint venture and, accordingly, the Corporation's investment in the amount of \$46.1 million as of June 30, 2011 is subject to risk. Refer to the Risk Management - Non-accruing and Non-performing Assets and Note 11 of the accompanying unaudited consolidated financial statements 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.

The Corporation's critical accounting policies are described in Management's Discussion and Analysis of Financial Condition and Results of Operations included in First BanCorp's 2010 Annual Report on Form 10-K. There have not been any material changes in the Corporation's critical accounting policies since December 31, 2010.

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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 quarter and six-month period ended June 30, 2011 was \$94.4 million and \$200.7 million, respectively, compared to \$119.1 million and \$235.9 million for the comparable periods in 2010. 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 quarter and six-month period ended June 30, 2011 was \$97.1 million and \$205.9 million, respectively, compared to \$122.9 million and \$251.4 million for the comparable periods of 2010.

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.

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| Quarter ended June 30,                            | Average Volume |               | Interest income <sup>(1)</sup> /<br>expense |            | Average Rate <sup>(1)</sup> |        |
|---------------------------------------------------|----------------|---------------|---------------------------------------------|------------|-----------------------------|--------|
|                                                   | 2011           | 2010          | 2011                                        | 2010       | 2011                        | 2010   |
| (Dollars in thousands)                            |                |               |                                             |            |                             |        |
| Interest-earning assets:                          |                |               |                                             |            |                             |        |
| Money market & other short-term investments       | \$ 558,388     | \$ 849,763    | \$ 400                                      | \$ 624     | 0.29%                       | 0.29%  |
| Government obligations <sup>(2)</sup>             | 1,829,696      | 1,422,418     | 6,214                                       | 8,157      | 1.36%                       | 2.30%  |
| Mortgage-backed securities                        | 1,114,221      | 3,141,519     | 10,560                                      | 35,418     | 3.80%                       | 4.52%  |
| Corporate bonds                                   | 2,000          | 2,000         | 29                                          | 29         | 5.82%                       | 5.82%  |
| FHLB stock                                        | 45,061         | 68,857        | 452                                         | 575        | 4.02%                       | 3.35%  |
| Equity securities                                 | 1,377          | 1,377         |                                             |            | 0.00%                       | 0.00%  |
| Total investments <sup>(3)</sup>                  | 3,550,743      | 5,485,934     | 17,655                                      | 44,803     | 1.99%                       | 3.28%  |
| Residential mortgage loans                        | 2,890,228      | 3,547,874     | 40,171                                      | 52,806     | 5.57%                       | 5.97%  |
| Construction loans                                | 659,887        | 1,445,251     | 4,268                                       | 9,132      | 2.59%                       | 2.53%  |
| C&I and commercial mortgage loans                 | 5,811,917      | 6,199,005     | 58,921                                      | 65,386     | 4.07%                       | 4.23%  |
| Finance leases                                    | 267,816        | 305,414       | 5,570                                       | 6,223      | 8.34%                       | 8.17%  |
| Consumer loans                                    | 1,367,447      | 1,528,264     | 39,522                                      | 44,223     | 11.59%                      | 11.61% |
| Total loans <sup>(4) (5)</sup>                    | 10,997,295     | 13,025,808    | 148,452                                     | 177,770    | 5.41%                       | 5.47%  |
| Total interest-earning assets                     | \$ 14,548,038  | \$ 18,511,742 | \$ 166,107                                  | \$ 222,573 | 4.58%                       | 4.82%  |
| Interest-bearing liabilities:                     |                |               |                                             |            |                             |        |
| Brokered CDs                                      | \$ 5,550,750   | \$ 7,210,631  | \$ 29,696                                   | \$ 41,499  | 2.15%                       | 2.31%  |
| Other interest-bearing deposits                   | 5,172,845      | 4,919,662     | 19,828                                      | 22,267     | 1.54%                       | 1.82%  |
| Loans payable                                     |                | 406,044       |                                             | 1,265      | 0.00%                       | 1.25%  |
| Other borrowed funds                              | 1,592,538      | 2,882,674     | 15,262                                      | 27,080     | 3.84%                       | 3.77%  |
| FHLB advances                                     | 493,242        | 959,011       | 4,220                                       | 7,587      | 3.43%                       | 3.17%  |
| Total interest-bearing liabilities <sup>(6)</sup> | \$ 12,809,375  | \$ 16,378,022 | \$ 69,006                                   | \$ 99,698  | 2.16%                       | 2.44%  |
| Net interest income                               |                |               | \$ 97,101                                   | \$ 122,875 |                             |        |
| Interest rate spread                              |                |               |                                             |            | 2.42%                       | 2.38%  |
| Net interest margin                               |                |               |                                             |            | 2.68%                       | 2.66%  |

| Six-Month Period Ended June 30, | Average Volume |      | Interest income <sup>(1)</sup> /<br>expense |      | Average Rate <sup>(1)</sup> |      |
|---------------------------------|----------------|------|---------------------------------------------|------|-----------------------------|------|
|                                 | 2011           | 2010 | 2011                                        | 2010 | 2011                        | 2010 |

(Dollars in  
thousands)

## Interest-earning assets:

Money market & other short-term  
investments

|                                       |            |            |        |          |       |       |
|---------------------------------------|------------|------------|--------|----------|-------|-------|
|                                       | \$ 523,431 | \$ 877,029 | \$ 709 | \$ 1,060 | 0.27% | 0.24% |
| Government obligations <sup>(2)</sup> | 1,588,216  | 1,353,376  | 12,403 | 16,977   | 1.57% | 2.53% |
| Mortgage-backed securities            | 1,406,078  | 3,203,535  | 27,565 | 76,000   | 3.95% | 4.78% |
| Corporate bonds                       | 2,000      | 2,000      | 58     | 58       | 5.85% | 5.85% |
| FHLB stock                            | 48,179     | 68,620     | 1,165  | 1,418    | 4.88% | 4.17% |
| Equity securities                     | 1,377      | 1,587      | 1      | 15       | 0.15% | 1.91% |

|                                  |           |           |        |        |       |       |
|----------------------------------|-----------|-----------|--------|--------|-------|-------|
| Total investments <sup>(3)</sup> | 3,569,281 | 5,506,147 | 41,901 | 95,528 | 2.37% | 3.50% |
|----------------------------------|-----------|-----------|--------|--------|-------|-------|

|                                   |           |           |         |         |        |        |
|-----------------------------------|-----------|-----------|---------|---------|--------|--------|
| Residential mortgage loans        | 3,075,475 | 3,550,968 | 88,015  | 106,405 | 5.77%  | 6.04%  |
| Construction loans                | 735,290   | 1,464,178 | 10,645  | 17,885  | 2.92%  | 2.46%  |
| C&I and commercial mortgage loans | 5,859,558 | 6,424,543 | 117,112 | 132,790 | 4.03%  | 4.17%  |
| Finance leases                    | 273,199   | 309,633   | 11,264  | 12,566  | 8.31%  | 8.18%  |
| Consumer loans                    | 1,389,570 | 1,546,732 | 80,042  | 89,043  | 11.62% | 11.61% |

|                                |            |            |         |         |       |       |
|--------------------------------|------------|------------|---------|---------|-------|-------|
| Total loans <sup>(4) (5)</sup> | 11,333,092 | 13,296,054 | 307,078 | 358,689 | 5.46% | 5.44% |
|--------------------------------|------------|------------|---------|---------|-------|-------|

|                               |               |               |            |            |       |       |
|-------------------------------|---------------|---------------|------------|------------|-------|-------|
| Total interest-earning assets | \$ 14,902,373 | \$ 18,802,201 | \$ 348,979 | \$ 454,217 | 4.72% | 4.87% |
|-------------------------------|---------------|---------------|------------|------------|-------|-------|

## Interest-bearing liabilities:

|                                 |              |              |           |           |       |       |
|---------------------------------|--------------|--------------|-----------|-----------|-------|-------|
| Brokered CDs                    | \$ 5,783,610 | \$ 7,330,746 | \$ 62,465 | \$ 85,881 | 2.18% | 2.36% |
| Other interest-bearing deposits | 5,205,321    | 4,775,792    | 41,118    | 43,850    | 1.59% | 1.85% |
| Loans payable                   |              | 604,144      |           | 3,442     | 0.00% | 1.15% |
| Other borrowed funds            | 1,626,460    | 2,943,079    | 30,484    | 54,380    | 3.78% | 3.73% |
| FHLB advances                   | 534,755      | 965,269      | 8,965     | 15,281    | 3.38% | 3.19% |

|                                                   |               |               |            |            |       |       |
|---------------------------------------------------|---------------|---------------|------------|------------|-------|-------|
| Total interest-bearing liabilities <sup>(6)</sup> | \$ 13,150,146 | \$ 16,619,030 | \$ 143,032 | \$ 202,834 | 2.19% | 2.46% |
|---------------------------------------------------|---------------|---------------|------------|------------|-------|-------|

|                     |  |  |            |            |  |  |
|---------------------|--|--|------------|------------|--|--|
| Net interest income |  |  | \$ 205,947 | \$ 251,383 |  |  |
|---------------------|--|--|------------|------------|--|--|

|                      |  |  |  |  |       |       |
|----------------------|--|--|--|--|-------|-------|
| Interest rate spread |  |  |  |  | 2.53% | 2.41% |
|----------------------|--|--|--|--|-------|-------|

|                     |  |  |  |  |       |       |
|---------------------|--|--|--|--|-------|-------|
| Net interest margin |  |  |  |  | 2.79% | 2.70% |
|---------------------|--|--|--|--|-------|-------|

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- (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 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 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 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 \$2.5 million for each of the quarters ended June 30, 2011 and 2010, and \$4.7 million and \$5.6 million for the six-month periods ended June 30, 2011 and 2010, 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.

**Part II**

|                                             | Quarter ended<br>June 30,<br>2011<br>compared to<br>2010<br>Increase<br>(decrease)<br>Due to: Rate<br>(In thousands) |         |          | Six-month period ended<br>June 30, 2011<br>compared to<br>2010<br>Increase<br>(decrease)<br>Due to: Rate<br>(In thousands) |          |          |
|---------------------------------------------|----------------------------------------------------------------------------------------------------------------------|---------|----------|----------------------------------------------------------------------------------------------------------------------------|----------|----------|
|                                             | Volume                                                                                                               |         | Total    | Volume                                                                                                                     |          | Total    |
| Interest income on interest-earning assets: |                                                                                                                      |         |          |                                                                                                                            |          |          |
| Money market & other short-term investments | \$ (209)                                                                                                             | \$ (15) | \$ (224) | \$ (455)                                                                                                                   | \$ 104   | \$ (351) |
| Government obligations                      | 1,867                                                                                                                | (3,810) | (1,943)  | 2,429                                                                                                                      | (7,003)  | (4,574)  |
| Mortgage-backed securities                  | (19,935)                                                                                                             | (4,923) | (24,858) | (36,988)                                                                                                                   | (11,447) | (48,435) |
| Corporate bonds                             |                                                                                                                      |         |          |                                                                                                                            |          |          |
| FHLB stock                                  | (219)                                                                                                                | 96      | (123)    | (461)                                                                                                                      | 208      | (253)    |
| Equity securities                           |                                                                                                                      |         |          | (2)                                                                                                                        | (12)     | (14)     |
| Total investments                           | (18,496)                                                                                                             | (8,652) | (27,148) | (35,477)                                                                                                                   | (18,150) | (53,627) |

|                                                   |             |            |             |             |             |             |
|---------------------------------------------------|-------------|------------|-------------|-------------|-------------|-------------|
| Residential mortgage loans                        | (9,311)     | (3,324)    | (12,635)    | (13,769)    | (4,621)     | (18,390)    |
| Construction loans                                | (5,028)     | 164        | (4,864)     | (9,778)     | 2,538       | (7,240)     |
| C&I and commercial mortgage loans                 | (3,985)     | (2,480)    | (6,465)     | (11,397)    | (4,281)     | (15,678)    |
| Finance leases                                    | (775)       | 122        | (653)       | (1,497)     | 195         | (1,302)     |
| Consumer loans                                    | (4,648)     | (53)       | (4,701)     | (9,088)     | 87          | (9,001)     |
| Total loans                                       | (23,747)    | (5,571)    | (29,318)    | (45,529)    | (6,082)     | (51,611)    |
| Total interest income                             | (42,244)    | (14,222)   | (56,466)    | (81,006)    | (24,232)    | (105,238)   |
| Interest expense on interest-bearing liabilities: |             |            |             |             |             |             |
| Brokered CDs                                      | (9,038)     | (2,765)    | (11,803)    | (17,092)    | (6,324)     | (23,416)    |
| Other interest-bearing deposits                   | 1,064       | (3,503)    | (2,439)     | 3,710       | (6,442)     | (2,732)     |
| Loan payable                                      | (1,265)     |            | (1,265)     | (3,442)     |             | (3,442)     |
| Other borrowed funds                              | (12,259)    | 441        | (11,818)    | (24,606)    | 710         | (23,896)    |
| FHLB advances                                     | (3,841)     | 474        | (3,367)     | (7,048)     | 732         | (6,316)     |
| Total interest expense                            | (25,339)    | (5,353)    | (30,692)    | (48,478)    | (11,324)    | (59,802)    |
| Change in net interest income                     | \$ (16,905) | \$ (8,869) | \$ (25,774) | \$ (32,528) | \$ (12,908) | \$ (45,436) |

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

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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 derivatives counterparties.

The following table reconciles net interest income in accordance with GAAP to net interest income, excluding valuations, and net interest income on a 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 a tax-equivalent basis:

|                                                                                         | Quarter Ended    |                  | Six-Month Period Ended |                  |
|-----------------------------------------------------------------------------------------|------------------|------------------|------------------------|------------------|
|                                                                                         | June 30,<br>2011 | June 30,<br>2010 | June 30,<br>2011       | June 30,<br>2010 |
| Interest Income GAAP                                                                    | \$ 163,418       | \$ 214,864       | \$ 344,321             | \$ 435,852       |
| Unrealized loss on derivative instruments                                               | 1,185            | 487              | 840                    | 1,231            |
| Interest income excluding valuations                                                    | 164,603          | 215,351          | 345,161                | 437,083          |
| Tax-equivalent adjustment                                                               | 1,504            | 7,222            | 3,818                  | 17,134           |
| Interest income on a tax-equivalent basis excluding valuations                          | 166,107          | 222,573          | 348,979                | 454,217          |
| Interest Expense GAAP                                                                   | 68,983           | 95,802           | 143,607                | 199,927          |
| Unrealized gain (loss) on derivative instruments and liabilities measured at fair value | 23               | 3,896            | (575)                  | 2,907            |
| Interest expense excluding valuations                                                   | 69,006           | 99,698           | 143,032                | 202,834          |
| Net interest income GAAP                                                                | \$ 94,435        | \$ 119,062       | \$ 200,714             | \$ 235,925       |
| Net interest income excluding valuations                                                | \$ 95,597        | \$ 115,653       | \$ 202,129             | \$ 234,249       |
| Net interest income on a tax-equivalent basis excluding valuations                      | \$ 97,101        | \$ 122,875       | \$ 205,947             | \$ 251,383       |

**Average Balances (in thousands)**

|                                                   |               |               |               |               |
|---------------------------------------------------|---------------|---------------|---------------|---------------|
| Loans and leases                                  | \$ 10,997,295 | \$ 13,025,808 | \$ 11,333,092 | \$ 13,296,054 |
| Total securities and other short-term investments | 3,550,743     | 5,485,934     | 3,569,281     | 5,506,147     |
| Average Interest-Earning Assets                   | \$ 14,548,038 | \$ 18,511,742 | \$ 14,902,373 | \$ 18,802,201 |
| Average Interest-Bearing Liabilities              | \$ 12,809,375 | \$ 16,378,022 | \$ 13,150,146 | \$ 16,619,030 |

**Average Yield/Rate**

|                                          |       |       |       |       |
|------------------------------------------|-------|-------|-------|-------|
| Average yield on interest-earning assets |       |       |       |       |
| GAAP                                     | 4.51% | 4.66% | 4.66% | 4.68% |

