



## 2013 ANNUAL REPORT

**1 First BanCorp**

# Financial Highlights

*In thousands (except for per share and ratio results)*

2013

2012

## FOR THE YEAR

Net interest income	\$ 514,945	\$ 461,705
Provision for loan and lease losses	243,751	120,499
Non-interest (loss) income	(15,489)	49,391
Non-interest expense	415,028	354,883
Income tax expense	(5,164)	(5,932)
Net (loss) income	\$ (164,487)	\$ 29,782
Net (loss) income attributable to common stockholders – basic	(164,487)	29,782
Net (loss) income attributable to common stockholders – diluted	(164,487)	29,782

## FINANCIAL RATIOS

Return on average assets (ROAA)	(1.28)%	0.23%
Return on average common equity (ROACE)	(13.01)%	2.14%
Interest rate margin <sup>1</sup>	4.21%	3.68%
Efficiency ratio	83.10%	69.44%

## PER COMMON SHARE

Basic (loss) income per share	\$ (0.80)	\$ 0.15
Diluted (loss) income per share	(0.80)	0.14
Cash dividends declared per share	—	—
Market price per common share <sup>2</sup>	6.19	4.58
Book value per common share	5.57	6.89
Tangible book value per common share	5.30	6.60
Average common shares outstanding	205,542	205,366
Average diluted common shares outstanding	205,542	205,828

## AT YEAR END

Assets	\$ 12,656,925	\$ 13,099,741
Loans	9,712,139	10,139,508
Allowance for loan and lease losses	285,858	435,414
Money market and investment securities	2,208,342	1,986,669
Deposits	9,879,924	9,864,546
Borrowings	1,431,959	1,640,399
Total equity	1,215,858	1,485,023
Tier 1 regulatory capital	1,484,490	1,640,082
Total regulatory capital	1,604,548	1,770,003

## CAPITAL RATIOS

Total capital	17.06%	17.82%
Tier 1 capital	15.78%	16.51%
Leverage	11.71%	12.60%

<sup>1</sup> Tax-equivalent basis.

<sup>2</sup> As of 12/31/2013 and 12/31/2012.

# Letter to Shareholders

*The year 2013 marked the celebration of First BanCorp's 65th anniversary. We are proud of our Corporation's history and grateful for the opportunity to serve the people and communities of Puerto Rico, the Eastern Caribbean and South Florida. We take great pride in making a positive impact on their quality of life and the strength of their businesses.*

**Our** Florida franchise continues to grow stronger and we view this market as well positioned for growth. We maintain a dominant position in the Eastern Caribbean region.

While Puerto Rico has taken many positive steps addressing fiscal policy issues and its liquidity, it continues to face economic hurdles as it enters its eighth consecutive year of recession. Despite these headwinds, our company and its dedicated management and engaged employees remain resolute in our efforts to successfully execute our strategic plan.

Our achievements during 2013 have produced both progress and momentum. As we mentioned in our shareholder letter last year, we have transitioned to an offensive posture following our successful recapitalization two years ago and made excellent progress in 2013 with respect to our primary objectives of improving our credit risk profile and building core franchise value, all while maintaining a strong capital position. From this strengthened

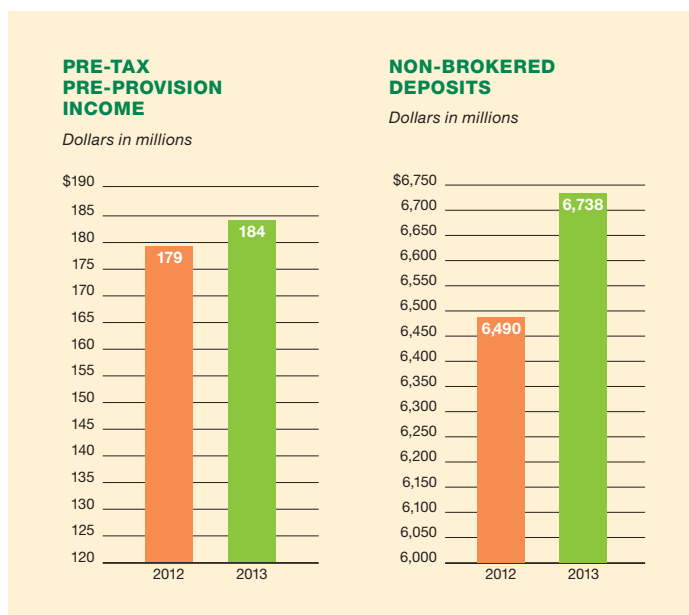
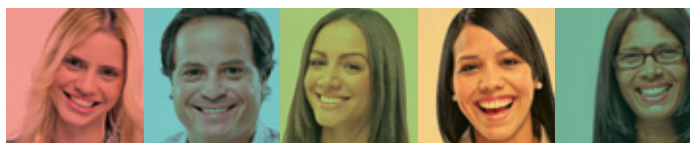


# 2013

## Accomplishments

**We made significant progress on a number of metrics as we moved forward with the execution of our strategic plan, guided by a detailed roadmap by business unit. During 2013, we achieved the following milestones:**

- Significant improvement in credit quality;
- Improved core profitability metrics;
- Continued building core franchise value; and
- Successful completion of a secondary offering.



position, we are looking forward to serving our customers and communities while growing our business. This letter will give you a high level overview of the successes we have achieved in a challenging economic environment and an evolving and demanding regulatory landscape.

### Asset Quality Significantly Improved

We made significant headway in the area of credit quality, having executed two large nonperforming bulk sale transactions, in the first half of 2013. For the year, including the write-down of collateral pledged to Lehman, nonperforming assets declined by \$513 million or 41% and nonperforming loans were reduced by \$427 million or 43%. Our nonperforming asset ratio for 2013 declined to 5.7% from 9.5% a year ago. We continue to move many complex credit cases to a position in which the assets can now be marketed and sold.

While we have come a long way in reducing asset quality concerns and de-risking the balance sheet, we recognize there is still more to be done. We continue to address legacy credit issues through workouts and OREO liquidation, as well as additional opportunistic sales of non-performing loans. We are well aware of the persistently challenging economic environment in which we operate and remain focused on further improving our asset quality metrics.

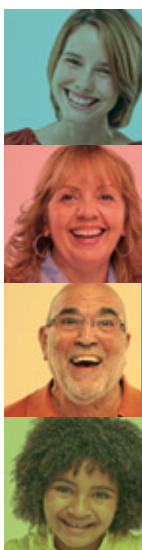
### Growth in Core Profitability

We are pleased to report that our core profitability metrics improved in 2013. While from a GAAP perspective we posted a net loss of \$165 million, excluding the impact of the bulk sale transactions and the write-off of the collateral pledged to Lehman and related fees, adjusted net income would have been \$45 million compared to \$30 million in 2012. Our pre-tax, pre-provision income grew from \$179 million in 2012 to \$184 million in 2013. Our improved performance in 2013, excluding bulk sale transactions, reflected lower credit losses on the commercial and construction loan portfolios and our focus on more profitable and diversified banking activities. Improvements in the funding mix, through growth in lower cost deposits and deposit pricing strategies, continued to impact net interest income and margin favorably.

Our net interest margin increased to 4.11% as compared to 3.64% in 2012 in spite of the low interest rate environment. We achieved this significant margin improvement through optimizing the mix of the loan portfolio and disciplined deposit pricing, as well as the repayment of higher cost borrowings. Our strategies to increase non-brokered deposits were successful, as these grew by \$248 million during 2013 while reducing reliance on brokered CDs by \$232 million. Our loan origination engines in commercial, consumer and mortgage continued to produce positive results with an increase of

approximately \$600 million to \$3.7 billion. Following the bulk sale transactions, we remain focused on rebuilding our commercial book, growing our consumer portfolio, including credit cards, and achieving growth in our Florida franchise where the economy is providing the opportunity.

As we continue to work toward increasing future profitability, through the de-risking of the balance sheet and the origination of quality loans, we maintain focus on the optimization of our expense base. While the cost of regulatory compliance has increased, together with the investment we have made in enhancing our technology infrastructure, our expense base is being aggressively managed. Nevertheless, it continues to be impacted by the credit related expenses of managing the non-performing and OREO portfolios. We view this as an opportunity for future profitability and efficiencies. Our increased core financial strength allows us to support our internal growth initiatives within the markets we serve in order to deliver high-quality banking and insurance products and services.



According to recent surveys, customers continue to rate **FirstBank** highly for its innovation and responsive and service focused employees.

## Core Franchise Continues to Grow Strong

With over 650,000 retail and commercial customers and more than 2,500 employees offering full retail and commercial banking services, First BanCorp is the second largest financial holding company in Puerto Rico in terms of asset size. We are the leading bank in the Virgin Islands with over 40% deposit market share and operate the largest branch and ATM network, and we have a strategic presence in the fast-growing south Florida region. According to recent surveys, customers continue to rate FirstBank highly for its innovation and responsive and service focused employees. With an attractive business mix, substantial loan share, an expanding product suite, and a strong capital base, our Company is poised to further expand customer relationships and cross selling opportunities.

We have leveraged our broadly recognized brand to increase deposits in our banking operations. Successful execution of our core deposit growth strategy during the year continued improving the composition of our deposit mix. With the recent launch of new deposit products, such as remote deposit capture and cash vault, and the enhancement of cash management and mobile and transaction banking services, we continue to complement our offering while reaching diverse segments.

We also continued to expand our consumer and residential banking business and our commitment to the local economy and the communities we serve. Residential mortgage originations increased approximately \$75 million in 2013 to \$831 million. We further contributed to Puerto Rico's economy by providing over \$1.7 billion in financing to commercial customers and governmental institutions.



The vitality of our communities is critical to our success. During 2013 FirstBank participated in approximately 300 financial literacy events across its territories with over 11,000 attendees for the



We continue to make a positive difference in the growth and stability of our communities.

promotion of education and financial literacy, housing and economic development, community and social development, and environmental and community revitalization programs. We continue to make a positive difference in the growth and stability of our communities.

### **Successful Completion of Secondary Offering**

During the third quarter, we successfully completed a \$209 million secondary offering, representing 31 million shares for the U.S. Treasury and our two large private equity investors reducing their ownership positions to 10 percent and 20 percent, respectively.

In addition, throughout 2013 senior management had an active investor schedule including several conferences and a non-deal road show through the Midwest. In total, management held over 140 one-on-one meetings. The goal of these meetings and the secondary offering is to further increase our institutional investor base and enhance the public float in our stock.

### **Moving Closer to Our Vision**

First BanCorp's strength, stability and reputation, are attributable to many factors. Led by our outstanding leadership team and dedicated hard-working employees, we have navigated many challenges and persevered in spite of market headwinds. Everything we do reflects our commitment to increasing shareholder value, to serving our customers and communities, engaging our employees and to fulfilling our vision to be the most highly regarded financial institution within the markets we serve. As we celebrate our 65th anniversary, we are keenly aware of the value of our franchise and the impact we have on our communities. We have more work ahead and embrace the challenge as we strive to increase the quality of earnings of our Company. We remain focused on the execution of our strategic plan and ultimately value creation for our shareholders.

Sincerely,

**Roberto R. Herencia**  
Chairman of the Board

**Aurelio Alemán**  
President and Chief Executive Officer

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-K**

(Mark one)

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

**For the Fiscal Year Ended December 31, 2013**

**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 No.)

**1519 Ponce de León Avenue, Stop 23**

**Santurce, Puerto Rico**

(Address of principal executive office)

**00908**

(Zip Code)

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

(787) 729-8200

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

**Common Stock (\$0.10 par value)**

**New York Stock Exchange**

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

**7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A (CUSIP: 318672201);**

**8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B (CUSIP: 318672300);**

**7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C (CUSIP: 318672409);**

**7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D (CUSIP: 318672508; and**

**7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E (CUSIP: 318672607)**

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 28, 2013 (the last trading day of the registrant's most recently completed second quarter) was \$384,939,642 based on the closing price of \$7.08 per share of common stock on the New York Stock Exchange on June 28, 2013. The registrant had no nonvoting common equity outstanding as of June 28, 2013. For the purposes of the foregoing calculation only, the registrant has defined affiliates to include (a) the executive officers named in Part III of this Annual Report Form 10-K; (b) all directors of the registrant; and (c) each shareholder, including the registrant's employee benefit plans, known to the registrant to be the beneficial owner of 5% or more of the outstanding shares of common stock of the registrant as of June 28, 2013. The registrant's response to this item is not intended to be an admission that any person is an affiliate of the registrant for any purposes other than this response.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 207,101,964 shares as of March 7, 2014.

**FIRST BANCORP**  
**2013 ANNUAL REPORT ON FORM 10-K**

**TABLE OF CONTENTS**

**PART I**

Item 1. Business .....	3
Item 1A. Risk Factors .....	30
Item 1B. Unresolved Staff Comments .....	52
Item 2. Properties .....	52
Item 3. Legal Proceedings .....	53
Item 4. Mine Safety Disclosure .....	53

**PART II**

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities .....	54
Item 6. Selected Financial Data .....	59
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations .....	61
Item 7A. Quantitative and Qualitative Disclosures About Market Risk .....	165
Item 8. Financial Statements and Supplementary Data .....	166
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure .....	277
Item 9A. Controls and Procedures .....	277
Item 9B. Other Information .....	277

**PART III**

Item 10. Directors, Executive Officers and Corporate Governance .....	278
Item 11. Executive Compensation .....	278
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters .....	278
Item 13. Certain Relationships and Related Transactions, and Director Independence .....	278
Item 14. Principal Accounting Fees and Services .....	278

**PART IV**

Item 15. Exhibits, Financial Statement Schedules .....	279
<b>SIGNATURES</b> .....	285



## Forward Looking Statements

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to the safe harbor created by such sections. When used in this Form 10-K or future filings by First BanCorp. (the “Corporation”) with the U.S. 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 to advise readers that various factors, including but not limited to the following, could cause actual results to differ materially from those expressed in, or implied by such “forward-looking statements”:

- uncertainty about whether the Corporation and FirstBank Puerto Rico (“FirstBank” or “the Bank”) 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 “New York FED” or “Federal Reserve”) and the consent order dated June 2, 2010 (the “FDIC Order”) and together with the Written Agreement, (the “Agreements”) that the Corporation’s banking subsidiary, FirstBank entered into with the Federal Deposit Insurance Corporation (“FDIC”) and the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico (“OCIF”) that, among other things, require the Bank to maintain certain capital levels and reduce its special mention, classified, delinquent and non-performing assets;
- the risk of being subject to possible additional regulatory actions;
- uncertainty as to the availability of certain funding sources, such as retail brokered certificates of deposit (“brokered CDs”);
- the Corporation’s reliance on brokered CDs and its ability to obtain, on a periodic basis, approval from the FDIC to issue brokered CDs to fund operations and provide liquidity in accordance with the terms of the FDIC Order;
- the risk of not being able to fulfill the Corporation’s cash obligations or resume paying dividends to the Corporation’s stockholders in the future due to the Corporation’s inability to receive approval from the New York FED or the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) to receive dividends from FirstBank or FirstBank’s failure to generate sufficient cash flow to make a dividend payment to the Corporation;
- 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, which has contributed and may continue to contribute to, among other things, the high levels of non-performing assets, charge-offs, and provisions and may subject the Corporation to further risk from loan defaults and foreclosures;
- the ability of FirstBank to realize the benefit of the deferred tax asset;
- adverse changes in general economic conditions in Puerto Rico, the United States (“U.S.”), and the U.S. Virgin Islands (“USVI”), and British Virgin Islands (“BVI”), including the interest rate environment, 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 reduce the Corporation’s revenues and earnings 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, the current fiscal problems and budget deficit of the Puerto Rico government and recent credit downgrades of the Puerto Rico government;
- a credit default by the Puerto Rico government or any of its public corporations or other instrumentalities, and recent and any future downgrades of the long-term debt ratings of the Puerto Rico government, which could adversely affect economic conditions in Puerto Rico;
- the risk that any portion of the unrealized losses in the Corporation’s investment portfolio is determined to be other-than-temporary, including unrealized losses on Puerto Rico government obligations;
- uncertainty about regulatory and legislative changes for financial services companies in Puerto Rico, the U.S., and the USVI and BVI, which could affect the Corporation’s financial condition or performance and could cause the Corporation’s actual results for future periods to differ materially from prior results and anticipated or projected results;
- changes in the fiscal and monetary policies and regulations of the federal government, including those determined by the Federal Reserve Board, the New York Fed, the FDIC, government-sponsored housing agencies, and regulators in Puerto Rico and the USVI and BVI;
- the risk of possible failure or circumvention of controls and procedures and the risk that the Corporation’s risk management policies may not be adequate;
- the risk that the FDIC may further increase the deposit insurance premium and/or require special assessments to replenish its insurance fund, causing an additional increase in the Corporation’s non-interest expenses;
- the impact on the Corporation’s results of operations and financial condition of acquisitions and dispositions;
- a need to recognize additional impairments on financial instruments, goodwill or other intangible assets relating to acquisitions;
- risks that downgrades in the credit ratings of the Corporation’s long-term senior debt will adversely affect the Corporation’s ability to access necessary external funds;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) on the Corporation’s businesses, business practices and cost of operations;
- the risk of losses in the value of investments in unconsolidated entities that the Corporation does not control; and
- general competitive factors and industry consolidation.

The Corporation does not undertake, and specifically disclaims any obligation, to update any “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 Item 1A. Risk Factors, in this Annual Report on Form 10-K, for a discussion of such factors and certain risks and uncertainties to which the Corporation is subject.

## **PART I**

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

### **Item 1. Business**

#### **GENERAL**

First BanCorp. is a publicly owned financial holding company that is subject to regulation, supervision and examination by the Federal Reserve Board. The Corporation was incorporated under the laws of the Commonwealth of Puerto Rico to serve as the bank holding company for FirstBank. The Corporation is a full service provider of financial services and products with operations in Puerto Rico, the United States and the USVI and BVI. As of December 31, 2013, the Corporation had total assets of \$12.7 billion, total deposits of \$9.9 billion and total stockholders’ equity of \$1.2 billion.

The Corporation provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2013, the Corporation controlled two wholly owned subsidiaries: FirstBank and FirstBank Insurance Agency, Inc. (“FirstBank Insurance Agency”). FirstBank is a Puerto Rico-chartered commercial bank, and FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency.

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

FirstBank conducts its business through its main office located in San Juan, Puerto Rico, 47 banking branches in Puerto Rico, 12 branches in the USVI and BVI and 10 branches in the state of Florida (USA). FirstBank has 5 wholly owned subsidiaries with operations in Puerto Rico: First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance company specializing in the origination of small loans with 26 offices in Puerto Rico; First Mortgage, Inc. (“First Mortgage”), a residential mortgage loan origination company with 37 offices in FirstBank branches and at stand-alone sites; First Management of Puerto Rico, a domestic corporation which holds tax-exempt assets; FirstBank Puerto Rico Securities Corp., a broker-dealer subsidiary engaged in municipal bond underwriting and financial advisory services on structured financings principally provided to government entities in the Commonwealth of Puerto Rico; and FirstBank Overseas Corporation, an international banking entity organized under the International Banking Entity Act of Puerto Rico. FirstBank had one active subsidiary with operations outside of Puerto Rico: First Express, a finance company specializing in the origination of small loans with 2 offices in the USVI.

#### **BUSINESS SEGMENTS**

The Corporation has six reportable segments: Consumer (Retail) Banking; Commercial and Corporate Banking; Mortgage Banking; Treasury and Investments; United States Operations; and Virgin Islands Operations. These segments are described below as well as in Note 31, “Segment Information,” to the Corporation’s audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K.

##### ***Consumer (Retail) Banking***

The Consumer (Retail) Banking segment consists of the Corporation’s consumer lending and deposit-taking activities conducted mainly through FirstBank’s branch network and loan centers in Puerto Rico. Loans to consumers include auto, boat and personal loans, credit cards, and lines of credit. Deposit products include

interest bearing and non-interest bearing checking and savings accounts, Individual Retirement Accounts (IRA) and retail certificates of deposit. Retail deposits gathered through each branch of FirstBank's retail network serve as one of the funding sources for the lending and investment activities.

### ***Commercial and Corporate Banking***

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

### ***Mortgage Banking***

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

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

### ***Treasury and Investments***

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

### ***United States Operations***

The United States Operations segment consists of all banking activities conducted by FirstBank in the United States mainland. FirstBank provides a wide range of banking services to individual and corporate

customers primarily in southern Florida through its 10 branches. Our success in attracting core deposits in Florida has enabled us to become less dependent on brokered CDs. The United States Operations segment offers an array of both retail and commercial banking products and services. Consumer banking products include checking, savings and money market accounts, retail certificates of deposit (“retail CDs”), internet banking services, residential mortgages, home equity loans, lines of credit, and automobile loans. Deposits gathered through FirstBank’s branches in the United States also serve as one of the funding sources for lending and investment activities in Puerto Rico.

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

### ***Virgin Islands Operations***

The Virgin Islands Operations segment consists of all banking activities conducted by FirstBank in the USVI and BVI, including retail and commercial banking services, with a total of twelve branches serving the islands in the USVI of St. Thomas, St. Croix, and St. John, and the islands in the BVI of Tortola and Virgin Gorda. The Virgin Islands Operations segment is driven by its consumer, commercial lending and deposit-taking activities.

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

### **Employees**

As of December 31, 2013, the Corporation and its subsidiaries employed 2,458 persons. None of its employees are represented by a collective bargaining group. The Corporation considers its employee relations to be good.

## **SIGNIFICANT EVENTS SINCE THE BEGINNING OF 2013**

### ***Bulk Sales of Assets and Transfer of Loans to Held for Sale***

On March 28, 2013, the Corporation completed the sale of adversely classified loans with a book value of \$211.4 million (\$100.1 million of commercial and industrial loans, \$68.8 million of commercial mortgage loans, \$41.3 million of construction loans, and \$1.2 million of residential mortgage loans), and \$6.3 million of OREO properties in a cash transaction. Included in the bulk sale was \$185.0 million of non-performing assets. The sales price of this bulk sale was \$120.2 million. Approximately \$39.9 million of reserves had already been allocated to the loans. This transaction resulted in total charge-offs of \$98.5 million and an incremental loss of \$58.9 million, reflected in the provision for loan and lease losses for the year 2013. In addition, the Corporation recorded \$3.9 million of professional fees specifically related to this bulk sale of assets. This transaction resulted in a total pre-tax loss of \$62.8 million.

In addition, during the first quarter of 2013, the Corporation transferred to held for sale non-performing loans with an aggregate book value of \$181.6 million. These transfers resulted in charge-offs of \$36.0 million and an incremental loss of \$5.2 million reflected in the provision for loan and lease losses for the year 2013.

During the second quarter of 2013, the Corporation completed the sale of a \$40.8 million non-performing commercial mortgage loan that was among the loans transferred to held for sale in the first quarter without incurring additional losses.

On June 21, 2013, the Corporation announced that it had completed a sale of non-performing residential mortgage loans with a book value of \$203.8 million and other real estate owned (“OREO”) properties with a book value of \$19.2 million in a cash transaction. The sales price of this bulk sale was \$128.3 million. Approximately \$30.1 million of reserves had already been allocated to the loans. This transaction resulted in total charge-offs of \$98.0 million and an incremental loss of \$69.8 million, of which \$67.9 million was reflected in the provision for loan and lease losses and \$1.9 million was reflected as part of net loss on OREO operations for the year 2013. In addition, the Corporation recorded \$3.1 million of professional service fees specifically related to this bulk sale of non-performing residential assets. This transaction resulted in a total pre-tax loss of \$72.9 million.

In separate transactions during 2013, the Corporation foreclosed on the collateral underlying \$39.2 million related to one of the loans written-off and transferred to held for sale in the first quarter. The Corporation recorded losses of \$4.9 million in 2013 related to this loan after the transfer to held for sale (\$1.7 million of lower of cost or market adjustment and \$3.2 million of write-downs to the value of foreclosed properties, recorded as part of net loss on OREO operations in the consolidated statement of income (loss)).

Furthermore, in the third quarter of 2013, approximately \$6.4 million of construction loan held for sale participations were paid-off, resulting in a gain of \$0.3 million included as part of “Other income” in the consolidated statement of income (loss).

The Corporation’s primary goal with respect to these sales has been to accelerate the disposition of non-performing assets, which is the main priority of the Corporation’s Strategic Plan. The opportunistic sale of distressed assets is a pivotal and tactical step in the Corporation’s efforts to reduce balance sheet risk, improve earnings in the future through reductions of credit related costs and enhance credit quality consistent with regulators’ expectations of adequate levels of adversely classified assets for financial institutions.

#### ***Impairment of Collateral Pledged to Lehman Brothers, Inc. (“Lehman”)***

On May 10, 2013, the Corporation received notice from its counsel that the United States Bankruptcy Court for the Southern District of New York had denied the Bank’s Motion for Summary Judgment filed in connection with its claim to recover certain assets pledged as collateral to Lehman and that the Motion for Summary Judgment submitted by Barclays Capital (“Barclays”) had been granted.

This matter relates to the claim that the Bank filed against Barclays to recover the securities (or the cash equivalent thereof) that were posted as collateral in connection with certain interest rate swap agreements executed with Lehman. Beginning with the second quarter of 2009, the Corporation classified the pledged securities as a non-performing asset with a book value of \$64.5 million. As a result of the Bankruptcy Court’s May 10, 2013 decision, the Corporation determined that it is probable that the asset is impaired and, in the 2013 second quarter, recorded a non-cash charge of \$66.6 million associated with the write-off of the carrying value of the pledged securities and related accrued interest. The Corporation has filed a Notice of Appeal and will continue with its efforts through the legal process to recover the value of the assets.

On December 3, 2013, the Bankruptcy Court issued a memorandum decision granting Barclays’ motion for civil contempt sanctions, in which the Bankruptcy Court granted Barclays entitlement to an award of sanctions from the Bank and directed the parties to meet and confer in an attempt to reach consensus on the award of sanctions. The parties have agreed that \$2.5 million represents an appropriate compromise as to the amount of reasonable counsel fees to which Barclays would be entitled to in the event that the Bankruptcy Court’s decision to award Barclays attorney fees is affirmed through the appeals process. A loss contingency of \$2.5 million was accrued in the fourth quarter of 2013.



### ***Secondary Offering***

On August 16, 2013, a secondary offering of the Corporation's common stock was completed by certain of the Corporation's existing stockholders. The United States Department of the Treasury ("Treasury") sold 12 million shares of common stock, funds affiliated with Thomas H. Lee Partners ("THL") sold 8 million shares of common stock, and funds managed by Oaktree Capital Management, L.P. ("Oaktree") sold 8 million shares of common stock. On September 11, 2013, the underwriters exercised their option to purchase an additional 2.9 million shares of common stock from the selling stockholders. The Corporation did not receive any proceeds from the offering. Non-interest expenses for 2013 included approximately \$1.7 million in costs associated with the secondary offering, including \$1.1 million paid by the Corporation for underwriting discounts and commissions. As of March 7, 2014, each of THL and Oaktree owns 20.21% of the Corporation's outstanding common stock and the U.S. Treasury owns 9.50% of such stock.

### ***Changes to the Puerto Rico Internal Revenue Code***

On June 30, 2013, the Puerto Rico Government approved Act No. 40 ("Act 40"), which amended the Puerto Rico Internal Revenue Code of 2011 (the "2011 PR Code"). The main provisions of Act 40 that impacted financial institutions include:

- (i) A new national gross receipts tax that in the case of financial institutions is 1% of gross income that is not deductible for purposes of computing net taxable income and is not part of the alternative minimum tax ("AMT"). This provision was retroactive to January 1, 2013. An expense of \$5.9 million was recorded during the year 2013 related to the national gross receipts tax. This expense is included as part of "Taxes, other than income taxes" in the consolidated statement of (loss) income. Subject to certain limitations, a financial institution will be able to claim a credit of 0.5% of its gross income against its regular income tax or the alternative minimum tax. A \$3.0 million benefit related to this credit was recorded as a reduction to the provision for income taxes in 2013.
- (ii) A decrease in the deduction available to corporations for the computation of the additional surtax from \$750,000 to \$25,000 and a change in the surtax rate to rates that range from 5% to 19%, resulting in an increase in the maximum statutory tax rate from 30% to 39%. This provision was also retroactive to January 1, 2013. The effect on operating results in 2013 related to these changes was a net benefit of approximately \$1.3 million, mainly due to the increase in the deferred tax asset of profitable subsidiaries. The deferred tax valuation allowance increased to \$522.7 million as of December 31, 2013 from \$359.9 million at December 31, 2012 as a result of changes in tax rates and operating results for the year.
- (iii) A higher AMT rate (30% of the alternative minimum net income, as compared to 20% previously) and various parallel computations required to be made before determining whether an AMT liability exists. This change did not have an impact on the Corporation's provision for income taxes recorded in 2013.
- (iv) The NOL carryover period increased from 10 years to 12 years for losses incurred in taxable years that commenced after December 31, 2004 and ended before January 1, 2013. The carryover period for NOLs incurred during taxable years commencing after December 31, 2012 is 10 years. The NOL deduction is now limited to 90% of taxable income for regular income tax purposes and 80% for AMT purposes.

### **WEBSITE ACCESS TO REPORT**

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

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

- Code of Ethics for CEO and Senior Financial Officers
- Code of Ethics applicable to all employees
- Corporate Governance Standards
- Independence Principles for Directors
- Luxury Expenditure Policy

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

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

## **MARKET AREA AND COMPETITION**

Puerto Rico, where the banking market is highly competitive, is the main geographic service area of the Corporation. As of December 31, 2013, the Corporation also had a presence in the state of Florida and in the United States and British Virgin Islands. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States mainland.

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

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

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

## SUPERVISION AND REGULATION

### *Recent Events Affecting the Corporation*

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

***Dodd-Frank Act.*** As a result of the Dodd-Frank Act, which became law on July 21, 2010, there has been and will be in the future additional regulatory oversight and supervision of the bank holding company and its subsidiaries.

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

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

On June 29, 2011, the Federal Reserve Board approved a final debit card interchange rule, which is now fully operational. The rule caps a debit card issuer's base fee at 21 cents per transaction and allows an additional 5 basis-point charge per transaction to help cover fraud losses. The debit card interchange rule reduced our interchange fee revenue in line with industry-wide expectations, beginning with the quarter ended December 31, 2011. The new pricing negatively impacted FirstBank fee income by an approximate \$2.0 million in 2012.

The Dodd-Frank Act also includes provisions that affect corporate governance and executive compensation at all publicly-traded companies and allows financial institutions to pay interest on business checking accounts. The legislation also restricts proprietary trading, places restrictions on the owning or sponsoring of hedge and private equity funds, and regulates the derivatives activities of banks and their affiliates. The Dodd-Frank Act established the Financial Stability Oversight Council, which identifies threats to the financial stability of the U.S., promote market discipline, and respond to emerging threats to the stability of the U.S. financial system.

Section 171 of the Dodd-Frank Act ("the Collins Amendment"), among other things, eliminates certain trust-preferred securities from Tier I capital. Preferred securities issued under the U.S. Department of the Treasury's (the "Treasury") Troubled Asset Relief Program ("TARP") are exempt from this treatment. Bank

holding companies, such as the Corporation, must fully phase out these instruments from Tier 1 capital by January 1, 2016 (25% allowed in 2015 and 0% in 2016); however, these instruments may remain in Tier 2 capital until the instruments are redeemed or mature.

**Regulatory Capital Developments.** On July 2, 2013, the federal banking agencies adopted final rules for U.S. banks that revise important aspects of the minimum regulatory capital requirements, the components of regulatory capital, and the risk-based capital treatment of bank assets and off-balance sheet exposures. The final rules, with which the Corporation and our subsidiary bank must comply beginning January 1, 2015, generally are intended to align U.S. regulatory capital requirements with international regulatory capital standards adopted by the Basel Committee on Banking Supervision, in particular the most recent international capital accord adopted in 2010 (and revised in 2011) known as “Basel III.” The new rules will increase the quantity and quality of capital required by, among other things, establishing a new minimum common equity Tier 1 ratio of 4.5% of risk-weighted assets and an additional common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. In addition, banks and bank holding companies are required to have a Tier 1 leverage ratio of 4.0%, a Tier 1 risk-based ratio of 6.0% and a total risk-based ratio of 8.0%. The final rules also revise the definition of capital by expanding the conditions for the inclusion of equity capital instruments and minority interests as Tier 1 capital, and will impose limitations on capital distributions and certain discretionary bonus payments if additional specified amounts, or “buffers,” of common equity Tier 1 capital are not met.

Consistent with Basel III and the Collins Amendment, the final rules also establish a more conservative standard for including an instrument such as trust-preferred securities as Tier 1 capital for bank holding companies with total consolidated assets of \$15 billion or more as of December 31, 2009. Bank holding companies such as the Corporation must fully phase out these instruments from Tier I capital by January 1, 2016, although qualifying trust preferred securities may be included as Tier 2 capital until the instruments are redeemed or mature. As of December 31, 2013, the Corporation had \$225 million in trust preferred securities that are subject to the phase-out from Tier 1 capital under the final regulatory capital rules discussed above.

In addition, the final rules revise and harmonize the bank regulators’ rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses that have been identified, by applying a variation of the Basel III “standardized approach” for the risk-weighting of bank assets and off-balance sheet exposures to all U.S. banking organizations other than large, internationally active banks.

The final capital rules will become effective for the Corporation and our subsidiary bank on a multi-year transitional basis starting on January 1, 2015, and in general will be fully effective as of January 1, 2019. We generally expect that the final rules will increase our regulatory capital requirements and will require us to hold more capital against certain of our assets and off-balance sheet exposures. The Corporation’s estimated pro-forma common equity Tier 1 ratio, Tier 1 capital ratio, total capital ratio, and the leverage ratio under the Basel III rules, giving effect as of December 31, 2013 to all the provisions that will be phase-in between January 1, 2015 and January 1, 2019, was 11.4%, 12.0%, 15.5%, and 9.8%, respectively. These ratios would exceed the fully phased-in minimum capital ratios under Basel III. Future estimates of the regulatory capital ratios under the Basel III rules may change over time as a result of further federal banking agency rulemaking or clarification.

**Prudential Regulation Developments.** In May 2012, the federal banking agencies issued general supervisory guidance for stress testing practices applicable to banking organizations with more than \$10 billion in total consolidated assets, such as us and our subsidiary bank, which became effective on July 23, 2012. This guidance outlines broad principles for a satisfactory stress testing framework, including principles related to governance, controls and use of results, and describes various stress testing approaches and how stress testing should be used at various levels within an organization. On October 9, 2012, the Federal Reserve Board and the other federal banking agencies issued a final rule implementing the requirements of the Dodd-Frank Act that generally requires bank holding companies with total consolidated assets of between \$10 billion and \$50 billion to comply with annual company-run stress testing requirements beginning in September 2013.

On February 1, 2014, the Federal Reserve approved a final rule strengthening supervision and regulation of large U.S. bank holding companies and foreign banking organizations, as required by the Dodd-Frank Act. Most of its enhanced prudential standards apply only to institutions with total consolidated assets of \$50 billion or more, which would not affect the Corporation. The final rule, however, requires publicly traded U.S. bank holding companies with total consolidated assets of \$10 billion or more, such as the Corporation, to establish enterprise-wide risk committees. These new requirements complement the stress testing and resolution planning requirements for large bank holding companies that the Federal Reserve previously finalized. The final rule does not make any changes to the company-run stress-testing requirements for bank holding companies with total consolidated assets of between \$10 billion and \$50 billion that were adopted in October 2012. The Corporation must comply with these new requirements by January 1, 2015. The final rule requires the Corporation's risk management framework to be commensurate with the Corporation's structure, risk profile, complexity, activities and size, and must include policies and procedures establishing risk-management governance, risk-management policies, and risk control infrastructure for the Corporation's global operations and processes and systems for implementing and monitoring compliance with such policies and procedures. Requirements applicable to the risk committee include a requirement that one independent director chair the committee, with the Corporation determining the appropriate proportion of independent directors on the committee, based on its size, scope, and complexity, provided that it meets the minimum requirement of one independent director. Also, at least one director with risk-management experience must be appointed to the risk committee.

On March 5, 2014, the Federal Reserve Board and the other federal banking agencies published final supervisory guidance (which was previously proposed for comment in July 2013) describing their supervisory expectations for the Dodd-Frank Act stress tests to be conducted by financial institutions, including the Corporation and the Bank. The final guidance provides flexibility to accommodate different risk profiles, sizes, business lines, market areas, and complexity approaches for banking institutions in the \$10 billion to \$50 billion asset range, and provide examples of practices that would be consistent with supervisory expectations. Affected banking organizations, including the Corporation, are required to perform their first Dodd-Frank Act stress tests by March 31, 2014. The final guidance also confirms that banking organizations with assets between \$10 billion and \$50 billion are not subject to the Federal Reserve Board capital plan rule, annual Comprehensive Capital Analysis and Review, Dodd-Frank Act supervisory stress tests, or related data collections, which apply to bank holding companies with assets of at least \$50 billion.

*Consumer Financial Protection Bureau.* On January 10, 2013, the CFPB issued a final regulation defining a "qualified mortgage" for purposes of the Dodd-Frank Act, and setting standards for mortgage lenders to determine whether a consumer has the ability to repay the mortgage. This regulation also affords safe harbor legal protections for lenders making qualified loans that are not "higher priced." It is unclear how this regulation, or this regulation in tandem with an anticipated rule defining "qualified residential mortgage" and setting standards governing loans that are to be packaged and sold as securities, will affect the mortgage lending market by potentially curbing competition, increasing costs or tightening credit availability.

On January 17, 2013, the CFPB issued a final regulation containing new mortgage servicing rules that took effect in January 2014 and are applicable to our bank subsidiary. The announced goal of the CFPB is to bring greater consumer protection to the mortgage servicing market.

These changes affect notices given to consumers as to delinquency, foreclosure alternatives, modification applications, interest rate adjustments and options for avoiding "force-placed" insurance. Servicers are prohibited from processing foreclosures when a loan modification is pending, and must wait until a loan is more than 120 days delinquent before initiating a foreclosure action.

The servicer must provide direct and ongoing access to its personnel, and provide prompt review of any loss mitigation application. Servicers must maintain accurate and accessible mortgage records for the life of a loan and until one year after the loan is paid off or transferred. These new standards are expected to add to the cost of conducting a mortgage servicing business.



*The Volcker Rule.* This section of the Dodd-Frank Act generally, subject to important exceptions, prohibits a banking entity such as the Corporation or FirstBank from acquiring or retaining any ownership in, or acting as sponsor to, a hedge fund or private equity fund. The Volcker Rule also prohibits these entities from engaging, for their own account, in short-form proprietary trading of certain securities, derivatives, commodity futures and options on these instruments.