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|                                                                                             |       |       |       |       |
|---------------------------------------------------------------------------------------------|-------|-------|-------|-------|
| Average rate on interest-bearing liabilities GAAP                                           | 2.16% | 2.35% | 2.20% | 2.43% |
| Net interest spread GAAP                                                                    | 2.35% | 2.31% | 2.46% | 2.25% |
| Net interest margin GAAP                                                                    | 2.60% | 2.58% | 2.72% | 2.53% |
| Average yield on interest-earning assets excluding valuations                               | 4.54% | 4.66% | 4.67% | 4.69% |
| Average rate on interest-bearing liabilities excluding valuations                           | 2.16% | 2.44% | 2.19% | 2.46% |
| Net interest spread excluding valuations                                                    | 2.38% | 2.22% | 2.48% | 2.23% |
| Net interest margin excluding valuations                                                    | 2.64% | 2.51% | 2.74% | 2.51% |
| Average yield on interest-earning assets on a tax-equivalent basis and excluding valuations | 4.58% | 4.82% | 4.72% | 4.87% |
| Average rate on interest-bearing liabilities excluding valuations                           | 2.16% | 2.44% | 2.19% | 2.46% |
| Net interest spread on a tax-equivalent basis and excluding valuations                      | 2.42% | 2.38% | 2.53% | 2.41% |
| Net interest margin on a tax-equivalent basis and excluding valuations                      | 2.68% | 2.66% | 2.79% | 2.70% |

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:

| (In thousands)                                                    | Quarter ended June 30, |          | Six-month period ended June 30, |            |
|-------------------------------------------------------------------|------------------------|----------|---------------------------------|------------|
|                                                                   | 2011                   | 2010     | 2011                            | 2010       |
| Unrealized loss on derivatives (economic undesignated hedges):    |                        |          |                                 |            |
| Interest rate caps                                                | \$ (1,185)             | \$ (440) | \$ (840)                        | \$ (1,171) |
| Interest rate swaps on loans                                      |                        | (47)     |                                 | (60)       |
| Net unrealized loss on derivatives (economic undesignated hedges) | \$ (1,185)             | \$ (487) | \$ (840)                        | \$ (1,231) |

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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:

|                                                                                                                 | Quarter ended June<br>30, |            | Six-month period ended June<br>30, |            |
|-----------------------------------------------------------------------------------------------------------------|---------------------------|------------|------------------------------------|------------|
|                                                                                                                 | 2011                      | 2010       | 2011                               | 2010       |
| Unrealized loss (gain) on derivatives (economic undesignated hedges):                                           |                           |            |                                    |            |
| Interest rate swaps and options on stock index deposits                                                         | \$                        | \$         | \$                                 | \$ 1       |
| Interest rate swaps and options on stock index notes                                                            | 42                        | (81)       | 47                                 | (51)       |
| Net unrealized loss (gain) on derivatives (economic undesignated hedges)                                        | \$ 42                     | \$ (81)    | \$ 47                              | \$ (50)    |
| Unrealized (gain) loss on liabilities measured at fair value:                                                   |                           |            |                                    |            |
| Unrealized (gain) loss on medium-term notes                                                                     | (65)                      | (3,815)    | 528                                | (2,857)    |
| Net unrealized (gain) loss on liabilities measured at fair value                                                | \$ (65)                   | \$ (3,815) | \$ 528                             | \$ (2,857) |
| Net unrealized (gain) loss on derivatives (economic undesignated hedges) and liabilities measured at fair value | \$ (23)                   | \$ (3,896) | \$ 575                             | \$ (2,907) |

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 agreements, 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 used for protection against rising interest rates.

Unrealized gains or losses on liabilities measured at fair value represent the change in the fair value of such liabilities (medium-term notes), 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 June 30, 2011, most of the interest rate swaps outstanding are used for protection against rising interest rates. Refer to Note 9 of the accompanying unaudited consolidated financial statements 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.

Net interest income decreased 21% to \$94.4 million for the second quarter of 2011 from \$119.1 million in the second quarter of 2010 and by 14% to \$200.7 million for the first six-months of 2011 from \$235.9 million in the first half of 2010. The decrease in net interest income was largely due to the decrease in volume of interest-earning assets, consistent with the Corporation's capital plan that includes deleveraging initiatives to preserve and improve its capital

position and the adverse impact on net interest margin of maintaining a high liquidity position.

The average volume of interest-earning assets for the second quarter and first half of 2011 decreased by \$4.0 billion and \$3.9 billion, respectively, as compared to comparable periods in 2010. Average total loans and leases decreased 16%, or \$2.0 billion, for the second quarter of 2011 and 15%, or \$2.0 billion, for the first six months of 2011 compared to the corresponding periods in 2010. The decrease was driven by sales, including \$518 million of performing residential mortgage loans sold during the first half of 2011, of which \$282 million occurred during the second quarter, and the aforementioned \$269 million sale of loans (mainly adversely classified loans) to a joint venture. Additional sales of non-performing loans during the second half of 2010, charge-offs, repayments of commercial facilities and foreclosures also contributed to the decrease in the loan portfolio. Average investment securities and other short-term investments decreased \$1.9 billion for each of the quarter and six month periods ended June 30, 2011 compared to the same periods in 2010. The Corporation has sold approximately \$2.2 billion of investment securities over the last 12 months, mainly U.S. agency MBS, including sales of over \$700 million during 2011 of which \$303 million of U.S. agency MBS and \$105 million of floating rates CMOs were completed during the second quarter of 2011. Proceeds from sales of loans and securities have been used in part to reduced broker CDs and other sources of funding and/or reinvested in lower risk-weighted assets such as highly liquid U.S. Treasury bills.

Partially offsetting the decline in the average volume of earning assets was an increase in the interest rate margin of 13 and 22 basis points (excluding valuations) for the quarter and six-month period ended June 30, 2011, respectively, compared to the corresponding periods in 2010. Higher net interest margins reflected the improvement in the mix of funding sources with the planned reduction in brokered CDs and increased balances in core deposits at a lower cost. The overall average cost of funding decreased by 28 and 27 basis point for the quarter and six month period ended June 30, 2011, respectively, compared to the same periods in 2010. Partially offsetting the improvement in margins due to lower funding costs, were the sales of certain loans and investments which earned

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relatively high yields and the adverse effect of maintaining liquidity levels. While the asset sales during 2011 were substantial, the full de-leverage associated with them could not be achieved since it was subject to the maturity schedule of funding sources. As a result, the Corporation kept during the second quarter of 2011 approximately \$725 million in short-term U.S. Treasury bills with maturities ranging from 3-6 months at an average yield of 0.08%. The excess liquidity maintained in the form of low yield, highly liquid instruments at a negative spread contributed to approximately \$3.0 million of the decrease in net interest income for the second quarter of 2011.

On an adjusted tax-equivalent basis, net interest income decreased by \$25.8 million, or 21%, for the second quarter of 2011 compared to the same period in 2010 and by \$45.4 million, or 18%, for the first half of 2011 compared to the first half of 2010 mainly due to the decline in average earning assets as discussed above. The decrease for 2011 also includes a decrease of \$5.7 million and \$13.3 million for the second quarter and first half of 2011, respectively, compared to the same period in 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 tax-exempt assets and lower yields on U.S. agency and MBS held by the IBEs.

**Provision and Allowance 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.

For the quarter and six-month period ended on June 30, 2011, the Corporation recorded a provision for loan and lease losses of \$59.2 million and \$147.9 million, respectively, compared to \$146.8 million and \$317.8 million for the comparable periods in 2010. The provision for almost all loan categories decreased during the second quarter and first half of 2011. Much of the decrease in the provision was related to lower charges to specific reserves on a reduced level of non-performing and adversely classified loans, commensurate with reductions in charges to general reserves due to reductions in historical loss rates and the overall decrease of the loan portfolio. 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-off 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 \$58.3 million and \$115.3 million in the second quarter and first half of 2011, respectively, compared to \$112.0 million and \$200.0 million, respectively, for the comparable periods in 2010. The provision for C&I loans in Puerto Rico decreased \$22.1 million during the second quarter of 2011, compared to the second quarter of 2010, reflecting a slower migration of loans to adversely classified categories and as a consequence lower charges to specific reserves for impaired C&I loans. The provision for residential mortgage loans in Puerto Rico, decreased by \$18.4 million for the second quarter of 2011, compared to 2010, on a reduced level of non-performing loans, while the provision for consumer loans and finance leases decreased by \$13.2 million, mainly reflecting improved trends in charge-offs and improvements in market and economic indicators for this portfolio. Decreases in historical loss rates and lower charges to specific reserves also caused a reduction of \$9.4 million in the provision for commercial mortgage loans in Puerto Rico for the second quarter of 2011 compared to the same period a year ago. Partially offsetting these favorable variances was an increase of \$9.4 million in the construction loan portfolio driven by increased specific and general reserves related to the land portfolio, including an increase of \$11.8 million in the specific reserve of certain land loans participations.

In Puerto Rico, the provision for almost all categories decreased during the first half of 2011, compared to the first half of 2010, except for the provision for C&I loans. The provision for construction loans for the first half of 2011 decreased by \$44.8 million, as compared to the first half of 2010, driven by reductions in non-performing and adversely classified loans as a result of loan sales and problem credit resolutions. The provision for residential mortgage loans decreased by \$33.8 million for the first half of 2011, compared to 2010, mainly due to improvements in delinquency and charge-offs trends while the provision for consumer and finance leases decreased by \$20.5 million also reflecting improvements in delinquency and historical loss rates commensurate with certain improvement in economic indicators related to this portfolio. Decreases in historical loss rates and lower charges to specific reserves also caused a reduction of \$13.7 million in the provision for commercial mortgage loans in Puerto Rico for the first half of 2011 compared to the first half of 2010. A higher level of non-performing loans was the main reason for the increase of \$28.0 million in the provision for C&I loans for the first half of 2011 as compared to 2010.

With respect to the loan portfolio in the United States, the Corporation recorded a provision of \$2.2 million and \$10.1 million in the second quarter and first half of 2011, respectively, compared to \$33.6 million and \$104.8 million, respectively, for the comparable periods

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in 2010. The significant decrease for the 2011 periods was driven by a reduction in the provision for construction loans of \$18.8 million and \$54.0 million for the quarter and six-month period ended June 30, 2011, respectively, compared to the same period a year ago. The decrease reflects lower charges to specific reserves on a reduced level of loans driven by sales of non-performing loans. The provision for commercial mortgage loans in the United States decreased by \$8.9 million and \$32.1 million for the quarter and six-month period ended June 30, 2011, compared to the same periods in 2010, also driven by a reduced level of adversely classified loans and reductions on historical loss rates. Fluctuations in the provision for the remaining portfolios were much lower, showing reductions in the provision for residential and consumer loans and a slight increase in the provision for C&I loans.

The provision recorded for the loan portfolio in the Virgin Islands during the second quarter decreased by \$2.5 million, compared to the second quarter of 2010, and increased by \$9.5 million for the first half of 2011 compared to the same period a year ago. The decrease for the quarter was mainly related to the commercial mortgage and construction loan portfolios. Meanwhile, the increase for the first half of 2011 was mainly related to a \$100 million relationship of the construction portfolio placed in non-performing status during the first quarter of 2011.

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.

**Non-Interest Income**

|                                                                                                         | <b>Quarter Ended June<br/>30,</b> |             | <b>Six-Month Period Ended June<br/>30,</b> |             |
|---------------------------------------------------------------------------------------------------------|-----------------------------------|-------------|--------------------------------------------|-------------|
|                                                                                                         | <b>2011</b>                       | <b>2010</b> | <b>2011</b>                                | <b>2010</b> |
|                                                                                                         | <b>(In thousands)</b>             |             |                                            |             |
| Other service charges on loans                                                                          | \$ 1,456                          | \$ 1,486    | \$ 3,174                                   | \$ 3,242    |
| Service charges on deposit accounts                                                                     | 3,054                             | 3,501       | 6,386                                      | 6,969       |
| Mortgage banking activities                                                                             | 9,336                             | 2,140       | 15,927                                     | 4,640       |
| Insurance income                                                                                        | 1,063                             | 2,146       | 2,396                                      | 4,421       |
| Broker-dealer income                                                                                    | 783                               | 1,347       | 831                                        | 1,554       |
| Other operating income                                                                                  | 5,187                             | 4,668       | 13,309                                     | 9,024       |
| Non-interest income before net gain on<br>investments and loss on early extinguishment of<br>borrowings | 20,879                            | 15,288      | 42,023                                     | 29,850      |
| Proceeds from securities litigation settlement                                                          |                                   |             | 679                                        |             |
| Gain on VISA shares                                                                                     |                                   |             |                                            | 10,668      |
| Net gain on sale of investments                                                                         | 21,949                            | 24,240      | 40,611                                     | 44,936      |
| OTTI on equity securities                                                                               |                                   | (3)         |                                            | (603)       |
| OTTI on debt securities                                                                                 | (607)                             |             | (607)                                      |             |
| Net gain on investments                                                                                 | 21,342                            | 24,237      | 40,683                                     | 55,001      |
| Loss on early extinguishment of borrowings                                                              | (1,823)                           |             | (1,823)                                    |             |

|                                             |           |           |           |           |
|---------------------------------------------|-----------|-----------|-----------|-----------|
| Equity in losses of unconsolidated entities | (1,536)   |           | (1,536)   |           |
| Total                                       | \$ 38,862 | \$ 39,525 | \$ 79,347 | \$ 84,851 |

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

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

Income from mortgage banking activities includes gains on sales and securitizations 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, if any, and hedging transactions related to securitizations of mortgage loans are recorded as part of mortgage banking activities.

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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 FirstBank's investment in CPG/GS, the entity that purchased \$269 million of loans from FirstBank during the first quarter of 2011, and consists of FirstBank's proportionate share of the income (losses) on CPG/GS and an out-of-period adjustment to correct an overstatement of the value of the investment in CPG/GS as of March 31, 2011 in the amount of \$1.9 million. This overstatement resulted from a determination that the discount rate used to value the investment should have been 17.57% rather than 16.24%. The Bank held a 35% subordinated ownership interest in CPG/GS. The majority owner of the joint venture 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 \$46.1 million in CPG/GS is at risk. Refer to Financial Condition and Operating Data Analysis Commercial and Construction Loans and to Note 11 of the accompanying unaudited consolidated financial statements for additional information about the Bank's investment in CPG/GS, including information about the determination of the initial value of the investment.

Non-interest income decreased \$0.7 million to \$38.9 million for the second quarter of 2011, compared to the second quarter of 2010, primarily due to:

Lower gains on sale of investments. The Corporation recorded a net gain on sale of U.S. agency fixed-rate MBS of \$19.9 million for the second quarter of 2011 compared to \$22.2 million for the same period in 2010. Also, in 2010 the Corporation recorded a \$2.0 million gain on the sale of approximately \$250 million of U.S. Treasury Notes.

Net non-cash charges of \$1.5 million related to the FirstBank's equity interest in CPG/GS. Approximately \$1.9 million of such charges represent an out of period adjustment to the initial valuation of the equity interest in CPG/GS. Refer to Note 11 of the accompanying unaudited consolidated financial statements for additional information.

A \$1.1 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. This transaction will generate expense reductions going forward in line with the Corporation's cost management strategies.

A \$0.6 million other-than-temporary impairment charge related to estimated credit losses on private label MBS.

A \$0.5 million decrease in service charges on deposit accounts.

The aforementioned factors were partially offset by the \$7.2 million increase in income from mortgage banking activities driven by the \$6.8 million gain recorded on the bulk sale of \$282 million of performing residential mortgage loans during the second quarter of 2011.

Non-interest income decreased by \$5.5 million for the first half of 2011, compared to the first half of 2010, primarily due to:

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

A lower volume of sales of investment securities. The Corporation recorded a gain of \$40.6 million on the sale of approximately \$745 million of MBS for the first half of 2011 compared to a gain of \$42.9 million on the sale of \$800 million of MBS for the first half of 2010. Among sales of MBS completed in 2011 were \$105 million of floating rates CMOs that carried an average yield of 0.95% and for which a gain of \$2.0 million was recorded. This gain on the sale of floating rate CMOs was partially offset by a \$1.8 million loss recorded on the early extinguishment of \$200 million of repurchase agreements (average rate of 1.06%) and \$100 million of advances from FHLB (rate of 1.62%), which should contribute to better interest margins in

the future. Also in 2010, as mentioned above, the Corporation recorded a \$2.0 million gain on the sale of approximately \$250 million of U.S. Treasury Notes.

A \$2.0 million decrease in income from insurance activities.

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The aforementioned factors were partially offset by:

An increase of \$11.3 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 a \$2.3 million increase in temporary impairment of servicing assets.

A \$2.8 million gain on the sale of substantially all of the assets of FirstBank Insurance VI and a \$1.0 million increase in fees from cash management services provided to corporate customers, included as part of Other operating income above.

**Non-Interest Expenses**

The following table presents the detail of non-interest expenses for the periods indicated:

|                                             | Quarter Ended June<br>30, |           | Six-month Period Ended June<br>30, |            |
|---------------------------------------------|---------------------------|-----------|------------------------------------|------------|
|                                             | 2011                      | 2010      | 2011                               | 2010       |
|                                             | (In thousands)            |           |                                    |            |
| Employees compensation and benefits         | \$ 29,407                 | \$ 30,958 | \$ 59,846                          | \$ 62,686  |
| Occupancy and equipment                     | 15,603                    | 14,451    | 30,853                             | 29,302     |
| Deposit insurance premium                   | 14,125                    | 15,369    | 27,590                             | 32,022     |
| Other taxes, insurance and supervisory fees | 3,557                     | 5,054     | 8,524                              | 10,740     |
| Professional fees                           | 6,072                     | 5,604     | 11,209                             | 10,891     |
| Servicing and processing fees               | 2,151                     | 2,555     | 4,362                              | 4,563      |
| Business promotion                          | 3,628                     | 3,340     | 6,292                              | 5,545      |
| Communications                              | 1,864                     | 1,828     | 3,742                              | 3,942      |
| Net loss on REO operations                  | 5,971                     | 10,816    | 11,471                             | 14,509     |
| Other                                       | 4,053                     | 8,636     | 5,408                              | 15,773     |
|                                             | \$ 86,431                 | \$ 98,611 | \$ 169,297                         | \$ 189,973 |

Non-interest expenses decreased \$12.2 million to \$86.4 million for the second quarter of 2011 from \$98.6 million for the second quarter of 2010. The decrease reflected:

A \$4.4 million decrease in the provision for unfunded loan commitments and letters of credit, included as part of Other in the table above, aligned with the sale during the first quarter of 2011 of non-performing construction loans to CPG/GS.

A \$4.8 million decrease in the loss on REO operations due to lower write-downs and losses on the sale of repossessed properties.

A \$1.6 million decrease in employees compensation and benefits expenses driven by a lower headcount, and

A \$1.6 million decrease in local regulatory examination fees driven by the reduction of the Bank's total assets in Puerto Rico.

Non-interest expenses decreased \$20.7 million for the first half of 2011, compared to the first half of 2010, primarily due to:

An \$11.0 million decrease in charges to the provision for unfunded loan commitments and letters of credit. A charge of \$7.0 million was recorded during the first half of 2010 compared to reserve releases of approximately \$4.0 million were recorded in the first half of 2011 mainly related to the non-performing construction loans portfolio sold to CPG/GS in the first quarter of 2011.

A decrease of \$4.4 million in the FDIC deposit insurance premium. However, a new deposit insurance assessment formula became effective on April 1, 2011 that redefines the assessment base for deposit insurance assessment as average total assets less average tangible equity, rather than on the amount of average total domestic deposits as in the previous rule. The deposit insurance premium assessment computed under the previous rule would have resulted in a \$12.3 million charge for the second quarter of 2011 instead of the \$14.1 million recorded under the new formula.

A \$3.0 million decrease in the loss on REO operations driven by lower write-downs and losses on the sale of properties, and

A \$2.8 million decrease in employees' compensation and benefits expenses as a result of cost reduction strategies and reductions in headcount. Over the last 12 months, the Corporation reduced its headcount by approximately 115, or 4%.

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### **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 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.

Under the Puerto Rico Internal Revenue Code of 1994, as amended (the "1994 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 1994 PR Code). The 1994 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 1994 PR Code, First BanCorp is subject to a maximum statutory tax rate of 39%. In 2009, the Puerto Rico Government approved Act No. 7 (the "Act") to stimulate Puerto Rico's economy and to reduce the Puerto Rico Government's fiscal deficit. The Act imposes a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which is 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 the capital gain statutory tax rate from 15% to 15.75%. These temporary measures are effective for tax years that commenced after December 31, 2008 and before January 1, 2012. The 1994 PR Code also includes an alternative minimum tax of 22% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements.

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 Entities ("IBEs") of the Bank ("FirstBank IBE") 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. Under the Act, all IBE are subject to the special 5% tax on their net income not otherwise subject to tax pursuant to the 1994 PR Code. This temporary measure is effective for tax years that commenced after December 31, 2008 and before January 1, 2012. FirstBank IBE 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.

On January 31, 2011, the Puerto Rico Government approved Act No. 1, which repealed the 1994 PR Code and replaced it with the Puerto Rico Internal Revenue Code of 2010 (the "2010 PR Code"). The provisions of the 2010 Code are generally applicable to taxable years commencing after December 31, 2010. The matters discussed above are equally applicable under the 2010 PR Code except that the maximum corporate tax rate has been reduced from 39% (40.95% for calendar years 2009 and 2010) to 30% (25% for taxable years commencing after December 31, 2013 if certain economic conditions are met by the Puerto Rico economy); and the net operating losses carryforward period has been extended from 7 years to 10 years. Corporations are entitled to elect to continue to determine their Puerto Rico income tax responsibility for such a 5-year period starting in 2011 to determine income tax responsibility under the provisions of the 1994 PR Code.

For the quarter and six-month period ended June 30, 2011, the Corporation recorded an income tax expense of \$2.6 million and \$6.2 million, respectively, compared to an income tax expense of \$3.8 million and \$10.7 million for the same periods in 2010. The decrease in the tax expense for the second quarter of 2011, compared to the same period in 2010, was mainly related to lower income derived from the operations of FirstBank Overseas and the

reduction in the statutory income tax rates applicable to subsidiaries. The decrease in the income tax expense for the first half of 2011, compared to the same period in 2010, reflects the impact in the first half of 2010 of a \$3.5 million charge to increase the valuation allowance related to deferred tax assets created prior to 2010 and lower income derived from the operations of FirstBank Overseas. As of June 30, 2011, the deferred tax asset, net of a valuation allowance of \$361.1 million, amounted to \$6.4 million compared to \$9.3 million as of December 31, 2010. The Corporation continued to reserve 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

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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 in the valuation allowance was that the Corporation's banking subsidiary, FirstBank Puerto Rico, continued in a three-year historical cumulative loss position as of the end of the second quarter of 2011, and has projected to be in a loss position for the remaining of 2011. As of June 30, 2011, management concluded that \$6.4 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.

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 Unrecognized Tax Benefit ( UTB ).

The Corporation classified all interest and penalties, if any, related to tax uncertainties as income tax expense. 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. There were no UTBs outstanding as of June 30, 2011 and December 31, 2010.

**Table of Contents****FINANCIAL CONDITION AND OPERATING DATA ANALYSIS****Assets**

Total assets were approximately \$14.1 billion as of June 30, 2011, down \$1.5 billion from approximately \$15.6 billion as of December 31, 2010. The Corporation continued to execute deleveraging initiatives included in the capital plan submitted to its regulators in order to preserve and improve its capital position. Total loans decreased \$1.2 billion driven by sales completed during the first half of 2011, including \$518 million of performing residential mortgage loans to another financial institution and the previously reported sale of a pool of loans, mainly adversely classified loans, amounting to approximately \$269 million to CPG/GS. Charge-offs, principal repayments of commercial credit facilities, sales of participations in commercial loan, sales of troubled assets in Florida, loan securitizations and foreclosures also contributed to a lower loan portfolio. Total investment securities decreased by \$377.4 million, driven by sales and prepayments of U.S. agency MBS, partially offset by purchases of highly liquid U.S. Treasury Bills. In line with the planned reduction of brokered CDs, the Corporation used some of the proceeds from sales of loans and investments to pay down maturing brokered CDs. The Corporation expects to use excess liquidity maintained in cash and short-term highly liquid securities (i.e. Treasury bills) to pay down maturing brokered CDs and other funding sources.

**Loan Portfolio**

The following table presents the composition of the Corporation's loan portfolio, including loans held for sale, as of the dates indicated:

| (In thousands)                                                                | <b>June 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|-------------------------------------------------------------------------------|--------------------------|------------------------------|
| Residential mortgage loans                                                    | \$ 2,880,989             | \$ 3,417,417                 |
| Commercial loans:                                                             |                          |                              |
| Construction loans                                                            | 515,934                  | 700,579                      |
| Commercial mortgage loans                                                     | 1,590,633                | 1,670,161                    |
| Commercial and Industrial loans                                               | 3,883,645                | 3,861,545                    |
| Loans to local financial institutions collateralized by real estate mortgages | 282,003                  | 290,219                      |
| Total commercial loans                                                        | 6,272,215                | 6,522,504                    |
| Finance leases                                                                | 263,223                  | 282,904                      |
| Consumer loans                                                                | 1,349,098                | 1,432,611                    |
| Total loans, held for investment                                              | 10,765,525               | 11,655,436                   |
| Loans held for sale                                                           | 20,781                   | 300,766                      |
| Total loans                                                                   | 10,786,306               | 11,956,202                   |
| Less:                                                                         |                          |                              |
| Allowance for loan and lease losses                                           | (540,878)                | (553,025)                    |

|                  |               |               |
|------------------|---------------|---------------|
| Total loans, net | \$ 10,245,428 | \$ 11,403,177 |
|------------------|---------------|---------------|

As of June 30, 2011, the Corporation's total loans decreased by \$1.2 billion, when compared with the balance as of December 31, 2010. All major loan categories decreased from 2010 levels mainly as a result of loans sales coupled with pay-downs and charge-offs, with the exception of the C&I loan portfolio which increased mainly due to loans granted to CPG/GS and due to certain construction loans converted to permanent C&I loans during 2011.

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Of the total gross loan portfolio held for investment of \$10.8 billion as of June 30, 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:

| <b>As of June 30, 2011</b>                                                    | <b>Puerto Rico</b>    | <b>Virgin Islands</b> | <b>Florida</b> | <b>Total</b>  |
|-------------------------------------------------------------------------------|-----------------------|-----------------------|----------------|---------------|
|                                                                               | <b>(In thousands)</b> |                       |                |               |
| Residential mortgage loans                                                    | \$ 2,155,355          | \$ 417,613            | \$ 308,021     | \$ 2,880,989  |
| Commercial loans:                                                             |                       |                       |                |               |
| Construction loans                                                            | 331,244               | 153,746               | 30,944         | 515,934       |
| Commercial mortgage loans                                                     | 1,060,028             | 63,279                | 467,326        | 1,590,633     |
| Commercial and Industrial loans                                               | 3,644,631             | 210,893               | 28,121         | 3,883,645     |
| Loans to local financial institutions collateralized by real estate mortgages | 282,003               |                       |                | 282,003       |
| Total commercial loans                                                        | 5,317,906             | 427,918               | 526,391        | 6,272,215     |
| Finance leases                                                                | 263,223               |                       |                | 263,223       |
| Consumer loans                                                                | 1,256,589             | 60,901                | 31,608         | 1,349,098     |
| Total loans held for investment, gross                                        | 8,993,073             | 906,432               | 866,020        | 10,765,525    |
| Allowance for loans and lease losses                                          | (453,990)             | (34,271)              | (52,617)       | (540,878)     |
| Total loans held for investment, net                                          | 8,539,083             | 872,161               | 813,403        | 10,224,647    |
| Loans held for sale                                                           | 18,000                | 2,781                 |                | 20,781        |
| Total loans                                                                   | \$ 8,557,083          | \$ 874,942            | \$ 813,403     | \$ 10,245,428 |

**Loan Production**

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.

The following table details First BanCorp's loan production, including purchases and refinancings, for the periods indicated:

| <b>Quarter Ended June 30,</b> |             | <b>Six-month Period Ended June 30,</b> |             |
|-------------------------------|-------------|----------------------------------------|-------------|
| <b>2011</b>                   | <b>2010</b> | <b>2011</b>                            | <b>2010</b> |
| <b>(In thousands)</b>         |             |                                        |             |

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|                             |            |            |              |              |
|-----------------------------|------------|------------|--------------|--------------|
| Residential real estate     | \$ 139,981 | \$ 140,216 | \$ 255,207   | \$ 266,888   |
| C&I and commercial mortgage | 270,766    | 313,970    | 689,789      | 618,905      |
| Construction                | 19,037     | 46,495     | 54,394       | 97,348       |
| Finance leases              | 21,436     | 21,206     | 41,546       | 44,256       |
| Consumer                    | 117,619    | 129,112    | 223,909      | 260,595      |
| Total loan production       | \$ 568,839 | \$ 650,999 | \$ 1,264,845 | \$ 1,287,992 |

The Corporation is experiencing continued loan demand and has continued with its targeted originations strategies. During the second quarter and first half of 2011 total loan originations, including refinancings and draws from existing commitments, amounted to approximately \$568.8 million and \$1.3 billion, respectively, compared to \$651 million and \$1.3 billion, respectively, for the comparable periods in 2010. The decrease for the second quarter of 2011, compared to 2010, was mainly related to construction loans, as the majority of originations for this portfolio came from draws of existing commitments, and due to lower credit facilities granted to the Puerto Rico and Virgin Islands government. Credit facilities granted to government were \$26.4 million and \$48.0 million for the second quarter and first half of 2011, respectively, compared to \$51.0 million and \$127.2 million, respectively, for the comparable periods in 2010. In addition to decreases in originations of construction and government loans, originations of consumer and residential mortgage loans also decreased during 2011 as compared to 2010. However, the second quarter of 2011 showed an increase of 15% in consumer-based originations, such as residential and consumer loans, compared to the first quarter of 2011 which is a positive sign.

**Table of Contents***Residential Real Estate Loans*

As of June 30, 2011, the Corporation's residential real estate loan portfolio held for investment decreased by \$536.4 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, sales of \$55.7 million to FNMA and FHLMC in the secondary market, and securitizations of \$90.3 million. Charge-offs and foreclosures also contributed to the decrease. Refer to the Contractual Obligations and Commitments discussion below for additional information about outstanding commitments to sell mortgage loans.

*Commercial and Construction Loans*

As of June 30, 2011, the Corporation's commercial and construction loan portfolio held for investment decreased by \$250.3 million, as compared to the balance as of December 31, 2010, due mainly to charge-offs of \$125.8 million, a reduction of \$80 million in the outstanding balance of credit facilities extended to the Puerto Rico and U.S. Virgin Islands governments, the sale of the underlying collateral of a \$33 million non-performing asset in Florida, sales of participation interests in \$30.4 million of certain commercial loans and pay downs. The Corporation's commercial loans are primarily variable- and adjustable-rate 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 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% interest in CPB/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 June 30, 2011, the carrying amount of the loan is \$136.1 million and is included in the Corporation's C&I loan receivable portfolio; while the carrying value of FirstBank's equity interest is \$46.1 million as of June 30, 2011, accounted under the equity method and included as part of Investment in unconsolidated entities in the Statement of Financial Condition. The 35% interest of FirstBank in CPB/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 11 of the accompanying unaudited consolidated financial statements 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 first half of 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 June 30, 2011, the carrying value of the advance facility and working capital line were \$80.0 million and \$0, respectively, and are included in the Corporation's C&I loan receivable portfolio.

As of June 30, 2011, the Corporation had \$216.4 million outstanding of credit facilities granted to the Puerto Rico government and/or its political subdivisions, down from \$325.1 million as of December 31, 2010, and \$113.2 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 has 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 June 30, 2011 in the amount of \$282.0 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 \$27.5 million and \$43.0 million for the quarter and six-month period ended June 30, 2011, respectively, as compared to the same periods 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's construction lending volume has been stagnant for the last two years due to the slowdown in the U.S. housing market and the current economic environment in Puerto Rico. 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 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.

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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 October 31, 2011, 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 during the period.

**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.

**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 \$106.1 million during the first half of 2011 driven mainly by loans converted to permanent financing commercial mortgage and C&I loans and charge-offs. In Florida the construction portfolio decreased by \$47.6 million, driven by the repossession and subsequent sale of the underlying collateral of a \$33.0 million residential project and due to charge-offs during the first half of 2011.