Final regulations implementing the Volcker Rule were adopted by the financial regulatory agencies on December 10, 2013. The regulations will become effective on April 1, 2014, but affected banking organizations generally will have until July 21, 2015 to bring their proprietary trading and private fund activities into conformance with the Volcker Rule and the new regulations. Banking organizations are expected to engage in “good faith efforts” to bring all of their covered activities into compliance by the July 2015 conformance date. The Corporation does not believe that it engages in any significant amount of proprietary trading as defined in the Volcker Rule and that any impact would be minimal. In addition, a review of the Corporation’s investments was undertaken to determine if any meet the Volcker Rule’s definition of covered funds. Based on that review, the Corporation’s investments are not considered covered funds under the Volcker Rule.

*Future Legislation and Regulation.* Additional consumer protection laws have recently been enacted, and the FDIC, Federal Reserve and CFPB have adopted and will adopt in the future numerous new regulations addressing banks’ credit card, overdraft, collection, privacy and mortgage lending practices. Additional consumer protection legislation and regulatory activity is anticipated in the near future.

Such proposals and legislation, if finally adopted and implemented, would change banking laws and our operating environment and that of our subsidiaries in ways that could be substantial and unpredictable. We cannot determine whether such proposals and legislation will be adopted, or the ultimate effect that such proposals and legislation, if enacted, or regulations issued to implement the same, would have upon our financial condition or results of operations.

*International Action.* Internationally, both the Basel Committee on Banking Supervision and the Financial Stability Board (established in April 2009 by the Group of Twenty (“G-20”) Finance Ministers and Central Bank Governors to take action to strengthen regulation and supervision of the financial system with greater international consistency, cooperation and transparency) have committed to raise capital standards and liquidity buffers within the banking system under Basel III. On September 12, 2010, the Group of Governors and Heads of Supervision agreed to the calibration and phase-in of the Basel III minimum capital requirements (raising the minimum Tier 1 equity ratio to 6.0%, with full implementation by January 2015) and introducing a capital conservation buffer of common equity of an additional 2.5% with implementation by January 2019. U.S. bank regulators approved a revised regulatory capital framework for implementing Basel III in July 2013 (see discussion above).

The U.S. banking regulators are also expected to adopt regulatory liquidity requirements, including a liquidity coverage ratio (LCR) and a net stable funding ratio (NSFR), which are intended to ensure that firms hold sufficient liquid assets over different time horizons to fund operations if other funding sources are unavailable. On January 6, 2013, the Basel Committee announced that its liquidity requirements would be phased-in annually beginning in 2015, when the minimum liquidity ratio requirement would be set at 60% of required liquidity, then increasing an additional 10% annually until fully implemented on January 1, 2019. Additionally, although the timing is uncertain, the U.S. banking regulators are expected to propose and enact rules regarding the NSFR.

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

The Corporation is subject to ongoing regulation, supervision, and examination by the Federal Reserve Board, and is required to file with the Federal Reserve Board periodic and annual reports and other information concerning its own business operations and those of its subsidiaries. In addition, the Corporation is subject to



regulation under the Bank Holding Company Act of 1956, as amended (the “Bank Holding Company Act” or “BHC Act”). Under the provisions of the Bank Holding Company Act, a bank holding company must obtain Federal Reserve Board approval before it acquires direct or indirect ownership or control of more than 5% of the voting shares of another bank, or merges or consolidates with another bank holding company. The Federal Reserve Board also has authority under certain circumstances to issue cease and desist orders against bank holding companies and their non-bank subsidiaries.

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

Under provisions in the Dodd-Frank Act and Federal Reserve Board policy, a bank holding company such as the Corporation is expected to act as a source of financial strength to its banking subsidiaries and to commit support to them. This support may be required at times when, absent such policy, the bank holding company might not otherwise provide such support. In the event of a bank holding company’s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks must be subordinated in right of payment to deposits and to certain other indebtedness of such subsidiary bank. As of December 31, 2013, and the date hereof, FirstBank was and is the only depository institution subsidiary of the Corporation.

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

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

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

Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The GLB Act specifically provides that the following activities have been determined to be “financial in nature”: (a) lending, trust and other banking activities; (b) insurance activities; (c) financial or economic

advice or services; (d) pooled investments; (e) securities underwriting and dealing; (f) existing bank holding company domestic activities; (g) existing bank holding company foreign activities; and (h) merchant banking activities. The merchant banking activities have been substantially curtailed by the Volcker Rule provisions in the Dodd-Frank Act.

The Corporation offers insurance agency services through its wholly owned subsidiary, FirstBank Insurance Agency. In association with JP Morgan Chase, the Corporation, through FirstBank Puerto Rico Securities, Inc., a wholly owned subsidiary of FirstBank, also offers municipal bond underwriting services focused mainly on municipal and government bonds or obligations issued by the Puerto Rico government and its public corporations. Additionally, FirstBank Puerto Rico Securities, Inc. offers financial advisory services.

### ***Sarbanes-Oxley Act***

The Sarbanes-Oxley Act of 2002 (“SOX”) implemented a range of corporate governance and other measures to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of disclosures under the federal securities laws. In addition, SOX has established membership requirements and responsibilities for the audit committee, imposed restrictions on the relationship between the Corporation and external auditors, imposed additional responsibilities for the external financial statements on our chief executive officer and chief financial officer, expanded the disclosure requirements for corporate insiders, required management to evaluate its disclosure controls and procedures and its internal control over financial reporting, and required the auditors to issue a report on the internal control over financial reporting.

The Corporation includes in its annual report on Form 10-K its management’s assessment regarding the effectiveness of the Corporation’s internal control over financial reporting. The internal control report includes a statement of management’s responsibility for establishing and maintaining adequate internal control over financial reporting for the Corporation; management’s assessment as to the effectiveness of the Corporation’s internal control over financial reporting based on management’s evaluation, as of year-end; and the framework used by management as criteria for evaluating the effectiveness of the Corporation’s internal control over financial reporting. As of December 31, 2013, First BanCorp’s management concluded that its internal control over financial reporting was effective. The Corporation’s independent registered public accounting firm reached the same conclusion.

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

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

The Corporation applied for, and the Treasury approved, a capital purchase in the amount of \$400,000,000. The Corporation entered into a Letter Agreement, dated as of January 16, 2009, including the Securities Purchase Agreement Standard Terms (collectively the “Letter Agreement”) with the Treasury, pursuant to which the Corporation issued and sold to the Treasury for an aggregate purchase price of \$400,000,000 in cash (i) 400,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series F (the “Series F Preferred Stock”), and (ii) a warrant to purchase 389,483 shares of the Corporation’s common stock at an exercise price of \$154.05 per share, subject to certain anti-dilution and other adjustments (the “warrant”). The TARP transaction closed on January 16, 2009. On July 20, 2010, we exchanged the Series F Preferred Stock, plus accrued dividends on the Series F Preferred Stock, for 424,174 shares of a new series of preferred stock, fixed rate Cumulative

Mandatorily Convertible Preferred Stock, Series G (the “Series G Preferred Stock”), and amended the warrant and, on December 2, 2010, the Letter Agreement and the certificate of designation for the Series G Preferred Stock were amended to, among other provisions, reduce the required capital amount to compel the conversion of the Series G Preferred Stock from \$500 million to \$350 million. On October 7, 2011, we exercised our right to convert the Series G Preferred Stock into 32,941,797 shares of common stock. As a result of the issuance of \$525 million of common stock in October 2011, the warrant was adjusted to provide for the issuance of approximately 1,285,899 shares of common stock at an exercise price of \$3.29 per share. On August 16, 2013, a secondary offering of the Corporation’s common stock was completed by certain of the Corporation’s existing stockholders, including the Treasury. The Treasury sold 13 million shares. As of December 31, 2013, the U.S. Treasury owns 9.50% of the Corporation’s outstanding common stock.

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

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

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

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

#### ***USA Patriot Act***

Under Title III of the USA Patriot Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions are required to, among other things, identify their

customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Presently, only certain types of financial institutions (including banks, savings associations and money services businesses) are subject to final rules implementing the anti-money laundering program requirements of the USA Patriot Act.

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

### ***Community Reinvestment***

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

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

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

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

### ***Regulatory Agreements***

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into the FDIC Order with the FDIC and OCIF. The FDIC Order provides for various things, including (among other things) the following: (1) having and retaining qualified management; (2) increased participation in the affairs of FirstBank by its Board of Directors; (3) development and implementation by FirstBank of a capital plan to attain a leverage ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 10% and a total risk-based capital ratio of at least 12%; (4) adoption and implementation of strategic, liquidity, and fund management and profit and budget plans and related projects within certain timetables set forth in the FDIC Order and on an ongoing basis; (5) adoption and implementation of plans for reducing FirstBank's positions in certain classified assets and delinquent and non-accrual loans within timeframes set forth in the FDIC Order; (6) refraining from lending to delinquent or classified borrowers already obligated to FirstBank on any extensions of credit so long as such credit remains uncollected, except where FirstBank's failure to extend further credit to a particular borrower would be detrimental to the best interests of FirstBank, and any such additional credit is approved by 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.

Effective June 3, 2010, the Corporation entered into the Written Agreement with the Federal Reserve. The Written Agreement provides, among other things, that the holding company must serve as a source of strength to FirstBank, and that, except with the consent of the Federal Reserve, (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 that reflects sufficient capital at the Corporation on a consolidated basis, which must be acceptable to the Federal Reserve, 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. In March 2011, the Corporation submitted an updated Capital Plan to the regulators. The updated Capital Plan contemplated a \$350 million capital raise through the issuance of new common shares for cash, and other actions to reduce the Corporation's and the Bank's risk-weighted assets, strengthen their capital positions, and meet the minimum capital ratios required under the FDIC Order. Among the strategies contemplated in the updated Capital Plan are reductions of the Corporation's loan and investment securities portfolio. The updated 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 were achieved. Although all of the regulatory capital ratios exceeded the minimum capital ratios for "well-capitalized" levels, as well as the minimum capital ratios required by the FDIC Order, as of December 31, 2013, FirstBank cannot be treated as a "well-capitalized" institution under regulatory guidance while operating under the FDIC Order.

On October 7, 2011, the Corporation successfully completed a private placement of \$525 million in shares of common stock. The net proceeds from the sale of common stock amounted to approximately \$490 million (net of offering costs), of which \$435 million were contributed to the Corporation's wholly owned banking subsidiary, FirstBank. The completion of the capital raise allowed the conversion of the 424,174 shares of the Corporation's Series G Preferred Stock, held by the Treasury, into 32.9 million shares of common stock at a conversion price of \$9.66. This conversion required for completion the payment of \$26.4 million for past-due undeclared cumulative dividends on the Series G Preferred Stock as required by the agreement with the Treasury.



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

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

In addition to the Capital Plan, the Corporation 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. As of December 31, 2013, the Corporation had completed all of the items included in the Capital Plan and is continuing to work on reducing non-performing loans. Further, the Corporation has reviewed and enhanced the Corporation's loan review program, various credit policies, the Corporation's treasury and investment policy, the Corporation's asset classification and allowance for loan and lease losses and non-accrual policies, the Corporation's charge-off policy, and the Corporation's appraisal program. The Regulatory 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 quarterly waivers to enable it to continue accessing the brokered CD market through March 31, 2014. FirstBank will request approvals for future periods.

### ***Dividend Restrictions***

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

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

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



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

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

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

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

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

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

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

### ***Federal Reserve Board Capital Requirements***

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

The Federal Reserve Board has also established minimum leverage ratio guidelines for bank holding companies. These guidelines mandate a minimum leverage ratio of Tier 1 capital to adjusted quarterly average total assets less certain amounts ("leverage amounts") equal to 3% for bank holding companies meeting certain criteria (including those having the highest regulatory rating). All other banking organizations are generally required to maintain a leverage ratio of at least 3% plus an additional cushion of at least 100 basis points and in some cases more. The Federal Reserve Board's guidelines also provide that bank holding companies experiencing internal growth or making acquisitions are expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the guidelines indicate that the Federal Reserve Board will continue to consider a "tangible Tier 1 leverage ratio" (i.e., after deducting all intangibles) in evaluating proposals for expansion or new activities.

The Federal Reserve Board's and other federal bank regulatory agencies' current risk-based capital guidelines for years have been based upon the 1988 capital accord ("Basel I") of the Basel Committee on Banking Supervision, a committee of central bankers and bank supervisors from the major industrialized countries. This body develops broad policy guidelines for use by each country's supervisors in determining the supervisory policies they apply. In response to the financial crisis, the Basel Committee adopted a new international regulatory capital accord, known as Basel III, that the U.S. federal banking agencies have implemented in the United States through final regulations, discussed above, that were adopted in July 2013. See, "*Recent Events Affecting the Corporation – Regulatory Capital Developments,*" above. These final rules come into effect on a multi-year transitional basis beginning on January 1, 2015. While we cannot calculate the precise impact of the final capital rules on our business and financial condition at this time, we generally expect that the final rules will increase our regulatory capital requirements and will require us to hold more capital against certain of our assets and off-balance sheet exposures.

### ***Source of Strength Doctrine***

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

### ***FDIC Capital Requirements***

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

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

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

As discussed above, the U.S. federal banking agencies have adopted final regulatory capital rules that will materially revise the current risk-based and leverage capital requirements. See, "*Recent Events Affecting the Corporation –Regulatory Capital Developments*," above. These final rules will come into effect on a multi-year transitional basis beginning on January 1, 2015, and we expect that the final rules, as they become effective, will increase our regulatory capital requirements and will require us to hold more capital against certain of our assets and off-balance sheet exposures.

***Prompt Corrective Action.*** The FDIA requires the federal bank regulatory agencies to take prompt corrective action against any undercapitalized insured depository institution. The FDIA establishes five capital categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Well-capitalized institutions significantly exceed the required minimum level for each relevant capital measure. Adequately capitalized institutions include depository institutions that meet but do not significantly exceed the required minimum level for each relevant capital measure. Undercapitalized institutions

consist of those that fail to meet the required minimum level for one or more relevant capital measures. Significantly undercapitalized characterizes depository institutions with capital levels significantly below the minimum requirements for any relevant capital measure. Critically undercapitalized refers to depository institutions with minimal capital and at serious risk for government seizure.

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

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

- prohibiting the payment of principal and interest on subordinated debt;
- prohibiting the holding company from making distributions without prior regulatory approval;
- placing limits on asset growth and restrictions on activities;
- placing additional restrictions on transactions with affiliates;
- restricting the interest rate the institution may pay on deposits;
- prohibiting the institution from accepting deposits from correspondent banks; and
- in the most severe cases, appointing a conservator or receiver for the institution

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

The federal banking agencies' final regulatory capital rules, discussed above, also modified the above prompt corrective action requirements to add a common equity Tier 1 risk-based ratio requirement, and increase certain other capital requirements for the various prompt corrective action thresholds. For example, the requirements for the bank to be considered well-capitalized under the rules are a 5.0% Tier 1 leverage ratio, a 6.5% common equity Tier 1 risk-based ratio, an 8.0% Tier 1 risk-based capital ratio and a 10.0% total risk-based capital ratio. To be adequately capitalized, those ratios are 4.0%, 4.5%, 6.0% and 8.0%, respectively. These changes take effect on January 1, 2015.

Although our regulatory capital ratios exceeded the required established minimum capital ratios for a "well-capitalized" institution as of December 31, 2013, as well as the capital requirements in the FDIC Order, because of the FDIC Order, FirstBank cannot be regarded as "well-capitalized" as of December 31, 2013. A bank's capital category, as determined by applying the prompt corrective action provisions of the law, however, may not constitute an accurate representation of the overall financial condition or prospects of a bank, such as the Bank, and should be considered in conjunction with other available information regarding financial condition and results of operations of the bank.

Set forth below are the Corporation's and Firstbank's capital ratios as of December 31, 2013 based on Federal Reserve and FDIC guidelines, respectively, and the capital ratios required to be attained and maintained under the FDIC Order:

	<u>First BanCorp</u>	<u>Banking Subsidiary</u>		
		<u>FirstBank</u>	<u>Well-Capitalized</u>	<u>Consent Order Minimum</u>
<b>As of December 31, 2013</b>				
Total capital (Total capital to risk-weighted assets) .....	17.06%	16.67%	10.00%	12.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) .....	15.78%	15.40%	6.00%	10.00%
Leverage ratio <sup>(1)</sup> .....	11.71%	11.44%	5.00%	8.00%

(1) Tier 1 capital to average assets.

### ***Deposit Insurance***

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

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

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

### ***Activities and Investments***

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

### ***Federal Home Loan Bank System***

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



FirstBank is a member of the FHLB of New York and as such is required to acquire and hold shares of capital stock in the FHLB in an amount calculated in accordance with the requirements set forth in applicable laws and regulations. FirstBank is in compliance with the stock ownership requirements of the FHLB. All loans, advances and other extensions of credit made by the FHLB to FirstBank are secured by a portion of FirstBank's mortgage loan portfolio, certain other investments and the capital stock of the FHLB held by FirstBank.

### ***Ownership and Control***

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

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

### ***Standards for Safety and Soundness***

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

### ***Brokered Deposits***

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well-capitalized institutions are not subject to limitations on brokered deposits, while adequately-capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the interest paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits. The FDIC Order requires FirstBank to obtain FDIC approval prior to issuing, increasing, renewing or rolling over brokered CDs and to develop a plan to reduce its reliance on brokered CDs. The FDIC has issued temporary approvals permitting FirstBank to renew and/or roll over certain amounts of brokered CDs maturing through March 31, 2014. FirstBank will continue to request approvals for future periods in a manner consistent with its plan to reduce its reliance on brokered CDs.



### ***Puerto Rico Banking Law***

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

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

The Banking Law requires every bank to maintain a legal reserve, which shall not be less than twenty percent (20%) of its demand liabilities, except government deposits (federal, state and municipal) that are secured by actual collateral. The reserve is required to be composed of any of the following securities or a combination thereof: (1) legal tender of the United States; (2) checks on banks or trust companies located in any part of Puerto Rico that are to be presented for collection during the day following the day on which they are received; (3) money deposited in other banks provided said deposits are authorized by the Commissioner and subject to immediate collection; (4) federal funds sold to any Federal Reserve Bank and securities purchased under agreements to resell executed by the bank with such funds that are subject to be repaid to the bank on or before the close of the next business day; and (5) any other asset that the Commissioner identifies from time to time.

Section 17 of the Banking Law permits Puerto Rico commercial banks to make loans to any one person, firm, partnership or corporation in an aggregate amount up to fifteen percent (15%) of the sum of: (i) the bank’s paid-in capital; (ii) the bank’s reserve fund; (iii) 50% of the bank’s retained earnings, subject to certain limitations; and (iv) any other components that the Commissioner may determine from time to time. If such loans are secured by collateral worth at least twenty five percent (25%) more than the amount of the loan, the aggregate maximum amount may reach one third (33.33%) of the sum of the bank’s paid-in capital, reserve fund, 50% of retained earnings, subject to certain limitations, and such other components that the Commissioner may determine from time to time. There are no restrictions under the Banking Law on the amount of loans that are wholly secured by bonds, securities and other evidences of indebtedness of the Government of the United States, or of the Commonwealth of Puerto Rico, or by bonds, not in default, of municipalities or instrumentalities of the Commonwealth of Puerto Rico.

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

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

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

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

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

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

#### ***International Banking Act of Puerto Rico (“IBE Act 52”)***

The business and operations of FirstBank International Branch (“FirstBank IBE” or the IBE division of FirstBank) and FirstBank Overseas Corporation (the IBE subsidiary of FirstBank) are subject to supervision and regulation by the Commissioner. Under the IBE Act 52, certain sales, encumbrances, assignments, mergers, exchanges or transfers of shares, interests or participation(s) in the capital of an international banking entity (an “IBE”) may not be initiated without the prior approval of the Commissioner. The IBE Act 52 and the regulations issued thereunder by the Commissioner (the “IBE Regulations”) limit the business activities that may be carried out by an IBE. Such activities are limited in part to persons and assets located outside of Puerto Rico.

Pursuant to the IBE Act 52 and the IBE Regulations, each of FirstBank IBE and FirstBank Overseas Corporation must maintain books and records of all its transactions in the ordinary course of business. FirstBank IBE and FirstBank Overseas Corporation are also required thereunder to submit to the Commissioner quarterly and annual reports of their financial condition and results of operations, including annual audited financial statements.

The IBE Act 52 empowers the Commissioner to revoke or suspend, after notice and hearing, a license issued thereunder if, among other things, the IBE fails to comply with the IBE Act, the IBE Regulations or the terms of its license, or if the Commissioner finds that the business or affairs of the IBE are conducted in a manner that is not consistent with the public interest.

In 2012, the Puerto Rico Government approved Act Number 273 (“Act 273”). Act 273 replaces, prospectively, IBE Act 52 with the objective of improving the conditions for conducting international financial transactions in Puerto Rico. An existing IBE, such as FirstBank IBE and FirstBank Overseas Corporation, can

continue operating under Act 52, however, it can voluntarily convert to an International Financial Entity (“IFE”) under Act 273 so it may broaden its scope of Eligible IFE Activities, as defined below, and obtain a grant of tax exemption under Act 273.

IFEs are licensed by the Commissioner, and authorized to conduct certain Act 273 specified financial transactions (“Eligible IFE Activities”). Once licensed, an IFE can request a grant of tax exemption (“Tax Grant”) from the Puerto Rico Department of Economic Development and Commerce, which will enumerate and secure the following tax benefits provided by Act 273 as contractual rights (i.e., regardless of future changes in Puerto Rico law) for a fifteen (15) year period:

(1) to the IFE:

- a fixed 4% Puerto Rico income tax rate on the net income derived by the IFE from its Eligible IFE Activities; and
- full property and municipal license tax exemptions on such activities.

(2) to its shareholders:

- 6% income tax rate on distributions to Puerto Rico resident shareholders of earnings and profits derived from the Eligible IFE Activities; and
- full Puerto Rico income tax exemption on such distributions to non-Puerto Rico resident shareholders.

The primary purpose of IFEs is to attract United States and foreign investors to Puerto Rico. Consequently, Act 273 authorizes them to engage in traditional banking and financial transactions, principally with non-residents of Puerto Rico. Furthermore, the scope of Eligible IFE Activities encompasses a wider variety of transactions than those previously authorized to IBEs.

As of the date of the issuance of this Annual Report on Form 10-K, FirstBank IBE and FirstBank Overseas Corporation are operating under Act 52.

### ***Puerto Rico Income Taxes***

Under the 2011 PR Code, as amended, the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file a consolidated tax return 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 NOL, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carryforward period. In the case of losses incurred during tax years that commenced after December 31, 2004 and ended before January 1, 2013, the carryforward period is extended to 12 years. The carryover period for a NOL incurred during taxable years commencing after December 31, 2012 is 10 years. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from “controlled” subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations. Dividend payments from a U.S. subsidiary to the Corporation are subject to a 10% withholding tax based on the provisions of the U.S. Internal Revenue Code.

Under the 2011 PR Code, as amended, First BanCorp. is subject to a maximum statutory tax rate of 39%. The 2011 PR Code also includes an alternative minimum tax of 30% that applies if the Corporation’s regular income tax liability is less than the alternative minimum tax requirements. Prior to the approval of Act 40, which amended the 2011 PR Code as explained below, First Bancorp.’s maximum statutory tax rate was 30% for the years that ended December 31, 2012 and 2011.

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 the IBE of the Bank and through the Bank’s subsidiary, FirstBank Overseas

Corporation, whose interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which Act No.7 imposed a special 5% tax on all IBEs. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that IBEs' net income exceeds 20% of the bank's total net taxable income.

On June 30, 2013, the Puerto Rico Government approved Act 40, which amended the 2011 PR Code, as discussed under "Significant Events Since the Beginning of 2013- Changes to the Puerto Rico Internal Revenue Code", and Act No. 46 ("Act 46") which brings changes to the sales and use tax regime.

Significant changes to the sales and use tax regime include adjustments to the business to business exclusion. The business to business exclusion applicable to services rendered from one registered business to another registered business remains in effect, except for certain services that will be taxable including, among others, service charges imposed by financial institutions on other businesses (commercial clients), collection services, repairs and maintenance services of real and personal property, and computer programming including modifications to previously designed systems. The sales and use tax provisions were effective beginning on July 1, 2013.

In addition, on October 14, 2013, Act No. 117 ("Act 117") implemented technical amendments to various income tax laws, including the 2011 PR Code. The main provisions of Act 117 that impacted financial institutions are the exemption from the imposition of the national gross receipts tax on foreign source income and the temporary requirement of an estimated tax payment in mid-October. On November 26, 2013, Act No.36 was enacted, to among other things, require the payment of estimated taxes related to personal property tax returns. The amendments of Act No. 36 will be effective during the year 2014.

### ***United States Income Taxes***

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

### ***Insurance Operations Regulation***

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

### ***Mortgage Banking Operations***

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

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

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



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

### **RISKS RELATING TO THE CORPORATION'S BUSINESS**

#### *We are operating under agreements with our regulators.*

We are subject to supervision and regulation by the Federal Reserve Board. We are a bank holding company and a financial holding company under the Bank Holding Company Act of 1956, as amended.

As such, we are permitted to engage in a broader spectrum of activities than those permitted to bank holding companies that are not financial holding companies. At this time, under the BHC Act, we may not be able to engage in new activities or acquire shares or control of other companies. In addition, we are subject to restrictions because of the Regulatory Agreements that our subsidiary FirstBank entered into with the FDIC and we entered into with the Federal Reserve, as further described below.

On June 4, 2010, we announced that FirstBank agreed to the FDIC Order issued by the FDIC and OCIF, and we entered into the Written Agreement with the Federal Reserve. These Regulatory Agreements stemmed from the FDIC's examination as of the period ended June 30, 2009 conducted during the second half of 2009. Although our regulatory capital ratios exceeded the required established minimum capital ratios for a "well-capitalized" institution as of December 31, 2013 and complied with the capital ratios required by the FDIC Order, FirstBank cannot be regarded as "well-capitalized" as of December 31, 2013 because of the FDIC Order.

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

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

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

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

***Our high level of non-performing loans may adversely affect our future results from operations.***

Even though, our level of non-performing loans decreased 43% during 2013, as compared to December 31, 2012, and our third and fourth quarters of 2013 were profitable, we have \$550.4 million in non-performing loans, which represents approximately 5% of our \$9.7 billion loan portfolio. We may not continue to be profitable given this high level of non-performing loans.

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

FirstBank relies primarily on customer deposits, the issuance of brokered CDs, and advances from the Federal Home Loan Bank, to maintain its lending activities and to replace certain maturing liabilities. As of December 31, 2013, we had \$3.48 billion in brokered deposits (including CDs and money market accounts) outstanding, representing approximately 35% of our total deposits, and a reduction of \$253.4 million from the year ended December 31, 2012. Approximately \$1.7 billion in brokered CDs mature over the next twelve months, and the average term to maturity of the retail brokered CDs outstanding as of December 31, 2013 was approximately 1.2 years. None of these CDs are callable at the Corporation's option.

Although FirstBank has historically been able to replace maturing deposits and advances, we may not be able to replace these funds in the future if our financial condition or general market conditions were to change or the FDIC did not approve our request to issue brokered deposits, as required by the FDIC Order. The FDIC Order requires FirstBank to obtain FDIC approval prior to issuing, increasing, renewing or rolling over brokered deposits and to maintain the plan to reduce its reliance on brokered deposits. Although the FDIC has issued temporary approvals permitting FirstBank to renew and/or roll over certain amounts of brokered CDs maturing in the past and we have received approval from the FDIC to issue brokered deposits through March 31, 2014, the FDIC may not continue to issue such approvals, even if the requests are consistent with our plans to reduce reliance on brokered deposits, and, even if issued, such approvals may not be for amounts of brokered deposits sufficient for FirstBank to meet its funding needs. The use of brokered deposits has been particularly important for the funding of our operations. If we are unable to issue brokered deposits, or are unable to maintain access to our other funding sources, our results of operations and liquidity would be adversely affected.

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

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

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

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 Corporation without the prior consent of the OCIF. FirstBank's net loss experienced in 2013 exhausted FirstBank's statutory reserve fund. FirstBank cannot pay dividends to the Corporation until it can replenish the reserve fund to an amount of at least 20% of the original capital contributed.

***If we do not obtain Federal Reserve approval to pay interest, principal or other sums on subordinated debentures or trust-preferred securities, a default under certain obligations may occur.***

The Written Agreement provides that we cannot declare or pay any dividends or make any distributions of interest, principal or other sums on subordinated debentures or trust-preferred securities without prior written approval of the Federal Reserve. With respect to our \$232 million of outstanding subordinated debentures, we elected to defer the interest payments that were due in March 2012, June 2012, September 2012, December 2012, March 2013, June 2013, September 2013, December 2013 and March 2014.

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

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

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

We have a construction loan portfolio held for investment, in the amount of \$168.7 million as of December 31, 2013, mostly secured by commercial and residential real estate properties. Due to their nature, these loans entail a higher credit risk than consumer and residential mortgage loans, since they are larger in size, concentrate more risk in a single borrower and are generally more sensitive to economic downturns. Although we previously ceased new originations of construction loans, decreasing collateral values, difficult economic conditions and numerous other factors continue to create volatility in the housing markets and have increased the possibility that additional losses may have to be recognized with respect to our current non-performing assets. Furthermore, given the slowdown in the real estate market, the properties securing these loans may be difficult to dispose of if they are foreclosed. Although we have taken a number of steps to reduce our credit exposure, as of December 31, 2013, we still had \$58.9 million in nonperforming construction loans held for investment. We may continue to incur credit losses over the near term, either because of continued deterioration of the quality of the loans or because of sales of such loans, which would likely accelerate the recognition of losses. Any such losses would adversely impact our overall financial performance and results of operations.

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

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

The level of the allowance reflects management's estimates based upon various assumptions and judgments as to specific credit risks, evaluation of industry concentrations, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan and lease losses inherently involves a high degree of subjectivity and requires management to make significant estimates and judgments regarding current credit risks and future trends, all of which may undergo material changes. If our estimates prove to be incorrect, our allowance for credit losses may not be sufficient to cover losses in our loan portfolio and our expense relating to the additional provision for credit losses could increase substantially.

Any such increases in our provision for loan losses or any loan losses in excess of our provision for loan losses would have an adverse effect on our future financial condition and results of operations. Given the difficulties facing some of our largest borrowers, these borrowers may fail to continue to repay their loans on a timely basis or we may not be able to assess accurately any risk of loss from the loans to these borrowers. Also, additional economic weakness, effect of the recent downgrade of Puerto Rico's general obligation debt to non-investment grade, among others, could require increase reserves.

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

Further deterioration of the value of real estate collateral securing our construction, commercial and residential mortgage loan portfolios would result in increased credit losses. As of December 31, 2013, approximately 2.23%, 18.85% and 26.46% of our loan portfolio consisted of construction, commercial mortgage and residential real estate loans, respectively.

A substantial part of our loan portfolio is located within the boundaries of the U.S. economy. Whether the collateral is located in Puerto Rico, the USVI, the BVI, or the U.S. mainland, the performance of our loan portfolio and the collateral value backing the transactions are dependent upon the performance of and conditions within each specific real estate market. Puerto Rico has been in an economic recession since 2006. Sustained weak economic conditions that have affected Puerto Rico and the United States over the last several years have resulted in declines in collateral values.

Construction and commercial loans, mostly secured by commercial and residential real estate properties, entail a higher credit risk than consumer and residential mortgage loans, since they are larger in size, may have less collateral coverage, concentrate more risk in a single borrower and are generally more sensitive to economic downturns. As of December 31, 2013, commercial mortgage and construction real estate loans amounted to \$2.0 billion or 21.1% of the total loan portfolio.

We measure the impairment of a loan based on the fair value of the collateral, if collateral dependent, which is generally obtained from appraisals. Updated appraisals are obtained when we determine that loans are impaired and are updated annually thereafter. In addition, appraisals are also obtained for certain residential mortgage loans on a spot basis based on specific characteristics such as delinquency levels, age of the appraisal and loan-to-value ratios. The appraised value of the collateral may decrease or we may not be able to recover collateral at its appraised value. A significant decline in collateral valuations for collateral dependent loans may require increases in our specific provision for loan losses and an increase in the general valuation allowance. Any such increase would have an adverse effect on our future financial condition and results of operations. During the year ended December 31, 2013, net charge-offs specifically related to values of properties collateralizing construction, commercial mortgage and residential mortgage loans portfolios totaled \$41.2 million, \$62.6 million and \$128.0 million, respectively, including charge-offs related to the bulk sales of assets described above.

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

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

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

Fixed-rate securities acquired by us are generally subject to decreases in market value when interest rates rise, which may require recognition of a loss (e.g., the identification of an other-than-temporary impairment on our available-for-sale investment portfolio), thereby adversely affecting our results of operations. Market-related reductions in value also influence our ability to finance these securities. Furthermore, increases in interest rates may result in an extension of the expected average life of certain fixed-income securities, such as fixed-rate passthrough mortgage-backed securities. Such an extension could exacerbate the drop in market value related to shifts in interest rates.

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

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

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

In general, fixed-income portfolio yields could decrease as the re-investment of pre-payment amounts would most certainly be at lower rates. 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 the 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 accretion of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by our investment in callable securities because decreases in interest rates might prompt the early redemption of such securities.

***Changes in interest rates on loans and borrowings may adversely affect net interest income.***

Basis risk is the risk of adverse consequences resulting from unequal changes in the difference, also referred to as the “spread” or basis, between the rates for two or more different instruments with the same maturity and occurs when market rates for different financial instruments or the indices used to price assets and liabilities change at different times or by different amounts. For example, the interest expense for liability instruments such



as brokered CDs might not change by the same amount as interest income received from loans or investments. To the extent that the interest rates on loans and borrowings change at different speeds and by different amounts, the margin between our LIBOR-based assets and the higher cost of the brokered CDs might be compressed and adversely affect net interest income.

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

For the years ended December 31, 2011, 2012, and 2013, we recognized a total of \$2.0 million, \$2.0 million, and \$0.2 million, respectively, in other-than-temporary impairments. To the extent that any portion of the unrealized losses in our investment securities portfolio of \$71.0 million as of December 31, 2013 is determined to be other-than-temporary and, in the case of debt securities, the loss is related to credit factors, we would recognize a charge to earnings in the quarter during which such determination is made and capital ratios could be adversely affected. Even if we do not determine that the unrealized losses associated with this portfolio require an impairment charge, increases in these unrealized losses adversely affect our tangible common equity ratio, which may adversely affect credit rating agency and investor sentiment towards us. Any negative perception also may adversely affect our ability to access the capital markets or might increase our cost of capital. Valuation and other-than-temporary impairment determinations will continue to be affected by external market factors including default rates, severity rates and macro-economic factors.

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

The Corporation's ability to access new non-deposit sources of funding could be adversely affected by downgrades in our credit ratings. The Corporation's liquidity is to a certain extent contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation's current credit ratings and any downgrades in such credit ratings can hinder the Corporation's access to external funding and/or cause external funding to be more expensive, which could in turn adversely affect results of operations. Also, changes in credit ratings may further affect the fair value of certain unsecured derivatives that consider the Corporation's own credit risk as part of the valuation. Following the downgrade of the general obligation rating of the Commonwealth of Puerto Rico, as discussed below, Moody's placed on review for downgrade certain ratings of three Puerto Rican banks, including the long-term ratings of FirstBank.

***Defective and repurchased loans may harm our business and financial condition.***

In connection with the sale and securitization of loans, we are required to make a variety of customary representations and warranties regarding First BanCorp. on the loans sold or securitized. Our obligations with respect to these representations and warranties are generally outstanding for the life of the loan, and they relate to, among other things:

- compliance with laws and regulations;
- underwriting standards;
- the accuracy of information in the loan documents and loan file; and
- the characteristics and enforceability of the loan

A loan that does not comply with these representations and warranties may take longer to sell, may impact our ability to obtain third party financing for the loan, and may not be saleable or may be saleable only at a significant discount. If such a loan is sold before we detect non-compliance, we may be obligated to repurchase the loan and bear any associated loss directly, or we may be obligated to indemnify the purchaser against any loss, either of which could reduce our cash available for operations and liquidity. Management believes that it has established controls to ensure that loans are originated in accordance with the secondary market's

requirements, but mistakes may be made, or certain employees may deliberately violate our lending policies. We seek to minimize repurchases and losses from defective loans by correcting flaws, if possible, and selling or re-selling such loans. Until now, losses incurred for repurchases of loans have been insignificant

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

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

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

***Cyber-attacks, system risks and data protection breaches could present significant reputational, legal and regulatory costs.***

First BanCorp. is under continuous threat of cyber-attacks especially as we continue to expand customer services via the internet and other remote service channels. Two of the most significant cyber attack risks that we may face are e-fraud and computer intrusion that might result in loss of sensitive customer data. Loss from e-fraud occurs when cybercriminals breach and extract funds from customer bank accounts. Computer intrusion attempts might result in the breach of sensitive customer data, such as account numbers and social security numbers, and could present significant reputational, legal and/or regulatory costs to the Corporation if successful. Our risk and exposure to these matters remains heightened because of the evolving nature and complexity of the threats from organized cybercriminals and hackers, and our plans to continue to provide electronic banking services to our customers.

If personal, non-public, confidential or proprietary information of our customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties.

***We rely on other companies to perform key aspects of our business infrastructure***

Third parties perform key aspects of our business operations such as data processing, information security, recording and monitoring transactions, online banking interfaces and services, internet connections and network access and the servicing of the credit card portfolio. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including those resulting from disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher

volumes, failure of a vendor to provide services for any reason or poor performance of services, or failure of a vendor to notify us of a reportable event, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third party vendor could also hurt our operations if those difficulties interfere with the vendor's ability to serve us. Replacing these third party vendors could also create significant delay and expense. Accordingly, use of such third parties creates an unavoidable inherent risk to our business operations.

***Hurricanes and other weather-related events could cause a disruption in our operations or other consequences that could have an adverse impact on our results of operations.***

A significant portion of our operations is located in a region susceptible to hurricanes. Such weather events can cause disruption to our operations and could have a material adverse effect on our overall results of operations. We maintain hurricane insurance, including coverage for lost profits and extra expense; however, there is no insurance against the disruption to the markets that we serve that a catastrophic hurricane could produce. Further, a hurricane in any of our market areas could adversely impact the ability of borrowers to timely repay their loans and may adversely impact the value of any collateral held by us. The severity and impact of future hurricanes and other weather-related events are difficult to predict and may be exacerbated by global climate change. The effects of future hurricanes and other weather-related events could have an adverse effect on our business, financial condition or results of operations.