The composition of the Corporation's construction loan portfolio held for investment as of June 30, 2011 by category and geographic location follows:

| <b>As of June 30, 2011</b>                                          | <b>Puerto Rico</b> | <b>Virgin Islands<br/>(In thousands)</b> | <b>Florida</b> | <b>Total</b> |
|---------------------------------------------------------------------|--------------------|------------------------------------------|----------------|--------------|
| Loans for residential housing projects:                             |                    |                                          |                |              |
| High-rise <sup>(1)</sup>                                            | \$ 12,358          | \$                                       | \$             | \$ 12,358    |
| Mid-rise <sup>(2)</sup>                                             | 33,055             | 4,939                                    | 38             | 38,032       |
| Single-family detach                                                | 45,150             | 1,540                                    | 4,780          | 51,470       |
| Total for residential housing projects                              | 90,563             | 6,479                                    | 4,818          | 101,860      |
| Construction loans to individuals secured by residential properties | 9,016              | 9,520                                    |                | 18,536       |
| Condo-conversion loans                                              | 6,905              |                                          |                | 6,905        |
| Loans for commercial projects                                       | 74,440             | 95,485                                   |                | 169,925      |
| Bridge loans residential                                            | 52,394             |                                          |                | 52,394       |
| Bridge loans commercial                                             |                    | 24,032                                   | 12,697         | 36,729       |
| Land loans residential                                              | 51,328             | 15,395                                   | 9,125          | 75,848       |
| Land loans commercial                                               | 44,341             | 2,126                                    | 4,320          | 50,787       |

|                                                              |            |            |           |            |
|--------------------------------------------------------------|------------|------------|-----------|------------|
| Working capital                                              | 3,052      | 1,041      |           | 4,093      |
| Total before net deferred fees and allowance for loan losses | 332,039    | 154,078    | 30,960    | 517,077    |
| Net deferred fees                                            | (795)      | (332)      | (16)      | (1,143)    |
| Total construction loan portfolio, gross                     | 331,244    | 153,746    | 30,944    | 515,934    |
| Allowance for loan losses                                    | (93,579)   | (24,487)   | (13,278)  | (131,344)  |
| Total construction loan portfolio, net                       | \$ 237,665 | \$ 129,259 | \$ 17,666 | \$ 384,590 |

(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 of up to 7 stories.

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The following table presents further information on the Corporation's construction portfolio as of and for the six-month period ended June 30, 2011:

|                                                                                 | (Dollars in thousands) |
|---------------------------------------------------------------------------------|------------------------|
| Total undisbursed funds under existing commitments                              | \$ 155,423             |
| Construction loans held for investment in non-accrual status <sup>(1)</sup>     | \$ 280,286             |
| Net charge offs - Construction loans <sup>(2)</sup>                             | \$ 64,445              |
| Allowance for loan losses - Construction loans                                  | \$ 131,344             |
| Non-performing construction loans to total construction loans                   | 54.33%                 |
| Allowance for loan losses - construction loans to total construction loans      | 25.46%                 |
| Net charge-offs (annualized) to total average construction loans <sup>(1)</sup> | 17.53%                 |

(1) Excludes \$5.1 million of non-performing construction loans held for sale as of June 30, 2011.

(2) Includes net charge-offs of \$10.7 million related to construction loans in Florida, \$19.3 million related to construction loans in Puerto Rico and \$13.4 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)  |          |
| Under \$300k    | \$55,424 |
| \$300k - \$600k | 8,450    |
| Over \$600k (1) | 26,689   |
|                 | \$90,563 |

(1) Mainly composed of one single-family detached project that account for approximately 70% of the residential housing projects in Puerto Rico with selling prices over \$600k.

*Consumer Loans and Finance Leases*

As of June 30, 2011, the Corporation's consumer loan and finance leases portfolio decreased by \$103.2 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 the first half of 2011. Nevertheless, the Corporation experienced a decrease in net charge-offs for consumer loans and finance leases that amounted to \$20.2 million for the first half of 2011, as compared to \$27.3 million for the same period a year ago.

**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 or held-to-maturity. The Corporation's total investment securities portfolio as of June 30, 2011 amounted to \$2.9 billion, a reduction of \$377.4 million mainly due to sales and prepayments of U.S. agency MBS. The reduction was the net result of approximately \$640 million of U.S. agency MBS and of \$105 million of U.S. agency floating rate CMOs sold during the first half of 2011, the call of

approximately \$50 million of investment securities (mainly U.S. agency debt securities) and MBS prepayments, partially offset by the purchase of approximately \$532 million of U.S. Treasury securities with maturities ranging from 4-6 months. The Corporation also acquired during 2011 approximately \$200 million of U.S. Treasury bills with a maturity of less than 3 months that were considered a cash equivalent and were included as part of money market instruments. While the asset sales during the first and second quarter of 2011 were substantial, the full de-leverage associated with them could not be achieved until the scheduled maturities of the borrowed funds. As a result, the Corporation kept excess liquidity during the second quarter through short-term U.S. Treasury bill.

The sales completed during the first half of 2011 included the sale of \$330 million of MBS originally intended to be held to maturity as a result of the deleverage initiatives included in the Corporation's capital plan. 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 92% 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 FNMA and FHLMC fixed-rate securities). On August 5, 2011, Standard and Poor's lowered its long term credit rating on the United States of America from AAA to AA+ and on August 8, 2011, Standard and Poor's lowered its credit ratings of the obligations of certain U.S. Government sponsored entities, including FNMA, FHLB and Freddie Mac, and other agencies with securities linked to long-term U.S. Government debt. These downgrades could have material adverse impact on global financial markets and economic

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conditions, and its ultimate impact is unpredictable and may not be immediately apparent. The Corporation's investment in equity securities is minimal, approximately \$0.1 million, which consists of common stock of a financial institution in Puerto Rico.

The following table presents the carrying value of investments at the indicated dates:

|                                                                                                                                            | <b>As of<br/>June 30,<br/>2011</b> | <b>As of<br/>December<br/>31,<br/>2010</b> |
|--------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|--------------------------------------------|
| <i>(In thousands)</i>                                                                                                                      |                                    |                                            |
| Money market investments                                                                                                                   | \$ 114,209                         | \$ 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                                                                                                   | 1,697,218                          | 1,212,067                                  |
| Puerto Rico Government obligations                                                                                                         | 162,315                            | 136,841                                    |
| Mortgage-backed securities                                                                                                                 | 973,091                            | 1,395,486                                  |
| Corporate bonds                                                                                                                            | 1,379                              |                                            |
| Equity securities                                                                                                                          | 83                                 | 59                                         |
|                                                                                                                                            | 2,834,086                          | 2,744,453                                  |
| Other equity securities, including \$41.0 million and \$54.6 million of FHLB stock as of June 30, 2011 and December 31, 2010, respectively | 42,252                             | 55,932                                     |
| Total money market and investment securities                                                                                               | \$ 2,990,547                       | \$ 3,369,332                               |

Mortgage-backed securities at the indicated dates consist of:

|                       | <b>As of<br/>June 30,<br/>2011</b> | <b>As of<br/>December 31,<br/>2010</b> |
|-----------------------|------------------------------------|----------------------------------------|
| <i>(In thousands)</i> |                                    |                                        |
| Held-to-maturity      |                                    |                                        |
| FHLMC certificates    | \$                                 | \$ 2,569                               |
| FNMA certificates     |                                    | 416,382                                |
|                       |                                    | 418,951                                |

|                                                                                  |            |              |
|----------------------------------------------------------------------------------|------------|--------------|
| Available-for-sale                                                               |            |              |
| FHLMC certificates                                                               | 3,184      | 1,817        |
| GNMA certificates                                                                | 792,979    | 991,378      |
| FNMA certificates                                                                | 110,106    | 215,059      |
| Collateralized Mortgage Obligations issued or guaranteed by FHLMC, FNMA and GNMA |            | 114,915      |
| Other mortgage pass-through certificates                                         | 66,822     | 72,317       |
|                                                                                  | 973,091    | 1,395,486    |
| Total mortgage-backed securities                                                 | \$ 973,091 | \$ 1,814,437 |

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The carrying values of investment securities classified as available-for-sale as of June 30, 2011 by contractual maturity (excluding mortgage-backed securities and equity securities) are shown below:

|                                                    | <b>Carrying<br/>Amount</b> | <b>Weighted<br/>Average Yield<br/>%</b> |
|----------------------------------------------------|----------------------------|-----------------------------------------|
| (Dollars in thousands)                             |                            |                                         |
| U.S. Government and agencies obligations           |                            |                                         |
| Due within one year                                | \$ 1,238,311               | 0.66                                    |
| Due after one year through five years              | 458,907                    | 1.43                                    |
|                                                    | 1,697,218                  | 0.87                                    |
| <br>Puerto Rico Government obligations             |                            |                                         |
| Due within one year                                | 732                        | 6.68                                    |
| Due after one year through five years              | 40,244                     | 5.08                                    |
| Due after five years through ten years             | 111,449                    | 5.21                                    |
| Due after ten years                                | 9,890                      | 5.88                                    |
|                                                    | 162,315                    | 5.22                                    |
| <br>Corporate bonds                                |                            |                                         |
| Due after ten years                                | 1,379                      | 5.80                                    |
|                                                    | 1,379                      | 5.80                                    |
| <br>Total                                          | 1,860,912                  | 1.25                                    |
| <br>Mortgage-backed securities                     | 973,091                    | 3.89                                    |
| <br>Equity securities                              | 83                         |                                         |
| <br>Total investment securities available for sale | \$ 2,834,086               | 2.15                                    |

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 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 \$50.1 million of investment securities, mainly U.S. agency debentures, with an average yield of 2.01% were called during the first half of 2011. As of June 30, 2011, the Corporation has approximately \$330.0 million in debt securities (U.S. agency and Puerto Rico government securities) with embedded calls and with an average yield of 2.46%. 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 accompanying unaudited consolidated financial statements for additional information regarding the Corporation's investment portfolio.

## **RISK MANAGEMENT**

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.

The Corporation's risk management policies are described below as well as in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of First BanCorp's 2010 Annual Report on Form 10-K.

### **Liquidity 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.

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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 June 30, 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. Management's Investment and Asset Liability Committee ( 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 Asset/Liability Manager 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 Asset/Liability Manager 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 a Basic Liquidity to assets ratio (cash, free liquid assets, and secured lines of credit to total assets) well in excess of the self-imposed minimum limit of 5%. As of June 30, 2011, the estimated basic liquidity ratio was approximately 11%, including un-pledged investment securities, and FHLB line of credit. At the end of the quarter, the Corporation had \$445 million available for additional credit on the FHLB line of credit. Unpledged liquid securities as of June 30, 2011 mainly consisted of U.S. Treasury securities fixed-rate MBS and U.S. agency debentures totaling approximately \$862.3 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 measure. The Corporation has continued to issue brokered CDs pursuant to approvals received from the FDIC to renew or roll over certain amounts through September 30, 2011.

*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 \$1.1 billion to \$5.2 billion as of June 30, 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

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that the Corporation's available borrowing capacity and efforts to grow deposits will be adequate to provide the necessary funding for the 2011 business plans. Nevertheless, management's alternative capital preservation strategies can be implemented should adverse liquidity conditions arise. Refer to Capital discussion below for additional information about capital raising efforts that would impact capital and liquidity levels.

The Corporation's principal sources of funding are:

**Brokered CDs** A large portion of the Corporation's funding has been retail brokered CDs issued by the Bank subsidiary, FirstBank Puerto Rico. Total brokered CDs decreased from \$6.3 billion at year-end 2010 to \$5.2 billion as of June 30, 2011. Although all the regulatory capital ratios exceeded the established well capitalized levels at June 30, 2011, 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 September 30, 2011. The Corporation has been using proceeds from repayments and sales of loans and investments to pay down maturing borrowings, including brokered CDs.

The average remaining term to maturity of the retail brokered CDs outstanding as of June 30, 2011 is approximately 1 year. Approximately 0.5% of the principal value of these certificates are 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 CDs, the Corporation would have to execute an accelerated de-leveraging through a systematic disposition of assets to meet its liquidity needs. During the first half of 2011, the Corporation issued \$415.7 million in brokered CDs to renew maturing brokered CDs having an average coupon of 0.88% (all-in cost of 1.15%). 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 June 30, 2011:

|                                 | <b>Total</b><br>(In thousands) |
|---------------------------------|--------------------------------|
| Three months or less            | \$ 1,114,208                   |
| Over three months to six months | 1,192,390                      |
| Over six months to one year     | 1,597,603                      |
| Over one year                   | 2,597,924                      |
| <b>Total</b>                    | <b>\$ 6,502,125</b>            |

Certificates of deposit in denominations of \$100,000 or higher include brokered CDs of \$5.2 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 denomination of \$100,000 or higher also include \$18.1 million of deposits through the Certificate of Deposit Account Registry Service (CDARS). In an effort to meet customer needs and provide its customers with the best products and services available, the Corporation's bank subsidiary, FirstBank Puerto Rico, has joined a program that gives depositors the opportunity to insure their money beyond the standard FDIC coverage. CDARS can offer customers access to FDIC insurance coverage beyond the \$250 thousand per account without limit by placing deposit in multiple banks through a single bank gateway, when they enter into the CDARS Deposit Placement Agreement, while earning attractive returns on their deposits.

**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 \$66.0 million to

\$5.9 billion from the balance of \$5.8 billion as of December 31, 2010, reflecting increases in core-deposit products such as retail CDs and commercial demand deposit accounts. Refer to Note 12 in the accompanying unaudited financial statements 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 quarter and six-month periods ended June 30, 2011 and 2010.

*Securities sold under agreements to repurchase* - The Corporation's investment portfolio is funded in part with repurchase agreements. Securities sold under repurchase agreements were \$1.2 billion as of June 30, 2011, compared with \$1.4 billion as of

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December 31, 2010. The decrease relates to \$200 million of repurchase agreement repaid prior to maturity. A loss of \$1.6 million on the early extinguishment of repurchase agreements was recorded during the second quarter of 2011. 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 \$1.2 billion of repurchase agreements outstanding as of June 30, 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. Certain counterparties are still not willing to extend the term of maturing repurchase agreements. Nevertheless, in addition to short-term repos, the Corporation has been able to maintain access to credit by using cost-effective sources such as FHLB advances. Refer to Note 13 in the accompanying notes to the unaudited interim consolidated financial statements 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, the Corporation has not experienced significant margin calls from counterparties arising from credit-quality-related write-downs in valuations and, as of June 30, 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 June 30, 2011 and December 31, 2010, the outstanding balance of FHLB advances was \$420.4 million and \$653.4 million, respectively. Approximately \$333.4 million of outstanding advances from the FHLB have 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 availability of credit lines. At the end of the second quarter of 2011, the Corporation had \$445 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.

With respect to the Corporation's \$231.9 million of outstanding subordinated debentures, we have provided, within the time frame prescribed by the indentures governing the subordinated debentures, a notice to the trustees of the subordinated debentures of our election to extend the interest payments on the debentures. 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 have elected to defer the interest payments that were due in September and December 2010 and in March and June 2011 because the Federal Reserve advised us that it would not provide its approval for the payment of interest on these subordinated debentures.

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 June 30, 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 \$90.3 million of FHA/VA mortgage loans into GNMA MBS during the first half of 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 new 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.

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The Corporation's credit as a long-term issuer is currently rated CCC+ on credit watch positive by Standard & Poor's (S&P) and CC by Fitch Ratings Limited (Fitch). At the FirstBank subsidiary level, long-term issuer ratings are currently Caa2 on credit watch positive by Moody's Investor Service (Moody's), eight notches below their definition of investment grade; CCC+ on credit watch positive by S&P seven notches below their definition of investment grade, and CC by Fitch, eight notches below their definition of investment grade.

During 2010, the Corporation suffered credit rating downgrades from S&P (from B to CCC+), and Fitch (from B- to CC) rating services. The FirstBank subsidiary also experienced credit rating downgrades in 2010: Moody's from B1 to B3, S&P from B to CCC+, and Fitch from B to CC. Furthermore, in April 2011 Moody's downgraded the Bank's credit rating from B3 to Caa2. The Corporation does not have any outstanding debt or derivative agreements that would be affected by the recent 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 the downgrades. The Corporation's ability to access new non-deposit sources of funding, however, could be adversely affected by these credit ratings and any additional downgrades.

*Cash Flows*

Cash and cash equivalents were \$353.7 million and \$545.1 million at June 30, 2011 and 2010, respectively. These balances decreased by \$16.6 million and \$159.0 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 the first half of 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 first half of 2011 and 2010, net cash provided by operating activities was \$74.8 million and \$111.4 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 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 include originating loans to be held to maturity and purchasing, selling and repayments of its available-for-sale and held-to-maturity investment securities. For the first half of 2011, net cash provided by investing activities was \$1.3 billion, primarily reflecting proceeds from loans (including sales and paydowns), as well as proceeds from securities sold or called during the first half of 2011 and MBS prepayments. Proceeds from sales of securities and loans and from repayments of loans and MBS were used in part to paydown maturing brokered CDs and other funding sources.

For the first half of 2010, net cash provided by investing activities was \$1.1 billion, primarily reflecting proceeds from loans, as well as proceeds from securities sold or called during the first half of 2010 and MBS prepayments. Partially offsetting these sources of cash were cash used for loan origination disbursements and 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. In the first half of 2011, net cash used in financing activities was \$1.4 billion due to repayments of maturing brokered CDs coupled with repayments of repurchase agreements and FHLB advances.

In the first half of 2010, net cash used in financing activities was \$1.4 billion due to the Corporation's decision to deleverage its balance sheet and pay down maturing repurchase agreements as well as advances from the FHLB and the FED. Partially offsetting these cash reductions was the growth of the core deposit base.

**Capital**

The Corporation's stockholders' equity amounted to \$1.0 billion as of June 30, 2011, a decrease of \$48.4 million compared to the balance as of December 31, 2010, driven by the net loss of \$43.3 million for the first half of 2011 and a decrease of \$5.1 million in

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other comprehensive income due to lower unrealized gains on available for sale securities. Based on the Agreement with the FED, currently neither First BanCorp, nor FirstBank, is permitted to pay dividends on capital securities without prior approval.

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into the Order with the FDIC (see Description of Business ). Although all of FirstBank's regulatory capital ratios exceeded the established well capitalized levels at June 30, 2011, 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 June 30, 2011 and December 31, 2010, based on existing established FED and FDIC guidelines.

|                                                               | <b>First</b>   |                  | <b>Banking Subsidiary<br/>To be<br/>well<br/>capitalized</b> | <b>Consent Order<br/>Requirements<br/>over time</b> |
|---------------------------------------------------------------|----------------|------------------|--------------------------------------------------------------|-----------------------------------------------------|
|                                                               | <b>BanCorp</b> | <b>FirstBank</b> |                                                              |                                                     |
| <b>As of June 30, 2011</b>                                    |                |                  |                                                              |                                                     |
| Total capital (Total capital to risk-weighted assets)         | 12.40%         | 12.15%           | 10.00%                                                       | 12.00%                                              |
| Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) | 11.08%         | 10.83%           | 6.00%                                                        | 10.00%                                              |
| Leverage ratio                                                | 8.04%          | 7.87%            | 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 deleveraging strategies completed during the first half of 2011 as further explained below and, in the case of FirstBank, also due to a \$22 million capital contribution from the holding company.

The Consent Order required that FirstBank submit a Capital Plan to the FDIC detailing the manner by which it would achieve a total capital to risk-weighted assets ratio of at least 12%, a Tier 1 capital to risk-weighted assets of at least 10% and a leverage ratio of at least 8% over time. In this respect, FirstBank submitted in March 2011, an updated Capital Plan that contemplates a \$350 million capital raise through the issuance of new common shares for cash, and other actions to further reduce the Corporation's and the Bank's risk-weighted assets, strengthen their capital positions and meet the minimum capital ratios required for FirstBank under the FDIC Order. Among the strategies contemplated in the Capital Plan are further reductions of the Corporation's loan portfolio and investment 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.

Among the deleveraging strategies incorporated into the Capital Plan and completed during the first half of 2011 are the following:

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 has 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 in exchange for \$88.5 million of cash, an acquisition loan of \$136.1 million and a 35% interest in CPG/GS. Approximately 93% of the loans were adversely classified loans and 55% were in non-performing status.

Proceeds from the sales of assets were used, in part, to pay down maturing liabilities. Although the Bank expected to meet the minimum capital ratios by June 30, 2011, given the time lag between the sales of the assets and the maturity of liabilities, the average assets for the quarter remained at higher levels, thus affecting temporarily the leverage ratio for the quarter. However, when computed using ending assets balance at June 30, 2011, which already include the full effect of deleverage, the leverage ratio would have been 8.38% and 8.20% for First BanCorp and FirstBank, respectively. Since the Bank's leverage ratio exceeded 8% as of June 30, 2011, based on the ending balance of assets, the Bank is technically in compliance with the minimum required capital ratios.

With respect to capital raise efforts, during the second quarter of 2011 the Corporation entered into separate agreements with Thomas H. Lee Partners, L.P. ( THL ) and with two funds managed by Oaktree Capital Management, L.P. ( Oaktree ) under which THL and Oaktree would purchase an aggregate of approximately \$348.2 million (\$174.1 million each investor) of common stock of the Corporation at a per share price of \$3.50 provided the Corporation sells an aggregate of \$500 million of shares of common stock. Each of these two investors' investment will represent approximately 24.36% of the outstanding shares of the Corporation's common stock upon completion of the capital raise and the conversion into common stock of the \$424.2 million of the Series G Preferred Stock, held by the U.S. Treasury. The Corporation has also entered into investment agreements with institutional investors and other private equity firms for the issuance of an aggregate of approximately \$176.8 million of the Corporation's common stock, which, together with the THL and Oaktree investments, result in \$525 million in commitments.

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The completion of this transaction is subject to the approval of the Corporation's stockholders and regulators. If approved, the transaction is expected to close during the third quarter of 2011.

If the stockholders and regulators approve the \$525 million capital raise, the Corporation will issue 150 million shares of common stock at \$3.50 per share and will immediately exercise its right to compel the conversion of all of the outstanding Series G Preferred Stock, which is held by the U.S. Treasury, into approximately 32.9 million shares of common stock. Also, the Corporation plans to conduct a rights offering that will enable current stockholders to purchase up to 10.7 million shares of common stock at the same \$3.50 price per share for an aggregate of \$37.3 million. The Corporation is expected to have nearly 229.98 million shares outstanding following the issuance of common stock to institutional investors and private equity firms, the conversion of the Series G Preferred Stock into common stock, the successful completion of the rights offering and the issuance of shares upon the exercise of anti-dilution rights held by certain of the institutional investors in the capital raise.

If the Corporation is unable to complete the capital raise, other capital preservation strategies are contemplated, including among others, an accelerated deleverage strategy through the sales of assets, which could allow us to continue to meet the minimum capital requirements required by the Order. The Corporation's tangible common equity ratio increased to 3.84% as of June 30, 2011, from 3.80% as of December 31, 2010, and the Tier 1 common equity to risk-weighted assets ratio as of June 30, 2011 decreased to 4.93% from 5.01% as of December 31, 2010.

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.

The following table is a reconciliation of the Corporation's tangible common equity and tangible assets for the periods ended June 30, 2011 and December 31, 2010, respectively:

|                                      | <b>June 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|--------------------------------------|--------------------------|------------------------------|
| <i>(In thousands)</i>                |                          |                              |
| Total equity – GAAP                  | \$ 1,009,578             | \$ 1,057,959                 |
| Preferred equity                     | (428,703)                | (425,009)                    |
| Goodwill                             | (28,098)                 | (28,098)                     |
| Core deposit intangible              | (12,866)                 | (14,043)                     |
| <b>Tangible common equity</b>        | <b>\$ 539,911</b>        | <b>\$ 590,809</b>            |
| <br>Total assets – GAAP              | <br>\$ 14,113,973        | <br>\$ 15,593,077            |
| Goodwill                             | (28,098)                 | (28,098)                     |
| Core deposit intangible              | (12,866)                 | (14,043)                     |
| <b>Tangible assets</b>               | <b>\$ 14,073,009</b>     | <b>\$ 15,550,936</b>         |
| <br><b>Common shares outstanding</b> | <br><b>21,304</b>        | <br><b>21,304</b>            |

|                                             |                 |                 |
|---------------------------------------------|-----------------|-----------------|
| <b>Tangible common equity ratio</b>         | <b>3.84%</b>    | <b>3.80%</b>    |
| <b>Tangible book value per common share</b> | <b>\$ 25.34</b> | <b>\$ 27.73</b> |

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 (SCAP), the results of which were announced on May 7, 2009. Management is currently monitoring this ratio, along with the other

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ratios discussed above, in evaluating the Corporation's capital levels and believes that, at this time, the ratio may continue to be of interest to investors.

The following table reconciles stockholders' equity (GAAP) to Tier 1 common equity:

| <i>(In thousands)</i>                                                                       | <b>June 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|---------------------------------------------------------------------------------------------|--------------------------|------------------------------|
| Total equity - GAAP                                                                         | \$ 1,009,578             | \$ 1,057,959                 |
| Qualifying preferred stock                                                                  | (428,703)                | (425,009)                    |
| Unrealized gain on available-for-sale securities (1)                                        | (12,659)                 | (17,736)                     |
| Disallowed deferred tax asset (2)                                                           | (272)                    | (815)                        |
| Goodwill                                                                                    | (28,098)                 | (28,098)                     |
| Core deposit intangible                                                                     | (12,866)                 | (14,043)                     |
| Cumulative change gain in fair value of liabilities accounted for under a fair value option | (1,889)                  | (2,185)                      |
| Other disallowed assets                                                                     | (808)                    | (226)                        |
| <b>Tier 1 common equity</b>                                                                 | <b>\$ 524,283</b>        | <b>\$ 569,847</b>            |
| <b>Total risk-weighted assets</b>                                                           | <b>\$ 10,630,162</b>     | <b>\$ 11,372,856</b>         |
| <b>Tier 1 common equity to risk-weighted assets ratio</b>                                   | <b>4.93%</b>             | <b>5.01%</b>                 |

- 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 \$11 million and \$13 million of the Corporation's deferred tax assets at June 30, 2011 and December 31, 2010, respectively were included without limitation in regulatory capital pursuant to the risk-based capital guidelines, while approximately \$0.3 million of such assets at June 30, 2011 and \$0.8 million at December 31, 2010 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 \$5 million of the Corporation's deferred tax liability at June 30, 2011 and December 31, 2010 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.

**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 June 30, 2011, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately \$723.6 million and \$70.3 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 enter into interest rate lock agreements with prospective borrowers.

**Table of Contents****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, commitments to sell mortgage loans and commitments to extend credit:

| <b>Contractual Obligations and Commitments</b>                             |                     |                             |                                         |                   |                          |
|----------------------------------------------------------------------------|---------------------|-----------------------------|-----------------------------------------|-------------------|--------------------------|
| <b>As of June 30, 2011</b>                                                 |                     |                             |                                         |                   |                          |
|                                                                            | <b>Total</b>        | <b>Less than 1<br/>year</b> | <b>1-3 years<br/>(In<br/>thousands)</b> | <b>3-5 years</b>  | <b>After 5<br/>years</b> |
| Contractual obligations:                                                   |                     |                             |                                         |                   |                          |
| Certificates of deposit                                                    | \$ 7,444,618        | 4,555,416                   | 2,813,656                               | 61,541            | 14,005                   |
| Federal funds purchased and securities sold under agreements to repurchase | 1,200,000           | 100,000                     | 600,000                                 | 500,000           |                          |
| Advances from FHLB                                                         | 420,440             | 87,000                      | 333,440                                 |                   |                          |
| Notes payable                                                              | 19,715              | 7,341                       |                                         |                   | 12,374                   |
| Other borrowings                                                           | 231,959             |                             |                                         |                   | 231,959                  |
| <b>Total contractual obligations</b>                                       | <b>\$ 9,316,732</b> | <b>\$ 4,749,757</b>         | <b>\$ 3,747,096</b>                     | <b>\$ 561,541</b> | <b>\$ 258,338</b>        |
| <br>Commitments to sell mortgage loans                                     | <br>\$ 59,872       | <br>\$ 59,872               |                                         |                   |                          |
| <br>Standby letters of credit                                              | <br>\$ 30,422       | <br>\$ 30,422               |                                         |                   |                          |
| <br>Commitments to extend credit:                                          |                     |                             |                                         |                   |                          |
| Lines of credit                                                            | \$ 566,718          | \$ 566,718                  |                                         |                   |                          |
| Letters of credit                                                          | 39,861              | 39,861                      |                                         |                   |                          |
| Commitments to originate loans                                             | 156,862             | 106,862                     | \$ 50,000                               |                   |                          |
| <b>Total commercial commitments</b>                                        | <b>\$ 763,441</b>   | <b>\$ 713,441</b>           | <b>\$ 50,000</b>                        |                   |                          |

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. In the ordinary course of business, the Corporation enters into operating leases and other commercial commitments. There have been no significant changes in such contractual obligations since December 31, 2010.

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 June 30, 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 there under was required. The book value of pledged securities with Lehman as of June 30, 2011 amounted to approximately \$64.5 million.

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

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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 September 15, 2011, 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 Bankruptcy Court, 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 investments classified as non-performing 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 growth 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 that 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 June 30, 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:

|                       | June 30, 2011                                               |         |                       |         | December 31, 2010                                           |         |                       |         |
|-----------------------|-------------------------------------------------------------|---------|-----------------------|---------|-------------------------------------------------------------|---------|-----------------------|---------|
|                       | Net Interest Income Risk (Projected for the next 12 months) |         |                       |         | 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        | \$ 9.8                                                      | 2.40%   | \$ 23.6               | 5.75%   | \$ 24.8                                                     | 5.37%   | \$ 24.8               | 5.60%   |
| - 200 bps ramp        | \$ (2.2)                                                    | (0.54)% | \$ (11.8)             | (2.89)% | \$ (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 the first half of 2011, the Corporation sold approximately \$745 million of MBS, while the loan portfolio decreased by \$1.2 billion. This decrease in assets from

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deleveraging strategies allowed a reduction of approximately \$1.5 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 \$23.6 million in a gradual parallel upward move of 200 basis points.

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 June 30, 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 decrease by \$11.8 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 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 \$100 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 June 30, 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) Income.

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, refer to Note 9 in the accompanying unaudited consolidated financial statements.

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The following tables summarize the fair value changes in the Corporation's derivatives as well as the sources of the fair values:

|                                                                    | <b>Six-month period<br/>ended<br/>June 30, 2011</b> |
|--------------------------------------------------------------------|-----------------------------------------------------|
| (In thousands)                                                     |                                                     |
| Fair value of contracts outstanding at the beginning of the period | \$ (4,796)                                          |
| Contracts terminated or called during the period                   | (15)                                                |
| Changes in fair value during the period                            | (905)                                               |
| Fair value of contracts outstanding as of June 30, 2011            | \$ (5,716)                                          |

**Source of Fair Value**

|                                       | <b>Payments Due by Period</b>                      |                                   |                                   |                                 |                                 |
|---------------------------------------|----------------------------------------------------|-----------------------------------|-----------------------------------|---------------------------------|---------------------------------|
|                                       | <b>Maturity<br/>Less<br/>Than<br/>One<br/>Year</b> | <b>Maturity<br/>1-3<br/>Years</b> | <b>Maturity<br/>3-5<br/>Years</b> | <b>In Excess<br/>of 5 Years</b> | <b>Total<br/>Fair<br/>Value</b> |
| (In thousands)                        |                                                    |                                   |                                   |                                 |                                 |
| <b>As of June 30, 2011</b>            |                                                    |                                   |                                   |                                 |                                 |
| Pricing from observable market inputs | \$ (33)                                            | \$ (580)                          | \$                                | \$ (5,103)                      | \$ (5,716)                      |
|                                       | \$ (33)                                            | \$ (580)                          | \$                                | \$ (5,103)                      | \$ (5,716)                      |

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.

As of June 30, 2011 and December 31, 2010, all of the derivative instruments held by the Corporation were considered economic undesignated hedges.

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. Currently, the Corporation is mostly engaged in derivative instruments with counterparties with a credit rating of single A or better. 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.

Refer to Note 20 of the accompanying unaudited consolidated financial statements for additional information regarding the fair value determination of derivative instruments.