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

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities in which we engage can be intense, and we may not be able to hire people or retain them, particularly in light of uncertainty concerning compensation restrictions applicable to banks but not applicable to other financial services firms. The unexpected loss of services of one or more of our key personnel could adversely affect our business because of the loss of their skills, knowledge of our markets and years of industry experience and, in some cases, because of the difficulty of promptly finding qualified replacement employees. Similarly, the loss of key employees, either individually or as a group, could result in a loss of customer confidence in our ability to execute banking transactions on their behalf.

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

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

The Dodd-Frank Act signed into law on July 21, 2010 requires the FDIC to increase the DIF's reserves against future losses, which will require institutions with assets greater than \$10 billion to bear an increased responsibility for funding the prescribed reserve to support the DIF. Since then, the FDIC addressed plans to bolster the DIF by increasing the required reserve ratio for the industry to 1.35 percent (ratio of reserves to insured deposits) by September 30, 2020, as required by the Dodd-Frank Act. The FDIC has also adopted a final rule raising its industry target ratio of reserves to insured deposits to 2 percent, 65 basis points above the statutory minimum, but the FDIC does not project that goal to be met for several years.

In February 2011, the FDIC issued a final rule that amended its deposit insurance assessment regulations. The rule implements a provision in the Dodd-Frank Act that changes the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average

Tier 1 capital. The rule also changed the assessment rate schedules for insured depository institutions so that approximately the same amount of revenue would be collected under the new assessment base as would be collected under the previous rate schedule and the schedules previously proposed by the FDIC. The rule also revised the risk-based assessment system for all large insured depository institutions (generally, institutions with at least \$10 billion in total assets, such as FirstBank). Under the rule, the FDIC uses a scorecard method to calculate assessment rates for all such institutions.

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

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

The Corporation has investments in entities that it does not control, including a 35% subordinated ownership interest in CPG/GS PR NPL, LLC ("CPG/GS"), organized under the laws of the Commonwealth of Puerto Rico, which is majority owned by PRLP Ventures LLC ("PRLP"), a company created by Goldman Sachs and Co. and Caribbean Property Group. 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 with a carrying value of \$7.3 million is also subordinated to the aggregate amount of its loans to CPG/GS in the amount of \$69.4 million as of December 31, 2013. Therefore, the Corporation will not receive any return on its investment 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 subordinated to PRLP's interest.

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's investment in this unconsolidated entity was considered significant under Rule 3-09 of Regulation S-X for the year ended December 31, 2012, requiring the filing of full financial statements of the investee for the years ended December 31, 2013, 2012 and 2011. The Corporation cannot provide assurance that the equity investee that it does not control 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. Additional write-downs to the carrying amount of the Corporation's equity interest could adversely impact the Corporation's results of operations.

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

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

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

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. A securities class action suit against us could result in substantial costs, potential liabilities and the diversion of management's attention and resources.

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

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

Our relationships with many of our customers are predicated upon our reputation as a fiduciary and a service provider that adheres to the highest standards of ethics, service quality and regulatory compliance. Adverse publicity, regulatory actions, like the Regulatory Agreements, litigation, operational failures, the failure to meet customer expectations and other issues with respect to one or more of our businesses could materially and adversely affect our reputation, or our ability to attract and retain customers or obtain sources of funding for the same or other businesses. Preserving and enhancing our reputation also depends on maintaining systems and procedures that address known risks and regulatory requirements, as well as our ability to identify and mitigate additional risks that arise due to changes in our businesses, the market places in which we operate, the regulatory environment and customer expectations. If any of these developments has a material adverse effect on our reputation, our business will suffer.

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

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

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

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

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

The goodwill impairment evaluation process requires us to make estimates and assumptions with regards to the fair value of our reporting units. Actual values may differ significantly from these estimates. Such differences could result in future impairment of goodwill that would, in turn, negatively impact our results of operations and the reporting unit where the goodwill is recorded. We conducted our 2013 evaluation of goodwill during the fourth quarter of 2013.



The Step 1 evaluation of goodwill allocated to the Florida reporting unit under both valuation approaches (market and discounted cash flow analysis) indicated that the fair value of the unit was above the carrying amount of its equity book value as of the valuation date (October 1), which meant that Step 2 was not undertaken. Goodwill with a carrying value of \$28.1 million was not impaired as of December 31, 2013 or 2012, nor was any goodwill written off due to impairment during 2013, 2012, and 2011. If we are required to record a charge to earnings in our consolidated financial statements because an impairment of the goodwill or amortizable intangible assets is determined, our results of operations could be adversely affected.

***The imposition of additional taxes in Puerto Rico may further deteriorate the economy, impact our profitability and adversely impact the credit quality of the Corporation's loan portfolios.***

On June 30, 2013, the Government of Puerto Rico signed into law Act 40, as one of the laws enacted to balance the budget for the general fund of the Government of Puerto Rico for fiscal year 2013-2014. Act 40 provides significant amendments to the 2011 PR Code, and affects mainly persons doing business in Puerto Rico. The main provisions of Act 40 that impact financial institutions include:

- (i) A new national gross receipts tax that in the case of financial institutions is 1% of gross income that is not deductible for purposes of computing net taxable income and is not part of the AMT. This provision was retroactive to January 1, 2013. An expense of \$5.9 million was recorded during the year 2013 related to the national gross receipts tax. This expense is included as part of "Taxes, other than income taxes" in the consolidated statement of (loss) income. Subject to certain limitations, a financial institution will be able to claim a credit of 0.5% of its gross income against its regular income tax or the alternative minimum tax. A \$3.0 million benefit related to this credit was recorded as a reduction to the provision for income taxes in 2013.
- (ii) A decrease in the deduction available to corporations for the computation of the additional surtax from \$750,000 to \$25,000 and a change in the surtax rate to rates that range from 5% to 19%, resulting in an increase in the maximum statutory tax rate from 30% to 39%. This provision was also retroactive to January 1, 2013. The effect on operating results in 2013 related to these changes was a net benefit of approximately \$1.3 million, mainly due to the increase in the deferred tax asset of profitable subsidiaries. The deferred tax valuation allowance increased to \$522.7 million as of December 31, 2013 from \$359.9 million at December 31, 2012 as a result of changes in tax rates and operating results for the year.
- (iii) A higher AMT rate (30% of the alternative minimum net income, as compared to 20% previously) and various parallel computations required to be made before determining whether an AMT liability exists. This change did not have an impact on the Corporation's provision for income taxes recorded in 2013.
- (iv) The NOL carryover period increased from 10 years to 12 years for losses incurred in taxable years that commenced after December 31, 2004 and ended before January 1, 2013. The carryover period for NOLs incurred during taxable years commencing after December 31, 2012 is 10 years. The NOL deduction is now limited to 90% of taxable income for regular income tax purposes and 80% for AMT purposes.

Significant changes to the sales and use tax regime include adjustments to the business to business exclusion. The business to business exclusion applicable to services rendered from one registered business to another registered business remains in effect, except for certain services that will be taxable including, among others, service charges imposed by financial institutions on other businesses (commercial clients), collection services, repairs and maintenance services related to real and personal property, and computer programming including modifications to previously designed systems. The sales and use tax provisions were effective beginning on July 1, 2013.

In addition, on October 14, 2013, Act No.117 ("Act 117") implemented technical amendments to various income tax laws, including the 2011 PR Code. The main provisions of Act 117 that impacted financial institutions are the exemption from the imposition of the national gross receipts tax on foreign source income and

the temporary requirement of an estimated tax payment in mid-October. On November 26, 2013, Act No.36 was enacted, to among other things, require the payment of estimated taxes related to personal property tax returns. These amendments of Act No. 36 will be effective during the year 2014.

Act 40 imposes various income tax provisions applicable to certain individual tax payers and non-financial institutions as well, including taxes on gross receipts and increases in statutory tax rates. The imposition of these taxes could adversely affect the Corporation's profitability, and could affect the disposable income of borrowers causing increases in delinquencies and foreclosure rates.

***Realization of deferred tax assets is dependent upon the generation of future taxable income by the Bank, which has been in a cumulative loss position since 2009.***

As of December 31, 2013, the Corporation had a gross deferred tax asset of \$539.2 million, including \$371.7 million associated with net operating losses ("NOLs"). Under Puerto Rico law, the Corporation and its subsidiaries, including FirstBank, which incurred most of the NOLs, are treated as separate taxable entities and are not entitled to file consolidated tax returns. To obtain the full benefit of the applicable deferred tax asset attributable to NOLs, FirstBank must have sufficient taxable income within the applicable carry forward period (7 years for taxable years beginning before January 1, 2005, 12 years for taxable years beginning after December 31, 2004 and before December 31, 2012, and 10 years for taxable years beginning after December 31, 2012). The Bank incurred all of the NOL's on or after 2009. Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on an assessment of the amount of the deferred tax asset that is "more likely than not" to be realized. In assessing the weight of positive and negative evidence, a significant negative factor that resulted in the recognition and maintenance of a significant valuation allowance against the deferred tax asset was that FirstBank was in a three-year cumulative loss position as of December 31, 2013. As of December 31, 2013, the Corporation recorded a valuation allowance of \$522.7 million. Due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that the Corporation will not be able to reverse portions or the full valuation allowance in the future or that the Corporation will need to continue increasing the valuation allowance related to deferred tax assets created in connection with the operations of FirstBank.

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

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

Fluctuations in federal, state, local and foreign taxes or a change to uncertain tax positions, including related interest and penalties, may impact the Corporation's effective tax rate. When particular tax matters arise, a number of years may elapse before such matters are audited and finally resolved. In addition, tax positions may be challenged by the U.S. Internal Revenue Service ("IRS") and the tax authorities in the jurisdictions in which we operate and we may estimate and provide for potential liabilities that may arise out of tax audits to the extent that uncertain tax positions fail to meet the recognition standard under applicable GAAP. Unfavorable resolution of any tax matter could increase the effective tax rate and could result in a material increase in our tax expense. Resolution of a tax issue may require the use of cash in the year of resolution. The years 2007 through 2009 have been examined by the IRS and disputed issues have been taken to administrative appeals. Although the timing of the resolution and/or closure of audits is highly uncertain, based on the latest developments, the Corporation believes it is reasonably possible that the IRS will conclude the audit of years 2007 through 2009 within the next twelve months. If any issues addressed in this audit are resolved in a manner not consistent with the Corporation's expectations, the Corporation could be required to adjust its provision for income taxes in the period in which such resolution occurs. The Corporation currently cannot reasonably estimate a range of possible changes to existing reserves.

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

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

## **RISKS RELATING TO THE BUSINESS ENVIRONMENT AND OUR INDUSTRY**

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

Given that most of our business is in Puerto Rico and the United States and given the degree of interrelation between Puerto Rico's economy and that of the United States, we are exposed to downturns in the U.S. economy. Continued high levels of unemployment and underemployment in the United States and depressed real estate valuations have negatively impacted the credit performance of mortgage loans, credit default swaps and other derivatives, and resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial banks and investment banks. These write-downs have caused many financial institutions to seek additional capital from private and government entities, merge with larger and stronger financial institutions and, in some cases, fail.

A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and other financial institutions. In particular, we may face the following risks in connection with these events:

- Our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage, and underwrite the loans become less predictive of future behaviors.
- The models used to estimate losses inherent in the credit exposure require difficult, subjective, and complex judgments, including forecasts of economic conditions and how these economic predictions might impair the ability of the borrowers to repay their loans, which may no longer be capable of accurate estimation and which may, in turn, impact the reliability of the models.
- Our ability to borrow from other financial institutions or to engage in sales of mortgage loans to third parties (including mortgage loan securitization transactions with government-sponsored entities and repurchase agreements) on favorable terms, or at all, could be adversely affected by further disruptions in the capital markets or other events, including deteriorating investor expectations.
- Competitive dynamics in the industry could change as a result of consolidation of financial services companies in connection with current market conditions.
- We may be unable to comply with the Regulatory Agreements, which could result in further regulatory enforcement actions.
- We expect to face increased regulation of our industry. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities.
- There may be downward pressure on our stock price.

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

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

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

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

***Our 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, which has been in a multi-year prolonged recession. Based on the first six months of fiscal year 2013-2014, the main economic indicators suggest that the Puerto Rico economy remains weak. The Commonwealth's gross national product has contracted (in real terms) every year except one since fiscal year 2007. For the fiscal year ended June 30, 2014, the Puerto Rico Planning Board projects a decline of 0.8% in real gross national product. This contraction may have had an adverse effect on employment and could have an adverse effect on Commonwealth tax revenues and, consequently, on the Commonwealth's ability to achieve a balanced budget.

The Government has implemented 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 increasing corporate taxes and reforming the employee retirement systems of the Commonwealth. Since the government is an important source of employment in Puerto Rico, these measures had a temporary adverse effect on the island's already weak economy. Despite the adverse effects, the government continues evaluating alternatives to decrease the general fund fiscal budget deficit. The fiscal year 2014 approved budget was configured with an \$820 million deficit, expected to be covered with \$575 million in general obligation debt service refinancing and \$245 million in new deficit financing from the Government Development Bank of Puerto Rico (GDB). On February 3, 2014, the government announced that it would reduce the fiscal year 2014 deficit to \$650 million by proposing legislation to reduce fiscal year 2014 appropriations by \$170 million. In addition, the Governor announced his commitment to recommend to the legislature the approval of a balanced budget for fiscal year 2015. On February 5, 2014, legislation was submitted to the Legislative Assembly to reduce fiscal year 2014 appropriations by \$170 million.

During the first six months of fiscal year 2014, total employment fell by 2.0% as compared to the same period for the prior fiscal year, and the unemployment rate averaged 14.8% compared to 14.2% for the same period of the prior fiscal year. According to the Establishment Survey, total payroll non-farm employment decreased by 4.3% during the first six months of fiscal year 2014. This reduction is partially attributable to attrition and to the changes to the Employees Retirement System, as more than 46% of the total employment reductions experienced during this period corresponded to decreases in state and local government employment.

The economy of Puerto Rico is very sensitive to the price of oil in the global market since it does not have a significant mass transit system available to the public and most of its electricity is powered by oil, making it highly sensitive to fluctuations in oil prices. A substantial increase in the price of oil could impact the economy adversely 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. Several bills have been filed at the Legislative Assembly that address energy costs in Puerto Rico. One bill supported by the Governor proposes to restructure the Telecommunications Regulatory Board into the Energy and Telecommunications Commission, which will be responsible for all energy and telecommunications regulatory matters. This new entity would also be responsible for all tariff-related issues. Another bill supported by the President of the Senate proposes to create a regulatory agency that will approve or reject energy rates for all energy producers in Puerto Rico and would be responsible for opening up Puerto Rico's energy market to competition. Both proposals aim to substantially reduce Puerto Rico's energy costs.

The decline in Puerto Rico's economy since 2006 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 loan portfolio, all of which have adversely affected our profitability. If a decline in economic activity continues, there could be further adverse effects on our profitability.

On February 4, 2014, Standard & Poor's Ratings Services ("S&P") lowered its rating on the general obligation bonds of the Commonwealth from "BBB-" to "BB+," which is a non-investment grade rating. S&P also lowered its rating on the GDB bonds to "BB," one notch below the Commonwealth's general obligation rating, and lowered its rating on the bonds of several other Commonwealth issuers. S&P maintained its "AA-" and "A+" ratings on the senior and subordinate bonds of the Puerto Rico Sales Tax Financing Authority ("COFINA").

On February 7, 2014, Moody's Investors Service ("Moody's") lowered its rating on the general obligation bonds of the Commonwealth two notches, from "Baa3" to "Ba2", which is a non-investment grade rating. Moody's also lowered its rating on the bonds of several other Commonwealth issuers to "Ba2," including GDB. On February 10, 2014, Fitch Ratings ("Fitch") lowered its rating on the general obligation bonds of the Commonwealth by two notches from "BBB-" to "BB", which is a non-investment grade rating. Fitch also lowered its ratings on the bonds of several other government agencies. Fitch maintained its "AA-" and "A+" ratings on COFINA's senior and subordinate bonds. It is uncertain how the financial markets may react to any potential further ratings downgrade of Puerto Rico's debt obligation. However, further deterioration in the fiscal situation, could adversely affect the value of our loans to government and our portfolio of Puerto Rico government and agencies securities.

As of December 31, 2013, the Corporation had \$454.6 million of credit facilities granted to the Puerto Rico Government, its municipalities and public corporations, of which \$397.8 million was outstanding, compared to \$158.4 million as of December 31, 2012. Approximately \$200.5 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality. The good faith, credit, and unlimited taxing power of each applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$84.6 million consists of loans to public corporations that receive revenues from the rates they charge for services or products, such as electric power services, including credit extended to the Puerto Rico Electric Power Authority for fuel purchases that have priority over senior bonds and other debt. Main public corporations have varying degrees of independence from the central government and many receive appropriations or other payments from the Puerto Rico's government general fund. Approximately \$112.7 million consists of loans to the central government or units of the central government. Debt issued by the central government can either carry the full faith, credit, and taxing power of the Commonwealth of Puerto Rico or represent an obligation, that is subject to annual budget appropriations. The



Commonwealth of Puerto Rico has never defaulted on its debt. Furthermore, the Corporation had \$205.1 million outstanding as of December 31, 2013 in financing to the hotel industry in Puerto Rico guaranteed by the Puerto Rico Tourism Development Fund (“TDF”). The TDF is a subsidiary of the GDB that works with private-sector financial institutions to structure financings for new hospitality projects. The TDF has a perfect track record of supporting its guarantees.

In addition, the Corporation held approximately \$71.0 million of obligation of the Puerto Rico government and agencies, mainly bonds of the GDB and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio, which were reflected at their aggregate fair value of \$51.3 million as of December 31, 2013. In mid-August 2013, the 30-year general obligation bonds of the Puerto Rico government, which are widely held by mutual funds, carried a yield of about 7.1%, which increased during the latter part of the third quarter of 2013, surpassing 10% at one point in September amid a general run-up in interest rates and significant selling by investors after Detroit filed for the largest municipal bankruptcy in United States history. The debt carried a yield of approximately 9.23% as of December 31, 2013. Based on S&P definition of a BB credit rating, the debt rating suggest that S&P views the Puerto Rico Government’s obligation as less vulnerable to nonpayment in the near term than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions; thus, the ultimate, impact of the government and agencies bond obligations downgrades on the overall economy is unpredictable and may not be immediately apparent.

The decrease in value during 2013 of the Puerto Rico government and agencies bonds held by the Corporation was mainly the result of the decreases on prices in the municipal bonds market caused by the Detroit default and subsequent significant sales of municipal bonds. The price declines also showed a correlation to benchmark interest rate movements. The Corporation believes that the declines in value resulted from the above factors and not a change in expected cash flows. The issuers of Puerto Rico government and agencies bonds held by the Corporation have not defaulted, and the contractual payments on these securities have been made as scheduled.

As of December 31, 2013, the Corporation had \$546.5 million of public sector deposits in Puerto Rico (\$285.6 million in transactional accounts and \$260.8 million in time deposits). Approximately 21% came from municipalities and 79% came from public corporations and the central government.

In 2014, Act 24-2014 was approved by the Puerto Rico Legislature, seeking to further strengthen the liquidity of the GDB and the GDB’s oversight over public funds. Among other measures, Act 24-2014 grants the GDB the ability to exercise additional oversight of certain public funds deposited at private financial institutions and grants the GDB the legal authority, subject to an entity’s ability to request waivers under certain specified circumstances, to require such public funds (other than funds of the Legislative Branch, the Judicial Branch, the University of Puerto Rico, governmental pension plans, municipalities and certain other independent agencies) to be deposited at the GDB, which is expected to result in a more efficient management of public resources in an effort to maximize liquidity and efficient use of public resources. The GDB has identified approximately \$450 million in public funds deposited in private financial institutions in Puerto Rico that the GDB’s management currently expects to capture in the first half of calendar year 2014. The Corporation believes that \$250 million in public deposits held by the Corporation are at high risk of migration. Current and future liquidity levels have been planned considering that risk. As such, no material adverse effects are expected as a result of the potential reduction in public funds. The Corporation will continue to focus on transactional accounts and capture deposits from entities excluded from Act 24-2014.

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

Our ability to engage in routine funding transactions could be adversely affected by future failures of financial institutions and the actions and commercial soundness of other financial institutions. Financial institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have

exposure to different industries and counterparties and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, investment companies and other institutional clients. In certain of these transactions, we are required to post collateral to secure the obligations to the counterparties. In the event of a bankruptcy or insolvency proceeding involving one of such counterparties, we may experience delays in recovering the assets posted as collateral, or we may incur a loss to the extent that the counterparty was holding collateral in excess of the obligation to such counterparty.

In addition, many of these transactions expose us to credit risk in the event of a default by our counterparty or client. In addition, the credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to us. In addition to loans extended to government entities, the largest loan to one borrower as of December 31, 2013 in the amount of \$240.1 million is with one financial institution in Puerto Rico, Doral Financial Corporation. Any losses resulting from our routine funding transactions may materially and adversely affect our financial condition and results of operations.

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

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

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

These programs have subjected financial institutions, particularly those participating in TARP, to additional restrictions, oversight and costs. In addition, new proposals for legislation are periodically introduced in the U.S. Congress that could further substantially increase regulation of the financial services industry, impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices, including in the areas of interest rates, financial product offerings and disclosures, and have an effect on bankruptcy proceedings with respect to consumer residential real estate mortgages, among other things. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied.

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

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

The Corporation faces increased regulation and regulatory scrutiny as a result of its participation in the TARP. The U.S. Department of the Treasury acquired shares of Common Stock from the Corporation in October 2011 in exchange for shares of preferred stock that it owned because of the Corporation's issuance of preferred

stock to Treasury in January 2009 pursuant to the TARP. In July 2010, the Corporation issued to Treasury a warrant, which amends, restates and replaces the original warrant that it issued to Treasury in January 2009 under the TARP. The Corporation's participation in the TARP also imposes limitations on the payments it may make to its senior leaders.

The Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes, and the regulations developed and to be developed thereunder include or will include, provisions affecting large and small financial institutions alike.

The Collins Amendment in the Dodd-Frank Act, among other things, requires the federal banking agencies to establish minimum leverage and risk-based capital requirements that will apply to both insured banks and their holding companies. Regulations implementing the Collins Amendment became effective on July 28, 2011 and set as a floor for the capital requirements of the Corporation and FirstBank a minimum capital requirement computed using the FDIC's general risk-based capital rules.

On July 2, 2013, the federal banking agencies adopted final rules for U.S. banks that revise in important respects the minimum regulatory capital requirements, the components of regulatory capital, and the risk-based capital treatment of bank assets and off-balance sheet exposures. The final rules, which come into effect for the Corporation and FirstBank beginning January 1, 2015, generally are intended to align U.S. regulatory capital requirements with international regulatory capital standards adopted by the Basel Committee on Banking Supervision, in particular the most recent international capital accord adopted in 2010 (and revised in 2011) known as "Basel III." The new rules will increase the quantity and quality of required capital by, among other things, establishing a new minimum common equity Tier 1 ratio of 4.5% of risk-weighted assets and an additional common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. In addition, banks and bank holding companies are required to have a Tier 1 leverage ratio of 4.0%, a Tier 1 risk-based ratio of 6.0% and a total risk-based ratio of 8.0%. The final rules also revise the definition of capital by expanding the conditions for the inclusion of equity capital instruments and minority interests as Tier 1 capital, and will impose limitations on capital distributions and certain discretionary bonus payments if additional specified amounts, or "buffers," of common equity Tier 1 capital are not met.

Consistent with Basel III and the Collins Amendment, the final rules also establish a more conservative standard for including an instrument such as trust-preferred securities as Tier 1 capital for bank holding companies with total consolidated assets of \$15 billion or more as of December 31, 2009, setting out a phase-out schedule. Bank holding companies such as the Corporation must fully phase out these instruments from Tier I capital by January 1, 2016, although qualifying trust preferred securities may be included as Tier 2 capital until the instruments are redeemed or mature. As of December 31, 2013, the Corporation had \$225 million in trust preferred securities that are subject to the phase-out from Tier 1 capital under the final regulatory capital rules discussed above.

In addition, the final rules revise and harmonize the bank regulators' rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses that have been identified recently, by applying a variation of the Basel III "standardized approach" for the risk-weighting of bank assets and off-balance sheet exposures to all U.S. banking organizations other than large, internationally active banks.

The final capital rules will become effective for the Corporation and our subsidiary bank on a multi-year transitional basis starting on January 1, 2015, and in general will be fully effective as of January 1, 2019. While we cannot calculate the precise impact of the final capital rules on our business and financial condition at this time, we believe that First BanCorp. and FirstBank will be able to meet well-capitalized capital ratios upon implementation of the requirements. Although we expect to continue to exceed the minimum requirements for well capitalized status following the implementation of Basel III, there can be no assurance that we will remain well capitalized.

The U.S banking regulators are also expected to adopt regulatory liquidity requirements, including a liquidity coverage ratio (LCR) and a net stable funding ratio (NSFR), which are intended to ensure that firms hold sufficient liquid assets over different time horizons to fund operations if other funding sources are unavailable. On January 6, 2013, the Basel Committee announced that its liquidity requirements would be phased-in annually beginning in 2015, when the minimum liquidity ratio requirement would be set at 60% of required liquidity, then increasing an additional 10% annually until fully implemented on January 1, 2019. Additionally, although the timing is uncertain, the U.S. banking regulators are expected to propose and enact rules regarding the NSFR.

Additional regulatory proposals and legislation, if finally adopted, would change banking laws and our operating environment and that of our subsidiaries in substantial and unpredictable ways. The ultimate effect that such legislation, if enacted, or regulations would have upon our financial condition or results of operations may be adverse.

***Rulemaking changes implemented by the CFPB will result in higher regulatory and compliance costs related to originating and servicing residential mortgage loans and may adversely affect our results of operations.***

The Dodd-Frank Act significantly changed the regulation of single-family residential mortgage lending in the United States. Among other things, the law transferred rule-making and enforcement powers from a number of federal agencies to the CFPB, imposed new risk retention and recordkeeping requirements on lenders (such as the Bank) which sell single-family residential mortgage loans in the secondary market, required revision of disclosure documents mandated by various federal laws, limited loan originator compensation and expanded recordkeeping and reporting requirements under other federal statutes.

New regulations implement the Dodd-Frank Act amendments to the Equal Credit Opportunity Act, the Truth in Lending Act (“TILA”), and the Real Estate Settlement Procedures Act (“RESPA”). Among other changes, these regulations: (i) require lenders to make a reasonable good faith determination of a prospective residential mortgage borrower’s ability to repay based on specific underwriting criteria certain of which need to be supported through the verification of third party records. To the extent the lender intends to originate “qualified mortgages” that presumptively satisfy the ability to pay requirement ( thereby providing the lender a safe harbor from compliance claims) stricter underwriting criteria is required, (ii) impose new requirements on mortgage servicing that address many issues, including periodic billing statements, error resolution, force-placed insurance, payment crediting and payoff, early intervention with delinquent borrowers, and enhanced loss mitigation procedures, (iii) specify new limitations on loan originator compensation and establish criteria for the qualifications of, and registration or licensing of loan originators, (iv) further restrict certain high-cost mortgage loans by expanding the coverage of the Home Ownership and Equity Protections Act of 1994, (v) expand mandated loan escrow accounts for certain loans, (vi) revise existing appraisal requirements under the Equal Credit Opportunity Act and require provision of a free copy of all appraisals to applicants for first lien loans, (vii) establish new appraisal standards for “higher-risk mortgages” under TILA, and (viii) combine in a single, new form required loan disclosures under the TILA and RESPA.

The new ability to repay requirements may result in reduced credit availability and higher borrowing costs to cover the costs of compliance. The ability of borrowers to raise new defenses in foreclosure proceedings on defaulted mortgage loans also may lead to increased foreclosure costs, extend foreclosure timeliness, and increase the severity of loan losses. Increased repurchase and indemnity requests with respect to mortgage loans sold into the secondary markets may also result.

Apart from use of the TILA/RESPA combined disclosure form, which becomes effective August 1, 2015, some of these new rules became effective in June 2013, while others became effective in January 2014. These and other changes required by the Dodd-Frank Act will require substantial modifications to the entire mortgage lending and servicing industry. Their impact may involve changes to our operations and increased compliance costs in making single-family residential mortgage loans. Forthcoming additional rulemaking affecting the residential mortgage business is also expected and may cause us to incur additional increased regulatory and compliance costs.

***Compliance with stress testing requirements may be challenging.***

The Corporation is currently subject to supervisory guidance for stress testing practices issued by the federal banking agencies in May 2012. This guidance outlines broad principles for a satisfactory stress testing framework and describes various stress testing approaches and how stress testing should be used at various levels within an organization. The Corporation is also subject to two new stress testing rules that implement provisions of the Dodd-Frank Act (the “DFA Stress Tests”), one issued by the Federal Reserve Board that applies to First BanCorp. on a consolidated basis and one issued by the FDIC that applies to the Bank. These DFA Stress Tests are designed to require banking organizations to assess the potential impact of different scenarios on their earnings, losses and capital over a set time period, with consideration given to certain relevant factors, including the organization’s condition, risks, exposures, strategies, and activities. These DFA Stress Tests require banking organizations with total consolidated assets of more than \$10 billion but less than \$50 billion, including the Corporation and the Bank, to conduct annual company-run stress tests using certain scenarios that the Federal Reserve Board will publish by November 15 of each year, report the results to their primary federal regulator and the Federal Reserve Board by March 31 of the following year, and publicly disclose, beginning in 2015, a summary of the results by June 30 of that year. On March 5, 2014, the federal banking agencies published final supervisory guidance (previously proposed in July 2013) describing their supervisory expectations for the DFA Stress Tests to be conducted by financial institutions, in the \$10 billion to \$50 billion asset range, including First BanCorp. and the Bank. The final guidance provides flexibility to accommodate different risk profiles, sizes, business lines, market areas, and complexity approaches for banking institutions in the \$10 billion to \$50 billion asset range, and provide examples of practices that would be consistent with supervisory expectations.

Under the DFA Stress Tests, the Corporation is required to conduct its first stress tests using financial statement data as of September 30, 2013, and to report the results to the Federal Reserve Board and the FDIC by March 31, 2014. In addition, the Corporation is required to begin publicly disclosing the stress test results by the end of June 2015 with respect to the stress test conducted in the fall of 2014. Such public disclosure of stress test results could result in reputational harm if the Corporation’s results are worse than those of its competitors or otherwise indicate that the Corporation’s risk profile is excessive or elevated. Furthermore, given that the Corporation will be subject to multiple stress testing requirements that are administered at different levels by more than one federal banking agency, and compliance with such requirements will be complicated, if the Corporation fails to fully comply with these requirements, it may be subject to regulatory action.

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

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

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

***We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.***

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A



successful regulatory challenge to an institution's performance under the Community Reinvestment Act or fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

***We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.***

The Bank Secrecy Act, the USA PATRIOT Act of 2001 and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition and results of operations.

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

***Sales in the public market under an outstanding resale registration statement filed with the SEC by the small group of large stockholders that hold in the aggregate approximately 50.55% of our outstanding shares could adversely affect the trading price of our common stock.***

The following stockholders individually own more than 10% of our outstanding shares of common stock, or an aggregate of approximately 50.55% of our outstanding shares of common stock: funds affiliated with THL, which own approximately 20.21%; funds managed by Oaktree, which own approximately 20.21%; and Treasury which owns approximately 10.139% including the shares of common stock issuable upon exercise of the warrant. We are obligated to keep the prospectus, which is part of the resale registration statement, current so that the securities can be sold in the public market at any time. The resale of the securities in the public market, or the perception that these sales might occur, could cause the market price of our common stock to decline.

***Issuance of additional equity securities in the public market and other capital management or business strategies that we may pursue also depress the market price of our common stock and could result in dilution of holders of our common stock and preferred stock.***

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



The Corporation has outstanding a warrant held by the Treasury to purchase 1,285,899 shares of common stock. If the Warrant is exercised, the issuance of shares of Common Stock would reduce our income per share, and further reduce the book value per share and voting power of our current common stockholders.

Additionally, THL, Oaktree and funds advised by Wellington Management Company, LLP (“Wellington”) have anti-dilution rights, which they acquired when they purchased shares of common stock in the \$525 million capital raise, completed in October 2011 that have been, and will be in the future, triggered, subject to certain exceptions, upon our issuance of additional shares of common stock. In such a case, THL, Oaktree and Wellington had, and will have, the right to acquire the amount of shares of common stock that will enable them to maintain their percentage ownership interest in the Corporation.

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

The stock markets have experienced high levels of volatility during the last few years. These market fluctuations have adversely affected, and may continue to adversely affect, the trading price of our common stock. In addition, the market price of our common stock has been subject to significant fluctuations and volatility because of factors specifically related to our businesses and may continue to fluctuate or decline.

Factors that could cause fluctuations, volatility or a decline in the market price of our common stock, many of which could be beyond our control, include the following:

- uncertainties and developments related to the resolution of the Puerto Rico Government fiscal problems;
- our ability to comply with the Regulatory Agreements;
- any additional regulatory actions against us;
- changes or perceived changes in the condition, operations, results or prospects of our businesses and market assessments of these changes or perceived changes;
- announcements of strategic developments, acquisitions and other material events by us or our competitors, including any failures of banks;
- changes in governmental regulations or proposals, or new governmental regulations or proposals, affecting us, including those relating to the financial crisis and global economic downturn and those that may be specifically directed to us;
- a continuing recession in the Puerto Rico market and a lack of growth in our other principal markets in the Virgin Islands and the United States;
- the departure of key employees;
- changes in the credit, mortgage and real estate markets;
- operating results that vary from the expectations of management, securities analysts and investors;
- operating and stock price performance of companies that investors deem comparable to us; and
- the public perception of the banking industry and its safety and soundness.

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

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

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

This suspension may have adversely affected and may continue to adversely affect our stock price. Further, because dividends on our Series A through E Preferred Stock have not been paid since we suspended dividend payments in August 2009, the holders of the preferred stock have the right to appoint two additional members to our Board of Directors. Any member of the Board of Directors appointed by the holders of Series A through E Preferred Stock is required to vacate his or her office if the Corporation resumes the payment of dividends in full for twelve consecutive monthly dividend periods.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

As of December 31, 2013, First BanCorp owned the following three main offices located in Puerto Rico:

- Headquarters—Located at First Federal Building, 1519 Ponce de León Avenue, Santurce, Puerto Rico, a 16 story office building. Approximately 60% of the building, an underground three level parking garage and an adjacent parking lot are owned by the Corporation.
- Service Center—a building located on 1130 Muñoz Rivera Avenue, Hato Rey, Puerto Rico. These facilities accommodate branch operations, data processing and administrative and certain headquarter offices. FirstBank inaugurated the Service Center in 2010. The building houses 180,000 square feet of modern facilities and over 1,000 employees from operations, FirstMortgage and FirstBank Insurance Agency headquarters and customer service. In addition, it has parking for 750 vehicles and 9 training rooms, including classrooms for training tellers and a computer room for interactive trainings, as well as a spacious cafeteria for employees and customers
- Consumer Lending Center—A three-story building with a three-level parking garage located at 876 Muñoz Rivera Avenue, Hato Rey, Puerto Rico. This facility is fully occupied by the Corporation.

The Corporation owned 20 branch and office premises and auto lots and leased 82 branch premises, loan and office centers and other facilities. In certain situations, financial services such as mortgage and, insurance businesses and commercial banking services are located in the same building. All of these premises are located in Puerto Rico, Florida and the USVI and BVI. Management believes that the Corporation's properties are well maintained and are suitable for the Corporation's business as presently conducted.

**Item 3. Legal Proceedings**

Reference is made to Note 28 Regulatory matters, commitments and contingencies included in the Notes to Consolidated Financial Statements in Item 8 of this Report, which is incorporated herein by reference.

**Item 4. Mine Safety Disclosure.**

Not applicable.

## PART II

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

#### **Information about Market and Holders**

The Corporation's common stock is traded on the NYSE under the symbol FBP. In 2010, following stockholder approvals, the Corporation amended its certificate of incorporation twice to increase the number of shares of common stock authorized for issuance from 250 million at the beginning of 2010 to 2.0 billion shares and to implement, effective January 7, 2011, a one-for-fifteen reverse stock split of all outstanding shares of common stock.

On March 7, 2014, there were 553 holders of record of the Corporation's common stock, not including beneficial owners whose shares are held in the name of brokers or other nominees. The last sales price for the common stock on that date was \$5.59.

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

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

<u>Quarter Ended</u>	<u>High</u>	<u>Low</u>	<u>Last</u>	<u>Dividends per Share</u>
<b>2013:</b>				
Fourth Quarter Ended December 31, 2013 .....	\$6.38	\$5.06	\$6.19	\$—
Third Quarter Ended September 30, 2013 .....	8.61	5.67	5.68	—
Second Quarter Ended June 30, 2013 .....	7.19	5.64	7.08	—
First Quarter Ended March 31, 2013 .....	6.30	4.59	6.23	—
<b>2012:</b>				
Fourth Quarter Ended December 31, 2012 .....	\$4.58	\$3.69	\$4.58	\$—
Third Quarter Ended September 30, 2012 .....	4.50	3.34	4.42	—
Second Quarter Ended June 30, 2012 .....	4.38	3.27	3.96	—
First Quarter Ended March 31, 2012 .....	4.95	3.37	4.40	—

On October 7, 2011, the Corporation successfully completed a private placement of \$525 million in shares of common stock (the "capital raise"). The proceeds from the capital raise amounted to approximately \$490 million (net of offering costs). Lead investors included funds affiliated with THL and Oaktree, which purchased from the Corporation an aggregate of \$348.2 million (\$174.1 million by each investor) of shares of the Corporation's common stock.

Upon the completion of this transaction and the conversion into common stock of the Series G Preferred Stock held by the Treasury, as further discussed below, each of THL and Oaktree became owners of 24.36% of the Corporation's shares of common stock outstanding. Subsequent to the closing, in related transactions, on October 12, 2011 and October 26, 2011, each of THL and Oaktree, respectively, purchased in the aggregate 937,493 shares of common stock from certain of the institutional investors who participated in the capital raise transaction.

On August 16, 2013, THL, Oaktree and the Treasury completed a secondary offering of the Corporation's common stock. The Treasury sold 12 million shares of common stock, THL sold 8 million shares of common stock, and Oaktree sold 8 million shares of common stock. Subsequently, on September 11, 2013, the underwriters in the secondary offering exercised their option to purchase an additional 2.9 million shares of

common stock from the selling stockholders (1,261,356 shares from the Treasury, 840,903 shares from THL and 840,904 shares from Oaktree). The Corporation did not receive any proceeds from the offering. As of March 7, 2014, each of THL and Oaktree owns 20.21% of the Corporation's outstanding common stock and the Treasury owns 9.50%, excluding the common shares underlying the warrant owned by the Treasury.

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

Effective April 1, 2013, the Board determined to increase the salary amounts paid to certain executive officers for fiscal year 2013 primarily by paying the increased salary amounts in the form of shares of the Corporation's Common Stock, instead of cash. The Corporation issued 220,639 shares of common stock with a weighted average market value of \$6.23 for compensation according to this determination. The Corporation withheld 71,326 shares from the common stock paid to the officers as additional compensation to cover employee payroll and income tax withholding liabilities; these shares are held as treasury shares. The Corporation paid any fractional share of salary stock that the officer was entitled to in cash.

In 2013, the Corporation granted 743,185 shares of restricted stock to certain executive officers, other employees, and independent directors.

The Corporation has 50,000,000 authorized shares of preferred stock. First BanCorp has five outstanding series of nonconvertible, noncumulative preferred stock: 7.125% noncumulative perpetual monthly income preferred stock, Series A (liquidation preference \$25 per share); 8.35% noncumulative perpetual monthly income preferred stock, Series B (liquidation preference \$25 per share); 7.40% noncumulative perpetual monthly income preferred stock, Series C (liquidation preference \$25 per share); 7.25% noncumulative perpetual monthly income preferred stock, Series D (liquidation preference \$25 per share.); and 7.00% noncumulative perpetual monthly income preferred stock, Series E (liquidation preference \$25 per share) (collectively the "Series A through E Preferred Stock"). Effective January 17, 2012, the Corporation delisted all of its outstanding series of non-convertible, non-cumulative preferred stock from the NYSE. The Corporation has not arranged for listing on another national securities exchange or for quotation of the Series A through E Preferred Stock in a quotation medium. On January 3, 2012, the Corporation filed a Form 25 with the Securities and Exchange Commission (the "Exchange") to voluntarily withdraw the Series A through E Preferred Stock from listing and registration on the NYSE.

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

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

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



### *2010 Exchange Offer and Treasury Exchange*

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

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

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

### *2013 Exchange Offer*

On February 14, 2013, the Corporation commenced an offer to issue up to 10,087,488 shares of its common stock, in exchange for (the "Exchange Offer") any and all of the issued and outstanding shares of its Series A through E Preferred Stock (\$63 million in aggregate liquidation preference value). The Exchange Offer was terminated on April 9, 2013 given that the Corporation did not receive the consent required from holders of the Series A through E Preferred Stock to amend the certificates of designation of each series of the Series A through E Preferred Stock to delete the right to designate two board members once the Corporation has not paid dividend on the Preferred Stock for a specified period (the Preferred Stock Amendment). The Preferred Stock Amendment was a condition to completion of the Exchange Offer. In addition, the related consent solicitation also terminated, and no consent fee became payable with respect to consents granted in favor of the Preferred Stock Amendment. All shares of the Series A through E Preferred Stock that were tendered were returned promptly to the tendering holders.

### **Dividends**

The Corporation had a policy of paying quarterly cash dividends on its outstanding shares of common stock subject to its earnings and financial condition. On July 30, 2009, after reporting a net loss for the quarter ended June 30, 2009, the Corporation announced that the Board of Directors resolved to suspend the payment of the common and preferred dividends (including the Series F Preferred Stock dividends), effective with the preferred dividend for the month of August 2009. The Corporation's ability to pay future dividends will necessarily depend upon its earnings and financial condition as well as its receipt of approval from the Federal Reserve to pay dividends. See the discussion under "Dividend Restrictions" under Item 1 for additional information concerning restrictions on the payment of dividends that apply to the Corporation and FirstBank.

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. The Corporation withheld approximately 71,326 shares from the common stock paid to certain senior officers as additional compensation to cover employee payroll and income tax withholding liabilities; these shares are also held as treasury shares. As of December 31, 2013 and December 31, 2012, the Corporation had 566,179, and 494,853 shares held as treasury stock, respectively.

The 2011 PR Code requires the withholding of income tax from dividend income to be received by resident U.S. citizens, special partnerships, trusts and estates and non-resident U.S. citizens, custodians, partnerships, and corporations from sources within Puerto Rico.

*Resident U.S. Citizens*

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

*Nonresident U.S. Citizens*

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

*U.S. Corporations and Partnerships*

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

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

The following table summarizes equity compensation plans approved by security holders and equity compensation plans that were not approved by security holders as of December 31, 2013:

<b>Plan category</b>	<b>(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, warrants and rights</b>	<b>(b) Weighted Average Exercise Price of Outstanding Options, warrants and rights</b>	<b>(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))</b>
Equity compensation plans approved by stockholders .....	101,435 <sup>(1)</sup>	\$206.95	6,444,461 <sup>(2)</sup>
Equity compensation plans not approved by stockholders .....	N/A	N/A	N/A
<b>Total .....</b>	<b>101,435</b>	<b>\$206.95</b>	<b>6,444,461</b>

- (1) Stock options granted under the 1997 stock option plan, which expired on January 21, 2007. All outstanding awards under the stock option plan continue in full force and effect, subject to their original terms and the shares of common stock underlying the options are subject to adjustments for stock splits, reorganization and other similar events.
- (2) Securities available for future issuance under the First BanCorp. 2008 Omnibus Incentive Plan (the “Omnibus Plan”), which was initially approved by stockholders on April 29, 2008 and amended with stockholder approval on December 9, 2011 to increase the number of shares reserved for issuance under the

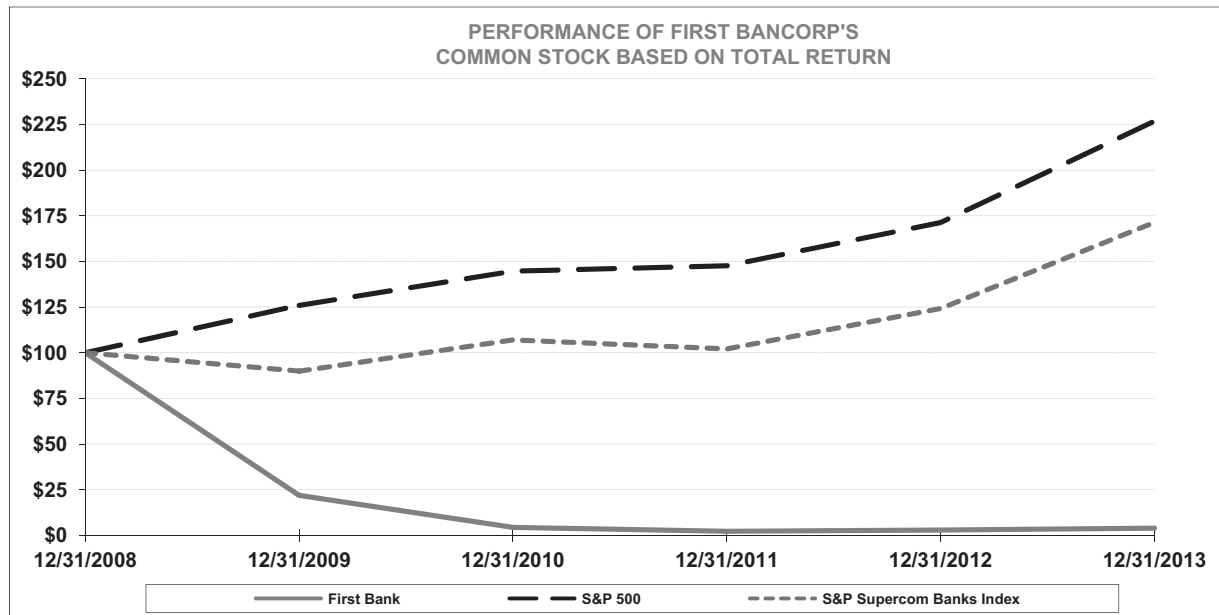
Omnibus Plan. The Omnibus Plan provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. As amended, this plan provides for the issuance of up to 8,169,807 shares of common stock, subject to adjustments for stock splits, reorganization and other similar events. As of December 31, 2012, 6,444,461 shares of Common Stock were available for future issuance under the Omnibus Plan.

### STOCK PERFORMANCE GRAPH

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

The graph below compares the cumulative total stockholder return of First BanCorp. during the measurement period with the cumulative total return, assuming reinvestment of dividends, of the S&P 500 Index and the S&P Supercom Banks Index (the "Peer Group"). The Performance Graph assumes that \$100 was invested on December 31, 2008 in each of First BanCorp. common stock, the S&P 500 Index and the Peer Group. The comparisons in this table are set forth in response to SEC disclosure requirements, and are therefore not intended to forecast or be indicative of future performance of First BanCorp.'s common stock.

The cumulative total stockholder return was obtained by dividing (i) the cumulative amount of dividends per share, assuming dividend reinvestment since the measurement point, December 31, 2008 plus (ii) the change in the per share price since the measurement date, by the share price at the measurement date.



## Item 6. Selected Financial Data

The following table sets forth certain selected consolidated financial data for each of the five years in the period ended December 31, 2013. This information should be read in conjunction with the audited consolidated financial statements and the related notes thereto.

### SELECTED FINANCIAL DATA

	Year Ended December 31,				
	2013	2012	2011	2010	2009
<b>Condensed Income Statements:</b>					
Total interest income	\$ 645,788	\$ 637,777	\$ 659,615	\$ 832,686	\$ 996,574
Total interest expense	130,843	176,072	266,103	371,011	477,532
Net interest income	514,945	461,705	393,512	461,675	519,042
Provision for loan and lease losses	243,751	120,499	236,349	634,587	579,858
Non-interest (loss) income	(15,489)	49,391	107,981	117,903	142,264
Non-interest expenses	415,028	354,883	338,054	366,158	352,101
(Loss) income before income taxes	(159,323)	35,714	(72,910)	(421,167)	(270,653)
Income tax expense	(5,164)	(5,932)	(9,322)	(103,141)	(4,534)
Net (loss) income	(164,487)	29,782	(82,232)	(524,308)	(275,187)
Net (loss) income attributable to common stockholders—basic	(164,487)	29,782	173,226	(122,045)	(322,075)
Net (loss) income attributable to common stockholders—diluted	(164,487)	29,782	195,763	(122,045)	(322,075)
<b>Per Common Share Results:</b>					
Net (loss) income per common share—basic	\$ (0.80)	\$ 0.15	\$ 2.69	\$ (10.79)	\$ (52.22)
Net (loss) income per common share—diluted	\$ (0.80)	\$ 0.14	\$ 2.18	\$ (10.79)	\$ (52.22)
Cash dividends declared	—	—	—	—	2.10
Average shares outstanding	205,542	205,366	64,466	11,310	6,167
Average shares outstanding diluted	205,542	205,828	89,658	11,310	6,167
Book value per common share	\$ 5.57	\$ 6.89	\$ 6.73	\$ 29.71	\$ 108.70
Tangible book value per common share <sup>(1)</sup>	\$ 5.30	\$ 6.60	\$ 6.54	\$ 27.73	\$ 101.45
<b>Balance Sheet Data:</b>					
Total loans, including loans held for sale	\$ 9,712,139	\$10,139,508	\$10,575,214	\$11,956,202	\$13,949,226
Allowance for loan and lease losses	285,858	435,414	493,917	553,025	528,120
Money market and investment securities	2,208,342	1,986,669	2,200,888	3,369,332	4,866,617
Intangible assets	54,866	60,944	39,787	42,141	44,698
Deferred tax asset, net	7,644	4,867	5,442	9,269	109,197
Total assets	12,656,925	13,099,741	13,127,275	15,593,077	19,628,448
Deposits	9,879,924	9,864,546	9,907,754	12,059,110	12,669,047
Borrowings	1,431,959	1,640,399	1,622,741	2,311,848	5,214,147
Total preferred equity	63,047	63,047	63,047	425,009	928,508
Total common equity	1,231,547	1,393,546	1,361,899	615,232	644,062
Accumulated other comprehensive (loss) income, net of tax	(78,736)	28,430	19,198	17,718	26,493
Total equity	1,215,858	1,485,023	1,444,144	1,057,959	1,599,063

	Year Ended December 31,				
	2013	2012	2011	2010	2009
<b>Selected Financial Ratios (In Percent):</b>					
<b>Profitability:</b>					
Return on Average Assets . . . . .	(1.28)	0.23	(0.57)	2.93	(1.39)
Return on Average Total Equity . . . . .	(12.39)	2.04	(7.31)	(36.23)	(14.84)
Return on Average Common Equity . . . . .	(13.01)	2.14	(13.38)	(80.07)	(34.07)
Average Total Equity to Average Total Assets . . . . .	10.36	11.24	7.83	8.10	9.36
Interest Rate Spread <sup>(2)</sup> . . . . .	4.01	3.41	2.59	2.48	2.62
Interest Rate Margin <sup>(2)</sup> . . . . .	4.21	3.68	2.86	2.77	2.93
Tangible common equity ratio <sup>(1)</sup> . . . . .	8.71	10.44	10.25	3.80	3.20
Dividend payout ratio . . . . .	—	—	—	—	(4.03)
Efficiency ratio <sup>(3)</sup> . . . . .	83.10	69.44	67.41	63.18	53.24
<b>Asset Quality:</b>					
Allowance for loan and lease losses to loans held for investment . . . . .	2.97	4.33	4.68	4.74	3.79
Net charge-offs to average loans . . . . .	4.01	1.74	2.68	4.76	2.48
Provision for loan and lease losses to net charge-offs . . . . .	0.69x	0.67x	0.80x	1.04x	1.74x
Non-performing assets to total assets . . . . .	5.73	9.45	10.19	10.02	8.71
Non-performing loans held for investment to total loans held for investment . . . . .	5.14	9.70	10.78	10.63	11.23
Allowance to total non-performing loans held for investment . . . . .	57.69	44.63	43.39	44.64	33.77
Allowance to total non-performing loans held for investment, excluding residential real estate loans . . . . .	85.56	65.78	61.73	65.30	47.06
<b>Other Information:</b>					
Common stock price: End of period . . . . .	\$ 6.19	\$ 4.58	\$ 3.49	\$ 6.90	\$ 34.50

(1) Non-GAAP measures. Refer to “Capital” discussion below for additional information regarding the components reconciliation of these measures.

(2) On a tax equivalent basis and excluding the changes in fair value of derivative instruments and financial liabilities measured at fair value (see “Net Interest Income” discussion below for reconciliation of these non-GAAP measures).

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



## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)**

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

### **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 and FirstBank Insurance Agency. Through its wholly owned subsidiaries, the Corporation operates offices in Puerto Rico, the United States Virgin Islands and British Virgin Islands, and the State of Florida (USA) concentrating in commercial banking, residential mortgage loan originations, finance leases, credit cards, personal loans, small loans, auto loans, insurance agency and broker-dealer activities.

As described in Item 8, Note 28 to the Consolidated Financial Statements, Regulatory Matters, Commitments, and Contingencies, FirstBank is currently operating under a Consent Order (the "FDIC Order") with the Federal Deposit Insurance Corporation ("FDIC") and the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico and First BanCorp has entered into a Written Agreement with the New York FED.

### **PUERTO RICO ECONOMIC ENVIRONMENT AND EXPOSURE TO PUERTO RICO GOVERNMENT**

Puerto Rico's economy has been in recession for eight consecutive years. The Puerto Rico's real gross national product, which increased by 0.1% in fiscal year 2012, is projected to decrease by 0.03% for fiscal year 2013 and 0.8% for 2014. The Bureau of Labor Statistics reported an unemployment rate of 15.4% for the month of December 2013.

Puerto Rico has about \$70 billion of outstanding debt and its debt cost has increased in 2013. In mid-August 2013, the 30-year general obligation bonds, which are widely held by mutual funds, carried a yield of about 7.1%, which increased during the latter part of the third quarter of 2013, surpassing 10% at one point in September amid a general run-up in interest rates and significant selling by investors after Detroit filed for the largest municipal bankruptcy in U.S. history. The debt carried a yield of approximately 9.54% as of December 31, 2013.

On February 4, 2014, S&P downgraded the Commonwealth of Puerto Rico's debt to BB+, one level below investment grade. S&P also downgraded to levels below investment grade the credit rating of the Government Development Bank of Puerto Rico ("GDB") and Employee Retirement System to BB and various ratings of the Puerto Rico Highways and Transportation Authority to BB+. On February 7, 2014, Moody's Investor Service ("Moody's") downgraded the Commonwealth of Puerto Rico general obligation bonds to Ba2, two notches below investment grade. Moody's also downgraded to Ba2 the Public Building Authority Bonds, the Pension Funding Bonds, the GDB senior notes, the Municipal Finance Authority Bonds, the Puerto Rico Infrastructure Finance Authority Special Tax Revenue Bonds, the Convention Center District Authority Hotel Occupancy Tax Revenue Bonds, the Puerto Rico Highway and Transportation Authority Transportation Revenue Bonds, various ratings of obligations of the Puerto Rico Aqueduct and Sewer Authority and the Puerto Rico Electric Power Authority. In addition, COFINA's senior-lien bonds were downgraded by Moody's to Baa1 from A2, retaining investment grade status. Following the downgrades by S&P and Moody's, Fitch became the third agency to downgrade the Commonwealth of Puerto Rico debt to a below investment grade. Fitch now rates Puerto Rico's general obligation bonds at BB, two notches below investment grade, from BBB-. Based on S&P definition of a BB credit rating, the debt rating suggest that S&P views the Puerto Rico Government's obligation as less vulnerable to nonpayment in the near term than other speculative issues. However, it faces major ongoing

uncertainties or exposure to adverse business, financial or economic conditions; thus, the ultimate impact of the downgrades is unpredictable and may not be immediately apparent. Following the downgrade of the general obligation rating of the Commonwealth of Puerto Rico, Moody's placed on review for downgrade certain ratings of three Puerto Rican banks, including the long-term ratings of FirstBank.

In February 2014, the Puerto Rico government announced that the projected deficit for fiscal year 2014, initially estimated at \$820 million, would be reduced by \$170 million to \$650 million. This represents a decline of \$640 million compared to the estimated deficit for the previous fiscal year. In addition to the \$170 million reduction in the budget for fiscal year 2014, the Puerto Rico government announced that a balanced budget will be introduced in April 2014 for fiscal year 2015. The Puerto Rico government has implemented certain measures to strengthen its financial position, including a comprehensive reform of the Employees, Teachers, and Judiciary Retirement Systems to address their unfunded status and annual funding shortfalls and a raise in utility fees. Revenue collections totaled \$3,959 million in the first semester of fiscal year 2014 (July-December 2013). This figure exceeded collections for the same period of fiscal 2013 by \$537 million and exceeded budget estimates for this period by \$92.5 million.

Public sector certificates of deposit have increased at the GDB by more than \$500 million from September 30, 2013 to December 31, 2013 and the GDB has identified approximately \$450 million in public funds deposited in financial institutions in Puerto Rico that the GDB's management expects to capture during the remainder of fiscal year 2014. The GDB expects to have the liquidity necessary to fund the Puerto Rico Commonwealth's needs through at least fiscal year 2014, including any cash needs resulting from recent rating agencies' actions. In February 2014, the GDB announced that the Commonwealth of Puerto Rico expects to issue general obligation bonds in the near term to refinance approximately \$1.1 billion of short-term liabilities and address the government's liquidity needs. On March 11, 2014, the Commonwealth of Puerto Rico sold \$3.5 billion in general obligation bonds.

As of December 31, 2013, the Corporation had \$454.6 million of credit facilities granted to the Puerto Rico government, its municipalities and public corporations, of which \$397.8 million was outstanding, compared to \$158.4 million as of December 31, 2012. Approximately \$200.5 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality. The good faith, credit, and unlimited taxing power of each applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$84.6 million consists of loans to public corporations that receive revenues from the rates they charge for services or products, such as electric power services, including credit extended to the Puerto Rico Electric Power Authority for fuel purchases that have priority over senior bonds and other debt. Main public corporations have varying degrees of independence from the central government and many receive appropriations or other payments from the Puerto Rico's government general fund. Approximately \$112.7 million consists of loans to the central government or units of the central government. Debt issued by the central government can either carry the full faith, credit, and taxing power of the Commonwealth of Puerto Rico or represent an obligation, that is subject to annual budget appropriations. The Commonwealth of Puerto Rico has never defaulted on its debt. Furthermore, the Corporation had \$205.1 million outstanding as of December 31, 2013 in financing to the hotel industry in Puerto Rico guaranteed by the TDF. The TDF is a subsidiary of the GDB that works with private-sector financial institutions to structure financings for new hospitality projects. The TDF has a perfect track record of supporting its guarantees.

In addition, the Corporation held approximately \$71.0 million of obligations of the Puerto Rico government and agencies, mainly bonds of the GDB and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio that were reflected at their aggregate fair value of \$51.3 million as of December 31, 2013.

As of December 31, 2013, the Corporation had \$546.5 million of public sector deposits in Puerto Rico (\$285.5 million in transactional accounts and \$260.8 million in time deposits). Approximately 21% came from municipalities and 79% came from public corporations and the central government.

In 2014, Act 24-2014 was approved by the Puerto Rico Legislature, seeking to further strengthen the liquidity of the GDB and the GDB's oversight over public funds. Among other measures, Act 24-2014 grants the GDB the ability to exercise additional oversight of certain public funds deposited at private financial institutions and grants the GDB the legal authority, subject to an entity's ability to request waivers under certain specified circumstances, to require such public funds (other than funds of the Legislative Branch, the Judicial Branch, the University of Puerto Rico, governmental pension plans, municipalities and certain other independent agencies) to be deposited at the GDB, which is expected to result in a more efficient management of public resources in an effort to maximize liquidity and efficient use of public resources. The GDB has identified approximately \$450 million in public funds deposited in private financial institutions in Puerto Rico that the GDB's management currently expects to capture in the first half of calendar year 2014. The Corporation believes that \$250 million in public deposits held by the Corporation are at high risk of migration. Current and future liquidity levels have been planned considering that risk. As such, no material adverse effects are expected as a result of the potential reduction in public funds. The Corporation will continue to focus on transactional accounts and capture deposits from entities excluded from Act 24- 2014.

No significant changes have been experienced in the exposure to the Puerto Rico government since the end of 2013. The Corporation will continue to closely monitor Puerto Rico's political and economic status and evaluate the loan and investment portfolio for any declines in value that could be considered other-than-temporary.

## **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 have significantly affected the results of operations in recent years, non-interest expenses (such as personnel, occupancy, deposit insurance premiums and other costs), non-interest income (mainly service charges and fees on deposits, insurance income and revenues from broker-dealer operations), gains (losses) on sales of investments, gains (losses) on mortgage banking activities, and income taxes.

Net loss for the year ended December 31, 2013 amounted to \$164.5 million compared to net income of \$29.8 million for 2012 and a net loss of \$82.2 million for 2011.

The Corporation's financial results for 2013, as compared to 2012, were negatively impacted by two significant items: (i) an aggregate loss of \$140.8 million (pre-tax) on two separate bulk sales of adversely classified and non-performing assets and valuation adjustments to certain loans transferred to held for sale, and (ii) a \$66.6 million loss related to the write-off of assets pledged as collateral to Lehman together with an additional \$2.5 million for a loss contingency related to attorneys' fees awarded to the counterparty in this matter. Refer to Item 1- Business- "Significant Events Since the Beginning of 2013" for a detailed description of these items and other significant transactions and legislation that impacted the operating results in 2013.

The following table shows a reconciliation with respect to the results of operations for the year ended December 31, 2013, excluding the charges identified in the foregoing paragraph, with the corresponding measures calculated and presented in accordance with GAAP:

(In thousands, except per share information)	Year ended December 31, 2013 As Reported (GAAP)	Bulk Sales Transaction Impact	Write-off collateral pledged to Lehman and related contingency for attorneys' fees	Year Ended December 31, 2013 Adjusted (Non-GAAP) <sup>(1)</sup>	Year Ended December 31, 2012 As Reported (GAAP)	Variance
Net interest income . . . . .	\$ 514,945	\$ —	\$ —	\$514,945	\$461,705	\$53,240
Provision for loan and lease losses . . . . .	243,751	(132,002)	—	111,749	120,499	(8,750)
Net interest income after provision for loans and lease losses . . . . .	271,194	132,002	—	403,196	341,206	61,990
<b>Non-interest (loss) income . . . . .</b>	<b>(15,489)</b>	<b>—</b>	<b>66,574</b>	<b>51,085</b>	<b>49,391</b>	<b>1,694</b>
<b>Non-interest expenses . . . . .</b>	<b>415,028</b>	<b>(8,840)</b>	<b>(2,500)</b>	<b>403,688</b>	<b>354,883</b>	<b>48,805</b>
(Loss) Income before income taxes . . . . .	(159,323)	140,842	69,074	50,593	35,714	14,879
Income tax expense . . . . .	(5,164)	—	—	(5,164)	(5,932)	768
<b>Net (loss) income . . . . .</b>	<b><u>\$(164,487)</u></b>	<b><u>\$ 140,842</u></b>	<b><u>\$69,074</u></b>	<b><u>\$ 45,429</u></b>	<b><u>\$ 29,782</u></b>	<b><u>\$15,647</u></b>
Earning (loss) per common share:						
Basic . . . . .	\$ (0.80)	\$ 0.68	\$ 0.34	\$ 0.22	\$ 0.15	\$ 0.07
Diluted . . . . .	\$ (0.80)	\$ 0.68	\$ 0.34	\$ 0.22	\$ 0.14	\$ 0.08

(1) Refer to “Basis of Presentation” below for additional information.

Excluding the impact of the bulk sales of adversely classified and non-performing assets and valuation adjustments to certain loans transferred to held for sale, and the Lehman related charges, the net income for the year ended December 31, 2013 was \$45.4 million, an increase of \$15.6 million compared to 2012, primarily reflecting: (i) a \$53.2 million increase in net interest income mainly due to a reduction in the average cost of deposits, mainly brokered CDs, an improved deposit mix, maturities of high-cost borrowings, an increase in the average volume of mortgage-backed securities (“MBS”), and the contribution of the credit card portfolio acquired in late May 2012, (ii) an \$8.8 million decrease in the adjusted provision for loan and lease losses, mainly attributable to a reduction in charges to specific reserves for commercial and construction loans commensurate with the decline in the level of impaired and adversely classified loans, particularly higher charges in 2012 related to a construction loan in the Virgin Islands that was transferred to held for sale in 2013, and lower provision requirements for the Puerto Rico residential mortgage loan portfolio, reflecting the overall reduction in the size of this portfolio and the improved portfolio composition after the bulk sale of non-performing residential mortgage loans completed in the second quarter of 2013, and (iii) a \$1.7 million increase in adjusted non-interest income mainly due to a \$2.6 million decrease in equity in loss of unconsolidated entity, and a \$1.8 million decrease in other-than-temporary impairments on debt and equity securities, partially offset by a \$3.1 million decrease in revenues from the mortgage banking business. These variances were partially offset by a \$48.8 million increase in adjusted non-interest expenses mainly due to credit-related expenses including: (i) a \$15.5 million increase in the adjusted net loss on OREO operations, driven by higher write-downs to commercial income-producing OREO properties in both the Virgin Islands and Puerto Rico, and (ii) a \$2.6 million increase in professional fees related to attorneys’ loan collection fees, appraisals, and other credit-related expenses. In addition, non-interest expenses increased due to: (i) an \$8.6 million increase in credit and debit cards processing expenses, including \$1.7 million of costs related to the conversion of the credit card processing platform, (ii) a \$9.2 million increase in fees related to the outsourcing of technology services attributable to a multi-year technology outsourcing agreement executed by the Corporation at the beginning of the second quarter of 2013, (iii) a \$5.9 million charge related to the new Puerto Rico national gross receipts tax (partially offset in net operating results by a related credit of \$3.0 million recorded as a reduction of the income tax expense), (iv) a

\$5.4 million increase in employees' compensation and benefits, and (v) non-recurring expenses of \$1.7 million of costs associated with the common stock offering by certain of the Corporation's existing stockholders, and \$1.2 million associated with a terminated preferred stock exchange offer.

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

	Year Ended December 31,					
	2013		2012		2011	
	Dollars	Per Share	Dollars	Per Share	Dollars	Per Share
	(In thousands, except for per common share amounts)					
Net income (loss) attributable to common stockholders for prior year	\$ 29,782	\$ 0.14	\$ 195,763	\$ 2.18	\$(122,045)	\$(10.79)
Increase (decrease) from changes in:						
Net interest income	53,240	0.26	68,193	0.76	(68,163)	(6.03)
Provision for loan and lease losses—bulk sales and transfer of loans to held for sale	(132,002)	(0.64)	—	—	102,938	9.10
Provision for loan and lease losses—excluding bulk sales and transfer of loans to held for sale	8,750	0.04	115,850	1.29	295,300	26.11
Mortgage banking revenues	(3,130)	(0.01)	(3,360)	(0.04)	9,705	0.86
Net gain on investments and impairments	1,807	0.01	(42,518)	(0.47)	(14,705)	(1.30)
Net nominal gain on transaction involving the sale of investment securities matched with the cancellation of borrowings prior to maturity	—	—	(438)	—	438	0.04
Equity in loss of unconsolidated entity	2,565	0.01	(15,029)	(0.17)	(4,227)	(0.37)
Impairment of collateral pledged to Lehman and related expenses	(69,074)	(0.34)	—	—	—	—
Other non-interest income	981	0.01	2,755	0.03	(1,133)	(0.10)
Employees' compensation and benefits	(4,945)	(0.02)	(7,135)	(0.08)	2,651	0.23
National gross receipts tax	(5,904)	(0.03)	—	—	—	—
Deposit insurance premium	3,602	0.02	6,080	0.07	6,689	0.59
Net loss on REO operations	(15,517)	(0.07)	(91)	—	5,148	0.46
Outsourcing technology services	(9,199)	(0.04)	(1,560)	(0.02)	(829)	(0.07)
Other professional fees	(3,256)	(0.02)	(446)	—	(154)	(0.01)
Credit and debit processing expenses	(6,904)	(0.03)	(4,932)	(0.06)	96	0.01
Credit card processing platform conversion costs	(1,715)	(0.01)	—	—	—	—
Branch consolidation and other restructuring expenses	(1,421)	(0.01)	—	—	—	—
Secondary offering costs	(1,669)	(0.01)	—	—	—	—
Terminated preferred stock exchange offer	(1,333)	(0.01)	—	—	—	—
Bulk sales expenses	(8,840)	(0.04)	—	—	—	—
Provision for off-balance sheet exposures	(1,471)	(0.01)	(4,315)	(0.05)	13,293	1.18
Contingency adjustment-tax credits	2,489	0.01	(2,489)	(0.03)	—	—
All other operating expenses	(2,091)	(0.01)	(1,941)	(0.02)	1,210	0.10
Income tax provision	768	—	3,390	0.04	93,819	8.30
Net (loss) income before changes in preferred stock dividends, preferred discount amortization and change in average common shares	(164,487)	(0.80)	307,777	3.43	320,031	28.31
Change in preferred dividends and preferred discount amortization	—	—	—	—	38,246	3.38
Favorable impact from issuing common stock in the conversion of the Series G Preferred Stock	—	—	(277,995)	(3.10)	277,995	24.58
Favorable impact from issuing common stock in exchange for Series A through E Preferred Stock	—	—	—	—	(385,387)	(34.07)
Favorable impact from issuing Series G Preferred Stock in exchange for Series F Preferred Stock	—	—	—	—	(55,122)	(4.87)
Change in average common shares <sup>(1)</sup>	—	—	—	(0.19)	—	(15.15)
Net (loss) income attributable to common stockholders	<u>\$ (164,487)</u>	<u>\$ (0.80)</u>	<u>\$ 29,782</u>	<u>\$ 0.14</u>	<u>\$ 195,763</u>	<u>\$ 2.18</u>



The key drivers of the Corporation's financial results for the year ended December 31, 2013 include the following:

- Net interest income for the year ended December 31, 2013 was \$514.9 million compared to \$461.7 million and \$393.5 million for the years ended December 31, 2012 and 2011, respectively. The increase for 2013 compared to 2012 was driven by a 42 basis points reduction in the average cost of funding achieved through lower deposit pricing (mainly brokered CDs), improved deposit mix, and the maturity of high-cost borrowings. In addition, the net interest income and margin were favorably impacted by a higher average volume of U.S. agency MBS. The net interest margin, excluding fair value adjustments, increased 47 basis points to 4.10% for the year ended December 31, 2013 compared to 2012 as it was favorably impacted by the aforementioned items as well as the reduction in non-performing loans and the full-year contribution of the credit card portfolio acquired from FIA Card Services ("FIA") in late May 2012. For a definition and reconciliation of this non-GAAP measure, refer to "Net Interest Income" below.

The increase for 2012 compared to 2011 was driven by an improvement of 81 basis points in the net interest margin, excluding fair value adjustments to 3.63%. The improvement in the net interest margin was primarily due to: (i) a decrease of 46 basis points in the average cost of funding achieved through lower deposit pricing, an improved deposit mix, and the maturity of high cost borrowings, and (ii) the contribution of the \$406 million credit cards portfolio acquired from FIA in late May 2012. This purchase increased the average balance of consumer loans by approximately \$214.3 million and contributed \$41.9 million to interest income, including \$6.6 million related to the discount accretion recorded as an adjustment to the yield on the purchased portfolio. The interest income recognized on credit cards was the main driver for the 36 basis points increase in the yield of total earning assets.

- The provision for loan and lease losses for 2013 was \$243.8 million compared to \$120.5 million and \$236.3 million for 2012 and 2011, respectively. The provision for the year ended December 31, 2013 includes a charge of \$132.0 million related to the bulk sales of adversely classified and non-performing assets and the transfer of certain construction and commercial loans to held for sale in the first half of 2013. Excluding the impact of the bulk sales of assets and the transfer of loans to held for sale, the provision for loan and lease losses for the year ended December 31, 2013 was \$111.7 million, a decrease of \$8.8 million compared to 2012. The decrease was mainly attributable to a reduction in charges to specific reserves for commercial and construction loans commensurate with the decline in the level of impaired and adversely classified loans, particularly higher charges in 2012 related to a construction loan in the Virgin Islands that was transferred to held for sale in 2013. In addition, the decrease was attributable to lower provision requirements for the Puerto Rico residential mortgage loan portfolio driven by lower charge-offs, an improved portfolio composition following the bulk sale of non-performing residential assets, and the impact in 2012 of adjustments to loss factors that were reflective of market conditions, including assumptions regarding loss severities that took into consideration qualitative and quantitative factors such as loan resolution and liquidation strategies and average time for liquidation, partially offset by an increase in the provision for consumer loans.

The Corporation completed two bulk sales of assets in the first half of 2013, including: (i) a bulk sale of non-performing residential mortgage loans with a book value of \$203.8 million and OREO properties with a book value of \$19.2 million, completed in the second quarter of 2013, and (ii) a bulk sale of adversely classified assets, mainly commercial and construction loans, with a book value of \$211.4 million and OREO properties with a book value of \$6.3 million, completed in the first quarter of 2013. In addition, during the first quarter of 2013, the Corporation transferred to held for sale

non-performing loans with an aggregate book value of \$181.6 million. The following table shows the impact of the bulk sales on net charge-offs, provision for loan and lease losses, and non-interest expenses for the year ended December 31, 2013:

(Dollars in thousands)

2013	As Reported (GAAP)	Bulk Sales Transaction Impact	Loans Transferred To Held For Sale Impact	Excluding Bulk Sales and Loans Transferred To Held For Sale Impact (Non-GAAP)
<b>Total net charge-offs</b> .....	<b>\$393,307</b>	<b>\$196,491</b>	<b>\$35,953</b>	<b>\$160,863</b>
Total net charge-offs to average loans .....	4.01%			1.68%
Residential mortgage .....	127,999	98,972	—	29,027
Residential mortgage loans net charge-offs to average loans .....	4.77%			1.13%
Commercial mortgage .....	62,602	40,057	14,553	7,992
Commercial mortgage loans net charge-offs to average loans .....	3.44%			0.45%
Commercial and Industrial .....	105,213	44,678	—	60,535
Commercial and Industrial loans net charge-offs to average loans .....	3.52%			2.04%
Construction .....	41,247	12,784	21,400	7,063
Construction loans net charge-offs to average loans .....	15.11%			2.91%
<b>Provision for loan and lease losses</b> .....	<b>\$243,751</b>	<b>\$126,780</b>	<b>\$ 5,222</b>	<b>\$111,749</b>
Residential mortgage .....	92,755	68,838	—	23,917
Commercial Mortgage .....	38,048	29,753	(1,033)	9,328
Commercial & Industrial .....	43,608	20,766	—	22,842
Construction .....	15,461	7,423	6,255	1,783
<b>Non-interest expenses</b> .....	<b>\$415,028</b>	<b>\$ 8,840</b>	<b>\$ —</b>	<b>\$406,188</b>
Professional fees .....	47,952	6,938	—	41,014
Net loss on OREO operations .....	42,512	1,879	—	40,633
Other expenses .....	29,983	23	—	29,960

The decrease for 2012, compared to 2011, was primarily driven by reduced charges to specific reserves for impaired loans driven by a lower migration of loans to non-performing and/or adversely classified categories commensurate with lower loss rates due to improvements in charge-off trends and the overall reduction in the size of the portfolio. A lower provision was reflected in all major loan categories, except for consumer loans.