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Set forth below is a detailed analysis of the Corporation's credit exposure by counterparty with respect to derivative instruments outstanding as of June 30, 2011 and December 31, 2010.

|                                                   |                       |            | As of June 30, 2011                                     |                            |                        | Accrued<br>interest<br>receivable<br><br>(payable) |
|---------------------------------------------------|-----------------------|------------|---------------------------------------------------------|----------------------------|------------------------|----------------------------------------------------|
| (In thousands)                                    |                       |            | Total<br>Exposure<br>at<br>Fair<br>Value <sup>(2)</sup> | Negative<br>Fair<br>Values | Total<br>Fair<br>Value |                                                    |
| Counterparty                                      | Rating <sup>(1)</sup> | Notional   |                                                         |                            |                        |                                                    |
| Interest rate swaps with<br>rated counterparties: |                       |            |                                                         |                            |                        |                                                    |
| JP Morgan                                         | A+                    | \$ 35,030  | \$                                                      | \$ (5,682)                 | \$ (5,682)             | \$                                                 |
| Credit Suisse First<br>Boston                     | A+                    | 5,474      |                                                         | (368)                      | (368)                  |                                                    |
| Goldman Sachs                                     | A                     | 6,515      | 988                                                     |                            | 988                    |                                                    |
| Morgan Stanley                                    | A                     | 108,371    |                                                         |                            |                        |                                                    |
|                                                   |                       | 155,390    | 988                                                     | (6,050)                    | (5,062)                |                                                    |
| Other derivatives:                                |                       |            |                                                         |                            |                        |                                                    |
| Other derivatives (3)                             |                       | 137,960    | 421                                                     | (1,075)                    | (654)                  | (136)                                              |
| Total                                             |                       | \$ 293,350 | \$ 1,409                                                | \$ (7,125)                 | \$ (5,716)             | \$ (136)                                           |

|                                                   |                       |            | As of December 31, 2010                                 |                            |                        | Accrued<br>interest<br>receivable<br><br>(payable) |
|---------------------------------------------------|-----------------------|------------|---------------------------------------------------------|----------------------------|------------------------|----------------------------------------------------|
| (In thousands)                                    |                       |            | Total<br>Exposure<br>at<br>Fair<br>Value <sup>(2)</sup> | Negative<br>Fair<br>Values | Total<br>Fair<br>Value |                                                    |
| Counterparty                                      | Rating <sup>(1)</sup> | Notional   |                                                         |                            |                        |                                                    |
| Interest rate swaps with<br>rated counterparties: |                       |            |                                                         |                            |                        |                                                    |
| JP Morgan                                         | A+                    | \$ 42,808  | \$ 889                                                  | \$ (4,865)                 | \$ (3,976)             | \$                                                 |
| Credit Suisse First<br>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:                                |                       |            |                                                         |                            |                        |                                                    |
| 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.

A Hull-White Interest Rate Tree approach is used to value the option components of derivative instruments. 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 \$0.6 million as of June 30, 2011. The Corporation compares the valuations obtained with valuations received from counterparties, as an internal control procedure

#### ***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 the 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 avoiding defaults and minimizing losses upon default within each region and for each business segment. In the case of C&I, commercial mortgage and construction loan portfolios, the Special Asset Group ( SAG ) focuses on strategies for the accelerated reduction of non-performing assets through note 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.

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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 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, since the second quarter of 2010, 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 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 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-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

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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 that are 120 days delinquent and with a loan to value higher than 60% are charged-off to its fair value. 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.

The Corporation continued to strengthen its reserve coverage for most portfolios. The allowance for loan losses to total loans for residential mortgage loans increased from 1.82% at December 31, 2010 to 2.34% as of June 30, 2011. The C&I loans reserve coverage ratio increased from 3.68% at December 31, 2010 to 4.53% at June 30, 2011. The construction loans reserve coverage ratio increased from 21.69% as of December 31, 2010 to 25.46% at June 30, 2011. In contrast, the commercial mortgage reserve coverage decreased from 6.32% at December 31, 2010 to 5.71% at June 30, 2011, due to lower historical loss rates, while the consumer and finance leases reserve coverage ratio decreased from 4.69% as of December 31, 2010 to 3.89% at June 30, 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 \$540.9 million, or 5.02% of total loans, at June 30, 2011, compared with \$553.0 million, or 4.54% of total loans at December 31, 2010. Refer to the Provision for Loan and Lease Losses discussion above for additional information.

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The following table sets forth an analysis of the activity in the allowance for loan and lease losses during the periods indicated:

| (Dollars in thousands)                                   | Quarter Ended<br>June 30, |            | Six-month Period Ended<br>June 30, |            |
|----------------------------------------------------------|---------------------------|------------|------------------------------------|------------|
|                                                          | 2011                      | 2010       | 2011                               | 2010       |
| Allowance for loan and lease losses, beginning of period | \$ 561,695                | \$ 575,303 | \$ 553,025                         | \$ 528,120 |
| Provision (recovery) for loan and lease losses:          |                           |            |                                    |            |
| Residential mortgage                                     | 12,845                    | 31,307     | 19,172                             | 60,046     |
| Commercial mortgage                                      | 6,062                     | 26,562     | 19,443                             | 67,352     |
| Commercial and Industrial                                | 21,486                    | 46,052     | 62,972                             | 35,135     |
| Construction                                             | 21,354                    | 32,068     | 43,817                             | 131,370    |
| Consumer and finance leases                              | (2,563)                   | 10,804     | 2,512                              | 23,855     |
| Provision for loan and lease losses                      | 59,184                    | 146,793    | 147,916                            | 317,758    |
| Charge-offs:                                             |                           |            |                                    |            |
| Residential mortgage                                     | (9,091)                   | (17,623)   | (14,495)                           | (30,969)   |
| Commercial mortgage                                      | (3,160)                   | (17,989)   | (34,331)                           | (37,307)   |
| Commercial and Industrial                                | (11,811)                  | (26,186)   | (28,155)                           | (50,108)   |
| Construction                                             | (47,310)                  | (43,250)   | (66,475)                           | (96,573)   |
| Consumer and finance leases                              | (12,113)                  | (15,468)   | (24,082)                           | (31,865)   |
|                                                          | (83,485)                  | (120,516)  | (167,538)                          | (246,822)  |
| Recoveries:                                              |                           |            |                                    |            |
| Residential mortgage                                     | 154                       | 4          | 397                                | 4          |
| Commercial mortgage                                      | 10                        | 150        | 77                                 | 171        |
| Commercial and Industrial                                | 1,048                     | 167        | 1,104                              | 313        |
| Construction                                             | 103                       | 46         | 2,030                              | 154        |
| Consumer and finance leases                              | 2,169                     | 2,357      | 3,867                              | 4,606      |
|                                                          | 3,484                     | 2,724      | 7,475                              | 5,248      |
| Net charge offs                                          | (80,001)                  | (117,792)  | (160,063)                          | (241,574)  |
| Allowance for loan and lease losses, end of period       | \$ 540,878                | \$ 604,304 | \$ 540,878                         | \$ 604,304 |
|                                                          | 5.02%                     | 4.83%      | 5.02%                              | 4.83%      |

Allowance for loan and lease losses to period end  
total loans receivable

Net charge-offs annualized to average loans

outstanding during the period 2.91% 3.62% 2.82% 3.63%

Provision for loan and lease losses to net

charge-offs during the period 0.74x 1.25x 0.92x 1.32x

The following table sets forth information concerning the allocation of the 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:

| (In thousands)                                                                       | As of<br>June 30, 2011 |         | As of<br>December 31, 2010 |         |
|--------------------------------------------------------------------------------------|------------------------|---------|----------------------------|---------|
|                                                                                      | Amount                 | Percent | Amount                     | Percent |
| Residential mortgage                                                                 | \$ 67,404              | 27%     | \$ 62,330                  | 29%     |
| Commercial mortgage loans                                                            | 90,785                 | 15%     | 105,596                    | 14%     |
| Construction loans                                                                   | 131,344                | 5%      | 151,972                    | 6%      |
| Commercial and Industrial loans (including loans to<br>local financial institutions) | 188,562                | 38%     | 152,641                    | 36%     |
| Consumer loans and finance leases                                                    | 62,783                 | 15%     | 80,486                     | 15%     |
|                                                                                      | \$ 540,878             | 100%    | \$ 553,025                 | 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 June 30, 2011 and December 31, 2010 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance:

|                                                          | <b>Residential<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>Mortgage<br/>Loans</b> | <b>C&amp;I<br/>Loans</b> | <b>Construction<br/>Loans</b> | <b>Consumer<br/>and<br/>Finance<br/>Leases</b> | <b>Total</b>  |
|----------------------------------------------------------|-------------------------------------------|------------------------------------------|--------------------------|-------------------------------|------------------------------------------------|---------------|
| <i>(Dollars in thousands)</i>                            |                                           |                                          |                          |                               |                                                |               |
| <b>As of June 30, 2011</b>                               |                                           |                                          |                          |                               |                                                |               |
| Impaired loans without specific reserves:                |                                           |                                          |                          |                               |                                                |               |
| Principal balance of loans, net of charge-offs           | \$ 170,109                                | \$ 23,357                                | \$ 59,138                | \$ 22,533                     | \$ 1,545                                       | \$ 276,682    |
| Impaired loans with specific reserves:                   |                                           |                                          |                          |                               |                                                |               |
| Principal balance of loans, net of charge-offs           | 397,817                                   | 218,937                                  | 311,406                  | 268,326                       | 10,062                                         | 1,206,548     |
| Allowance for loan and lease losses                      | 52,073                                    | 30,402                                   | 92,162                   | 71,149                        | 678                                            | 246,464       |
| Allowance for loan and lease losses to principal balance | 13.09%                                    | 13.89%                                   | 29.60%                   | 26.52%                        | 6.74%                                          | 20.43%        |
| Loans with general allowance:                            |                                           |                                          |                          |                               |                                                |               |
| Principal balance of loans                               | 2,313,063                                 | 1,348,339                                | 3,795,104                | 225,075                       | 1,600,714                                      | 9,282,295     |
| Allowance for loan and lease losses                      | 15,331                                    | 60,383                                   | 96,400                   | 60,195                        | 62,105                                         | 294,414       |
| Allowance for loan and lease losses to principal balance | 0.66%                                     | 4.48%                                    | 2.54%                    | 26.74%                        | 3.88%                                          | 3.17%         |
| Total loans held for investment:                         |                                           |                                          |                          |                               |                                                |               |
| Principal balance of loans                               | \$ 2,880,989                              | \$ 1,590,633                             | \$ 4,165,648             | \$ 515,934                    | \$ 1,612,321                                   | \$ 10,765,525 |
| Allowance for loan and lease losses                      | 67,404                                    | 90,785                                   | 188,562                  | 131,344                       | 62,783                                         | 540,878       |
| Allowance for loan and lease losses to principal balance | 2.34%                                     | 5.71%                                    | 4.53%                    | 25.46%                        | 3.89%                                          | 5.02%         |
| <b>As of December 31, 2010</b>                           |                                           |                                          |                          |                               |                                                |               |

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<br>lease losses | 42,666 | 26,869 | 65,030 | 57,833 | 264 | 192,662 |
|----------------------------------------|--------|--------|--------|--------|-----|---------|

|                                                                |        |        |        |        |        |        |
|----------------------------------------------------------------|--------|--------|--------|--------|--------|--------|
| Allowance for loan and<br>lease losses to principal<br>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<br>lease losses | 19,664 | 78,727 | 87,611 | 94,139 | 80,222 | 360,363 |
|----------------------------------------|--------|--------|--------|--------|--------|---------|

|                                                                |       |       |       |        |       |       |
|----------------------------------------------------------------|-------|-------|-------|--------|-------|-------|
| Allowance for loan and<br>lease losses to principal<br>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<br>lease losses | 62,330 | 105,596 | 152,641 | 151,972 | 80,486 | 553,025 |
|----------------------------------------|--------|---------|---------|---------|--------|---------|

|                                                                |       |       |       |        |       |       |
|----------------------------------------------------------------|-------|-------|-------|--------|-------|-------|
| Allowance for loan and<br>lease losses to principal<br>balance | 1.82% | 6.32% | 3.68% | 21.69% | 4.69% | 4.74% |
|----------------------------------------------------------------|-------|-------|-------|--------|-------|-------|

The following tables show the activity for impaired loans and the related specific reserves during the first half of 2011:

|  | Quarter ended    |                  | Six-month period ended |                  |
|--|------------------|------------------|------------------------|------------------|
|  | June 30,<br>2011 | June 30,<br>2010 | June 30,<br>2011       | June 30,<br>2010 |
|  | (In thousands)   |                  |                        |                  |

**Impaired Loans:**

|                                                                                              |              |              |              |              |
|----------------------------------------------------------------------------------------------|--------------|--------------|--------------|--------------|
| Balance at beginning of period                                                               | \$ 1,562,122 | \$ 1,846,086 | \$ 1,383,641 | \$ 1,656,264 |
| Loans determined impaired during the period                                                  | 62,124       | 253,195      | 339,672      | 570,528      |
| Net charge-offs                                                                              | (66,271)     | (98,376)     | (126,891)    | (199,635)    |
| Loans sold, net of charge-offs                                                               |              | (52,000)     | (850)        | (70,749)     |
| Loans foreclosed, paid in full and partial<br>payments or no longer considered impaired, net | (74,745)     | (78,073)     | (112,342)    | (85,576)     |
| Balance at end of period                                                                     | \$ 1,483,230 | \$ 1,870,832 | \$ 1,483,230 | \$ 1,870,832 |

|                                | Quarter ended    |                  | Six-month period ended |                  |
|--------------------------------|------------------|------------------|------------------------|------------------|
|                                | June 30,<br>2011 | June 30,<br>2010 | June 30,<br>2011       | June 30,<br>2010 |
|                                | (In thousands)   |                  |                        |                  |
| <b>Specific Reserve:</b>       |                  |                  |                        |                  |
| Balance at beginning of period | \$ 253,476       | \$ 245,300       | \$ 192,662             | \$ 182,145       |
| Provision for loan losses      | 59,259           | 130,718          | 180,693                | 295,132          |
| Net charge-offs                | (66,271)         | (98,376)         | (126,891)              | (199,635)        |
| Balance at end of period       | \$ 246,464       | \$ 277,642       | \$ 246,464             | \$ 277,642       |

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### ***Credit Quality***

Credit quality performance in 2011 continued to show signs of stabilization, as demonstrated by, among other things, a \$30.5 million decrease in non-performing loans held for investment and a \$16.2 million decrease in adversely classified commercial and construction loans held for investment. Total adversely classified commercial and construction loans held for investment decreased to \$1.220 billion as of June 30, 2011 (\$581.1 million C&I loans; \$305.4 million commercial mortgage loans; \$334.0 million construction loans) from \$1.237 billion as of December 31, 2010 (\$558.9 million C&I loans; \$353.9 million commercial mortgage loans; \$323.9 million construction loans). Charge-offs, sales, loan modifications and payments result in a lower ending balance of non-performing assets. Other key credit quality metrics showed improvements, including declines in net charge offs.

### ***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 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 at the date of acquisition (estimated realizable value).

### ***Other Repossessed Property***

The other repossessed property category includes generally repossessed boats and autos acquired in settlement of loans. Repossessed boats and autos are recorded at the lower of cost or estimated fair value.

### ***Investment Securities***

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.

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The following table presents non-performing assets as of the dates indicated:

|                                                                                                      | <b>June 30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|------------------------------------------------------------------------------------------------------|--------------------------|----------------------------------|
| (Dollars in thousands)                                                                               |                          |                                  |
| Non-performing loans held for investment:                                                            |                          |                                  |
| Residential mortgage                                                                                 | \$ 380,165               | \$ 392,134                       |
| Commercial mortgage                                                                                  | 196,037                  | 217,165                          |
| Commercial and Industrial                                                                            | 309,888                  | 317,243                          |
| Construction                                                                                         | 280,286                  | 263,056                          |
| Consumer and finance leases                                                                          | 42,065                   | 49,391                           |
| Total non-performing loans held for investment                                                       | 1,208,441                | 1,238,989                        |
| Other real estate owned                                                                              | 96,618                   | 84,897                           |
| Other repossessed property                                                                           | 14,884                   | 14,023                           |
| Investment securities (1)                                                                            | 64,543                   | 64,543                           |
| Total non-performing assets, excluding loans held for sale                                           | \$ 1,384,486             | \$ 1,402,452                     |
| Non-performing loans held for sale                                                                   | 5,087                    | 159,321                          |
| Total non-performing assets, including loans held for sale                                           | \$ 1,389,573             | \$ 1,561,773                     |
| Past due loans 90 days and still accruing                                                            | \$ 156,919               | \$ 144,114                       |
| Non-performing assets to total assets                                                                | 9.85%                    | 9.96%                            |
| Non-performing loans held for investment to total loans held for investment                          | 11.23%                   | 10.63%                           |
| Allowance for loan and lease losses                                                                  | 540,878                  | 553,025                          |
| Allowance to total non-performing loans held for investment                                          | 44.76%                   | 44.64%                           |
| Allowance to total non-performing loans held for investment, excluding residential real estate loans | 65.30%                   | 65.30%                           |

(1) Collateral pledged with Lehman Brothers Special Financing, Inc.