Net charge-offs totaled \$393.3 million for the year ended December 31, 2013, or 4.01% of average loans, including \$232.4 million of net charge-offs related to the bulk sales of adversely classified and non-performing loans and the transfer of certain loans to held for sale in 2013. Excluding the impact of charge-offs related to the bulk sales and the transfer of loans to held for sale, total net charge-offs for 2013 were \$160.9 million, or 1.68% of average loans, compared to \$179.0 million, or 1.74% of average loans in 2012, and \$295.5 million, or 2.68% of average loans in 2011. The decrease was mainly driven by credit quality improvement primarily achieved through the sales of adversely classified and non-performing loans. The provision for loan and lease losses and net charge-offs, excluding the impact of the bulk sales of assets and the transfer of loans to held for sale are Non-GAAP measures; refer to “Basis of Presentation” discussion below for additional information. Also 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 recorded a non-interest loss of \$15.5 million for the year ended December 31, 2013 compared to non-interest income of \$49.4 million and \$108.0 million for the years ended December 31, 2012 and 2011, respectively. The decrease in 2013, compared to 2012, was mainly related to the

\$66.6 million write-off of the collateral pledged to Lehman. Excluding the impact of the Lehman collateral write-off, non-interest income totaled \$51.1 million, an increase of \$1.7 million when compared to 2012. The increase was mainly related to a lower loss on the investment in the unconsolidated entity to which the Corporation sold loans in 2011. The Corporation recorded \$16.7 million of equity in loss of unconsolidated entity in 2013 compared to a loss of \$19.3 million in 2012. Other positive variances include: (i) a \$1.8 million reduction in other-than-temporary impairments on available-for-sale debt and equity securities, (ii) higher ATM and POS interchange fees as well as merchant fees, an increase of approximately \$4.6 million, and (iii) an increase of \$0.4 million in insurance income. These positive variances were partially offset by, among other things,: (i) a \$3.1 million decrease in revenues from the mortgage banking business mainly due to lower profit margins on sales and securitizations of residential mortgage loans, partially offset by an increase in servicing fees and a decrease in the valuation allowance on servicing assets, (ii) lower of cost or market adjustments on commercial and construction loans held for sale that resulted in a charge of \$2.0 million in 2013, mainly related to the restructuring of a commercial mortgage loan held for sale in which the Corporation received certain properties in partial satisfaction of a debt arrangement, and (iii) a \$2.5 million decrease in income from broker-dealer activities due to fewer transactions closed in 2013. Refer to “Non-Interest Income” discussion below for additional information.

The decrease in 2012, compared to 2011, was driven by the deleveraging strategies executed in 2011, including a \$40.6 million gain on sales of investments, mainly MBS, and a \$12.1 million gain recorded for completed bulk sales of approximately \$518 million of performing residential mortgage loans to another financial institution. In addition, equity in loss of the unconsolidated entity of approximately \$19.3 million was recorded in 2012, a negative variance of \$15.0 million compared to a loss of \$4.2 million in 2011. These factors were partially offset by \$7.2 million in interchange and other related fees earned on the credit cards portfolio acquired in late May 2012.

- Non-interest expenses for 2013 were \$415.0 million compared to \$354.9 million and \$338.1 million for 2012 and 2011, respectively. The increase in non-interest expenses for 2013, as compared to 2012, was principally due to credit-related expenses including: (i) a \$17.4 million increase in net losses on OREO operations mainly due to a \$16.7 million increase in write-downs to the value of OREO properties, mainly income-producing commercial properties in both the Virgin Islands and Puerto Rico, and a \$1.9 million loss on the sale of certain OREO properties as part of the bulk sale of non-performing residential assets completed in the second quarter of 2013, and (ii) increases of approximately \$6.9 million in professional fees related to the bulk sales of assets and \$2.6 million of professional fees related to attorneys’ loan collection fees, appraisals and other credit related fees. Other increases in non-interest expenses include: (i) an \$8.6 million increase in credit and debit cards processing expenses, reflecting the full-year impact of expenses associated with the credit card portfolio acquired in late May 2012 as well as \$1.7 million of costs related to the conversion of the credit card processing platform, (ii) a \$9.2 million increase in fees related to the outsourcing of technology services attributable to a multi-year technology outsourcing agreement executed by the Corporation at the beginning of the second quarter of 2013, (iii) a \$5.9 million charge related to the new Puerto Rico national gross receipts tax, (iv) a \$5.4 million increase in employees’ compensation and benefits, (v) a \$2.8 million increase in the amortization of intangible assets, mainly related to the purchased credit card relationship intangible asset, and (vi) non-recurring expenses of \$1.7 million of costs associated with the common stock offering by certain of the Corporation’s existing stockholders, and \$1.2 million associated with a terminated preferred stock exchange offer. These increases were partially offset by a \$3.6 million decrease in the deposit insurance premium expense. Refer to “Non-Interest Expenses” discussion below for additional information.

The increase in non-interest expenses for 2012, as compared to 2011, was principally due to: (i) a \$10.4 million increase in expenses related to the credit card portfolio acquired in late May 2012, (ii) a \$7.1 million increase in employees’ compensation and benefits mainly due to the filling of vacant positions including several managerial and supervisory positions as well as higher incentive compensation expense, (iii) a \$4.3 million negative variance in the provision for off-balance-sheet exposures, mainly

for unfunded loan commitments and letters of credit (lower reserve releases in 2012), and (iv) a \$2.5 million non-recurring charge associated with a contingency adjustment related to the collectibility of certain tax credits. These increases were partially offset by a \$6.1 million decrease in the deposit insurance premium mainly resulting from the decrease in the Bank's average assets and the improved capital position.

- For 2013, the Corporation recorded an income tax expense of \$5.2 million compared to \$5.9 million and \$9.3 million in 2012 and 2011, respectively. The decrease in 2013, compared to 2012, was mainly related to a \$3.0 million income tax credit available to the Corporation, or 50% of the new Puerto Rico national gross receipts tax liability, and a \$1.3 million benefit due to the increase in the deferred tax assets of profitable subsidiaries resulting from an increase in the statutory tax rates from 30% to 39%, partially offset by a \$3.2 million increase in reserves for uncertain tax positions and related accrued interest. Refer to "Income Taxes" discussion below for additional information, including information about amendments to the Puerto Rico Internal Revenue Code.

The reduction in 2012, compared to 2011, was mainly related to a reduction in deferred tax assets of profitable subsidiaries in 2011 due to a reduction in statutory tax rates and the recognition in 2011 of an Unrecognized Tax Benefit ("UTB") liability of \$3.2 million, including accrued interest.

- As of December 31, 2013, total assets were \$12.7 billion, a decrease of \$442.8 million, or 3%, from December 31, 2012. The decrease was mainly related to a \$427.4 million decrease in total loans and a \$25.6 million decrease in the OREO inventory. This decrease was driven by the two bulk sales of adversely classified and non performing assets completed during the first and second quarters of 2013 that aggregated \$415.2 million of loans and \$25.5 million of OREO properties, the individual sale of a non-performing commercial mortgage loan with a book value of \$40.8 million and the repayment of a \$35.6 million commercial loan in the third quarter of 2013. The decrease in total assets was also attributable to a decline of \$291.2 million in cash and cash equivalents, the \$66.6 million write-off of the collateral pledged to Lehman, and a \$16.7 million decrease in the carrying value of the investment in the unconsolidated entity to which the Corporation sold loans in 2011. These decreases were partially offset by a \$247.2 million increase in the available-for-sale investment securities portfolio, led by purchases of 15-20 year U.S. agency MBS during 2013, and a \$149.6 million reduction in the total allowance for loan and lease losses. Refer to the "Financial Condition and Operating Data" discussion below for additional information.
- As of December 31, 2013, total liabilities were \$11.4 billion, a decrease of \$173.7 million, from December 31, 2012. The decrease was mainly related to the repayment of \$208.4 million of matured FHLB advances and a \$232.4 million decrease in brokered CDs. This was partially offset by an increase of \$247.8 million in non-brokered deposits and a \$19.3 million increase in accounts payable and other liabilities mainly due to increases in accrued expenses primarily related to payroll and benefits, the national gross receipts tax, and the increase in reserves for uncertain tax positions. Refer to the "Risk Management – Liquidity and Capital Adequacy" discussion below for additional information about the Corporation's funding sources.
- As of December 31, 2013, the Corporation's stockholders' equity was \$1.2 billion, a decrease of \$269.2 million from December 31, 2012. The decrease was mainly driven by the net loss of \$164.5 million for the year ended December 31, 2013 and a \$107.2 million decrease in other comprehensive income due to unrealized losses on available-for-sale MBS attributable to changes in market interest rates and a decrease in the fair value of Puerto Rico Government obligations. The Corporation's Total Capital, Tier 1 Capital and Leverage ratios decreased to 17.06%, 15.78% and 11.71%, respectively, from 17.82%, 16.51% and 12.60%, respectively, as of December 31, 2012. Meanwhile, FirstBank's Total Capital, Tier 1 Capital and Leverage ratios as of December 31, 2013 were 16.67%, 15.40% and 11.44%, respectively, as compared to 17.35%, 16.04% and 12.25%, respectively, as of December 31, 2012. In addition, the Corporation's tangible common equity ratio decreased to 8.71% as of December 31, 2013, from 10.44% as of December 31, 2012, and the Tier 1 common equity to risk-weighted assets ratio decreased to 12.72% as of December 31, 2013 from 13.61% as of December 31,

2012. All ratios were adversely impacted by the losses on the bulk sales and the transfer of certain loans to held for sale and the impairment of the collateral pledged to Lehman, discussed above. Refer to the “Risk Management – Capital” section below for additional information including further information about these non-GAAP financial measures and recent regulatory capital changes. Although all the regulatory capital ratios exceeded the established “well capitalized” levels, as well as the minimum capital ratios required by the FDIC Order, as of December 31, 2013, FirstBank cannot be treated as a “well-capitalized” institution since it is still subject to the FDIC Order.

- Total loan production, including purchases, refinancings and draws from existing revolving and non-revolving commitments, was \$3.4 billion for the year ended December 31, 2013, excluding the utilization activity on outstanding credit cards, compared to \$2.8 billion, for 2012. The increase in loan production was mainly related to disbursements on credit facilities granted to government entities, primarily in Puerto Rico, higher production of commercial loans in Florida, and an increase in residential mortgage and auto loan originations.
- Total non-performing loans, including non-performing loans held for sale, were \$550.4 million as of December 31, 2013, a decrease of \$427.5 million, or 43%, from December 31, 2012. This reduction primarily reflects an aggregate of \$382.5 million of non-performing loans sold as part of the bulk sales of assets completed in the first and second quarters of 2013, and the individual sale of a \$40.8 million non-performing commercial mortgage loan. Foreclosures on the collateral underlying problem loans with corresponding transfers to the OREO portfolio and charge-offs also contributed to the decrease.
- Total non-performing assets were \$725.4 million as of December 31, 2013, a decrease of \$512.8 million, or 41%, from December 31, 2012. The decrease was driven by the aforementioned sales of non-performing loans, a decrease of \$25.6 million in OREO, and the \$66.6 million write-off of the collateral pledged to Lehman. The ratio of non-performing assets to total assets decreased to 5.73% as of December 31, 2013 from 9.45% as of December 31, 2012. Refer to the “Risk Management—Non-accruing and Non-performing Assets” section below for additional information.

## **CRITICAL ACCOUNTING POLICIES AND PRACTICES**

The accounting principles of the Corporation and the methods of applying these principles conform to GAAP. The Corporation’s critical accounting policies relate to the 1) allowance for loan and lease losses; 2) other than temporary impairments (“OTTIs”); 3) income taxes; 4) classification and values of investment securities; 5) valuation of financial instruments; 6) income recognition on loans, 7) loan acquisitions, 8) loans held for sale, and 9) equity method accounting for investment in the unconsolidated entity. These critical accounting policies involve judgments, estimates and assumptions made by management that affect the amounts recorded for assets and liabilities and for contingent liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates, if different assumptions or conditions prevail. Certain determinations inherently require greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than those originally reported.

### **Allowance for Loan and Lease Losses**

The Corporation maintains the allowance for loan and lease losses at a level considered adequate to absorb losses currently inherent in the loan and lease portfolio. The Corporation does not maintain an allowance for held-for-sale loans or purchased-credit impaired (“PCI”) loans that are performing in accordance with or better than expectations as of the date of acquisition, as the fair values of these loans already reflects a credit component. The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable losses believed to be inherent in the loan portfolio that have not been specifically identified. The determination of the allowance for loan and lease losses requires significant estimates, including the timing and amounts of expected future cash flows on impaired loans, consideration of current economic conditions, and historical loss experience pertaining to the portfolios and pools of homogeneous loans, all of which may be susceptible to change.



The Corporation aggregates loans with similar credit risk characteristics into portfolio segments: commercial mortgage, construction, commercial and industrial, residential mortgage, and consumer loans. Classes are usually disaggregations of the portfolio segments. The classes within the residential mortgage segment are residential mortgages guaranteed by the U.S. government and other loans. The classes within the consumer portfolio are: auto, finance leases, and other consumer loans. Other consumer loans mainly include unsecured personal loans, credit cards, home equity lines, lines of credits, and marine financing. The classes within the construction loan portfolio are: land loans, construction of commercial projects, and construction of residential projects. The commercial mortgage and commercial and industrial segments are not further segmented into classes. The adequacy of the allowance for loan and lease losses is based on judgments related to the credit quality of the loan portfolio. These judgments consider ongoing evaluations of the loan portfolio, including such factors as the economic risks associated with each loan class, the financial condition of specific borrowers, the level of delinquent loans, historical loss experience, the value of any collateral and, where applicable, the existence of any guarantees or other documented support. In addition to the general economic conditions and other factors described above, additional factors also considered include the internal risk ratings assigned to the loan. Internal risk ratings are assigned to each commercial loan at the time of approval and are subject to subsequent periodic review by the Corporation's senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation's continued evaluation of its asset quality.

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

The allowance for loan and lease losses consists of specific reserves based upon valuations of loans considered to be impaired and general reserves. A specific valuation allowance is established for individual impaired loans in the commercial mortgage, construction, commercial and industrial, and residential mortgage loan portfolios, 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 for impaired commercial mortgage, construction, commercial and industrial, and real estate loans with individual principal balances of \$1 million or more, TDRs, 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 and for collateral dependent loans, 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 a collateral dependent loan over the resulting fair value of the collateral is charged-off when deemed uncollectible.

For all other loans, which include small, homogeneous loans, such as auto loans, all classes in the consumer loan portfolio, residential mortgages in amounts under \$1 million and commercial and construction loans not considered impaired, the Corporation maintains a general valuation allowance established through a process that begins with estimates of incurred losses based upon various statistical analyses. The general reserve is primarily determined by applying loss factors according to the loan type and assigned risk category (pass, special mention, and substandard not considered impaired; all doubtful loans are considered impaired).

The Corporation uses a roll-rate methodology to estimate losses on its consumer loan portfolio based on delinquencies and considering credit bureau score bands. The Corporation tracks the historical portfolio performance, generally over a 24-month loss period (12 months for credit cards), to arrive at a weighted average distribution in each subgroup of each delinquency bucket. Roll-to-loss rates (loss factors) are calculated by multiplying the roll rates from each subgroup within the delinquency buckets forward through loss. Once roll rates are calculated, the resulting loss factor is applied to the existing receivables in the applicable subgroups within the delinquency buckets and the end results are aggregated to arrive at the required allowance level. The



Corporation's assessment also involves evaluating key qualitative and environmental factors, which include credit and macroeconomic indicators such as unemployment, bankruptcy trends, recent market transactions, and collateral values to account for current market conditions that are likely to cause estimated credit losses to differ from historical loss experience. The Corporation analyzes the expected delinquency migration to determine the future volume of delinquencies. The Corporation reflects the effect of these environmental factors on each delinquency bucket as an adjustment that increases the historical loss rate applied to each group.

The non-PCI portion of the credit card portfolio acquired from FIA in 2012 was recorded at the fair value on the acquisition date of \$353.2 million, net of a discount of \$18.2 million. The discount at acquisition is attributable to uncertainties in the cash flows of this portfolio based on an estimation of inherent credit losses. As previously discussed, the discount recorded at acquisition is accreted and recognized in interest income over the period in which substantially all of the inherent losses associated with the non-PCI loans at the acquisition date were estimated to occur. Subsequent to acquisition, the Corporation evaluates its estimate of embedded losses on a quarterly basis. The allowance for non-PCI loans acquired is determined considering the outstanding balance of the portfolio net of the unaccreted discount. To the extent the required allowance exceeds the unaccreted discount, a provision is required. The provision recorded during 2012 and 2013 relates to new purchases on these non-PCI credit card loans and to the allowance methodology described above. The provision in 2012 and 2013 was not related to changes in expected loan losses assumed in the accounting for the acquisition of the portfolio. In the case of the PCI portion of the portfolio acquired from FIA, recorded at the fair value on the acquisition date of \$15.7 million (and having an unpaid principal and interest balance of \$34.6 million), the accounting guidance prohibits the carryover or creation of valuation allowances in the initial accounting for impaired loans acquired in a transfer. Subsequent to acquisition, decreases in expected principal cash flows of PCI loans due to further credit deterioration will generally result in an impairment charge recognized in the Corporation's provision for loan and lease losses, resulting in an increase to the allowance for loan losses. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loans.

The residential mortgage pools cash flow analyses are performed at the individual loan level and then aggregated to the pool level in determining the overall expected loss ratio. The model applies risk-adjusted prepayment curves, default curves, and severity curves to each loan in the pool. For loan restructuring pools, the present value of expected future cash flows under new terms, at the loan's effective interest rate, are taken into consideration. Additionally, the default risk and prepayments related to loan restructurings are based on, among other things, the historical experience of these loans. Loss severity is affected by the expected house price scenario, which is based in part on recent house price trends. Default curves are used in the model to determine expected delinquency levels. The risk-adjusted timing of liquidations and associated costs are used in the model, and are risk-adjusted for the geographic area in which each property is located (Puerto Rico, Florida, or the Virgin Islands). For residential mortgage loans, the determination of reserves includes the incorporation of updated loss factors applicable to loans expected to liquidate over the next twelve months, considering the expected realization of similarly valued assets at disposition. The allowance determination for residential mortgage loans also takes into consideration other qualitative factors, such as changes in business strategies, including loan resolution and liquidation procedures that might result in an overall adjustment applied to this portfolio segment.

For commercial loans, including construction loans, the general reserve is based on historical loss ratios supplemented by management judgment and interpretation. The loss ratios are derived from a migration analysis, which tracks the historical net charge-offs experienced over a historical 24-month loss period on loans according to their internal risk rating, applying adjustments, as necessary, to each loss rate based on assessments of recent loss ratio trends (12 months). Historical loss rates may be adjusted for certain qualitative factors that, in management's judgment, are necessary to reflect losses inherent in the portfolio. Qualitative factors that management considers in the general reserve analysis include general economic conditions, and geographic trends impacting expected losses, collateral value trends, asset quality trends, concentrations, risk management and loan administration, and changes in lending practices. 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—Net charge-offs consist of the unpaid principal balances of loans held for investment that the Corporation determines are uncollectible, net of recovered amounts. Charge-offs are recorded as a reduction to the allowance for loan and lease losses and subsequent recoveries of previously charged off amounts are credited to the allowance for loan and lease losses. Collateral dependent loans in the construction, commercial mortgage, and commercial and industrial loan portfolios are charged off to their fair value when loans are considered impaired. Within the consumer loan portfolio, loans in the auto and finance leases are reserved once they are 120 days delinquent and are charged off to their estimated net realizable value when collateral deficiency is deemed uncollectible (i.e., when foreclosure/repossession is probable) or when the loan is 365 days past due. 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, including credit card loans, are charged off when payments are 180 days in arrears. On a quarterly basis, residential mortgage loans that are 120 days delinquent and have a loan-to-value ratio that is higher than 60% are charged-off to their fair value when there is a collateral deficiency. Generally, all loans 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 when the asset is the sole source of repayment. The Corporation does not record charge-offs on PCI loans that are performing in accordance with or better than expectations as of the date of acquisition, as the fair value of these loans already reflects a credit component. The Corporation records charge-offs on PCI loans only if actual losses exceed estimated losses incorporated into the fair value recorded at acquisition.

#### **Other-than-temporary impairments**

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

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

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

The impairment analysis of equity securities is performed and reviewed on an ongoing basis based on the latest financial information and any supporting research report made by a major brokerage firm. This analysis is very subjective and based, among other things, on relevant financial data such as capitalization, cash flow, liquidity, systematic risk, and debt outstanding of the issuer. Management also considers the issuer's industry trends, the historical performance of the stock, credit ratings, as well as the Corporation's intent to hold the security for an extended period. If management believes there is a low probability of recovering book value in a reasonable time frame, it records an impairment by writing the security down to market value. As previously mentioned, equity securities are monitored on an ongoing basis but special attention is given to those securities that have experienced a decline in fair value for six months or more. An impairment charge is generally recognized when the fair value of an equity security has remained significantly below cost for a period of 12 consecutive months or more.

### **Income Taxes**

The Corporation is required to estimate income taxes in preparing its consolidated financial statements. This involves the estimation of current income tax expense together with an assessment of temporary differences resulting from differences in the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The determination of current income tax expense involves estimates and assumptions that require the Corporation to assume certain positions based on its interpretation of current tax regulations. Management assesses the relative benefits and risks of the appropriate tax treatment of transactions, taking into account statutory, judicial and regulatory guidance and recognizes tax benefits only when deemed probable. Changes in assumptions affecting estimates may be required in the future and estimated tax liabilities may need to be increased or decreased accordingly. The accrual of tax contingencies is adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation. The Corporation's effective tax rate includes the impact of tax contingencies and changes to such accruals, as considered appropriate by management. When particular matters arise, a number of years may elapse before such matters are audited by the taxing authorities and finally resolved. Favorable resolution of such matters or the expiration of the statute of limitations may result in the release of tax contingencies that are recognized as a reduction to the Corporation's effective rate in the year of resolution. Unfavorable settlement of any particular issue could increase the effective rate and may require the use of cash in the year of resolution.

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of the Corporation's net deferred tax asset assumes that the Corporation will be able to generate sufficient future taxable income based on estimates and assumptions. If these estimates and related assumptions change, the Corporation may be required to record valuation allowances against its deferred tax asset resulting in additional income tax expense in the consolidated statements of income. Management evaluates its deferred tax asset on a quarterly basis and assesses the need for a valuation allowance, if any. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax asset will not be realized. Changes in the valuation allowance from period to period are included in the Corporation's tax provision in the period of change (see Note 24 to the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K).

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp. is treated as a foreign corporation for U.S. income tax purposes and is generally subject to U.S. income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations. The Corporation is also subject to taxes on its income from sources within the USVI. 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 2011, as amended (the “2011 PR Code”), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file a consolidated tax return 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 NOL, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carryforward period. In the case of losses incurred during tax years that commenced after December 31, 2004 and ended before January 1, 2013, the carryforward period is extended to 12 years. The carryover period for a NOL incurred during taxable years commencing after December 31, 2012 is 10 years. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from “controlled” subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

Under the 2011 PR Code, First BanCorp. is subject to a maximum statutory tax rate of 39%. The 2011 PR Code also includes an alternative minimum tax of 30% that applies if the Corporation’s regular income tax liability is less than the alternative minimum tax requirements. Prior to the approval of Act No. 40 (“Act 40”), known as the “Tax Burden Adjustment and Redistribution Act,” which amended the 2011 PR Code as explained below, First Bancorp.’s maximum statutory tax rate was 30% for the years that ended December 31, 2012 and 2011.

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 an IBE of the Bank and through the Bank’s subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which Act No. 7 imposed a special 5% tax on all IBEs. The 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 IBE’s net income exceeds 20% of the bank’s total net taxable income.

On June 30, 2013, the Puerto Rico government approved Act 40, which amended the 2011 PR Code, and Act 46, which changes the sales and use tax regime. The main provisions of Act 40 that impacted financial institutions include:

- (i) A new national gross receipts tax that in the case of financial institutions is 1% of gross income that is not deductible for purposes of computing net taxable income and is not part of the alternative minimum tax (“AMT”). This provision was retroactive to January 1, 2013. An expense of \$5.9 million was recorded during the year 2013 related to the national gross receipts tax. This expense is included as part of “Taxes, other than income taxes” in the consolidated statement of (loss) income. Subject to certain limitations, a financial institution will be able to claim a credit of 0.5% of its gross income against its regular income tax or the alternative minimum tax. A \$3.0 million benefit related to this credit was recorded as a reduction to the provision for income taxes in 2013.
- (ii) A decrease in the deduction available to corporations for the computation of the additional surtax from \$750,000 to \$25,000 and a change in the surtax rate to rates that range from 5% to 19%, resulting in an increase in the maximum statutory tax rate from 30% to 39%. This provision was also retroactive to January 1, 2013. The effect on operating results in 2013 related to these changes was a net benefit of approximately \$1.3 million, mainly due to the increase in the deferred tax asset of profitable subsidiaries. The deferred tax valuation allowance increased to \$522.7 million as of December 31, 2013 from \$359.9 million at December 31, 2012 as a result of changes in tax rates and operating results for the year.
- (iii) A higher AMT rate (30% of the alternative minimum net income, as compared to 20% previously) and various parallel computations required to be made before determining whether an AMT liability exists. This change did not have an impact on the Corporation’s provision for income taxes recorded in 2013.

- (iv) The NOL carryover period increased from 10 years to 12 years for losses incurred in taxable years that commenced after December 31, 2004 and ended before January 1, 2013. The carryover period for NOLs incurred during taxable years commencing after December 31, 2012 is 10 years. The NOL deduction is now limited to 90% of taxable income for regular income tax purposes and 80% for AMT purposes.

The significant changes to the sales and use tax regime include adjustments to the business to business exclusion. The business to business exclusion applicable to services rendered from one registered business to another registered business remains in effect, except for certain services that will be taxable including, among others, service charges imposed by financial institutions on other businesses (commercial clients), collection services, repairs and maintenance services related to real and personal property, and computer programming including modifications to previously designed systems. The sales and use tax provisions were effective beginning on July 1, 2013.

In addition, on October 14, 2013, Act 117 implemented technical amendments to various income tax laws, including the 2011 PR Code. The main provisions of Act 117 that impacted financial institutions are the exemption from the imposition of the national gross receipts tax on foreign source income and the temporary requirement of an estimated tax payment in mid-October. On November 26, 2013, Act No.36 was enacted to, among other things, require the payment of estimated taxes related to personal property tax returns. These amendment of Act No. 36 will be effective during the year 2014.

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 analysis: 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 under this analysis and the tax benefit claimed on a tax return is referred to as an UTB. The Corporation classifies interest and penalties, if any, related to UTBs as components of income tax expense. Refer to Note 24 of the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K for further information related to this accounting guidance.

### **Investment Securities Classification and Related Values**

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



## Valuation of financial instruments

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

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 for classifying financial instruments. The hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Three levels of inputs may be used to measure fair value:

- Level 1** Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3** Valuations are observed from unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Under the fair value accounting guidance, an entity has the irrevocable option to elect, on a contract-by-contract basis, to measure certain financial assets and liabilities at fair value at inception of the contract, and thereafter, to reflect any changes in fair value in current earnings. The Corporation did not make any fair value option election as of December 31, 2013 or 2012.

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

### *Investment securities available for sale*

The fair value of investment securities was the market value based on quoted market prices (as is the case with equity securities, Treasury notes, and non callable U.S. Agency debt securities), when available (Level 1), 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 (Level 2). 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 (Level 3).

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 based on a nonrated security. The market valuation is derived from a model that utilizes relevant assumptions such as the 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, and 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, and other) to provide an estimate of default and loss severity. Refer to Note 4 to the Corporation's audited financial statements for the year ended December 31, 2013 included in item 8 of this form 10-K for additional information about assumptions used in the valuation of private label MBS.

#### *Derivative instruments*

The fair value of most of the Corporation's 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 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 marked-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 in 2013 was immaterial.

#### **Income Recognition on Loans**

Loans that the Corporation has the ability and intent to hold for the foreseeable future are classified as held for investment. The substantial majority of the Corporation's loans are classified as held for investment. Loans are stated at the principal outstanding balance, net of unearned interest, cumulative charge-offs, unamortized deferred origination fees and costs, and unamortized premiums and discounts. Fees collected and costs incurred in the origination of new loans are deferred and amortized using the interest method or a method that approximates the interest method over the term of the loan as an adjustment to interest yield. Unearned interest on certain personal and auto loans and finance leases and discounts and premiums are recognized as income under a method that approximates the interest method. When a loan is paid off or sold, any unamortized net deferred fee (cost) is credited (charged) to income. Credit card loans are reported at their outstanding unpaid principal balance plus uncollected billed interest and fees net of amounts deemed uncollectible. PCI loans are reported net of any remaining purchase accounting adjustments. See "Loans acquired" below for the accounting policy for PCI loans.

*Non-Performing and Past-Due Loans*—Loans on which the recognition of interest income has been discontinued are designated as non-performing. Loans are classified as non-performing when interest and principal have not been received for a period of 90 days or more, with the exception of residential mortgage loans guaranteed by the FHA or the VA and credit cards. It is the Corporation's policy to report delinquent mortgage loans insured by the FHA or guaranteed by the VA as loans past due 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. However, the Corporation discontinues the recognition of income for FHA/VA loans when such loans are over 18 months delinquent. As permitted by regulatory guidance issued by the Federal Financial Institutions Examination Council ("FFIEC"), credit card loans are generally charged off in the period in which the account becomes 180 days past due. Credit card loans continue to accrue finance charges and fees until charge off at 180 days. Loans generally may be placed on non-performing status prior to when required by the policies described above when there are doubts about the potential to collect all of the principal based on collateral deficiencies or, in other situations, when collection of all of the principal or interest is not expected due to deterioration in the financial condition of the borrower.

When a loan is placed on non-performing status, any accrued but uncollected interest income is reversed and charged against interest income. In the case of credit card loans, the Corporation generally continues to accrue interest and fees on delinquent loans until the loans are charged off. Interest income on non-performing loans is recognized only to the extent it is received in cash. However, when there is doubt regarding the ultimate collectibility of loan principal, all cash thereafter received is applied to reduce the carrying value of such loans (i.e., the cost recovery method). Generally, the Corporation returns a loan to accrual status when all delinquent interest and principal becomes current under the terms of the loan agreement or when the loan is well secured and in process of collection, and collectibility of the remaining interest and principal is no longer doubtful. Loans that are past due 30 days or more as to principal or interest are considered delinquent, with the exception of residential mortgage, commercial mortgage, and construction loans, which are considered past due when the borrower is in arrears two or more monthly payments.

*Impaired Loans*—A loan is considered impaired when, based upon current information and events, it is probable that the Corporation will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the loan agreement. Loans with insignificant delays or insignificant shortfalls in the amounts of payments expected to be collected are not considered to be impaired. The Corporation measures impairment individually for those loans in the construction, commercial mortgage, and commercial and industrial portfolios with a principal balance of \$1 million or more, including loans for which a charge-off has been recorded based upon the fair value of the underlying collateral and loans that have been modified in a TDR. The Corporation also evaluates for impairment purposes certain residential mortgage loans and home equity lines of credit with high delinquency and loan-to-value levels. Generally, consumer loans are not individually evaluated for impairment on a regular basis except for impaired marine financing loans in amounts that exceed \$1 million, home equity lines with high delinquency and loan-to-value levels and TDRs. Held-for-sale loans are not reported as impaired, as these loans are recorded at the lower of cost or fair value.

A restructuring of a loan constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. TDRs typically result from the Corporation's loss mitigation activities and residential mortgage loans modified in accordance with guidelines similar to those of the U.S. government's Home Affordable Mortgage Program, and could include rate reductions, principal forgiveness, forbearance, refinancing of any past-due amounts, including interest, escrow, and late charges and fees, extensions of maturities, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure generally for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are evaluated in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan.

In connection with commercial restructurings, the decision to maintain a loan that has been restructured on accrual status is based on a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation includes consideration of the borrower's current capacity to pay, which, among other things, may include a review of the borrower's current financial statements, an analysis of global cash flow sufficient to pay all debt obligations, and an evaluation of secondary sources of payment from the client and any guarantors. This evaluation also includes an evaluation of the borrower's current willingness to pay, which may include a review of past payment history, an evaluation of the borrower's willingness to provide information on a timely basis, and consideration of offers from the borrower to provide additional collateral or guarantor support. The credit evaluation also reflects consideration of the borrower's future capacity and willingness to pay, which may include evaluation of cash flow projections, consideration of the adequacy of collateral to cover all principal and interest, and trends indicating improving profitability and collectibility of receivables.

The evaluation of mortgage and consumer loans for restructurings includes an evaluation of the client's disposable income and credit report, the value of the property, the loan to value relationship, and certain other client-specific factors that have impacted the borrower's ability to make timely principal and interest payments on the loan. In connection with retail restructurings, a nonperforming loan will be returned to accrual status when current as to principal and interest and upon sustained historical repayment performance.

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

- (i) The loan is in compliance with the terms of the restructuring agreement and, therefore, is not considered impaired under the revised terms; and
- (ii) The loan yields a market interest rate at the time of the restructuring. In other words, the loan was restructured with an interest rate equal to or greater than what the Corporation would have been willing to accept at the time of the restructuring for a new loan with comparable risk.

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

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

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

All individually impaired loans are evaluated for a specific allowance. The Corporation generally measures impairment and the related specific allowance for individually impaired loans based on the difference between the recorded investment of the loan and the present value of the loans' expected future cash flows, discounted at the effective original interest rate of the loan at the time of modification, or the loan's observable market price. If the loan is collateral dependent, the Corporation measures impairment based upon the fair value of the underlying collateral, which the Corporation determines based on the current fair value of the collateral less estimated selling costs, instead of discounted cash flows, regardless of whether foreclosure is probable. Loans are identified as collateral dependent if the repayment is expected to be provided solely by the underlying collateral, through liquidation or operation of the collateral. If the fair value of the loan is less than the recorded investment, the Corporation recognizes impairment by either a direct write-down or establishing an allowance for the loan or by adjusting an allowance for the impaired loan. For an impaired loan that is collateral dependent, charge-offs are taken in the period in which the loan, or portion of the loan, is deemed uncollectible, and any portion of the loan not charged off is adversely credit risk rated no worse than substandard.

### **Loans Acquired**

All purchased loans are recorded at fair value at the date of acquisition. Loans acquired with evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments are considered PCI loans. In connection with the acquisition of an approximate \$406 million portfolio of FirstBank-branded credit card loans from FIA Card Services (FIA) in 2012, the Corporation concluded that a portion of such loans were PCI loans. In accounting for PCI loans, the difference between contractually required payments and the cash flows expected to be collected at acquisition, is referred to as the nonaccretable difference. The nonaccretable difference, which is neither accreted into income nor recorded on the consolidated statement of financial condition, reflects estimated

future credit losses expected to be incurred over the life of the loans. The excess of cash flows expected to be collected over the estimated fair value of PCI loans is referred to as the accretable yield. This amount is not recorded on the statement of financial condition, but is accreted into interest income over the remaining life of the loans, using the effective-yield method.

Subsequent to acquisition, the Corporation completes quarterly evaluations of expected cash flows. Decreases in expected cash flows attributable to credit will generally result in an impairment charge to the provision for loan and lease losses and the establishment of an allowance for loan and lease losses. Increases in expected cash flows will generally result in a reduction in any allowance for loan and lease losses established subsequent to acquisition and an increase in the accretable yield. The adjusted accretable yield is recognized in interest income over the remaining life of the loans.

Because the initial fair value of PCI loans recorded at acquisition includes an estimate of credit losses expected to be realized over the remaining lives of the loans, the Corporation separately tracks and reports PCI loans and excludes these loans from its delinquency and non-performing loan statistics.

For acquired loans that are not deemed impaired at acquisition, subsequent to acquisition the Corporation recognizes the difference between the initial fair value at acquisition and the undiscounted expected cash flows in interest income over the period in which substantially all of the inherent losses associated with the non-PCI loans at the acquisition date are estimated to occur.

### **Loans held for sale**

Loans that the Corporation intends to sell or that the Corporation does not have the ability and intent to hold for the foreseeable future are classified as held-for-sale loans. Loans held for sale are stated at the lower-of-cost-or-market. Generally, the loans held-for-sale portfolio consists of conforming residential mortgage loans that the Corporation intends to sell to GNMA and government sponsored entities such as FNMA and FHLMC. Generally, residential mortgage loans held for sale are valued on an aggregate portfolio basis and the value is primarily derived from quotations based on the mortgage-backed securities market. The amount by which cost exceeds market value in the aggregate portfolio of loans held for sale, if any, is accounted for as a valuation allowance with changes therein included in the determination of net income and reported as part of mortgage banking activities in the consolidated statement of income (loss). The fair value of commercial mortgage and construction loans held for sale is primarily derived from external appraisals with changes in the valuation allowance reported as part of other non-interest income in the consolidated statement of income (loss). In certain circumstances, the Corporation transfers loans to/from held for sale or held for investment based on a change in strategy. In particular, although no decision to sell any portion of its non-performing loan portfolio has been made, the Corporation continues to evaluate options to further reduce non-performing loan levels. These options could include bulk loan sales. If such a change in holding strategy is made, significant adjustments to the loans' carrying values may be necessary. These loans are transferred to held for sale at the lower of cost or fair value on the date of transfer and establish a new cost basis upon transfer. Write-downs of loans transferred from held for investment to held for sale are recorded as charge-offs at the time of transfer.

### **Equity method for investments in unconsolidated entities**

In connection with a sale of loans with a book value of \$269.3 million to CPG/GS completed on February 16, 2011, the Bank received a 35% subordinated interest in CPG/GS. The Corporation accounts for its investment in CPG/GS under the equity method and includes the investment as part of investment in unconsolidated entity in the consolidated statements of financial condition. When applying the equity method, the Corporation follows the HLBV method to determine its share of earnings or losses of the unconsolidated entity. Under the HLBV method, the Corporation determines its share of earnings or losses by determining the difference between its "claim on the entity's book value" at the end of the period as compared to the beginning of the period. This claim is calculated as the amount the Corporation would receive if the entity were to liquidate all of its assets at recorded amounts determined in accordance with GAAP and distribute the resulting cash to the investors.

## **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 repricing and maturity mismatch of the Corporation's assets and liabilities. Net interest income for the year ended December 31, 2013 was \$514.9 million, compared to \$461.7 million and \$393.5 million for 2012 and 2011, respectively. On a tax-equivalent basis and excluding the changes in the fair value of derivative instruments and unrealized gains and losses on liabilities measured at fair value, net interest income for the year ended December 31, 2013 was \$527.4 million compared to \$466.6 million and \$406.0 million for 2012 and 2011, respectively.

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

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

## Part I

Year Ended December 31,	Average volume			Interest income <sup>(1)</sup> / expense			Average rate <sup>(1)</sup>		
	2013	2012	2011	2013	2012	2011	2013	2012	2011
	(Dollars in thousands)								
Interest-earning assets:									
Money market and other short-term investments	\$ 684,074	\$ 640,644	\$ 567,548	\$ 1,927	\$ 1,827	\$ 1,556	0.28%	0.29%	0.27%
Government obligations <sup>(2)</sup>	338,571	555,364	1,350,505	7,892	9,839	20,992	2.33%	1.77%	1.55%
Mortgage-backed securities	1,666,091	1,182,142	1,181,183	52,841	37,090	44,140	3.17%	3.14%	3.74%
Corporate bonds	—	1,204	2,000	—	76	116	0.00%	6.31%	5.80%
FHLB stock	30,941	35,035	43,676	1,359	1,427	1,885	4.39%	4.07%	4.32%
Equity securities	1,330	1,377	1,377	—	6	1	0.00%	0.44%	0.07%
Total investments <sup>(3)</sup>	2,721,007	2,415,766	3,146,289	64,019	50,265	68,690	2.35%	2.08%	2.18%
Residential mortgage loans	2,681,753	2,800,647	2,944,367	148,033	150,854	165,502	5.52%	5.39%	5.62%
Construction loans	272,917	388,404	616,980	8,722	10,357	17,026	3.20%	2.67%	2.76%
C&I and commercial mortgage loans	4,804,608	5,277,593	5,849,444	196,814	214,510	237,410	4.10%	4.06%	4.06%
Finance leases	240,479	239,699	263,403	20,591	20,887	21,879	8.56%	8.71%	8.31%
Consumer loans	1,799,402	1,561,085	1,357,381	220,089	196,293	157,451	12.23%	12.57%	11.60%
Total loans <sup>(4)(5)</sup>	9,799,159	10,267,428	11,031,575	594,249	592,901	599,268	6.06%	5.77%	5.43%
Total interest-earning assets	\$12,520,166	\$12,683,194	\$14,177,864	\$658,268	\$643,166	\$667,958	5.26%	5.07%	4.71%
Interest-bearing liabilities:									
Interest-bearing checking accounts									
Savings accounts	\$ 1,127,857	\$ 1,092,640	\$ 1,014,280	\$ 8,419	\$ 9,421	\$ 13,760	0.75%	0.86%	1.36%
Certificates of deposit	2,344,444	2,258,001	2,032,665	15,852	17,382	20,530	0.68%	0.77%	1.01%
Brokered CDs	2,310,200	2,215,599	2,260,106	29,264	34,602	45,960	1.27%	1.56%	2.03%
Interest-bearing deposits	3,251,091	3,488,312	5,134,699	38,252	66,854	111,477	1.18%	1.92%	2.17%
Other borrowed funds	9,033,592	9,054,552	10,441,750	91,787	128,259	191,727	1.02%	1.42%	1.84%
FHLB advances	1,131,959	1,171,615	1,459,476	33,025	36,162	53,873	2.92%	3.09%	3.69%
Total interest-bearing liabilities <sup>(6)</sup>	357,661	404,033	467,522	6,031	12,142	16,336	1.69%	3.01%	3.49%
Net interest income	\$10,523,212	\$10,630,200	\$12,368,748	\$130,843	\$176,563	\$261,936	1.24%	1.66%	2.12%
Interest rate spread				\$527,425	\$466,603	\$406,022	4.02%	3.41%	2.59%
Net interest margin							4.21%	3.68%	2.86%

(1) On an adjusted tax-equivalent basis. The adjusted tax-equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate (39.0% for 2013; 30% for 2012; 30% for the Corporation's subsidiaries other than IBEs and 25% for the Corporation's IBEs in 2011) 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 derivatives 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 on 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 \$13.8 million, \$12.7 million and \$9.8 million for 2013, 2012 and 2011, 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

	2013 Compared to 2012 Increase (decrease) Due to:			2012 Compared to 2011 Increase (decrease) Due to:		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest income on interest-earning assets:						
Money market and other short-term investments . . . . .	123	(23)	100	207	64	271
Government obligations . . . . .	(4,447)	2,500	(1,947)	(13,223)	2,070	(11,153)
Mortgage-backed securities . . . . .	15,344	407	15,751	33	(7,083)	(7,050)
Corporate bonds . . . . .	(76)	—	(76)	(48)	8	(40)
FHLB stock . . . . .	(173)	105	(68)	(362)	(96)	(458)
Equity securities . . . . .	—	(6)	(6)	—	5	5
Total investments . . . . .	10,771	2,983	13,754	(13,393)	(5,032)	(18,425)
Residential mortgage loans . . . . .	(6,484)	3,663	(2,821)	(7,897)	(6,751)	(14,648)
Construction loans . . . . .	(3,385)	1,750	(1,635)	(6,113)	(556)	(6,669)
C&I and commercial mortgage loans . . . . .	(19,300)	1,604	(17,696)	(23,226)	326	(22,900)
Finance leases . . . . .	67	(363)	(296)	(2,017)	1,025	(992)
Consumer loans . . . . .	29,558	(5,762)	23,796	24,902	13,940	38,842
Total loans . . . . .	456	892	1,348	(14,351)	7,984	(6,367)
Total interest income . . . . .	11,227	3,875	15,102	(27,744)	2,952	(24,792)
Interest expense on interest-bearing liabilities:						
Brokered CDs . . . . .	(4,284)	(24,318)	(28,602)	(32,675)	(11,948)	(44,623)
Other interest-bearing deposits . . . . .	2,194	(10,064)	(7,870)	3,389	(22,234)	(18,845)
Other borrowed funds . . . . .	(1,198)	(1,939)	(3,137)	(9,675)	(8,036)	(17,711)
FHLB advances . . . . .	(1,267)	(4,844)	(6,111)	(2,066)	(2,128)	(4,194)
Total interest expense . . . . .	(4,555)	(41,165)	(45,720)	(41,027)	(44,346)	(85,373)
Change in net interest income . . . . .	\$ 15,782	\$ 45,040	\$ 60,822	\$ 13,283	\$ 47,298	\$ 60,581

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 IBEs are tax-exempt under Puerto Rico tax law (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 tax 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 (39.0% for 2013) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law.

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

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

	Year Ended December 31,		
	2013	2012	2011
<b>(Dollars in thousands)</b>			
Interest income—GAAP	\$ 645,788	\$ 637,777	\$ 659,615
Unrealized gain (loss) on derivative instruments	(1,695)	(901)	1,548
Interest income excluding valuations	644,093	636,876	661,163
Tax-equivalent adjustment	14,175	6,290	6,795
Interest income on a tax-equivalent basis excluding valuations	658,268	643,166	667,958
Interest expense—GAAP	130,843	176,072	266,103
Unrealized gain (loss) on derivative instruments and liabilities measured at fair value	—	491	(4,167)
Interest expense excluding valuations	130,843	176,563	261,936
Net interest income—GAAP	\$ 514,945	\$ 461,705	\$ 393,512
Net interest income excluding valuations	\$ 513,250	\$ 460,313	\$ 399,227
Net interest income on a tax-equivalent basis excluding valuations	\$ 527,425	\$ 466,603	\$ 406,022
<b>Average Balances</b>			
Loans and leases	\$ 9,799,159	\$10,267,428	\$11,031,575
Total securities and other short-term investments	2,721,007	2,415,766	3,146,289
Average interest-earning assets	\$12,520,166	\$12,683,194	\$14,177,864
Average interest-bearing liabilities	\$10,523,212	\$10,630,200	\$12,368,748
<b>Average Yield/Rate</b>			
Average yield on interest-earning assets—GAAP	5.16%	5.03%	4.65%
Average rate on interest-bearing liabilities—GAAP	1.24%	1.66%	2.15%
Net interest spread—GAAP	3.92%	3.37%	2.50%
Net interest margin—GAAP	4.11%	3.64%	2.78%
Average yield on interest-earning assets excluding valuations	5.14%	5.02%	4.66%
Average rate on interest-bearing liabilities excluding valuations	1.24%	1.66%	2.12%
Net interest spread excluding valuations	3.90%	3.36%	2.54%
Net interest margin excluding valuations	4.10%	3.63%	2.82%
Average yield on interest-earning assets on a tax-equivalent basis and excluding valuations	5.26%	5.07%	4.71%
Average rate on interest-bearing liabilities excluding valuations	1.24%	1.66%	2.12%
Net interest spread on a tax-equivalent basis and excluding valuations	4.02%	3.41%	2.59%
Net interest margin on a tax-equivalent basis and excluding valuations	4.21%	3.68%	2.86%

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:

<i>(In thousands)</i>	<u>Year Ended December 31,</u>		
	<u>2013</u>	<u>2012</u>	<u>2011</u>
Unrealized gain (loss) on derivatives (economic undesignated hedges):			
Interest rate caps . . . . .	\$ 10	\$—	\$ —
Interest rate swaps on loans . . . . .	<u>1,685</u>	<u>901</u>	<u>(1,548)</u>
Net unrealized gain (loss) on derivatives (economic undesignated hedges) . . . . .	<u>\$1,695</u>	<u>\$901</u>	<u>\$(1,548)</u>

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:

<i>(In thousands)</i>	<u>Year Ended December, 31</u>		
	<u>2013</u>	<u>2012</u>	<u>2011</u>
Unrealized (gain) loss on interest rate swaps and other derivatives on medium-term notes (economic undesignated hedges) . . . . .	\$—	\$ —	\$ 45
Unrealized (gain) loss on medium-term notes measured at fair value . . . . .	<u>—</u>	<u>(491)</u>	<u>4,122</u>
Net unrealized (gain) loss on derivatives (economic undesignated hedges) and liabilities measured at fair value . . .	<u>\$—</u>	<u>\$(491)</u>	<u>\$4,167</u>

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 notes payable.

Unrealized gains or losses on derivatives represent changes in the fair value of derivatives, primarily interest rate swaps and caps used for protection against rising interest rates.

Unrealized gains or losses on liabilities measured at fair value represent the change in the fair value of medium-term notes elected to be measured at fair value, other than the accrual of interests. These medium-term notes were repaid in 2012.

Derivative instruments, such as interest rate swaps, are subject to market risk. While the Corporation does have certain trading derivatives to facilitate customer transactions, the Corporation does not utilize derivative instruments for speculative purposes. As of December 31, 2013, most of the interest rate swaps outstanding are used for protection against rising interest rates. Refer to Note 29 of the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K for further details concerning the notional amounts of derivative instruments and additional information. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on net interest income. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, and the expectations for rates in the future.

## 2013 compared to 2012

Net interest income increased 11% to \$514.9 million for 2013 from \$461.7 million in 2012. The increase was primarily driven by a reduction in the average cost of funds, a higher volume of MBS, and interest income contributed by the credit cards portfolio acquired in late May 2012.

The net interest margin excluding valuations improved by 47 basis points to 4.10% compared to 2012. The improvement in the net interest margin was mainly derived from renewals of maturing brokered CDs at lower rates, improved deposit pricing, an improved deposit mix, and funding cost reductions resulting from maturities of high-cost borrowings. The average cost and balance of brokered CDs decreased by 74 basis points and \$237.2 million, respectively, for the year ended December 31, 2013 compared to 2012. These reductions resulted in a decline of \$28.6 million in interest expense. During 2013, the Corporation repaid \$2.2 billion of maturing brokered CDs with an all-in cost of 1.64%, and issued \$2.0 billion of new brokered CDs with an all-in cost of 0.82%.

In addition, the Corporation reduced the average cost of funds by lowering the rates paid on certain of its savings, interest-bearing checking accounts, and retail CDs. For the year ended December 31, 2013, the average rate paid on non-brokered deposits declined by 17 basis points to 0.93% compared to 2012. This reduction in the average cost of non-brokered deposits resulted in a decrease of approximately \$10.1 million in interest expense. The average balance of non-brokered deposits for 2013 increased \$216.3 million to \$5.8 billion compared to 2012. The Corporation's strategic focus remains to grow non-brokered deposits and improve the overall funding mix. The Corporation also benefited from the maturities of some high-cost borrowings, including maturities during 2013 of approximately \$208.4 million of FHLB advances that carried an average cost of 3.92% and the full-year effect of the repayments in the first half of 2012 of the \$21 million medium-term notes (average rate of 5.65%) and the \$100 million repurchase agreement (rate of 4.38%), which, in the aggregate, contributed to a decrease of \$9.2 million in interest expense.

The net interest income was also positively impacted by the increase in the average volume of investment securities. For the year ended December 31, 2013, the average volume of investment securities and interest-bearing cash equivalents increased \$305.2 million to \$2.7 billion compared to 2012. The higher volume contributed to an increase of \$8.3 million in interest income compared to 2012. The increase in volume resulted mainly from the purchase, during 2013, of approximately \$682.9 million of 15-20 year U.S. agency MBS with an average yield of 1.99%.

The aforementioned favorable items were partially offset by a \$1.1 million decrease in the interest income on loans, mainly due to a \$468.3 million decrease in the average volume of loans. The average volume of commercial and construction loans decreased by \$588.5 million, resulting in a decrease of approximately \$20.5 million in interest income, driven by significant repayments of commercial credit facilities, and the bulk sale of adversely classified loans completed in the first quarter of 2013. In addition, the interest income of the residential mortgage loans portfolio decreased by \$4.1 million driven by higher inflows of loans to non-performing status. These variances were partially offset by a \$23.5 million increase in interest income on consumer loans, driven by an increase of \$18.7 million in the interest income contributed by the credit card loans portfolio reflecting the full-year effect of this portfolio that was acquired in late May 2012.

On an adjusted tax-equivalent basis, net interest income increased by \$60.8 million, or 13%, for 2013 compared to 2012 mainly due to reductions in the overall cost of funding, and a higher volume of investment securities, as discussed above. The increase for 2013 also includes an increase of \$7.9 million in the tax-equivalent adjustment, compared to 2012, mainly related to the increase in statutory tax rates in Puerto Rico and a higher average volume of tax-exempt securities held by the IBE, First Bank Overseas Corporation. The tax-equivalent adjustment increases interest income on tax-exempt securities and loans by an amount that makes tax-exempt income comparable, on a pre-tax basis, to the Corporation's taxable income as previously stated.

## 2012 compared to 2011

Net interest income increased 17% to \$461.7 million for 2012 from \$393.5 million in 2011. The increase was primarily driven by a reduction in the average cost of funds and interest income contributed by the credit cards portfolio acquired in late May 2012.

The net interest margin excluding valuations for 2012 improved by 81 basis points compared to 2011. The improvement in the net interest margin excluding valuations was mainly derived from improved deposit pricing, an improved deposit mix, renewals of maturing brokered CDs at lower current rates, and funding cost reductions resulting from the re-structuring of repurchase agreements and maturities of high cost borrowings. The Corporation reduced the average cost of funds by lowering rates paid on certain savings, interest-bearing checking accounts and retail CDs. The average rate on non-brokered deposits declined by 41 basis points during 2012, driving the reduction of approximately \$18.8 million in interest expense, while the average balance of non-brokered deposits increased by \$259.2 million. The Corporation continued to reduce brokered CDs, which decreased by \$1.6 billion in average balance. The average cost of brokered CDs decreased by 25 basis points during 2012 as compared to 2011. During 2012, the Corporation repaid approximately \$2.6 billion of maturing brokered CDs with an all-in cost of 1.98% and new issuances amounted to \$2.3 billion with an all-in cost of 0.92%. The Corporation's strategic focus remains to grow non-brokered deposits and improve the overall funding mix. Also, the Corporation benefited from the restructuring of \$900 million of repurchase agreements during the second half of 2011 and first quarter of 2012, which resulted in a reduction of \$7.7 million in interest expense compared to 2011. Further reductions in interest expense were achieved as the Corporation repaid some high-cost borrowings such as \$100 million of repurchase agreements and \$21 million of medium-term notes in 2012. Finally, improvements in the cost of funds were also attributable to approximately \$159 million of FHLB advances with an average cost of 3.16% that matured in 2012. The Corporation entered into \$300 million of long-term FHLB advances during the third quarter of 2012 with an average cost of 1.11%.

Also contributing to the improvement in net interest income and margin was additional interest income of \$41.9 million recorded in 2012 from the credit card portfolio purchased in late May 2012, including \$6.6 million related to the discount accretion recorded as an adjustment to the yield of the purchased portfolio. The interest income from credit cards was the main driver of the 36 basis points increase in the yield of total earning assets. This purchase increased the average volume of consumer loans by approximately \$214.3 million in 2012, as compared to 2011. Partially offsetting these increases was a decline in the volume of interest-earning assets reflecting the execution in 2011 of deleveraging strategies, including sales of loans and securities, and significant repayments of commercial credit facilities and maturities and calls of investment securities. Average interest-earning assets decreased by \$1.5 billion, reflecting a \$764.1 million reduction in average total loans and leases and a \$730.5 million reduction in average investment securities. The decrease in average loans was driven by significant repayments of commercial credit facilities, foreclosures, charge-offs and the full impact of sales executed in 2011 as part of the Corporation's capital plan in order to preserve capital. The decrease in the average volume of investment securities mainly relates to maturities of Treasury and agency debt securities and Puerto Rico government obligations called before their contractual maturities as well as the full impact of sales completed in 2011. Proceeds from sales, repayments and calls of loans and securities have been used, in part, to reduce maturing brokered CDs, repurchase agreements, advances from the FHLB and notes payable. Higher cash balances put pressure on the net interest margin. The average cash balances, at an average rate of 0.29%, were higher by approximately \$73.1 million compared to 2011 due to heightened regulatory liquidity expectations for the industry and a challenging interest rate environment.

On an adjusted tax-equivalent basis and excluding valuations, net interest income increased by \$60.6 million, or 14%, for 2012 compared to 2011 mainly due to reductions in the overall cost of funding and the contribution of the recently acquired credit card portfolio, as discussed above. The tax-equivalent adjustment decreased by \$0.5 million for 2012 compared to 2011.

## **Provision for Loan and Lease Losses**

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

During 2013, the Corporation recorded a provision for loan and lease losses of \$243.8 million, compared to \$120.5 million in 2012 and \$236.3 million in 2011.

### **2013 compared to 2012**

The provision for loan and lease losses for 2013 of \$243.8 million increased by \$123.3 million compared to the provision recorded for 2012. The increase in the provision was mainly related to the bulk sales of assets completed in 2013 that resulted in charges to the provision of \$126.8 million. Furthermore, the increase for 2013 also reflects a charge of \$5.2 million to the provision related to the transfer of certain non-performing commercial and construction loans to held for sale during the first quarter of 2013.

Excluding the impact of the bulk sales of assets and the transfer of loans to held for sale, the provision for loan and lease losses for 2013 was \$111.7 million, a decrease of \$8.8 million compared to 2012. The decrease was mainly attributable to a reduction in charges to specific reserves for commercial and construction loans commensurate with the decline in the level of impaired and adversely classified loans, particularly higher charges in 2012 related to a construction loan in the Virgin Islands that was transferred to held for sale in 2013. In addition, the decrease was attributable to lower provision requirements for the Puerto Rico residential mortgage loan portfolio driven by lower charge-offs, an improved portfolio composition following the bulk sale of non-performing residential assets, and the impact in 2012 of adjustments to loss factors that were reflective of market conditions, including assumptions regarding loss severities that took into consideration qualitative and quantitative factors such as loan resolution and liquidation strategies and average time for liquidation. The aforementioned decreases were partially offset by an increase in the provision for consumer loans mainly due to a higher general reserve for auto loans based on historical loss experience, and the overall increase in the size of this portfolio, and an increase in the provision of the credit card loans portfolio that was acquired in late May 2012.

The bulk sale of approximately \$217.7 million of adversely classified and non-performing assets completed in the first quarter of 2013, mainly commercial loans, resulted in charge-offs of approximately \$98.5 million. In determining the historical loss rate for the computation of the general reserve for commercial loans, the Corporation includes the portion of these charge-offs that was related to the acceleration of previously reserved credit losses amounting to approximately \$39.9 million. The Corporation considered that the portion not deemed to be credit-related losses was not indicative of the ultimate losses that may have occurred had the assets been resolved on an individual basis, over time and not in a steeply discounted bulk sale. A transaction, such as this one, entered into to expedite the reduction of non-performing and adversely classified assets, can result in charge-offs that are not reflective of true credit-related charge-off history since there is a component related to the discounted value realized on a bulk sale basis. Accordingly, the Corporation concluded it is reasonable to exclude the component related to the discounted value from its historical charge-off analysis used in estimating its allowance for loan losses.

In terms of geography and categories, in Puerto Rico, the Corporation recorded a provision of \$245.6 million compared to \$112.4 million in 2012. The increase primarily reflects a provision of \$120.6 million recorded on the bulk sales of assets attributable to Puerto Rico loans. Excluding the impact of the bulk sales of



assets and the transfer of loans to held for sale, the provision for loan and lease losses in Puerto Rico increased \$12.6 million to \$125 million compared to 2012. The higher provision was mainly related to an increase of \$21.3 million in the provision for consumer loans reflecting higher general reserves on auto and boat loans based on historical loss experience and the overall increase in the size of this portfolio and, to a lesser extent, an increase in the provision for the non-PCI credit card loans portfolio acquired in late May 2012. This was partially offset by a decrease of \$10.8 million in the provision for residential mortgage loans driven by lower charge-offs, an improved portfolio composition following the bulk sale of non-performing residential assets, and the impact in 2012 of adjustments to loss factors that were reflective of market conditions, including assumptions regarding loss severities that took into consideration qualitative and quantitative factors such as loan resolution and liquidation strategies and average time for liquidation.

With respect to the portfolio in the U.S., the Corporation recorded a reserve release of \$10.7 million in 2013 compared to a reserve release of \$9.1 million in 2012. The variance mainly reflects a reduction in the amount of adversely classified commercial loans and stability in collateral values. In addition, there was a recovery of \$4.5 million related to a troubled debt restructured loan paid-off in Florida.

The Virgin Islands region recorded a provision of \$8.8 million in 2013 compared to \$17.7 million in 2012. The provision in 2013 includes a charge of \$5.2 million related to the bulk sale of non-performing residential assets attributable to Virgin Islands loans completed in the second quarter of 2013, and a charge of \$6.3 million related to a commercial construction loan relationship transferred to held for sale in the first quarter of 2013. Excluding the impact of the bulk sale of non-performing residential assets and the transfer of loans to held for sale attributable to Virgin Islands loans, the Corporation recorded a reserve release of \$2.6 million, or a \$19.8 million reduction in the provision as compared to 2012. The decrease mainly reflects higher charges in 2012 related to the loan relationship that was transferred to held for sale in 2013.

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.

### **2012 compared to 2011**

The provision for loan and lease losses for 2012 of \$120.5 million decreased by \$115.9 million, or 49%, compared to the provision recorded for 2011. The decline in the provision for 2012, compared to 2011, was reflected in all major loan categories, except for consumer loans, and resulted from reduced charges to specific reserves for impaired loans driven by a lower migration of loans to non-performing and/or adversely classified categories commensurate with lower loss rates due to improvements in charge-off trends and the overall reduction in the size of the portfolio. The allowance coverage for the non-impaired portfolio (general reserve) is determined using a methodology that incorporates loss rates and risk rating by loan category. Historical loss rates, adjusted for current risk factors, continued to improve as lower recent charge-off activity replaced higher levels rolled out of the 24-month look back period used when evaluating the general reserve determination. The provision for loan and lease losses in 2012 was \$58.5 million lower than net charge-offs, reflecting some improvement in credit quality.

In terms of geography and categories, in Puerto Rico, the Corporation recorded a provision of \$112.4 million compared to \$170.1 million in 2011. The decrease primarily reflects declines of \$35.7 million and \$34.8 million in the provision for commercial mortgage and C&I loans, respectively. This decrease was mainly due to a lower migration of loans to adversely classified or impaired categories, which resulted in lower charges to specific reserves, improved charge-off trends and the overall reduction in the size of these portfolios. Also, more stable collateral values resulted in lower charges to the specific reserves for collateral dependent impaired loans. A loan loss reserve release of \$3.1 million for construction loans was recorded in 2012, compared to a provision

of \$1.8 million in 2011, driven by lower charge-off activity and a lower migration of loans to non-performing and/or impaired status. Partially offsetting these decreases in charges was an increase of \$15.0 million in the provision for consumer loans, mainly related to the non-PCI credit card portfolio acquired from FIA in 2012, and an increase of \$2.8 million in the provision for residential mortgage loans, mainly due to adjustments that are reflective of current market conditions, including assumptions regarding loss severities that, among other things, considered current strategies in the disposition of foreclosed properties.

With respect to the portfolio in the U.S., the Corporation recorded a reserve release of \$9.1 million in 2012 compared to a provision of \$28.2 million in 2011. The decrease was mainly related to a reserve release of \$6.7 million for commercial mortgage loans, compared to a provision of \$12.8 million in 2011. This reduction was driven by improved charge-off trends, the reduction in the amount of adversely classified loans and more stable collateral values. The provision for residential mortgage loans decreased by \$13.1 million, compared to 2011, due to reductions in net charge-offs, improved delinquency trends and a stabilization in the expectation of loss severities for this portfolio.

The Virgin Islands region recorded a decrease of \$20.9 million in the provision for loan and lease losses compared to 2011, mainly related to a decrease of \$22.2 million in the provision for construction loans. The decrease was primarily related to the provision charged in 2011 to a commercial construction loan relationship placed in non-accrual status early in 2011.

#### Non-Interest (Loss) Income

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>
		(In thousands)	
Service charges on deposit accounts .....	\$ 12,797	\$ 12,982	\$ 12,472
Mortgage banking activities .....	16,830	19,960	23,320
Insurance income .....	5,955	5,549	4,456
Broker-dealer income .....	97	2,630	1,385
Other operating income .....	<u>32,256</u>	<u>29,492</u>	<u>29,585</u>
Non-interest income before net (loss) gain on investments, loss on early extinguishment of borrowings, equity in loss of unconsolidated entity, and write-off of collateral pledged to Lehman .....	<u>67,935</u>	<u>70,613</u>	<u>71,218</u>
Proceeds from securities litigation settlement and other proceeds .....	—	36	679
Net gain on sale of investments .....	—	—	53,117
OTTI on equity securities .....	(42)	—	—
OTTI on debt securities .....	<u>(117)</u>	<u>(2,002)</u>	<u>(1,971)</u>
Net (loss) gain on investments .....	<u>(159)</u>	<u>(1,966)</u>	<u>51,825</u>
Loss on early extinguishment of borrowings .....	—	—	(10,835)
Impairment -collateral pledged to Lehman .....	(66,574)	—	—
Equity in loss of unconsolidated entity .....	<u>(16,691)</u>	<u>(19,256)</u>	<u>(4,227)</u>
Total .....	<u><u>\$(15,489)</u></u>	<u><u>\$ 49,391</u></u>	<u><u>\$107,981</u></u>

Non-interest income primarily consists of service charges on deposit accounts; commissions derived from various banking, securities and insurance activities; gains and losses on mortgage banking activities; interchange and other fees related to debit and credit cards; equity in earnings (loss) of the unconsolidated entity; and net gains and losses on investments and impairments.

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, and unrealized gains and losses on forward contracts used to hedge the Corporation's securitization pipeline. In addition, lower-of-cost-or-market valuation adjustments to the Corporation's residential mortgage loans held for sale portfolio and servicing rights portfolio, if any, are recorded as part of mortgage banking activities.

Insurance income consists mainly of insurance commissions earned by the Corporation's subsidiary, FirstBank Insurance Agency, Inc.

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.

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 entity relates to FirstBank's investment in CPG/GS, the entity that purchased \$269 million of loans from FirstBank during the first quarter of 2011. The Bank holds a 35% subordinated ownership interest in CPG/GS. The majority owner of CPG/GS is entitled to recover its initial investment and a priority return of 12% prior to any return paid to the Bank. Accordingly, the Bank's investment of \$7.3 million in CPG/GS as of December 31, 2013 is at risk. Refer to Note 13 of the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K for additional information about the Bank's investment in CPG/GS.

### **2013 compared to 2012**

Non—interest loss for 2013 amounted to \$15.5 million, including the \$66.6 million write-off of the collateral pledged to Lehman, compared to non-interest income of \$49.4 million for 2012. Adjusted non-interest income, excluding the Lehman collateral write-off, increased \$1.7 million, primarily reflecting:

- A \$2.6 million decrease in losses on the Bank's investment in the unconsolidated entity to which the Bank sold loans in 2011, CPG/GS. Equity in loss of unconsolidated entity in 2013 amounted to \$16.7 million compared to a loss of \$19.3 million in 2012. This investment is accounted for under the equity method following the HLBV method to determine the Bank's share of CPG/GS earnings or loss. Under the HLBV method, the Bank determines its share of CPG/GS earnings or loss 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 assuming the liquidation of the entity at the end of each reporting period. The variance is mainly driven by results of operations, including changes in the fair value of loans receivable held by CPG/GS where fair value is determined on a discounted cash flow basis. At valuation dates, key inputs and assumptions are updated to reflect changes in the market, the performance of the underlying assets, and expectations of a market participant. The Bank reports its share of CPG/GS's operating results on a one-quarter lag basis.
- An aggregate increase of \$4.6 million in merchant fees and ATM and POS interchange fees, recorded as part of "Other" in the table above.
- A \$1.8 million decrease in OTTI charges on debt and equity securities. The OTTI charge for both periods is mainly related to credit losses associated with private label mortgage-backed securities held by the Corporation with an amortized cost of \$55.0 million as of December 31, 2013.
- A \$0.8 million increase in loan fees, including commitment unused fees, agent fees, and other non-deferrable fees on commercial loans, included as part of "Other" in the table above.
- A \$0.4 million increase in income from the insurance agency activities, mainly related to a higher volume.

Partially offset by:

- A \$3.1 million decrease in revenues from the mortgage banking business mainly due to lower profit margins on sales and securitization of residential mortgage loans. Realized gains on sales and securitizations decreased by \$5.1 million compared to 2012. This was partially offset by a \$1.5 million increase in servicing fees, commensurate with a higher servicing portfolio, and a favorable variance of approximately \$0.9 million related to the decrease in the valuation allowance of servicing assets.
- A \$2.5 million decrease in income from broker-dealer activities, mainly underwriting fees, due to fewer transactions closed in 2013.
- Lower of cost or market adjustments to commercial loans held for sale that resulted in a net charge of \$2.0 million in 2013. These adjustments were related to non-performing loans transferred at the beginning of the year, particularly a commercial mortgage loan in which the Corporation received foreclosed real estate in partial satisfaction of a debt arrangement. This charge is included as part of "Other" in the table above.

### **2012 compared to 2011**

Non-interest income decreased \$58.6 million, or 54%, to \$49.4 million in 2012, primarily reflecting:

- The impact in the previous year of a \$38.6 million gain on the sale of approximately \$640 million of MBS, as part of the Corporation's deleveraging strategies executed in 2011 to preserve capital, and of a \$3.5 million gain attributable to a tender offer by the Puerto Rico Housing Finance Authority to purchase certain of its outstanding bonds.
- A \$3.4 million decrease in mortgage banking activities driven by the impact in 2011 of a \$12.1 million gain recorded for completed bulk sales of approximately \$518 million of performing residential mortgage loans with servicing releases, also as part of the Corporation's deleveraging strategies executed in 2011 and included in the Capital Plan. This was partially offset by increased gains from the Corporation's mortgage loan securitization activities, lower temporary impairments to the value of servicing assets and a higher gain in sales of residential mortgage loans with servicing retained due to a higher volume of sales.
- Equity in loss of unconsolidated entity of approximately \$19.3 million recorded in 2012, a negative variance of \$15.0 million, compared to a loss of \$4.2 million recorded in 2011.
- The impact in 2011 of a \$2.8 million gain recorded on the sale of substantially all the assets of First Bank Insurance VI, included as part of "Other" in the table above.

The aforementioned factors were partially offset by \$7.2 million in interchange and other related fees earned on the credit card portfolio acquired in late May 2012 and an increase of \$1.2 million in fees from the broker-dealer subsidiary, FirstBank Securities, mainly due to higher underwriting fees.

## Non-Interest Expense

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>
	(In thousands)		
Employees' compensation and benefits . . . . .	\$130,969	\$125,610	\$118,475
Occupancy and equipment . . . . .	60,858	61,037	61,924
Insurance and supervisory fees . . . . .	48,470	52,596	57,923
Taxes, other than income taxes . . . . .	17,997	13,363	13,395
Professional fees:			
Collections, appraisals and other credit-related fees . . . . .	11,321	6,797	6,269
Outsourcing technology services . . . . .	14,144	4,945	3,385
Other professional fees . . . . .	22,487	14,985	15,067
Credit and debit card processing expenses . . . . .	12,909	6,005	1,073
Business promotion . . . . .	15,977	14,093	12,283
Communications . . . . .	7,401	7,085	7,117
Net loss on OREO and OREO operations . . . . .	42,512	25,116	25,025
Loss contingency for attorneys' fees-Lehman litigation . . . . .	2,500	—	—
Other . . . . .	27,483	23,251	16,118
Total . . . . .	<u>\$415,028</u>	<u>\$354,883</u>	<u>\$338,054</u>

### 2013 compared to 2012

Non-interest expense increased by \$60.1 million to \$415.0 million principally attributable to credit-related expenses, including:

- A \$17.4 million increase in the net loss on OREO operations mainly related to higher write-downs to the value of OREO properties, mainly commercial income-producing properties in both Puerto Rico and the Virgin Islands. Write-downs to OREO properties in 2013 totaled \$31.8 million compared to \$15.1 million in 2012. In addition, a loss of \$1.9 million was recorded in 2013 in connection with the sale of certain OREO properties included as part of the bulk sale of residential non-performing assets completed in the second quarter. An increase in the commercial OREO inventory also contributed to higher expenses in 2013. Additions to the commercial OREO inventory in 2013 amounted to \$68.5 million.
- A \$6.9 million increase in professional fees related to the bulk sales of assets in 2013, of which approximately \$5.0 million was included as part of "Other professional fees" in the table above and \$1.9 million was included as part of "Collections, appraisals, and other credit-related fees" in the table above.
- A \$2.6 million increase in professional fees related to attorneys' loan collection fees, appraisals and other credit-related expenses.

In addition, the increase was also attributable to:

- A \$6.9 million increase in credit and debit card processing expenses mainly related to the credit card loan portfolio acquired in late May 2012.
- A \$1.7 million increase in costs related to the conversion of the credit cards processing platform in 2013, most of them included as part of "Other" in the table above.
- A \$9.2 million increase in fees for professional services related to the outsourcing of technology services, mainly due to services provided by FIS under a multi-year technology outsourcing agreement executed by the Corporation at the beginning of the second quarter of 2013. The Bank's information

technology (“IT”) operations were outsourced effective April 1, 2013. Under the multi-year agreement the IT provider, FIS, assumed full operational responsibility for the Bank’s IT operations and staff and the alliance is expected to result in lower operating costs and greater operational efficiencies in future periods. The increases in professional fees attributed to this agreement were partially offset by savings in employees’ compensation and benefits expense related to employees transferred to the IT service provider and savings in software maintenance costs.

- A \$1.2 million increase in professional fees related to expenses associated with a terminated preferred stock exchange offer, included as part of “Other professional fees” in the table above.
- A \$4.6 million increase in taxes, other than income taxes, driven by charges of \$5.9 million related to the new Puerto Rico national gross receipts tax.
- A \$5.4 million increase in employees’ compensation and benefits due to the filling of vacant positions, including several managerial and supervisory positions, certain non-periodic expenses such as lump sum and severance payments, salary merit increases and higher stock-based compensation expenses. These increases were partially offset by savings of approximately \$5.1 million related to employees transferred to FIS, as described above.
- A \$2.5 million loss contingency related to attorneys’ fees granted by the court to Barclays Capital in connection with the denial of the Corporation’s Summary Judgment on its claim to recover assets pledged to Lehman, which the Corporation appealed.
- A \$2.8 million increase in the amortization of intangible assets mainly related to the purchased credit card relationship intangible asset recognized in connection with the credit card loan portfolio acquired in late May 2012, included as part of “Other” in the table above.
- A \$1.7 million increase associated with the secondary offering of the Corporation’s common stock by certain of the existing stockholders, which are primarily reflected in “Other” in the table above.

These increases were partially offset by a \$3.6 million decrease in the deposit insurance premium expense. This charge is included as part of “Insurance and supervisory fees” in the table above.

### **2012 compared to 2011**

Non-interest expense increased by \$16.8 million to \$354.9 million principally attributable to:

- A \$7.1 million increase in employees’ compensation and benefits mainly due to the filling of vacant positions, including several managerial and supervisory positions, and higher incentive compensation expenses.
- A \$10.4 million increase in expenses related to the credit card portfolio acquired in late May 2012, mainly servicing and processing fees expenses and accrued expenses related to the credit cards portfolio rewards program.
- A \$4.3 million negative variance related to the provision for probable losses on off-balance-sheet exposures, mainly for unfunded loan commitments and letters of credit. Reserve releases of \$6.2 million were recorded in 2011, mainly related to non-performing construction loans, including loans sold to CPG/GS early in 2011. This is included as part of “Other” in the table above.
- A \$2.5 million non-recurring charge associated with a contingency adjustment related to the collectability of certain tax credits, included as part of “Other” in the table above.

These increases were partially offset by a \$6.1 million decrease in the deposit insurance premium, included as part of “Insurance and supervisory fees” in the table above, mainly resulting from the decrease in the Bank’s average assets and the Bank’s improved capital position.



## 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 U.S. income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the 2011 PR Code, the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax return 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 ("NOL"), a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carryforward period. In the case of losses incurred during tax years that commenced after December 31, 2004 and ended before January 1, 2013, the carryforward period is extended to 12 years. The carryover period for a NOL incurred during taxable years commencing after December 31, 2012 is 10 years. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from "controlled" subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

Under the 2011 PR Code, First BanCorp. is subject to a maximum statutory tax rate of 39%. The 2011 PR Code also includes an alternative minimum tax of 30% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements. Prior to the approval of Act No. 40 ("Act 40"), known as the "Tax Burden Adjustment and Redistribution Act," which amended the 2011 PR Code as explained below, First Bancorp.'s maximum statutory tax rate was 30% for the years that ended December 31, 2012 and 2011.

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 an IBE of the Bank and through an the Bank's subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which Act No. 7 imposed a special 5% tax on all IBEs. The 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 IBE's net income exceeds 20% of the bank's total net taxable income.

On June 30, 2013, the Puerto Rico government approved Act 40, which amended the 2011 PR Code, and Act No. 46 ("Act 46"), which changes the sales and use tax regime. The main provisions of Act 40 that impacted financial institutions include:

- (i) A new national gross receipts tax that in the case of financial institutions is 1% of gross income that is not deductible for purposes of computing net taxable income and is not part of the alternative minimum tax ("AMT"). This provision was retroactive to January 1, 2013. An expense of \$5.9 million was recorded during the year 2013 related to the national gross receipts tax. This expense is included as part of "Taxes, other than income taxes" in the consolidated statement of (loss) income. Subject to certain limitations, a financial institution will be able to claim a credit of 0.5% of its gross income against its regular income tax or the alternative minimum tax. A \$3.0 million benefit related to this credit was recorded as a reduction to the provision for income taxes in 2013.
- (ii) A decrease in the deduction available to corporations for the computation of the additional surtax from \$750,000 to \$25,000 and a change in the surtax rate to rates that range from 5% to 19%, resulting in an increase in the maximum statutory tax rate from 30% to 39%. This provision was also retroactive to January 1, 2013. The effect on operating results in 2013 related to these changes was a net benefit of

approximately \$1.3 million, mainly due to the increase in the deferred tax asset of profitable subsidiaries. The deferred tax valuation allowance increased to \$522.7 million as of December 31, 2013 from \$359.9 million at December 31, 2012 as a result of changes in tax rates and operating results for the year.