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The following table shows non-performing assets by geographic segment:

| (Dollars in thousands)                                     | <b>June 30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|------------------------------------------------------------|--------------------------|----------------------------------|
| <b>Puerto Rico:</b>                                        |                          |                                  |
| Non-performing loans held for investment:                  |                          |                                  |
| Residential mortgage                                       | \$ 325,145               | \$ 330,737                       |
| Commercial mortgage                                        | 144,668                  | 177,617                          |
| Commercial and Industrial                                  | 301,195                  | 307,608                          |
| Construction                                               | 166,467                  | 196,948                          |
| Finance leases                                             | 3,208                    | 3,935                            |
| Consumer                                                   | 36,829                   | 43,241                           |
| Total non-performing loans held for investment             | 977,512                  | 1,060,086                        |
| REO                                                        | 74,067                   | 67,488                           |
| Other repossessed property                                 | 14,715                   | 13,839                           |
| Investment securities                                      | 64,543                   | 64,543                           |
| Total non-performing assets, excluding loans held for sale | \$ 1,130,837             | \$ 1,205,956                     |
| Non-performing loans held for sale                         | 5,087                    | 159,321                          |
| Total non-performing assets, including loans held for sale | \$ 1,135,924             | \$ 1,365,277                     |
| Past due loans 90 days and still accruing                  | \$ 132,491               | \$ 142,756                       |
| <b>Virgin Islands:</b>                                     |                          |                                  |
| Non-performing loans held for investment:                  |                          |                                  |
| Residential mortgage                                       | \$ 11,165                | \$ 9,655                         |
| Commercial mortgage                                        | 7,566                    | 7,868                            |
| Commercial and Industrial                                  | 5,689                    | 6,078                            |
| Construction                                               | 109,144                  | 16,473                           |
| Consumer                                                   | 767                      | 927                              |
| Total non-performing loans held for investment             | 134,331                  | 41,001                           |
| REO                                                        | 5,812                    | 2,899                            |
| Other repossessed property                                 | 137                      | 108                              |
| Total non-performing assets, excluding loans held for sale | \$ 140,280               | \$ 44,008                        |
| Non-performing loans held for sale                         |                          |                                  |
| Total non-performing assets, including loans held for sale | \$ 140,280               | \$ 44,008                        |
| Past due loans 90 days and still accruing                  | \$ 18,013                | \$ 1,358                         |

**Florida:**

|                                                            |            |            |
|------------------------------------------------------------|------------|------------|
| Non-performing loans held for investment:                  |            |            |
| Residential mortgage                                       | \$ 43,855  | \$ 51,742  |
| Commercial mortgage                                        | 43,803     | 31,680     |
| Commercial and Industrial                                  | 3,004      | 3,557      |
| Construction                                               | 4,675      | 49,635     |
| Consumer                                                   | 1,261      | 1,288      |
| Total non-performing loans held for investment             | 96,598     | 137,902    |
| REO                                                        | 16,739     | 14,510     |
| Other repossessed property                                 | 32         | 76         |
| Total non-performing assets, excluding loans held for sale | \$ 113,369 | \$ 152,488 |
| Non-performing loans held for sale                         |            |            |
| Total non-performing assets, including loans held for sale | \$ 113,369 | \$ 152,488 |
| Past due loans 90 days and still accruing                  | \$ 6,415   | \$         |

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Total non-performing loans were \$1.21 billion as of June 30, 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 its investment and receive a priority 12% return on its invested capital. The Corporation's equity interest of \$46.1 million is subordinated to the aggregate amount of its loans to CPG/GS in the amount of \$216.1 million as of June 30, 2011 and to the interest and priority return of CPG/GS majority investor. Total non-performing loans held for investment, which exclude non-performing loans held for sale, were \$1.21 billion at June 30, 2011, which represented 11.23% of total loans held for investment. This was down \$30.5 million from December 31, 2010. The decrease in non-performing loans held for investment from the fourth quarter of 2010 reflected declines in all loan categories, except for the construction loan portfolio.

Non-performing commercial mortgage loans held for investment decreased by \$21.1 million, or 9.73%, from the end of the fourth quarter of 2010. This decline was substantially related to a \$85.6 million loan relationship in Puerto Rico and one loan relationship in Florida, amounting to \$3.5 million, which were formally restructured so as to be reasonably assured of principal and interest repayment and of performance according to its modified terms. The Corporation restructured each of these relationships through loan splitting. The decrease was partially offset by loans entering into non-accrual, driven by two relationships in excess of \$10 million. In Puerto Rico, a \$46.1 million loan relationship entered into non-performing status in the second quarter of 2011 and a \$16.0 million loan was also placed in non-performing status during the second quarter of 2011 in Florida. Non-performing commercial mortgage loans in the Virgin Islands decreased \$0.3 million from December 31, 2010.

Non-performing residential mortgage loans decreased by \$12.0 million from the balance as of December 31, 2010. The decrease was associated with several factors, including: (i) loans modified that successfully completed a trial period prior to be restored to accrual status, (ii) charge-offs, and (iii) foreclosures. The amount of loans restored to accrual status due to payments received was offset by the additions to non-performing registered during the period. In Puerto Rico, non-performing residential mortgage loans decreased by \$5.6 million. Meanwhile, non-performing residential mortgage loans decreased by \$7.9 million in the United States, and increased \$1.5 million in the Virgin Islands. Approximately \$247.6 million, or 65% of total non-performing residential mortgage loans, have been written down to their net realizable value as of June 30, 2011.

C&I non-performing loans held for investment decreased by \$7.4 million, or 2.32%, from the end of the fourth quarter of 2010. The decrease was primarily related to payments and charge-offs. The Corporation received aggregate payments of approximately \$21.8 million on two non-performing loans in Puerto Rico during the second quarter of 2011. The Corporation recorded \$27.1 million in net charge-offs for the first half of 2011, of which \$26.3 million relate to the Puerto Rico portfolio. In the United States and the Virgin Islands, C&I non-performing loans decreased by \$0.6 million and \$0.4 million, respectively.

The levels of non-performing consumer loans, including finance leases, showed a \$7.3 million decrease during the first half of 2011. The decrease was mainly related to auto financings in Puerto Rico, partially offset by an increase in non-performing boat financings.

Non-performing construction loans held for investment increased by \$17.2 million, or 6.55%, from the end of the fourth quarter of 2010. The increase mainly reflected to the placement in non-performing status of a \$100 million loan relationship related to a commercial project in the Virgin Islands region, which was the single largest construction relationship in performing status prior to 2011. This was partially offset by charge-offs and problem credit resolutions including the sale of troubled assets. The Corporation recorded \$27.4 million in charge-offs related to the aforementioned \$100 million relationship. Non-performing construction loans in the United States decreased \$45.0 million mainly due to the repossession and subsequent sale of the underlying collateral of a \$33.0 million residential project in Florida and due to a \$2.1 million loan which was formally restructured so as to be reasonably assured of principal and interest repayment and performance according to its modified terms. Non-performing construction loans in Puerto Rico decreased \$30.5 million mainly due to payments and charge-offs. There were no inflows of construction projects into non-performing status in Puerto Rico and the United States during the first half of 2011. In the Virgin Islands region a \$14.7 million loan (net of a \$6.9 million charge-off) associated with the

development of a commercial real estate project was placed in non-performing status and coupled with the \$100 million relationship, contributed to a \$92.7 million increase in non-performing loans for this region.

At June 30, 2011, approximately \$152.2 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 \$68.9 million of restructured loans maintained in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status. Collections are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant.

During the six month period ended June 30, 2011, interest income of approximately \$2.4 million related to non-performing loans with a carrying value of \$617.3 million as of June 30, 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 June 30, 2011 was 44.76%, compared to 44.64% as of December 31, 2010. As of June 30, 2011, approximately \$396.5 million, or 32.8%, of total non-performing loans have been charged-off to their net realizable value as shown in the following table.

| <i>(Dollars in thousands)</i><br><b>As of June 30, 2011</b>                                                           | <b>Residential<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>Mortgage<br/>Loans</b> | <b>C&amp;I<br/>Loans</b> | <b>Construction<br/>Loans</b> | <b>Consumer<br/>and<br/>Finance<br/>Leases</b> | <b>Total</b> |
|-----------------------------------------------------------------------------------------------------------------------|-------------------------------------------|------------------------------------------|--------------------------|-------------------------------|------------------------------------------------|--------------|
| Non-performing loans held for investment charged-off to realizable value                                              | \$ 247,594                                | \$ 16,444                                | \$ 68,227                | \$ 62,733                     | \$ 1,545                                       | \$ 396,543   |
| Other non-performing loans held for investment                                                                        | 132,571                                   | 179,593                                  | 241,661                  | 217,553                       | 40,520                                         | 811,898      |
| Total non-performing loans held for investment                                                                        | \$ 380,165                                | \$ 196,037                               | \$ 309,888               | \$ 280,286                    | \$ 42,065                                      | \$ 1,208,441 |
| Allowance to non-performing loans held for investment                                                                 | 17.73%                                    | 46.31%                                   | 60.85%                   | 46.86%                        | 149.25%                                        | 44.76%       |
| Allowance to non-performing loans held for investment, excluding non-performing loans charged-off to realizable value | 50.84%                                    | 50.55%                                   | 78.03%                   | 60.37%                        | 154.94%                                        | 66.62%       |
| <b>As of December 31, 2010</b>                                                                                        |                                           |                                          |                          |                               |                                                |              |
| 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 investment                                                                        | 101,016                                   | 196,926                                  | 216,092                  | 230,917                       | 48,732                                         | 793,683      |
| Total non-performing loans held for investment                                                                        | \$ 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 through programs sponsored by the Federal Government. 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 June 30, 2011, the Corporation's TDR loans consisted of \$303.0 million of residential mortgage loans, \$49.4 million commercial and industrial loans, \$151.3 million commercial mortgage loans, \$14.1 million of construction loans and \$9.2 million of consumer loans. Outstanding unfunded loan commitments on TDR loans amounted to \$1.1 million as of June 30, 2011.

Included in the \$151.3 million of commercial mortgage TDR loans are certain loan relationships restructured through loan splitting, two in the second quarter of 2011, one in the first quarter of 2011 and one in the fourth quarter of 2010. Each of these loan relationships were restructured into two notes; one that represents the portion of the loan that is expected to be fully collected along with contractual interest and the second note that represents the portion of the original loan that was charged-off. The renegotiations of these loans have been made after analyzing the borrowers and guarantors capacity to repay the debt and ability to perform under the modified terms. For the first relationship restructured in the second quarter, the first note amounting to \$2.1 million was placed on a monthly amortization schedule that amortizes the debt over 30 years and the second note for \$3.6 million represents mainly previously taken charge-offs on this loan. For the second relationship restructured in the second quarter, the first note of \$3.9 million was placed on a 30 year amortization schedule at a market rate of interest, while the second note of \$1.3 million, was charged-off. For the relationship restructured in the first quarter of 2011, the first note of \$57.5 million was placed on a monthly payment that amortize the debt over 30 years at a market rate of interest. The second note, amounting to \$28.3 million was fully charged-off. For the relationship restructured in the fourth quarter of 2010, as part of the renegotiation of the loans, the first note of \$17 million was placed on a monthly payment schedule that amortizes the debt over 30 years at a market rate of interest. The second note for \$2.7 million was fully charged-off. The following tables provide additional information about the volume of this type of loan restructurings and the effect on the allowance for loan and lease losses in 2011.

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|                                                       |           |
|-------------------------------------------------------|-----------|
| Principal balance deemed collectible at end of period | \$ 80,189 |
| Amount charged-off during the first half of 2011      | \$ 29,576 |
| Charges to the provision for loan losses              | \$ 5,989  |
| Allowance for loan losses                             | \$ 1,034  |

The loans comprising the \$80.2 million that have been deemed collectible were placed in accruing status as the borrowers have exhibited a period of sustained performance but continue to be individually evaluated for impairment purposes. These loans contributed to a \$110.0 million decrease in non-performing loans over the last three quarters.

The REO portfolio, which is part of non-performing assets, increased by \$11.7 million, mainly reflecting increases in commercial properties in the United States, and increases in both residential and commercial properties in Puerto Rico and the Virgin Islands, partially offset by sales. 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 real estate acquired in satisfaction of debt. During the first half of 2011, the Corporation sold approximately \$29.5 million of REO properties (\$11.1 million in Florida, \$17.8 million in Puerto Rico and \$0.6 million in the Virgin Islands). These figures exclude the aforementioned \$33.0 million land 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 held for investment, excluding loans guaranteed by the U.S. Government, increased during the first half of 2011 by \$11.2 million to \$74.0 million, or 0.69% of total loans held for investment, at June 30, 2011. However, loans 30 to 59 days delinquent decreased \$60.1 million, or 14%, to \$366.1 million as of June 30, 2011.

*Net Charge-offs and Total Credit Losses*

Total net charge-offs for the first half of 2011 were \$160.1 million, or 2.82% of average loans on an annualized basis. This was down \$81.5 million, or 34%, from \$241.6 million, or an annualized 3.63%, in the first half of 2010. Lower net charge-offs were reflected in the Puerto Rico portfolio, primarily in construction loans, and the United States portfolio, primarily in the construction and commercial mortgage loans; with a \$49.3 million and \$66.9 million decrease, respectively. Net charge-offs in the Virgin Islands increased by \$34.7 million.

Construction loans net charge-offs in the first half of 2011 were \$64.4 million, down from \$96.4 million in the first half of 2010. Net charge-offs for construction loans in the Virgin Islands amounted to \$34.4 million, of 53% of total net charge-offs for construction loans in 2011, of which \$27.4 million relate to the aforementioned \$100 million relationship placed in non-performing status in 2011. Construction loan net-charge-offs in Puerto Rico amounted to \$19.3 million, or \$35.2 million lower than net charge-offs for the first half of 2010, driven by four relationships with charge-offs totaling \$15.7 million associated with commercial and residential projects. In the United States, construction loan net charge-offs were \$10.7 million, a decrease of \$31.1 million when compared to the same period in 2010, of which approximately \$5.1 million was related to the foreclosure of a land loan that was sold during the second quarter of 2011. After this sale, the construction portfolio in the United States has been reduced to \$30.9 million as of June 30, 2011, from \$78.5 million as of December 31, 2010.

Commercial mortgage loan net charge-offs in the first half of 2011 were \$34.3 million, or an annualized 4.26% of related average loans, down from \$37.1 million or an annualized 4.71% of related average loans, in the first half of 2010. Net charge-offs for commercial mortgage loans were mainly driven by a \$28.3 million charge-off related to the aforementioned \$85.6 million relationship in Puerto Rico restructured by the Corporation through a loan split. Commercial mortgage loans net charge-offs in the United States amounted to \$4.2 million, of which \$1.2 million relate to another restructured relationship through a loan split.

C&I loans net charge-offs in the first half of 2011 were \$27.1 million, or an annualized 1.27%, a decrease of \$22.7 million when compared to the \$49.8 million, or an annualized 2.05% of related loans, recorded in the first half of 2010. Approximately 97%, or \$26.3 million, of net charge-offs recorded in the first half of 2011 were in Puerto

Rico, of which \$16.4 million relate to eight relationships in excess of \$1 million. No significant C&I loans charge-offs were recorded in the United States or Virgin Islands portfolios.

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Residential mortgage loan net charge-offs were \$14.1 million, or an annualized 0.92% of related average loans. This represents a decrease of \$16.9 million from \$31.0 million, or an annualized 1.74% of related average loan balances for the first half of 2010. Although there continues to be valuation pressure, the Corporation experienced reductions in delinquent loans. Approximately \$9.2 million in charge-offs for the first half of 2011 (\$6.2 million in Puerto Rico and \$3.0 million in Florida) resulted from valuations for impairment purposes of residential mortgage loan portfolios considered homogeneous given high delinquency and loan-to-value levels, compared to \$21.3 million recorded in the first half of 2010. The total amount of the residential mortgage loan portfolio that has been charged-off to its net realizable value as of June 30, 2011 amounted to \$247.6 million. This represents approximately 65% of total non-performing residential mortgage loan portfolio outstanding as of June 30, 2011. Net charge-offs for residential mortgage loans also include \$4.0 million related to loans foreclosed during the first half, compared to \$6.6 million recorded for loans foreclosed in the first half of 2010. 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 the first half of 2011 were \$20.2 million compared to net charge-offs of \$27.3 million for the first half of 2010. Annualized net charge-offs as a percentage of related loans decreased to 2.43% from 2.94% for the first half of 2010.