- (iii) A higher AMT rate (30% of the alternative minimum net income, as compared to 20% previously) and various parallel computations required to be made before determining whether an AMT liability exists. This change did not have an impact on the Corporation's provision for income taxes recorded in 2013.
- (iv) The NOL carryover period increased from 10 years to 12 years for losses incurred in taxable years that commenced after December 31, 2004 and ended before January 1, 2013. The carryover period for NOLs incurred during taxable years commencing after December 31, 2012 is 10 years. The NOL deduction is now limited to 90% of taxable income for regular income tax purposes and 80% for AMT purposes.

The significant changes to the sales and use tax regime include adjustments to the business to business exclusion. The business to business exclusion applicable to services rendered from one registered business to another registered business remains in effect, except for certain services that will be taxable including, among others, service charges imposed by financial institutions on other businesses (commercial clients), collection services, repairs and maintenance services related to real and personal property, and computer programming including modifications to previously designed systems. The sales and use tax provisions were effective beginning on July 1, 2013.

In addition, on October 14, 2013, Act No.117 ("Act 117") implemented technical amendments to various income tax laws, including the 2011 PR Code. The main provisions of Act 117 that impacted financial institutions are the exemption from the imposition of the national gross receipts tax on foreign source income and the temporary requirement of an estimated tax payment in mid-October. On November 26, 2013, Act No.36 was enacted to, among other things, require the payment of estimated taxes related to personal property tax returns. These amendments of Act No. 36 will be effective during the year 2014.

For additional information relating to income taxes, see Note 24 to the Corporation's audited financial statements for the year ended December 31, 2012 included in Item 8 of this Form 10-K, including the reconciliation of the statutory to the effective income tax rate for 2012, 2011 and 2010.

### **2013 compared to 2012**

For 2013, the Corporation recorded an income tax expense of \$5.2 million compared to an income tax expense of \$5.9 million for 2012. The income tax expense for 2013 mainly comprises an income tax expense of \$3.2 million due to the principal and accrued interest related to UTBs (discussed in detail below) and the income tax expense of profitable subsidiaries, partially offset by the benefit of \$1.3 million due to the change in the statutory tax rate from 30% to 39% in 2013 and by the credit available for the gross national receipt tax of \$3.0 million. As of December 31, 2013, the deferred tax asset, net of a valuation allowance of \$522.7 million, amounted to \$7.6 million compared to \$4.9 million as of December 31, 2012. The main driver of the increased deferred tax asset was the credit available for the national gross receipt tax together with the increase in the statutory applicable tax rate from 30% to 39% per Act 40 enacted during the second quarter of 2013.

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on an assessment of the amount of the deferred tax asset that is "more likely than not" to be realized. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. In making such assessment, significant weight is given to evidence that can be objectively verified, including both positive and negative evidence. 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.

In assessing the weight of positive and negative evidence, a significant negative factor that resulted in the maintenance of the valuation allowance was that the Corporation's banking subsidiary, FirstBank Puerto Rico, continues in a three-year historical cumulative loss position as of the end of the year 2013, mainly due to charges to the provision for loan and lease losses in prior years as a result of the economic downturn and more recently as a result of the bulk loan sales transactions completed in 2013. As of December 31, 2013, the Corporation had a gross deferred tax asset of \$539.2 million, including \$371.7 million associated with NOLs. The Bank incurred all of the NOLs after 2009. The Corporation maintained a valuation allowance of \$522.7 million as of December 31, 2013 against the deferred tax asset. As of December 31, 2013, management concluded that \$7.6 million of the deferred tax asset will be realized as it relates 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 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 analysis: 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 under this analysis and the tax benefit claimed on a tax return is referred to as an UTB.

The Corporation recorded UTBs of \$4.3 million, all of which would, if recognized, affect the Corporation's effective tax rate. The Corporation classified all interest and penalties, if any, related to tax uncertainties as income tax expense. As of December 31, 2013, the Corporation's accrued interest that relates to tax uncertainties amounted to \$2.4 million and there is no need to accrue for the payment of penalties. For 2013, the total amount of interest recognized by the Corporation as part of income tax expense related to tax uncertainties was \$1.3 million. The years 2007 through 2009 have been examined by the United States Internal Revenue Service ("IRS") and disputed issues were taken to administrative appeals in 2011. During the third and fourth quarter of 2013, the Corporation reassessed its UTB mainly due to changes in management judgment given the lengthy administrative appeals process, communications with the IRS and expectations as to resolution. During October 2013, the Corporation filed a mediation request with the IRS appeals office in an effort to expedite the resolution of the audits under their examination. Subsequent to the filing of the mediation request, the Corporation has exchanged communications with the IRS, and management expects the prompt resolution of this matter. However, the Corporation currently cannot reasonably estimate a range of possible changes to the existing reserves. The amount of the Corporation's UTBs may increase or decrease for various reasons, including changes in the amounts for current tax year positions, the expiration of open income tax returns due to the expiration of statutes of limitations, changes in management's judgment about the level of uncertainty, the status of examinations, litigation and legislative activity, and the addition, or elimination, of uncertain tax positions.

The Corporation's liability for income taxes includes its liability for UTBs, and interest that relates to tax years still subject to review by taxing authorities. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the 2011 PR Code is four years; the statutes of limitations for the Virgin Islands and for U.S. income tax purposes are three years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation's liability for income taxes. Any such adjustment could be material to results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For Puerto Rico and Virgin Islands income tax purposes,

all tax years subsequent to 2009 and 2010, respectively, remain open to examination. Tax year 2010 is currently under examination by the Puerto Rico Department of Treasury. The examination is at a preliminary stage. Taxable years from 2007 remain open to examination for U.S. income tax purposes.

### **2012 compared to 2011**

For 2012, the Corporation recorded an income tax expense of \$5.9 million compared to an income tax expense of \$9.3 million for 2011. The lower income tax expense for 2012 was primarily due to a reduction in deferred tax assets of profitable subsidiaries due to a reduction in statutory tax rates in 2011. In addition, the income tax expense for 2011 includes UTBs of \$3.2 million, including accrued interest. As of December 31, 2012, the deferred tax asset, net of a valuation allowance of \$359.9 million, amounted to \$4.9 million compared to \$5.4 million as of December 31, 2011.

### **OPERATING SEGMENTS**

Based upon the Corporation's organizational structure and the information provided to the Chief Executive Officer of the Corporation and, to a lesser extent, the Board of Directors, the operating segments are driven primarily by the Corporation's lines of business for its operations in Puerto Rico, the Corporation's principal market, and by geographic areas for its operations outside of Puerto Rico. As of December 31, 2013, the Corporation had six reportable segments: Consumer (Retail) Banking; Commercial and Corporate Banking; Mortgage Banking; Treasury and Investments; United States operations; and Virgin Islands operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation's organizational chart, nature of the products, distribution channels and the economic characteristics of the products were also considered in the determination of the reportable segments. For additional information regarding First BanCorp's reportable segments, please refer to Note 31, "Segment Information," to the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K.

The accounting policies of the segments are the same as those described in Note 1, — "Nature of Business and Summary of Significant Accounting Policies," to the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K. The Corporation evaluates the performance of the segments based on net interest income, the estimated provision for loan and lease losses, non-interest income, and direct non-interest expenses. The segments are also evaluated based on the average volume of their interest-earning assets less the allowance for loan and lease losses. In 2013, 2012, and 2011, other operating expenses not allocated to a particular segment amounted to \$94.1 million, \$87.3 million, and \$84.5 million, respectively. Expenses pertaining to corporate administrative functions that support the operating segment but are not specifically attributable to or managed by any segment are not included in the reported financial results of the operating segments. The unallocated corporate expenses include certain general and administrative expenses and related depreciation and amortization expenses.

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

#### *Consumer(Retail)Banking*

The Consumer (Retail) Banking segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through FirstBank's branch network and loan centers in Puerto Rico. Loans to consumers include auto, boat and personal loans, credit cards and lines of credit. Deposit products include

interest bearing and non-interest bearing checking and savings accounts, Individual Retirement Accounts and retail CDs. Retail deposits gathered through each branch of FirstBank's retail network serve as one of the funding sources for the lending and investment activities.

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

Personal loans, credit cards, and, to a lesser extent, marine financing also contribute to interest income generated on consumer lending. In 2012, the Corporation reentered the credit card business with the acquisition of an approximate \$406 million portfolio of FirstBank-branded credit cards from FIA (carrying value of \$316.0 million as of December 31, 2013). Management plans to continue to be active in the consumer loans market, applying the Corporation's strict underwriting standards. Other activities included in this segment are finance leases and insurance activities in Puerto Rico.

The highlights of the Consumer (Retail) Banking segment's financial results for the year ended December 31, 2013 include the following:

- Segment income before taxes for the year ended December 31, 2013 was \$67.0 million compared to \$74.6 million and \$55.6 million for the years ended December 31, 2012 and 2011, respectively.
- Net interest income for the year ended December 31, 2013 was \$204.8 million compared to \$176.6 million and \$138.4 million for the years ended December 31, 2012 and 2011, respectively. The increase in 2013, compared to 2012, was driven by the full-year impact of the interest income contributed by the credit card portfolio acquired in late May 2012 and by lower rates paid on core deposits. The consumer loan portfolio is mainly composed of fixed-rate loans financed with shorter-term borrowings, thus positively affected by lower deposit costs. The increase in 2012, compared to 2011, was driven by lower rates paid on core deposits, and the contribution to net interest income of the credit card portfolio acquired in late May 2012.
- The provision for loan and lease losses for 2013 increased by \$21.3 million to \$54.2 million compared to 2012 and increased by \$15.0 million to \$32.9 million when comparing 2012 with 2011. The increase in the provision for 2013, compared to 2012, reflects higher general reserves on auto and marine financings based on historical loss experience and, to a lesser extent, an increase in the provision for the non-PCI credit cards loan portfolio acquired in late May 2012. The increase in 2012, compared to 2011, was mainly attributable to the allowance for non-PCI credit card loans acquired from FIA in 2012.
- Non-interest income for the year ended December 31, 2013 was \$39.0 million compared to \$33.4 million and \$27.7 million for the years ended December 31, 2012 and 2011, respectively. The increase in 2013 was mainly related to an aggregate increase of \$3.9 million in merchant fees and ATM and POS interchange fees, and an increase of \$0.4 million in income from the insurance agency activities. The increase in 2012, compared to 2011, was mainly related to \$7.2 million of interchange and other related fees earned on the credit card portfolio acquired in 2012. This was partially offset by a decrease of approximately \$2 million in debit card interchange fees given the mandated lower interchange fee structure (Durbin Amendment) implemented on October 1, 2011. The Durbin Amendment put a cap on how much banks and debit networks are allowed to charge for a check/debit card transaction. The cap is currently set at \$0.21 plus 0.05% of the transaction.
- Direct non-interest expenses for the year ended December 31, 2013 were \$122.6 million compared to \$102.4 million and \$92.5 million for the years ended December 31, 2012 and 2011, respectively. The increase for 2013 was primarily due to higher credit-card processing expenses, including costs related to the conversion of the credit card processing platform, and a higher amount of amortization of the purchased credit card relationship intangible. In addition, there were increases in 2013 in fees for professional services mainly related to consulting fees, as well as increases in employees'



compensation, marketing, and the charge related to the new Puerto Rico national gross receipts tax corresponding to this business segment. The increase for 2012, compared to 2011, was primarily due to credit-card related costs including, among others, expenses related to the servicing of the portfolio, accrued expenses for the credit cards awards program and the amortization of the purchased credit card relationship intangible asset.

### *Commercial and Corporate Banking*

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

The highlights of the Commercial and Corporate Banking segment's financial results for the year ended December 31, 2013 include the following:

- Segment loss before taxes for the year ended December 31, 2013 was \$5.0 million compared to income of \$81.0 million for 2012 and \$30.6 million for 2011.
- Net interest income for the year ended December 31, 2013 was \$157.7 million compared to \$164.2 million and \$190.5 million for the years ended December 31, 2012 and 2011, respectively. The decrease in net interest income for 2013, compared to 2012, was mainly related to a decrease of \$483.0 million in the average balance of commercial loans in Puerto Rico led by significant repayments, the bulk sale of adversely classified assets completed in the first quarter of 2013 and foreclosures. Higher inflows of loans to non-performing status in 2013, compared to 2012, also contributed to the decrease in net interest income. The decrease in net interest income for 2012, compared to 2011, was mainly related to a decrease of \$662.9 million in the average balance of commercial loans in Puerto Rico led by principal repayments.
- The provision for loan losses for 2013 was \$102.0 million compared to \$42.9 million and \$118.5 million for 2012 and 2011, respectively. The increase in 2013, compared to 2012, reflects a charge of approximately \$56.9 million related to the bulk sale of adversely classified assets and the transfer of certain loans to held for sale completed in the first quarter of 2013. Excluding the effect of the bulk sale and the transfer of loans to held for sale, the provision for this business segment increased \$2.2 million to \$45.1 million mainly related to an increase in the general reserve of construction loans. The decrease in 2012, compared to 2011, was mainly related to a lower provision for commercial mortgage and C&I loans mainly attributable to a lower migration of loans to adversely classified or impaired categories, resulting in, lower charges to specific reserves, improved charge-offs trends and the overall reduction in the size of these portfolios. Also, more stable collateral values resulted in lower charges to the specific reserve of collateral dependent impaired loans. Refer to the "Provision for Loan and Lease Losses" discussion above and to the "Risk Management—Allowance for Loan and Lease Losses and Non-performing Assets" discussion below for additional information with respect to the credit quality of the Corporation's commercial and construction loan portfolio.



- Total non-interest income for the year ended December 31, 2013 amounted to \$3.9 million compared to \$10.1 million and \$8.6 million for the years ended December 31, 2012 and 2011, respectively. The decrease in 2013, compared to 2012, was mainly related to lower of cost or market adjustments to commercial loans held for sale that resulted in a net charge of \$2.0 million in 2013. These adjustments were related to non-performing loans transferred to held for sale at the beginning of the year, particularly a commercial mortgage loan in which the Corporation received foreclosed real estate in partial satisfaction of a debt arrangement. In addition, the income from broker-dealer activities decreased by \$2.5 million, mainly underwriting fees, due to fewer transactions closed in 2013, partially offset by higher non-deferrable loan fees, such as agent and commitment unused fees. The increase in 2012, compared to 2011, was mainly related to an increase of \$1.2 million in fees from the broker-dealer subsidiary, mainly underwriting fees, and an increase in cash management and overdraft fees of corporate customers.
- Direct non-interest expenses for 2013 were \$64.6 million, compared to \$50.4 million in 2012, and \$50.0 million in 2011. During 2013, compared to 2012, the main variances were related to a \$11.0 million increase in write-downs to the value of commercial OREO properties in Puerto Rico, and a \$3.9 million increase related to professional fees related to the bulk sale of adversely classified assets. In addition, there were increases in employees' compensation and benefits due to the filling of vacant positions, including several managerial and supervisory positions, and non-periodic payments, including lump sum and severance payments, an increase in expenses related to the new Puerto Rico national gross receipts tax allocated to this business segment, and lower reserve releases for unfunded loan commitments. During 2012, compared to 2011, the main variances were related to a negative variance of \$4.3 million associated with lower reserve releases for the allowance of off-balance-sheet exposures, mainly unfunded loan commitments and increases in employees' compensation and professional service fees, offset by the portion of the decrease in the FDIC deposit insurance premium allocated to this portfolio and lower losses on REO operations, including lower write-downs and losses on the disposition of REO properties.

### *Mortgage Banking*

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

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

The highlights of the Mortgage Banking segment's financial results for the year ended December 31, 2013 include the following:

- Segment loss before taxes for the year ended December 31, 2013 was \$51.1 million compared to a loss of \$0.2 million for 2012 and income of \$7.2 million for 2011.

- Net interest income for the year ended December 31, 2013 was \$71.5 million compared to \$61.3 million and \$56.9 million for the years ended December 31, 2012 and 2011, respectively. The increase in net interest income for 2013, compared to 2012, was mainly related to the decrease in the average cost of funding. The Mortgage Banking portfolio is principally composed of fixed-rate residential mortgage loans tied to long-term interest rates that are financed with shorter-term borrowings, thus positively affected in a lower interest rate scenario. In addition, the lower cost of funding attributed to this business segment relates to the decrease in the average volume of loans after the sale of non-performing loans in the second quarter of 2013. The increase in net interest income for 2012, compared to 2011, was mainly related to the decrease in the average cost of funding that offset the decrease of \$82.9 million in the volume of average residential mortgage loans in Puerto Rico.
- The provision for loan and lease losses for 2013 was \$89.4 million compared to \$36.6 million and \$33.7 million for the years ended December 31, 2012 and 2011, respectively. The increase in 2013, compared to 2012, reflects a charge of approximately \$63.7 million related to the bulk sale of residential non-performing assets completed in 2013. Excluding the effect of the bulk sale, the provision for this business segment decreased \$10.8 million to \$25.7 million. The variance in the provision reflects lower charge-offs, improved credit quality following the bulk sale of non-performing residential assets, and the impact in 2012 of adjustments to loss factors that were reflective of market conditions, including assumptions regarding loss severities that took into consideration qualitative and quantitative factors such as loan resolution and liquidation strategies and average time for liquidation.
- Non-interest income for the year ended December 31, 2013 was \$15.8 million compared to \$18.1 million and \$22.3 million for the years ended December 31, 2012 and 2011, respectively. The decrease in 2013, compared to 2011, was mainly due to lower profit margins on sales and securitizations of residential mortgage loans, partially offset by an increase in servicing fees and a decrease in the valuation allowance of servicing assets. The decrease in 2012, compared to 2011, was mainly related to \$12.1 million in gains recorded for completed bulk sales of approximately \$518 million of performing residential mortgage loans with servicing release completed in 2011. In 2012, this was partially offset by higher gains on sale of loans with servicing retained and lower impairments on the value of servicing assets.
- Direct non-interest expenses in 2013 were \$48.9 million compared to \$43.1 million and \$38.3 million for 2012 and 2011, respectively. The increase in 2013, compared to 2012, reflects expenses of approximately \$5.0 million related to the bulk sale completed in the second quarter of 2013 as well as higher attorneys' loan collection fees and the charge related to the new Puerto Rico national gross receipts tax corresponding to this business segment. The increase in 2012, compared to 2011, reflects a \$2.5 million non-recurring charge associated with a contingency adjustment related to the collectability of certain mortgage-related tax credits and also included increases in employees' compensation and professional service fees. This was partially offset by the portion of the decrease in the amount of the FDIC deposit insurance premium allocated to this segment.

### *Treasury and Investments*

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

The investment function is intended to implement a leverage strategy for the purposes of liquidity management, interest rate management and earnings enhancement.

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

The highlights of the Treasury and Investments segment's financial results for the year ended December 31, 2013 include the following:

- Segment loss before taxes for the year ended December 31, 2013 amounted to \$58.5 million compared to a loss of \$12.8 million for 2012 and a loss of \$27.7 million for 2011.
- Net interest income for the year ended December 31, 2013 was \$18.8 million compared to net interest losses of \$4.9 million and \$63.6 million for the years ended December 31, 2012 and 2011, respectively. The increase in net interest income was mainly related to both a decrease in the average cost of funding, driven by the renewals of maturing brokered CDs at lower rates and the maturity of certain high-cost borrowings, and an increase in the volume of MBS that was driven by purchases of approximately \$682.9 million of 15-20 year U.S. agency MBS in 2013. The lower net interest loss for 2012, compared to 2011, was mainly attributable to the decrease in the average cost of funding driven by lower rates paid on brokered CDs, the maturity of certain high-cost borrowings such as repurchase agreements and FHLB advances, and the prepayment of medium-term notes. In addition, amounts credited to this segment increased in 2012 due to higher amounts charged to the Commercial and Corporate Banking segment aligned with the overall average increase in short-term index rates in 2012, in particular 3-month LIBOR. The factors offset the decrease in the average volume of investment securities and the maintenance of higher cash balances at the Federal Reserve.
- Non-interest loss for the year ended December 31, 2013 amounted to \$66.6 million compared to loss of \$1.6 million and income of \$41.6 million for the years ended December 31, 2012 and 2011, respectively. The higher loss in 2013, compared to 2012, was mainly due to the \$66.6 million write-off of the collateral pledged to Lehman, partially offset by lower OTTI charges to available-for-sale debt and equity securities. The negative variance in 2012, compared to 2011, reflects the impact in 2011 of gains on the sale of MBS, resulting from deleveraging strategies executed in 2011 as part of the Corporation's Capital Plan in order to preserve capital and meet the requirements of the FDIC Order.
- Direct non-interest expenses for 2013 were \$10.6 million compared to \$6.3 million and \$5.7 million for 2012 and 2011, respectively. The increase in 2013, compared to 2012, was mainly attributable to: (i) the loss contingency of \$2.5 million related to attorneys' fees granted by the court to the other party in connection with the denial of the Corporation's motion for Summary judgment on its claim to recover assets pledged to Lehman, which the Corporation appealed, (ii) expenses of \$1.7 million related to the secondary offering of the Corporation's common stock by certain of the existing stockholders, and (iii) expenses of \$1.2 million related to the terminated preferred stock exchange offer. The increase in 2012, compared to 2011, was mainly attributable to higher compensation expenses due to the reallocation of recourses.

### *United States Operations*

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

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

The highlights of the United States operations segment's financial results for the year ended December 31, 2013 include the following:

- Segment income before taxes for the year ended December 31, 2013 was \$8.0 million compared to income of \$3.3 million and a loss of \$36.0 million for the years ended December 31, 2012 and 2011, respectively.
- Net interest income for the year ended December 31, 2013 was \$24.5 million compared to \$20.1 million and \$21.5 million for the years ended December 31, 2012 and 2011, respectively. The increase in 2013, as compared to 2012, was mainly related to reductions in the average cost of funding and maturities of FHLB advances. The decrease in 2012, as compared to 2011, was mainly related to the decrease of \$83.3 million in the average volume of commercial loans and lower charges made to operating segments in Puerto Rico due to decreases in longer-terms interest rate indexes.
- During 2013, a reserve release of \$10.7 million was recorded for this segment, compared to a reserve release of \$9.1 million and a provision of \$28.2 million for 2012 and 2011, respectively. The higher reserve release in 2013, compared to 2012, was mainly related to a reduction in the amount of adversely classified commercial loans and stability in collateral values. In addition, there was a recovery of \$4.5 million related to a troubled debt restructured loan paid-off in Florida. The decrease in 2012, compared to 2011, was mainly related to a reserve release of \$6.7 million for commercial mortgage loans, compared to a provision of \$12.8 million in 2011. This reduction was driven by improved charge-off trends, the reduction in the amount of adversely classified loans and more stable collateral values. The provision for residential mortgage loans decreased by \$13.1 million, compared to 2011, due to reductions in net charge-offs, improved delinquency trends and certain stabilization in the expectation of loss severities for this portfolio. Refer to the "Provision for Loan and Lease Losses" discussion above and to the "Risk Management – Allowance for Loan and Lease Losses and Non-performing Assets" discussion below for additional information with respect to the credit quality of the loan portfolio in the United States.
- Total non-interest income for the year ended December 31, 2013 amounted to \$1.3 million compared to \$1.8 million and \$1.3 million for the years ended December 31, 2012 and 2011, respectively. The decrease in 2013, compared to 2012, was mainly due to a \$0.5 million loss related to valuation adjustments on fixed assets as they are no longer being used for operations after the consolidation of certain branches in Florida. The increase in 2012, compared to 2011, was mainly related to a higher volume of sales of residential mortgage loans to government-sponsored entities and increases in non-deferrable loan fees.
- Direct non-interest expenses in 2013 were \$28.6 million compared to \$27.7 million and \$30.5 million for 2012 and 2011, respectively. The increase in 2013, compared to 2012, reflects higher employees' compensation, professional fees and occupancy expenses. The decrease in 2013, compared to 2012, was mainly related to lower losses on REO operations and the lower FDIC insurance premium allocated to this segment.

### *Virgin Islands Operations*

The Virgin Islands Operations segment consists of all banking activities conducted by FirstBank in the U.S. and British Virgin Islands, including retail and commercial banking services, with a total of twelve branches currently serving the islands in the USVI of St. Thomas, St. Croix and St. John, and the islands in the BVI of Tortola and Virgin Gorda. The Virgin Islands Operations segment is driven by its consumer, commercial lending and deposit-taking activities.

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

The highlights of the Virgin Islands operations segment's financial results for the year ended December 31, 2013 include the following:

- Segment loss before taxes for the year ended December 31, 2013 was \$8.9 million compared to losses of \$3.6 million and \$13.9 million for the years ended December 31, 2012 and 2011, respectively.
- Net interest income for the year ended December 31, 2013 was \$37.7 million compared to \$44.4 million and \$49.9 million for the years ended December 31, 2012 and 2011, respectively. The decrease in net interest income in 2013, compared to 2012, was mainly related to a \$155.3 million decrease in the average volume of loans. The decrease in net interest income in 2012, compared to 2011, was mainly related to a \$92.1 million decrease in the average volume of loans and, to a lesser extent, an increase of \$6.6 million in non-performing residential mortgage loans.
- The provision for loan and lease losses for 2013 decreased by \$8.3 million compared to the same period in 2012 and decreased by \$20.9 million when comparing 2012 with the same period in 2011. The provision in 2013 includes a charge of \$5.2 million related to the bulk sale of non-performing residential assets attributable to Virgin Islands loans completed in the second quarter of 2013 and a charge of \$6.3 million related to a commercial construction loan relationship transferred to held for sale in the first quarter of 2013. Excluding the impact of the bulk sale of non-performing residential assets and the transfer of loans to held for sale attributable to Virgin Islands loans, the Corporation recorded a reserve release of \$2.6 million, or a \$19.8 million reduction in the provision as compared to 2012. The decrease mainly reflects higher charges in 2012 related to the loan relationship that was transferred to held for sale in 2013. The decrease in 2012, compared to 2011, was mainly related to higher charges to the specific reserve in 2011 assigned to the aforementioned construction loan relationship that was placed in non-accrual status early in 2011. In addition, in 2012, lower charges to specific reserves were related to a lower migration of loans to impaired status.
- Non-interest income for the year ended December 31, 2013 was \$7.9 million, compared to \$6.9 million and \$10.7 million for the years ended December 31, 2012 and 2011. The increase in 2013, compared to 2012, was mainly related to an increase in merchant, ATM and POS interchange fees. The decrease in 2012, compared to 2011, was mainly related to the impact in 2011 of the \$2.8 million gain recorded on the sale of substantially all of the assets of First Bank Insurance VI and lower interchange fees on debit cards impacted by the Durbin Amendment, as described above.
- Direct non-interest expenses for the year ended December 31, 2013 were \$45.7 million compared to \$37.8 million and \$36.5 million for the years ended December 31, 2012 and 2011, respectively. The increase in 2013, compared to 2012, was mainly due to a \$7.5 million increase in write-downs to OREO properties, primarily income-producing commercial properties, and an increase in professional service fees. The increase in 2012, compared to 2011, was mainly due to higher REO operating expenses and losses in connection with a higher inventory, partially offset by decreases in professional service fees and the portion of the decrease of the FDIC insurance premium allocated to this segment.

## FINANCIAL CONDITION AND OPERATING DATA ANALYSIS

### Financial Condition

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

	2013	December 31, 2012	2011
	(In thousands)		
<b>ASSETS</b>			
Interest-earning assets:			
Money market and other short-term investments	\$ 684,074	\$ 640,644	\$ 567,548
Government obligations	338,571	555,364	1,350,505
Mortgage-backed securities	1,666,091	1,182,142	1,181,183
Corporate bonds	—	1,204	2,000
FHLB stock	30,941	35,035	43,676
Equity securities	1,330	1,377	1,377
Total investments	<u>2,721,007</u>	<u>2,415,766</u>	<u>3,146,289</u>
Residential mortgage loans	2,681,753	2,800,647	2,944,367
Construction loans	272,917	388,404	616,980
Commercial loans	4,804,608	5,277,593	5,849,444
Finance leases	240,479	239,699	263,403
Consumer loans	1,799,402	1,561,085	1,357,381
Total loans	<u>9,799,159</u>	<u>10,267,428</u>	<u>11,031,575</u>
Total interest-earning assets	12,520,166	12,683,194	14,177,864
Total non-interest-earning assets <sup>(1)</sup>	292,295	283,180	177,852
Total assets	<u>\$12,812,461</u>	<u>\$12,966,374</u>	<u>\$14,355,716</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Interest-bearing liabilities:			
Interest-bearing checking accounts	\$ 1,127,857	\$ 1,092,640	\$ 1,014,280
Savings accounts	2,344,444	2,258,001	2,032,665
Certificates of deposit	2,310,200	2,215,599	2,260,106
Brokered CDs	3,251,091	3,488,312	5,134,699
Interest-bearing deposits	9,033,592	9,054,552	10,441,750
Other borrowed funds	1,131,959	1,171,615	1,459,476
FHLB advances	357,661	404,033	467,522
Total interest-bearing liabilities	10,523,212	10,630,200	12,368,748
Total non-interest-bearing liabilities	962,199	878,881	862,420
Total liabilities	11,485,411	11,509,081	13,231,168
Stockholders' equity:			
Preferred stock	63,047	63,047	341,658
Common stockholders' equity	1,264,003	1,394,246	782,890
Stockholders' equity	<u>1,327,050</u>	<u>1,457,293</u>	<u>1,124,548</u>
Total liabilities and stockholders' equity	<u>\$12,812,461</u>	<u>\$12,966,374</u>	<u>\$14,355,716</u>

(1) Includes, among other things, the allowance for loan and lease losses and the valuation of available-for-sale investment securities.

The Corporation's total average assets were \$12.8 billion and \$13.0 billion as of December 31, 2013 and 2012, respectively, a decrease for 2013 of \$153.9 million or 1% as compared to 2012. The reduction in total



average assets was mainly due to a decrease of \$468.3 million in average loans primarily reflecting the impact of the two bulk sales of adversely classified and nonperforming assets partially offset by an increase of \$305.2 million in average investments securities and interest-bearing cash equivalent driven by purchases of U.S. agency MBS.

The Corporation's total average liabilities were \$11.5 billion as of December 31, 2013, a decrease of \$23.7 million compared to December 31, 2012. The decrease in total average liabilities mainly resulted from the roll-off of maturing brokered CDs, the maturity of certain FHLB advances, and the full year impact of the repayment in the first half of 2012 of medium-term notes and repurchase agreements. These variances were partially offset by an increase in the average balance of non-brokered deposits.

## Assets

Total assets were approximately \$12.7 billion as of December 31, 2013, down \$442.8 million from December 31, 2012. The decrease was mainly related to a \$427.4 million decrease in total loans and a \$25.6 million decrease in the OREO inventory. This decrease was driven by the two bulk sales of adversely classified and non performing assets completed during the first and second quarter of 2013 that aggregated \$415.2 million of loans and \$25.5 million of OREO properties, the individual sale of a non-performing commercial mortgage loan with a book value of \$40.8 million and a \$35.6 million commercial loan paid-off in the third quarter of 2013. The decrease in total assets was also attributable to a decline of \$291.2 million in cash and cash equivalents and the \$66.6 million write-off of the collateral pledged to Lehman. These decreases were partially offset by a \$247.2 million increase in the available-for-sale investment securities portfolio led by purchases of \$682.9 million of 15-20 year U.S. agency MBS during 2013 (partially offset by U.S. agency MBS repayments and declines in the fair value of U.S. agency MBS and Puerto Rico government obligations), and a \$149.6 million reduction in the total allowance for loan and lease losses.

## Loans Receivable, including Loans Held for Sale

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

<i>(In thousands)</i>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Residential mortgage loans . . . . .	\$2,549,008	\$ 2,747,217	\$ 2,873,785	\$ 3,417,417	\$ 3,595,508
Commercial loans:					
Commercial mortgage loans <sup>(1)</sup> . . . . .	1,823,608	1,883,798	1,565,411	1,670,161	1,693,424
Construction loans <sup>(1)</sup> . . . . .	168,713	361,875	427,863	700,579	1,492,589
Commercial and Industrial loans <sup>(1)(2)</sup> . . . . .	2,788,250	2,793,157	3,856,695	3,861,545	4,927,304
Loans to local financial institutions collateralized by real estate mortgages . . . . .	240,072	255,390	273,821	290,219	321,522
Total commercial loans . . . . .	<u>5,020,643</u>	<u>5,294,220</u>	<u>6,123,790</u>	<u>6,522,504</u>	<u>8,434,839</u>
Finance leases . . . . .	245,323	236,926	247,003	282,904	318,504
Consumer loans . . . . .	<u>1,821,196</u>	<u>1,775,751</u>	<u>1,314,814</u>	<u>1,432,611</u>	<u>1,579,600</u>
Total loans held for investment . . . . .	9,636,170	10,054,114	10,559,392	11,655,436	13,928,451
Less:					
Allowance for loan and lease losses . . . . .	<u>(285,858)</u>	<u>(435,414)</u>	<u>(493,917)</u>	<u>(553,025)</u>	<u>(528,120)</u>
Total loans held for investment, net . . . . .	9,350,312	9,618,700	10,065,475	11,102,411	13,400,331
Loans held for sale . . . . .	<u>75,969</u>	<u>85,394</u>	<u>15,822</u>	<u>300,766</u>	<u>20,775</u>
Total loans, net . . . . .	<u>\$9,426,281</u>	<u>\$ 9,704,094</u>	<u>\$10,081,297</u>	<u>\$11,403,177</u>	<u>\$13,421,106</u>

(1) During the second quarter of 2013, after a comprehensive review of substantially all of the loans in our commercial portfolios, the classification of certain loans was revised to more accurately depict the nature of

the underlying loans. This reclassification resulted in a net increase of \$269.0 million in commercial mortgage loans, since the principal source of repayment for such loans is derived primarily from the operation of the underlying real estate, with a corresponding decrease of \$246.8 million in commercial and industrial loans and a \$22.2 million decrease in construction loans. The Corporation evaluated the impact of this reclassification on the provision for loan losses and determined that the effect of this adjustment was not material to any previously reported results.

- (2) As of December 31, 2013, includes \$1.2 billion of commercial loans that are secured by real estate (owner-occupied commercial loans secured by real estate) but are not dependent upon the real estate for repayment.

## Lending Activities

As of December 31, 2013, the Corporation's total loans, net of allowance, decreased by \$277.8 million, when compared with the balance as of December 31, 2012. The major reductions were mainly the result of the two bulk sales of assets. The first bulk sale, which took place during the first quarter of 2013, was mainly composed of adversely classified and non-performing loans with a book value of \$211.4 million (\$100.1 million of C&I loans, \$68.8 million of commercial mortgage loans, \$41.3 million of construction loans, and \$1.2 million of residential mortgage loans).

The second bulk sale, which took place during the second quarter of 2013, was mainly composed of non-performing residential mortgage loans with a book value of \$203.8 million. The decrease related to the bulk sales was partially offset by increases in the loan portfolio of Florida and outstanding loans to the public sector.

As shown in the table above, the 2013 loans held for investment portfolio was comprised of commercial loans (52%), residential real estate loans (27%), and consumer and finance leases (21%). Of the total gross loan portfolio held for investment of \$9.6 billion as of December 31, 2013, approximately 84% has credit risk concentration in Puerto Rico, 9% in the United States (mainly in the state of Florida) and 7% in the Virgin Islands, as shown in the following table:

<u>As of December 31, 2013</u>	<u>Puerto Rico</u>	<u>Virgin Islands</u>	<u>United States</u>	<u>Total</u>
		(In thousands)		
Residential mortgage loans . . . . .	\$1,906,982	\$348,816	\$293,210	\$2,549,008
Commercial mortgage loans . . . . .	1,464,085	74,271	285,252	1,823,608
Construction loans . . . . .	105,830	33,744	29,139	168,713
Commercial and Industrial loans . . . . .	2,436,709	125,757	225,784	2,788,250
Loans to local financial institutions collateralized by real estate mortgages . . . . .	240,072	—	—	240,072
Total commercial loans . . . . .	4,246,696	233,772	540,175	5,020,643
Finance leases . . . . .	245,323	—	—	245,323
Consumer loans . . . . .	1,739,478	49,689	32,029	1,821,196
Total loans held for investment . . . . .	\$8,138,479	\$632,277	\$865,414	\$9,636,170
Loans held for sale . . . . .	35,394	40,575	—	75,969
Total loans, gross . . . . .	<u>\$8,173,873</u>	<u>\$672,852</u>	<u>\$865,414</u>	<u>\$9,712,139</u>

<u>As of December 31, 2012</u>	<u>Puerto Rico</u>	<u>Virgin Islands</u>	<u>United States</u>	<u>Total</u>
	(In thousands)			
Residential mortgage loans . . . . .	\$2,092,450	\$380,660	\$274,107	\$ 2,747,217
Commercial mortgage loans . . . . .	1,486,648	62,981	334,169	1,883,798
Construction loans . . . . .	241,775	98,040	22,060	361,875
Commercial and Industrial loans . . . . .	2,618,815	122,104	52,238	2,793,157
Loans to local financial institutions collateralized by real estate mortgages . . . . .	255,390	—	—	255,390
Total commercial loans . . . . .	4,602,628	283,125	408,467	5,294,220
Finance leases . . . . .	236,926	—	—	236,926
Consumer loans . . . . .	1,692,878	51,213	31,660	1,775,751
Total loans held for investment . . . . .	\$8,624,882	\$714,998	\$714,234	\$10,054,114
Loans held for sale . . . . .	81,546	3,848	—	85,394
Total loans, gross . . . . .	<u>\$8,706,428</u>	<u>\$718,846</u>	<u>\$714,234</u>	<u>\$10,139,508</u>

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

	<u>For the Year Ended December 31,</u>				
	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	(In thousands)				
Beginning balance as of January 1 . . . . .	\$ 9,704,094	\$10,081,297	\$11,403,177	\$13,421,106	\$12,806,766
Residential real estate loans originated and purchased . . . . .	830,959	756,133	563,138	526,389	591,889
Construction loans originated and purchased . . . . .	57,514	76,822	93,183	175,260	433,493
C&I and commercial mortgage loans originated and purchased . . . . .	1,661,128	1,236,910	1,480,192	1,706,604	3,153,278
Finance leases originated . . . . .	104,968	93,700	83,651	90,671	80,716
Consumer loans originated and purchased <sup>(1)</sup> . . . . .	1,055,940	1,281,872	493,511	508,577	514,774
Total loans originated and purchased . . . . .	3,710,509	3,445,437	2,713,675	3,007,501	4,774,150
Sales and securitizations of loans . . . . .	(968,626)	(468,463)	(1,175,463)	(529,413)	(464,705)
Repayments and prepayments . . . . .	(2,801,685)	(3,049,722)	(2,422,071)	(3,704,221)	(3,010,857)
Other decreases <sup>(2)</sup> . . . . .	(218,011)	(304,455)	(438,021)	(791,796)	(684,248)
Net (decrease) increase . . . . .	(277,813)	(377,203)	(1,321,880)	(2,017,929)	614,340
Ending balance as of December 31 . . . . .	<u>\$ 9,426,281</u>	<u>\$ 9,704,094</u>	<u>\$10,081,297</u>	<u>\$11,403,177</u>	<u>\$13,421,106</u>
Percentage (decrease) increase . . . . .	(2.86)%	(3.74)%	(11.59)%	(15.04)%	4.80%

(1) For 2012, includes the initial carrying value of \$368.9 million related to the credit card portfolio acquired from FIA and \$226.9 million of subsequent utilization activity on outstanding credit cards.