The following table presents annualized net charge-offs to average loans held-in-portfolio:

|                            | <b>For the Quarter Ended</b> |                 | <b>For the Six-Month Period</b> |                 |
|----------------------------|------------------------------|-----------------|---------------------------------|-----------------|
|                            | <b>June</b>                  | <b>June 30,</b> | <b>June 30,</b>                 | <b>June 30,</b> |
|                            | <b>30,</b>                   | <b>2010</b>     | <b>2011</b>                     | <b>2010</b>     |
|                            | <b>2011</b>                  |                 |                                 |                 |
| Residential mortgage loans | 1.24%                        | 1.99%           | 0.92%                           | 1.74%           |
| Commercial mortgage        | 0.81%                        | 4.56%           | 4.26%                           | 4.71%           |
| Commercial and industrial  | 1.01%                        | 2.25%           | 1.27%                           | 2.05%           |
| Construction loans         | 28.62%                       | 11.96%          | 17.53%                          | 13.17%          |
| Consumer loans (1)         | 2.43%                        | 2.86%           | 2.43%                           | 2.94%           |
| Total loans                | 2.91%                        | 3.62%           | 2.82%                           | 3.63%           |

(1) Includes lease financing.

The above ratios are based on annualized charge-offs and are not necessarily indicative of the results expected for the entire year or in subsequent periods.

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The following table presents net charge-offs (annualized) to average loans held-in-portfolio by geographic segment:

|                               | Quarter Ended |               | Six-Month Period Ended |               |
|-------------------------------|---------------|---------------|------------------------|---------------|
|                               | June 30, 2011 | June 30, 2010 | June 30, 2011          | June 30, 2010 |
| <b>PUERTO RICO:</b>           |               |               |                        |               |
| Residential mortgage          | 1.39%         | 2.09%         | 0.85%                  | 1.60%         |
| Commercial mortgage           | 0.34%         | 0.34%         | 5.55%                  | 0.52%         |
| Commercial and Industrial     | 1.08%         | 2.48%         | 1.31%                  | 2.19%         |
| Construction                  | 6.90%         | 8.56%         | 7.95%                  | 11.04%        |
| Consumer and finance leases   | 2.49%         | 2.94%         | 2.50%                  | 2.95%         |
| Total loans                   | 1.57%         | 2.81%         | 2.22%                  | 2.80%         |
| <b>VIRGIN ISLANDS:</b>        |               |               |                        |               |
| Residential mortgage (1)      | -0.13%        | 0.00%         | -0.04%                 | 0.24%         |
| Commercial mortgage           | 0.00%         | 0.00%         | 0.00%                  | 0.00%         |
| Commercial and Industrial (2) | -0.19%        | -1.41%        | 0.67%                  | -0.73%        |
| Construction                  | 77.30%        | 0.01%         | 37.88%                 | 0.08%         |
| Consumer and finance leases   | 0.75%         | 0.46%         | 0.91%                  | 2.22%         |
| Total loans                   | 14.59%        | -0.32%        | 7.46%                  | 0.11%         |
| <b>FLORIDA:</b>               |               |               |                        |               |
| Residential mortgage          | 2.07%         | 3.67%         | 2.68%                  | 4.71%         |
| Commercial mortgage           | 2.00%         | 13.84%        | 1.83%                  | 13.53%        |
| Commercial and Industrial     | 0.00%         | 1.16%         | 0.47%                  | 6.16%         |
| Construction                  | 38.62%        | 32.75%        | 31.63%                 | 29.93%        |
| Consumer and finance leases   | 2.85%         | 4.86%         | 2.23%                  | 4.40%         |
| Total loans                   | 4.38%         | 14.59%        | 4.33%                  | 14.23%        |

1 - For the second quarter and first half of 2011 recoveries in residential mortgage loans in the Virgin Islands exceeded charge-offs.

2 - For the second quarter of 2011 and second quarter and first half of 2010, recoveries in commercial and industrial loans in the Virgin Islands exceeded charge-off.

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Total credit losses (equal to net charge-offs plus losses on REO operations) for the first half of 2011 amounted to \$171.5 million, or 3.00% on an annualized basis to average loans and repossessed assets in contrast to credit losses of \$256.1 million, or a loss rate of 3.83%, for the first half of 2010.

The following table presents a detail of the REO inventory and credit losses for the periods indicated:

|                                               | Quarter Ended<br>June 30, |                    | Six-Month Period Ended<br>June 30, |                    |
|-----------------------------------------------|---------------------------|--------------------|------------------------------------|--------------------|
|                                               | 2011                      | 2010               | 2011                               | 2010               |
|                                               | (Dollars in thousands)    |                    |                                    |                    |
| <b>REO</b>                                    |                           |                    |                                    |                    |
| REO balances, carrying value:                 |                           |                    |                                    |                    |
| Residential                                   | \$ 60,924                 | \$ 49,189          | \$ 60,924                          | \$ 49,189          |
| Commercial                                    | 24,796                    | 17,863             | 24,796                             | 17,863             |
| Construction                                  | 10,898                    | 5,306              | 10,898                             | 5,306              |
| Total                                         | \$ 96,618                 | \$ 72,358          | \$ 96,618                          | \$ 72,358          |
|                                               |                           |                    |                                    |                    |
| REO activity (number of properties):          |                           |                    |                                    |                    |
| Beginning property inventory,                 | 490                       | 331                | 479                                | 285                |
| Properties acquired                           | 119                       | 131                | 210                                | 229                |
| Properties disposed                           | (114)                     | (61)               | (194)                              | (113)              |
| Ending property inventory                     | 495                       | 401                | 495                                | 401                |
|                                               |                           |                    |                                    |                    |
| Average holding period (in days)              |                           |                    |                                    |                    |
| Residential                                   | 274                       | 217                | 274                                | 217                |
| Commercial                                    | 344                       | 268                | 344                                | 268                |
| Construction                                  | 342                       | 447                | 342                                | 447                |
|                                               | 300                       | 246                | 300                                | 246                |
|                                               |                           |                    |                                    |                    |
| REO operations (loss) gain:                   |                           |                    |                                    |                    |
| Market adjustments and (losses) gain on sale: |                           |                    |                                    |                    |
| Residential                                   | \$ (1,723)                | \$ (818)           | \$ (4,356)                         | \$ (2,063)         |
| Commercial                                    | (1,817)                   | (4,214)            | (2,920)                            | (4,890)            |
| Condo-conversion projects                     |                           | (2,140)            |                                    | (2,140)            |
| Construction                                  | (53)                      | (1,426)            | 82                                 | (1,377)            |
|                                               | (3,593)                   | (8,598)            | (7,194)                            | (10,470)           |
| Other REO operations expenses                 | (2,378)                   | (2,218)            | (4,277)                            | (4,039)            |
| <b>Net Loss on REO operations</b>             | <b>\$ (5,971)</b>         | <b>\$ (10,816)</b> | <b>\$ (11,471)</b>                 | <b>\$ (14,509)</b> |
|                                               |                           |                    |                                    |                    |
| <b>CHARGE-OFFS</b>                            |                           |                    |                                    |                    |
| Residential charge-offs, net                  | (8,937)                   | (17,619)           | (14,098)                           | (30,965)           |

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|                                              |                    |                     |                     |                     |
|----------------------------------------------|--------------------|---------------------|---------------------|---------------------|
| Commercial charge-offs, net                  | (13,913)           | (43,858)            | (61,305)            | (86,931)            |
| Construction charge-offs, net                | (47,207)           | (43,204)            | (64,445)            | (96,419)            |
| Consumer and finance leases charge-offs, net | (9,944)            | (13,111)            | (20,215)            | (27,259)            |
| Total charge-offs, net                       | (80,001)           | (117,792)           | (160,063)           | (241,574)           |
| <b>TOTAL CREDIT LOSSES (1)</b>               | <b>\$ (85,972)</b> | <b>\$ (128,608)</b> | <b>\$ (171,534)</b> | <b>\$ (256,083)</b> |
| <b>LOSS RATIO PER CATEGORY (2):</b>          |                    |                     |                     |                     |
| Residential                                  | 1.45%              | 2.05%               | 1.18%               | 1.83%               |
| Commercial                                   | 1.08%              | 3.10%               | 2.18%               | 2.85%               |
| Construction                                 | 27.82%             | 12.82%              | 17.20%              | 13.53%              |
| Consumer                                     | 2.41%              | 2.84%               | 2.41%               | 2.92%               |
| <b>TOTAL CREDIT LOSS RATIO (3)</b>           | <b>3.09%</b>       | <b>3.92%</b>        | <b>3.00%</b>        | <b>3.83%</b>        |

- (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.

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### **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, 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 \$10.8 billion as of June 30, 2011, approximately 84% have credit risk concentration in Puerto Rico, 8% in the United States and 8% in the Virgin Islands.

The largest loan to one borrower as of June 30, 2011 in the amount of \$282.0 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.

As of June 30, 2011, the Corporation had \$216.4 million outstanding of credit facilities granted to the Puerto Rico Government and/or its political subdivisions, down from \$325.1 million as of December 31, 2010, and \$113.2 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.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For information regarding market risk to which the Corporation is exposed, see the information contained in Part I Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations - Risk Management.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Control and Procedures**

First BanCorp's management, including its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of First BanCorp's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of June 30, 2011. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

**Internal Control over Financial Reporting**

There have been no changes to the Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

In the opinion of the Company's management, the pending and threatened legal proceedings of which management is aware will not have a material adverse effect on the financial condition, results of operations or cash flows of the Corporation.

**ITEM 1A. RISK FACTORS**

Our business, operating results and/or the market price of our common and preferred stock may be significantly affected by a number of factors. For a detailed discussion of certain risk factors that could affect the Corporation's operations, financial condition or results for future periods see the risk factors below and in Item 1A, Risk Factors, in the Corporation's 2010 Annual Report on Form 10-K. These factors could also cause actual results to differ materially from historical results or the results contemplated by the forward-looking statements contained in this report. Also refer to the discussion in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations in this report for additional information that may supplement or update the discussion of risk factors in the Corporation's 2010 Form 10-K.

The risks described in the Corporation's 2010 Form 10-K and in this report are not the only risks facing the Corporation. Additional risks and uncertainties not currently known to the Corporation or currently deemed by the Corporation to be immaterial also may materially adversely affect the Corporation's business, financial condition or results of operations.

***Additional capital resources may not be available when needed or at all.***

Due to our financial results over the past two years, we need to access the capital markets in order to raise additional capital to absorb future credit losses relating to the distressed economic environment and potential further deterioration in our loan portfolio, to maintain adequate liquidity and capital resources, to finance future growth, investments or strategic acquisitions and to implement the capital plans required by the Agreements. We have been taking steps to obtain additional capital.

During the second quarter of 2011, the Corporation entered into separate agreements with Thomas H. Lee Partners, L.P. (THL) and with two funds managed by Oaktree Capital Management, L.P. (Oaktree) under which THL and Oaktree would purchase an aggregate of approximately \$348.2 million (approximately \$174.1 million by each investor) of Common Stock at a per share price of \$3.50 provided the Corporation sells an aggregate of \$500 million of shares of Common Stock. Each of these investors' investment will represent approximately 24.36% of the outstanding shares of Common Stock upon completion of the capital raise and the conversion into Common Stock of the \$424.2 million of the Series G Preferred Stock, held by the U.S. Treasury. The Corporation also entered into investment agreements with institutional investors and other private equity firms for the issuance of shares of Common Stock for an aggregate price of approximately \$176.8 million, which, together with the THL and Oaktree investments, result in \$525 million in commitments. The completion of this transaction is subject to the approval of the Corporation's stockholders and regulators. If approved, the transaction is expected to close during the third quarter of 2011.

If the stockholders and regulators approve the \$525 million capital raise, the Corporation will issue 150 million shares of Common Stock at \$3.50 per share and will immediately exercise its right to compel the conversion of all of the outstanding Series G Preferred Stock, which is held by the U.S. Treasury, into approximately 32.9 million shares of Common Stock. Also, the Corporation plans to raise up to \$37.3 million through a Rights Offering, which will enable current stockholders to purchase up to approximately 10.7 million shares of Common Stock at the same \$3.50 price per share. The Corporation is expected to have nearly 229.98 million shares outstanding following the issuance of Common Stock to institutional investors and private equity firms, the conversion of the Series G Preferred Stock into Common Stock, the successful completion of the Rights Offering, and the issuance of shares upon the exercise of anti-dilution rights by certain of the institutional investors.

No assurance can be given that the Corporation's stockholders will approve, or that the Corporation will be able to complete, the sale of the \$525 million of common stock. If this transaction and the conversion of the Series G Preferred Stock are not completed, no assurance can be given that the Corporation will be able to sell common stock in other transactions or that any such transactions will be at a price as high as \$3.50. Moreover, if the capital raise is

not completed, there is no assurance that the Corporation will be able to satisfy the U.S. Treasury's requirement that the Corporation sell a minimum of \$350 million of common stock in order for the Corporation to compel the conversion of the Series G Preferred Stock into common stock. Finally, if the capital raise is not completed, no assurance can be given that the Corporation will be able to comply with the conditions of the Order that FirstBank entered into with the FDIC or the Agreement that the Corporation entered into with the FED.

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### ***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% 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 \$46.1 million is subordinated to the aggregate amount of its loans to CPG/GS in the amount of \$216.1 million as of June 30, 2011 and to the interest and priority return of CPG/GS majority investor.

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 financial condition or results of operations.

### ***Our credit quality may be adversely affected by Puerto Rico's current economic condition.***

A significant portion of our financial activities and credit exposure is concentrated in the Commonwealth of Puerto Rico, and Puerto Rico's economy continues to deteriorate. Since March 2006, a number of key economic indicators have shown that the economy of Puerto Rico has been in recession.

Construction has remained weak since 2009 as Puerto Rico's fiscal situation and decreasing public investment in construction projects has affected the sector. Although some improvement is suggested by the increase of 7.7% in cement sales during the five-month period ended May 31, 2011 as compared to the same period in 2010, since cement sales are an indicator of construction activity, it is too soon to know whether this improvement will continue.

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 1.8%, and an increase of 0.7% for Fiscal Year 2012. The Government Development Bank for Puerto Rico 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 2.1% in the rate of contraction of Puerto Rico's economy in the third quarter of Fiscal Year 2011 as compared to a decrease of 5.9% in the rate of contraction in the third quarter of Fiscal Year 2010.

The government of the Commonwealth of Puerto Rico is currently addressing a fiscal deficit, which in its initial stages was estimated at approximately \$3.2 billion or over 30% of its annual budget. It is implementing a multi-year budget plan for reducing the deficit, as its access to the municipal bond market and its credit ratings depend, in part, on achieving a balanced budget. Some of the measures implemented by the government include reducing expenses, including public-sector employment through 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 14.9% for the month of June 2011, a rate lower than the 16% for the month of May, and the 16.2% for June 2010. The economy of Puerto Rico is very sensitive to the price of oil in the global market. Puerto Rico does not have significant mass transit system available to the public and most of its electricity is powered by oil, making it highly sensitive to fluctuations in oil prices. A substantial increase in its price could impact adversely 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.

On August 8, 2011, Moody's downgraded the general obligation rating of the Commonwealth of Puerto Rico to Baa1 from A3 with a negative outlook. Moody's has also assigned the Baa1 rating and negative outlook to two upcoming series of bonds. The downgrade also applies to those ratings that are based on or capped at the general obligation rating of the commonwealth.

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**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not applicable.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. RESERVED**

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

See the Exhibit Index following the signature page to this Quarterly Report on Form 10-Q for a list of exhibits filed or furnished with this report, which Exhibit Index is incorporated herein by reference.

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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.**

Registrant

Date: August 15, 2011

By: /s/ Aurelio Alemán  
Aurelio Alemán  
President and Chief Executive Officer

Date: August 15, 2011

By: /s/ Orlando Berges  
Orlando Berges  
Executive Vice President  
and Chief Financial Officer

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**Exhibit Index**

- 12.1 Ratio of Earnings to Fixed Charges.
- 12.2 Ratio of Earnings to Fixed Charges and Preference Dividends.
- 31.1 CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101\*\* Interactive Data File (Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2011, furnished in XBRL (eXtensible Business Reporting Language))

\*\* To be filed by amendment as permitted by the 30-day grace period set forth in SEC Release No. 33-9002