- (2) Includes, among other things, the change in the allowance for loan and lease losses and cancellation of loans due to the repossession of the collateral and loans repurchased.

### **Residential Real Estate Loans**

As of December 31, 2013, the Corporation's residential real estate loan portfolio held for investment decreased by \$198.2 million as compared to the balance as of December 31, 2012, mainly reflecting the bulk sale of non-performing residential loans with a book value of \$203.7 million completed in the second quarter of 2013, foreclosures of \$35.6 million, charge-offs and principal repayments. Such decrease was partially offset by loan originations retained in the portfolio during the period. 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. Refer to the "Contractual Obligations and Commitments" discussion below for additional information about outstanding commitments to sell mortgage loans.

Residential real estate loan production and purchases for the year ended December 31, 2013 increased by \$74.9 million, compared to 2012, and increased by \$193.0 million for 2012 compared to 2011. The Corporation's strategy is to penetrate markets by providing customers with a variety of high quality mortgage products. The Corporation's residential mortgage loan originations are handled by FirstMortgage, its mortgage loan origination subsidiary. FirstMortgage supplements its internal direct originations through a strategic program to purchase ongoing residential mortgage loan production from mortgage bankers in Puerto Rico. Purchases of \$224.6 million in 2013 were mainly conforming residential mortgage loans. Purchases of conforming residential mortgage loans provide the Corporation the flexibility to retain or sell the loans, including securitization transactions depending upon the Corporation's interest rate risk management strategies. When the Corporation sells such loans, it generally keeps the servicing of the loans.

### **Commercial and Construction Loans**

As of December 31, 2013, the Corporation's commercial and construction loan portfolio held for investment decreased by \$273.6 million, as compared to the balance as of December 31, 2012. The reduction primarily reflects the impact of the bulk sale of adversely classified and non-performing assets with a book value of \$210.2 million (\$100.1 million of C&I loans, \$68.8 million of commercial mortgage loans, and \$41.3 million of construction loans), the transfer of \$146 million of non-performing loans to held for sale (net of \$36.0 million of charge-offs recorded at the time of transfer), of which \$40.8 million was sold during the second quarter of 2013, and to a lesser extent, charge-offs recorded during the year ended December 31, 2013, including a \$25.4 million charge-off related to a single commercial relationship restructured in the first quarter of 2013 into a split Note A/ B. These variances were partially offset by an increase of \$132 million in the commercial portfolio of Florida. As part of the Florida strategy, the Corporation has expanded its resources in the middle market and corporate areas in light of lending growth opportunities in this sector. The Corporation's commercial loans are primarily variable- and adjustable-rate loans.

Total commercial and construction loans originated amounted to \$1.7 billion for 2013, an increase of \$404.9 million when compared to originations during 2012. The increase was mainly related to credit facilities extended to government entities and an increase in loan originations in Florida. Originations related to government entities amounted to \$554.3 million in 2013 compared to \$212.4 million in 2012, while commercial loan originations in Florida increased by \$217.5 million.

As of December 31, 2013, the Corporation had \$454.6 million of credit facilities granted to the Puerto Rico government, its municipalities and public corporations, of which \$397.8 million was outstanding, compared to \$158.4 million outstanding as of December 31, 2012, and \$60.6 million outstanding in credit facilities granted to the government of the Virgin Islands, compared to \$35.5 million as of December 31, 2012. Approximately \$200.5 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal

debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality. The good faith, credit, and unlimited taxing power of each applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$84.6 million consists of loans to public corporations that receive revenues from the rates they charge for services or products, such as electric power services including credit extended to the Puerto Rico Electric Power Authority for fuel purchases that have priority over senior bonds and other debt. Main public corporations have varying degrees of independence from the central government and many receive appropriations or other payments from the Puerto Rico's government general fund. Approximately \$112.7 million of the amount outstanding consists of loans to the central government or units of the central government. Debt issued by the central government can either carry the full faith, credit, and taxing power of the Commonwealth of Puerto Rico or represent an obligation, that is subject to annual budget appropriations. The Commonwealth of Puerto Rico has never defaulted on its debt. Furthermore, the Corporation had \$205.1 million outstanding as of December 31, 2013 in financing to the hotel industry in Puerto Rico guaranteed by the TDF. The TDF is a subsidiary of the GDB that works with private-sector financial institutions to structure financings for new hospitality projects. The TDF has a perfect track record of supporting its guarantees.

In addition to loans extended to government entities, the largest loan to one borrower as of December 31, 2013 in the amount of \$240.1 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 single-family residential mortgage loans in Puerto Rico. This loan is subject to collateral substitution that requires the borrower to substitute defaulted mortgages.

Construction loan originations decreased by \$19.3 million in 2013, from \$76.8 million in 2012. The Corporation has significantly reduced its exposure to construction loans and construction loan originations are mainly draws from existing commitments, including construction facilities tied to financings to the hotel industry guaranteed by the TDF.

The decrease in the construction loan portfolio held for investment was driven by the inclusion of construction loans having a book value of \$41.3 million in the bulk sale of adversely classified and non-performing assets completed during the first quarter of 2013 and the transfer of construction loans of \$55.3 million to held for sale (net of \$21.4 million of charge-offs recorded at the time of transfer).

The composition of the Corporation's construction loan portfolio held for investment as of December 31, 2013 by category and geographic location follows:

	<u>Puerto Rico</u>	<u>Virgin Islands</u>	<u>United States</u>	<u>Total</u>
	(In thousands)			
<b>As of December 31, 2013</b>				
Loans for residential housing projects:				
Mid-rise <sup>(1)</sup> . . . . .	\$ 35,458	\$ 4,669	\$ 36	\$ 40,163
Single-family, detached . . . . .	18,211	—	6,295	24,506
Total for residential housing projects . . . . .	<u>53,669</u>	<u>4,669</u>	<u>6,331</u>	<u>64,669</u>
Construction loans to individuals secured by residential properties . . . . .				
Loans for commercial projects . . . . .	5,319	1,521	—	6,840
Bridge loans—residential . . . . .	810	3,924	12,097	16,831
Bridge loans—commercial . . . . .	258	—	—	258
Land loans—residential . . . . .	—	13,450	—	13,450
Land loans—commercial . . . . .	26,449	8,472	4,585	39,506
Total before net deferred fees and allowance for loan losses . . . . .	19,082	1,870	6,126	27,078
Net deferred cost (fees) . . . . .	\$105,587	\$33,906	\$ 29,139	\$168,632
Total construction loan portfolio, gross . . . . .	<u>243</u>	<u>(162)</u>	<u>—</u>	<u>81</u>
Allowance for loan losses . . . . .	105,830	33,744	29,139	168,713
Total construction loan portfolio, net . . . . .	<u>(18,439)</u>	<u>(6,962)</u>	<u>(10,413)</u>	<u>(35,814)</u>
	<u>\$ 87,391</u>	<u>\$26,782</u>	<u>\$ 18,726</u>	<u>\$132,899</u>

(1) Mid-rise relates to buildings of up to 7 stories.

The following table presents further information on the Corporation's construction portfolio as of and for the year ended December 31, 2013:

(In thousands)	
Total undisbursed funds under existing commitments . . . . .	<u>\$65,184</u>
Construction loans held for investment in non-accrual status . . . . .	<u>\$58,866</u>
Construction loans held for sale in non-accrual status . . . . .	<u>\$47,802</u>
Net charge offs—Construction loans <sup>(1)</sup> . . . . .	<u>\$41,247</u>
Allowance for loan losses—Construction loans . . . . .	<u>\$35,814</u>
Non-performing construction loans to total construction loans, including held for sale . . . . .	<u>49.27%</u>
Allowance for loan losses for construction loans to total construction loans held for investment . . . . .	<u>21.23%</u>
Net charge-offs to total average construction loans <sup>(2)</sup> . . . . .	<u>15.11%</u>

(1) Includes net charge-offs of \$34.2 million related to the bulk sales of assets and the transfer of loans to held for sale.

(2) The ratio of construction loans net charge-offs to average loans, excluding charge-offs associated with the bulk sales of assets and the transfer of loans to held for sale, was 2.91%



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

	<u>(In Thousands)</u>
Construction loan portfolio:	
Under \$300k .....	\$16,284
\$300k – \$600k .....	—
Over \$600k <sup>(1)</sup> .....	<u>37,385</u>
	<u>\$53,669</u>

(1) Mainly composed of four residential housing projects in Puerto Rico.

#### *Consumer Loans and Finance Leases*

As of December 31, 2013, the Corporation's consumer loan and finance lease portfolio increased by \$53.8 million, as compared to the portfolio balance as of December 31, 2012. This increase was mainly the result of loan originations activity, driven by auto loan originations, partially offset by charge-offs and repayments.

Total consumer and finance lease originations (excluding credit card utilization activity) amounted to \$812.9 billion for 2013, compared to originations during 2012 of \$779.6 million. The increase was mainly related to a \$39.2 million increase in auto loans and finance leases originations.

#### **Investment Activities**

As part of its strategy to diversify its revenue sources and maximize its net interest income, First BanCorp. maintains an investment portfolio that is classified as available for sale. The Corporation's total available-for-sale investment securities portfolio as of December 31, 2013 amounted to \$2.0 billion, an increase of \$247.2 million from December 31, 2012, mainly due to an increase of approximately \$257.2 million in mortgage backed securities resulting from purchases in 2013 of approximately \$682.9 million of 15-20 year U.S. Agency MBS with an average yield of 1.99%. The Corporation deployed some of its cash balances, generating income of between 0.25% and 0.35%, into highly liquid securities with a higher yield.

Approximately 95% of the Corporation's available-for-sale securities portfolio is invested in U.S. Government and Agency debentures and fixed-rate U.S. government sponsored-agency MBS (mainly GNMA, FNMA and FHLMC fixed-rate securities). The Corporation's investment in equity securities classified as available for sale is minimal, approximately \$33 thousand, which consists of common stock of another financial institution in Puerto Rico.

As of December 31, 2013, the Corporation held approximately \$71.0 million of Puerto Rico government and agencies bond obligations, mainly bonds of the GDB and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio, which were reflected at their aggregate fair value of \$51.3 million. In mid-August 2013, the 30-year general obligation bonds of the Puerto Rico government, which are widely held by mutual funds, carried a yield of about 7.1%, which increased during the latter part of the third quarter of 2013, surpassing 10% at one point in September amid a general run-up in interest rates and significant selling by investors after Detroit filed for the largest municipal bankruptcy in United States history. The debt carried a yield of approximately 9.54% as of December 31, 2013. On February 4, 2014, S&P downgraded the Commonwealth of Puerto Rico's debt to BB+, one level below investment grade. S&P also downgraded to levels below investment grade the credit rating of the GDB and the Employee Retirement System to BB and various ratings of the Puerto Rico Highways and Transportation Authority to BB+. On February 7, 2014, Moody's downgraded the Commonwealth of Puerto Rico general obligation bonds to Ba2, two notches below investment grade. Moody's also downgraded to Ba2 the Public Building Authority Bonds, the Pension Funding Bonds, the GDB senior notes, the Municipal Finance Authority Bonds, the Puerto Rico Infrastructure Finance Authority

Special Tax Revenue Bonds, the Convention Center District Authority Hotel Occupancy Tax Revenue Bonds, the Puerto Rico Highway and Transportation Authority Transportation Revenue Bonds, various ratings of the Puerto Rico Aqueduct and Sewer Authority, and the Puerto Rico Electric Power Authority. In addition, the Puerto Rico Sales Tax Financing Corporation's senior-lien bonds were downgraded by Moody's to Baa1 from A2, retaining investment grade status. Following the downgrades by S&P and Moody's, Fitch became the third agency to downgrade the Commonwealth of Puerto Rico debt to a below investment grade. Fitch now rates Puerto Rico's general obligation bonds at BB, two notches below investment grade, from BBB-. Based on S&P definition of a BB credit rating, the debt rating suggest that S&P views the Puerto Rico Government's obligation as less vulnerable to nonpayment in the near term than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions; thus, the ultimate, impact of the downgrades is unpredictable and may not be immediately apparent.

The decrease in value during 2013 of the Puerto Rico government and agencies bonds held by the Corporation was mainly the result of the decrease on prices in the municipal bonds market caused by the Detroit default and subsequent significant sales of municipal bonds. The price declines also showed a correlation to benchmark interest rate movements. The Corporation believes that the declines in value resulted from the above factors and not a change in expected cash flows. The issuers of Puerto Rico government and agencies bonds held by the Corporation have not defaulted, and the contractual payments on these securities have been made as scheduled. Despite the recent downgrades of Puerto Rico's debt, the risk profile has not changed materially taking into account progress on different elements such as increases in tax collections, reforms of the retirement systems, current negotiation on debt repayment acceleration clauses, intention to access the market and increase the tax supported debt, and spending control efforts. All three rating agencies recognized the efforts of the Puerto Rico government to bolster finances and strengthen fundamental credit factors, including actions to control spending, reduce debt issuance, reform the retirement system, and promote economic development. The Puerto Rico government announced that a balanced budget is expected for fiscal year 2015, a year earlier than originally projected. In terms of liquidity, the GDB has indicated it has the liquidity to fund the Commonwealth's needs through at least fiscal year 2014 and expects to improve its liquidity upon accessing the markets. Based on these facts and the Corporation's ability and intent to hold these securities until a recovery of the fair value occurs, the unrealized losses are considered temporary. The Corporation will continue to closely monitor Puerto Rico's political and economic status and evaluate the portfolio for any declines in value that could be considered other-than-temporary.

The following table presents the carrying value of investments as of December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
	(In thousands)	
Money market investments . . . . .	\$ 201,369	\$ 216,835
Investment securities available for sale, at fair value:		
U.S. government and agencies obligations . . . . .	256,994	247,072
Puerto Rico government obligations . . . . .	51,330	71,200
Mortgage-backed securities . . . . .	1,669,925	1,412,774
Equity securities . . . . .	33	31
	<u>1,978,282</u>	<u>1,731,077</u>
Other equity securities, including \$28.4 million and \$37.5 million of FHLB stock as of December 31, 2013 and 2012, respectively . . . . .	<u>28,691</u>	<u>38,757</u>
Total money market and investment securities . . . . .	<u>\$2,208,342</u>	<u>\$1,986,669</u>

Mortgage-backed securities as of December 31, 2013 and 2012 consisted of:

<i>(In thousands)</i>	<u>2013</u>	<u>2012</u>
Available-for-sale:		
FHLMC certificates . . . . .	\$ 322,187	\$ 129,240
GNMA certificates . . . . .	445,008	604,672
FNMA certificates . . . . .	861,783	627,636
Collateralized mortgage obligations issued or guaranteed by FHLMC . . . . .	81	300
Other mortgage pass-through certificates . . . . .	<u>40,866</u>	<u>50,926</u>
Total mortgage-backed securities . . . . .	<u>\$1,669,925</u>	<u>\$1,412,774</u>

The carrying values of investment securities classified as available for sale as of December 31, 2013 by contractual maturity (excluding mortgage-backed securities and equity securities) are shown below:

<i>(In thousands)</i>	<u>Carrying Amount</u>	<u>Weighted average yield %</u>
U.S. government and agencies obligations		
Due within one year . . . . .	\$ 7,499	0.12
Due after one year through five years . . . . .	48,592	1.05
Due after five years through ten years . . . . .	<u>200,903</u>	<u>1.31</u>
	<u>256,994</u>	<u>1.23</u>
Puerto Rico government obligations		
Due within one year . . . . .	9,790	3.50
Due after five years through ten years . . . . .	27,737	4.51
Due after ten years . . . . .	<u>13,803</u>	<u>5.82</u>
	<u>51,330</u>	<u>4.74</u>
Total . . . . .	308,324	1.96
Mortgage-backed securities . . . . .	1,669,925	2.69
Equity securities . . . . .	33	—
Total investment securities available for sale . . . . .	<u>\$1,978,282</u>	<u>2.57</u>

No sales of securities available for sale were completed in 2013. The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of December 31, 2013 and 2012 was \$0.3 million and \$1.3 million, respectively.

For the years ended December 31, 2013 and 2012, the Corporation recorded OTTI charges through earnings of \$0.2 million and \$2.0 million, respectively, mainly related to the credit loss portion of available-for-sale private label MBS. Refer to Note 4 to the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K for additional information regarding the Corporation's evaluation of OTTI on available-for-sale securities.

Net interest income of future periods 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 of 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 \$25.7 million of FHLB debt securities with an average yield of 0.35% were

called during 2013. As of December 31, 2013, the Corporation has approximately \$61.7 million in debt securities (U.S. Agencies and Puerto Rico government securities) with embedded calls and with an average yield of 1.79%. Refer to the “Risk Management” section below for further analysis of the effects of changing interest rates on the Corporation’s net interest income and of the interest rate risk management strategies followed by the Corporation. Also refer to Note 4 to the Corporation’s audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K for additional information regarding the Corporation’s investment portfolio.

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

The following table presents the maturities or repricings of the loan and investment portfolio as of December 31, 2013:

	One Year or Less	2-5 Years		Over 5 Years		Total
		Fixed Interest Rates	Variable Interest Rates	Fixed Interest Rates	Variable Interest Rates	
(In thousands)						
Investments:						
Money market investments . . . . .	\$ 201,369	\$ —	\$ —	\$ —	\$—	\$ 201,369
Mortgage-backed securities . . . . .	40,865	1,644	—	1,627,416	—	1,669,925
Other securities <sup>(1)</sup> . . . . .	53,292	48,592	—	242,443	—	344,327
Total investments . . . . .	295,526	50,236	—	1,869,859	—	2,215,621
Loans: <sup>(2) (3)</sup>						
Residential mortgage . . . . .	604,780	278,419	—	1,686,977	—	2,570,176
C&I and commercial mortgage . . . . .	4,144,938	415,272	149,035	149,684	—	4,858,929
Construction . . . . .	197,391	16,168	—	2,956	—	216,515
Finance leases . . . . .	76,775	165,049	—	3,499	—	245,323
Consumer . . . . .	555,131	1,194,390	—	71,675	—	1,821,196
Total loans . . . . .	5,579,015	2,069,298	149,035	1,914,791	—	9,712,139
Total earning assets . . . . .	\$5,874,541	\$2,119,534	\$149,035	\$3,784,650	\$—	\$11,927,760

- (1) Equity securities available for sale and other equity securities and loans having no stated scheduled repayment date and no stated maturity were included under the “one year or less category.”
- (2) Scheduled repayments were reported in the maturity category in which the payment is due and variable rates were reported based on the next repricing date.
- (3) Non-accruing loans were included under the “one year or less category.”

### ***Goodwill and other intangible assets***

The Corporation evaluates goodwill for impairment on an annual basis, generally during the fourth quarter, or more often if events or circumstances indicate there may be impairment. The Corporation evaluated goodwill for impairment as of October 1, 2013. Goodwill impairment testing is performed at the segment (or “reporting unit”) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to a reporting unit, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill. The Corporation’s goodwill is related to the acquisition of FirstBank Florida in 2005.

The Corporation bypassed the qualitative assessment in 2013 and proceeded directly to perform the first step of the two-step goodwill impairment test. The first step (“Step 1”) involves a comparison of the estimated

fair value of the reporting unit to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is not considered impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of the impairment.

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

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

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

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

For purposes of the market comparable approach, valuation was determined based on market multiples for comparable companies and market participant assumptions applied to the reporting unit to derive an implied value of equity.

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

The Step 1 evaluation of goodwill allocated to the Florida reporting unit, which is one level below the United States business segment, under both valuation approaches (market and DCF) indicated that the fair value of the unit was above the carrying amount of its equity book value as of the valuation date (October 1), which meant that Step 2 was not undertaken. Based on the analysis under both the income and market approaches, the estimated fair value of the reporting units exceeds the carrying amount of the unit, including goodwill, at the evaluation date.

The Corporation engaged a third-party valuator to assist management in the annual evaluation of the Florida unit’s goodwill as of the October 1 valuation date. In reaching its conclusion on impairment, management

discussed with the valuator the methodologies, assumptions, and results supporting the relevant values for the goodwill and determined that they were reasonable.

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

Goodwill was not impaired as of December 31, 2013 or 2012, nor was any goodwill written off during 2013, 2012, and 2011.

#### Other Intangibles

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

In connection with the acquisition of the FirstBank-branded credit card loan portfolio in 2012, the Corporation recognized at acquisition a purchased credit card relationship intangible of \$24.5 million (\$19.8 million and \$23.5 million as of December 31, 2013 and 2012, respectively) which is being amortized on an accelerated basis based on the estimated attrition rate of the purchased credit card accounts, which reflects the pattern in which the economic benefits of the intangible asset are consumed. These benefits are consumed as the revenue stream generated by the cardholder relationship is realized.

The Corporation performed impairment tests for the years ended December 31, 2013, 2012, and 2011 and determined that no impairment was needed to be recognized for other intangible assets.

## **RISK MANAGEMENT**

### **General**

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

The Corporation has in place a risk management framework to monitor, evaluate and manage the principal risks assumed in conducting its activities. First BanCorp.'s business is subject to nine 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, (8) model risk, and (9) capital risk. First BanCorp. has adopted policies and procedures designed to identify and manage the risks to which the Corporation is exposed.

### **Risk Definition**

#### Liquidity Risk

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

#### Interest Rate Risk

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



### Market Risk

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

### Credit Risk

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

### Operational Risk

Operational risk is the risk to earnings or capital arising from problems with services’ or products’ delivery. This risk is a function of internal controls, information systems, employee integrity and operating processes. It also includes risks associated with the Corporation’s preparedness for the occurrence of an unforeseen event. This risk is inherent across all functions, products and services of the Corporation. Refer to “—Operational Risk” section below for further details.

### Legal and Regulatory Risk

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

### Reputational Risk

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

### Model Risk

Model Risk is the potential for adverse consequences from decisions based on incorrect or misused model outputs and reports. The use of models exposes the Corporation to some level of model risk. Model errors can contribute to incorrect valuations and lead to operational errors, inappropriate business decisions or incorrect financial entries. Model risk can be reduced substantially through rigorous model identification and validation.

### Capital Risk

Capital risk is the risk that the Corporation may lose value on its capital or has an inadequate Capital Plan, which results in insufficient capital resources to:

- Meet minimum regulatory requirements or as required as part of the Consent Order. The Corporation’s authority to operate as a bank is dependent upon the maintenance of adequate capital resources;
- Support its credit rating. A weaker credit rating would increase the Corporation’s cost of funds; or
- Support its growth and strategic options.

## **Risk Governance**

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

### Board of Directors

The Board of Directors oversees the Corporation's overall risk governance program with the assistance of the Board Committees discussed below.

### Risk Committee

The Risk Committee of the Corporation is appointed by the Board of Directors of the Corporation to assist the Board in fulfilling its responsibility to oversee management regarding the Corporation's management of its company-wide risk management framework. The Committee's role is one of oversight, recognizing that management is responsible for designing, implementing and maintaining an effective risk management framework.

### Asset/Liability Committee

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

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

### Credit Committee

The Credit Committee of the Board of Directors is appointed by the Board of Directors to assist the Board of Directors in its oversight of the Corporation's policies related to all matters of the Corporation's lending function, hereafter "Credit Management." The purpose of the Committee is to review the quality of the Corporation's credit portfolio and the trends affecting that portfolio; to oversee the effectiveness and administration of credit-related policies; to approve those loans as required by the lending authorities approved by the Board; and to report to the Board regarding Credit Management.

### Audit Committee

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

- The conduct and integrity of the Corporation's financial reporting to any governmental or regulatory body, stockholders, other users of the Corporation's financial reports and the public;
- The performance of the Corporation's internal audit function;

- The Corporation’s internal control over financial reporting and disclosure controls and procedures;
- The qualifications, engagement, compensation, independence and performance of the Corporation’s independent auditors, their conduct of the annual audit of the Corporation’s financial statements, and their engagement to provide any other services;
- The Corporation’s legal and regulatory compliance;
- The application of the Corporation’s related person transaction policy as established by the Board of Directors;
- The application of the Corporation’s code of business conduct and ethics as established by management and the Board of Directors; and
- The preparation of the Audit Committee report required to be included in the Corporation’s annual proxy statement by the rules of the SEC.

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

#### Compliance Committee

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

#### Executive Risk Management Committee

The Executive Risk Management Committee is responsible for exercising oversight of information regarding FirstBanCorp’s enterprise risk management framework, including the significant policies, procedures, and practices employed to manage the identified risk categories, credit risk, operational risk, legal and regulatory risk, reputational risk, model risk, and capital risk. In carrying out its oversight responsibilities, each Committee member is entitled to rely on the integrity and expertise of those people providing information to the Committee and on the accuracy and completeness of such information, absent actual knowledge of inaccuracy.

#### Regional Risk Management Committee

This management committee is appointed by the Chief Risk Officer of the Corporation to assist the Corporation in overseeing, and receiving information regarding the Corporation’s policies, procedures and related practices relating to the Corporation’s identified risks in the regions of Puerto Rico, Florida and USVI and BVI. In so doing, the Regional Committee’s primary general functions involve:

- The evaluation of different risks within the Regions to identify any gaps and the implementation of any necessary controls to close such gap;
- The establishment of a process to enable the recognition, assessment, and management of the risks that could affect the Regions; and
- The responsibility to ensure that the Executive Risk Management Committee receives appropriate information about the Corporation’s identified risks within the Regions.

### Other Management Committees

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

- (1) Management’s Investment and Asset Liability Committee (“MIALCO”)—oversees interest rate and market risk, liquidity management and other related matters. Refer to “—Liquidity Risk and Capital Adequacy and Interest Rate Risk Management” below for further details.
- (2) Information Technology Steering Committee—is responsible for the oversight of and counsel on matters related to information technology, including the development of information management policies and procedures throughout the Corporation.
- (3) Bank Secrecy Act Committee—is responsible for oversight, monitoring and reporting of the Corporation’s compliance with the Bank Secrecy Act.
- (4) Credit Committees (Credit Management Committee and Delinquency Committee)—oversee and establish standards for credit risk management processes within the Corporation. The Credit Management Committee is responsible for the approval of loans above an established size threshold. The Delinquency Committee is responsible for the periodic review of (1) past-due loans, (2) overdrafts, (3) non-accrual loans, (4) other real estate owned (“OREO”) assets, and (5) the bank’s watch list and non-performing loans.
- (5) Vendor Management Committee—oversees policies, procedures and related practices related to the Corporation’s vendor management efforts. The Vendor Management Committee’s primary functions involve the establishment of a process and procedures to enable the recognition, assessment, management and monitoring of vendor management risks.
- (6) The Community Reinvestment Act Executive Committee—is responsible for oversight, monitoring and reporting of the Corporation’s compliance with CRA regulatory requirements. The Bank is committed to develop programs and products that increase access to credit and create a positive impact on Low and Moderate Income individuals and communities.
- (7) Anti-Fraud Committee – oversees the Corporation’s policies, procedures and related practices relating to the Corporation’s anti-fraud measures.

### Officers

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

- 1) Chief Executive Officer is responsible for the overall risk governance structure of the Corporation.
- 2) Chief Risk Officer is responsible for the oversight of the risk management organization as well as risk governance processes. The CRO, with the collaboration of the Enterprise Risk Management and Operational Risk Director monitors key risks and manages the operational risk program.
- 3) Commercial Credit Risk Officer, Retail Credit Risk Officer, Chief Lending Officer and other senior executives are responsible for managing and executing the Corporation’s credit risk program.
- 4) Chief Financial Officer, together with the Corporation’s Treasurer, manages the Corporation’s interest rate and market and liquidity risk programs and, together with the Corporation’s Chief Accounting Officer, is responsible for the implementation of accounting policies and practices in accordance with GAAP and applicable regulatory requirements. The Chief Financial Officer is assisted by the Risk Assessment Manager in the review of the Corporation’s internal control over financial reporting.
- 5) Chief Accounting Officer is responsible for the development and implementation of the Corporation’s accounting policies and practices and the review and monitoring of critical accounts and transactions to ensure that they are managed in accordance with GAAP and applicable regulatory requirements.

- 6) Strategic and Capital Planning Officer is responsible for the development of the Corporation's strategic and business plan, by coordinating and collaborating with the executive team and all corporate bodies concerned with the strategic and business planning process. The Strategic and Capital Planning Director is also responsible for developing and executing a strategy for stress testing modeling framework.

#### Other Officers

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

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

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

#### **Liquidity Risk and Capital Adequacy**

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

The Corporation manages liquidity at two levels. The first is the liquidity of the parent company, which is the holding company that owns the banking and non-banking subsidiaries. The second is the liquidity of the banking subsidiary. As of September 30, 2013, FirstBank could not pay any dividends to the parent company except upon receipt of prior approval by the New York FED and the Federal Reserve Board because of the Regulatory Agreements.

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

In order to ensure adequate liquidity through the full range of potential operating environments and market conditions, the Corporation conducts its liquidity management and business activities in a manner that will

preserve and enhance funding stability, flexibility and diversity. Key components of this operating strategy include a strong focus on the continued development of customer-based funding, the maintenance of direct relationships with wholesale market funding providers, and the maintenance of the ability to liquidate certain assets when, and if, requirements warrant.

The Corporation develops and maintains contingency funding plans. These plans evaluate the Corporation's liquidity position under various operating circumstances and allow the Corporation to ensure that it will be able to operate through periods of stress when access to normal sources of funds is constrained. The plans project funding requirements during a potential period of stress, specify and quantify sources of liquidity, outline actions and procedures for effectively managing through a difficult period, and define roles and responsibilities. Under 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 the current funding position of the Corporation and the Bank, thereby ensuring the ability of the Corporation and the Bank, to honor its respective commitments, and establishing liquidity triggers monitored by the MIALCO in order to maintain the ordinary funding of the banking business. Four different scenarios are defined in the Contingency Funding Plan: local market event, credit rating downgrade, an economic cycle downturn event, 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 core liquidity, basic liquidity, and time-based reserve measures. As of December 31, 2013, the estimated core liquidity reserve (which includes cash and free liquid assets) was \$1.35 billion or 10.67% of total assets. The basic liquidity ratio (which adds available secured lines of credit to the core liquidity) was approximately 14.35% of total assets. As of December 31, 2013, the Corporation had \$466.2 million available for additional credit from the FHLB NY. Unpledged liquid securities as of December 31, 2013 mainly consisted of fixed-rate MBS and U.S. agency debentures amounting to approximately \$707.6 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. Most of the cash balances are deposited with the Federal Reserve Bank and in money market instruments generating interest income at a rate between 0.25% and 0.35%. As of December 31, 2013, the holding company had \$38.1 million of cash and cash equivalents. Cash and cash equivalents at the Bank level as of December 31, 2013 were approximately \$647.6 million. The Bank has \$3.1 billion in brokered CDs as of December 31, 2013, of which approximately \$1.7 billion mature over the next twelve months. Liquidity at the Bank level is highly dependent on bank deposits, which fund 78.5% of the Bank's assets (or 53.6% excluding brokered CDs). The Corporation has continued to issue brokered CDs pursuant to temporary approvals received from the FDIC to renew or roll over, up to specified amounts, brokered CDs through March 31, 2014. 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.

#### *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. 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 continued reducing the amounts of outstanding brokered CDs. The reduction in brokered CDs is consistent with the requirements of the FDIC Order that preclude the issuance of brokered CDs without FDIC approval and require a plan to reduce the amount of brokered CDs. As of December 31, 2013,



brokered CDs decreased \$232.4 million to \$3.1 billion from December 31, 2012. At the same time as the Corporation focuses on reducing its reliance on brokered deposits, it is seeking to add core deposits. During 2013, the Corporation increased non-brokered deposits, excluding government deposits, by \$71.3 million.

The Corporation continues to have the support of creditors, including counterparties to repurchase agreements, the FHLB, and other agents such as wholesale funding brokers. While liquidity is an ongoing challenge for all financial institutions, management believes that the Corporation's available borrowing capacity and efforts to grow retail deposits will be adequate to provide the necessary funding for the Corporation's business plans in the foreseeable future.

The Corporation's principal sources of funding are:

### Deposits

The following table presents the composition of total deposits:

	Weighted Average Rate as of December 31, 2013	As of December 31,		
		2013	2012	2011
		(In thousands)		
Savings accounts . . . . .	0.73%	\$2,334,831	\$2,295,766	\$ 2,145,625
Interest-bearing checking accounts . . . .	0.67%	1,167,480	1,108,053	1,066,753
Certificates of deposit . . . . .	1.07%	5,526,401	5,623,340	5,989,587
Interest-bearing deposits . . . . .	0.93%	9,028,712	9,027,159	9,201,965
Non-interest-bearing deposits . . . . .		851,212	837,387	705,789
Total . . . . .		<u>\$9,879,924</u>	<u>\$9,864,546</u>	<u>\$ 9,907,754</u>
Interest-bearing deposits:				
Average balance outstanding . . . . .		\$9,033,592	\$9,054,552	\$10,441,750
Non-interest-bearing deposits:				
Average balance outstanding . . . . .		\$ 855,231	\$ 770,278	\$ 702,690
Weighted average rate during the period on interest-bearing deposits . . . . .		1.02%	1.42%	1.84%

*Brokered CDs*—A large portion of the Corporation's funding has been retail brokered CDs issued by FirstBank. Total brokered CDs decreased by \$232.4 million to \$3.1 billion as of December 31, 2013. Although all of the Bank's regulatory capital ratios exceeded the established "well capitalized" levels, and the minimum capital requirements of the FDIC Order as of December 31, 2013, because of the FDIC Order, FirstBank cannot be considered a "well capitalized" institution and cannot replace maturing brokered CDs without the prior approval of the FDIC. Since the issuance of the FDIC Order, the FDIC has granted the Bank quarterly waivers to enable it to continue accessing the brokered deposit market in specified amounts. The most recent waiver is effective through March 31, 2014. The Bank will request approvals for future periods. The Corporation used proceeds from repayments of loans and investments to pay down maturing borrowings, including brokered CDs. Also, the Corporation successfully implemented its core deposit growth strategy that resulted in an increase of \$71.3 million in non-brokered deposits, excluding government deposits, during 2013.

The average remaining term to maturity of the retail brokered CDs outstanding as of December 31, 2013 is approximately 1.2 years.

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 has enabled the Corporation 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. During 2013, the Corporation issued \$2.0 billion in brokered CDs having an average all-in cost of 0.82% to renew maturing brokered CDs. Management believes it will continue to obtain waivers from the restrictions on the issuance of brokered CDs under the FDIC Order to meet its obligations and execute its business plans.

The following table presents a maturity summary of brokered and retail CDs with denominations of \$100,000 or higher as of December 31, 2013:

	<u>Total</u>
	<u>(In thousands)</u>
Three months or less . . . . .	\$ 582,116
Over three months to six months . . . . .	557,928
Over six months to one year . . . . .	1,431,971
Over one year . . . . .	<u>2,115,741</u>
Total . . . . .	<u>\$4,687,756</u>

Certificates of deposit in denominations of \$100,000 or higher include brokered CDs of \$3.1 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 deposits with denominations of \$100,000 or higher also include \$3.2 million of deposits through the Certificate of Deposit Account Registry Service.

*Government deposits*—As of December 31, 2013, the Corporation had \$546.5 million of public sector deposits in Puerto Rico (\$285.6 million in transactional accounts and \$260.8 million in time deposits) compared to \$346.3 million as of December 31, 2012. Approximately 21% came from municipalities in Puerto Rico and 79% came from public corporations and the central government.

In 2014, Act 24-2014 was approved by the Puerto Rico Legislature, seeking to further strengthen the liquidity of the GDB and the GDB's oversight over public funds. Among other measures, Act 24-2014 grants the GDB the ability to exercise additional oversight of certain public funds deposited at private financial institutions and grants the GDB the legal authority, subject to an entity's ability to request waivers under certain specified circumstances, to require such public funds (other than funds of the Legislative Branch, the Judicial Branch, the University of Puerto Rico, governmental pension plans, municipalities and certain other independent agencies) to be deposited at the GDB, which is expected to result in a more efficient management of public resources in an effort to maximize liquidity and efficient use of public resources. The GDB has identified approximately \$450 million in public funds deposited in private financial institutions in Puerto Rico that the GDB's management currently expects to capture in the first half of calendar year 2014. The Corporation believes that \$250 million in public deposits held by the Corporation are at high risk of migration. Current and future liquidity levels have been planned considering that risk. As such, no material adverse effects are expected as a result of the potential reduction in public funds. The Corporation will continue to focus on transactional accounts and capture deposits from entities excluded from Act 24-2014.

*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 and government deposits, increased by \$71.3 million to \$6.0 billion during 2013, reflecting increases in core-deposit products such as savings, interest-bearing checking accounts, as well as non-interest bearing deposits primarily in Puerto Rico and the Virgin Islands. Refer to Note 14 in the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K for further details.

Refer to the “Net Interest Income” discussion above for information about average balances of interest-bearing deposits, and the average interest rates paid on deposits for the years ended December 31, 2013, 2012 and 2011.

### **Borrowings**

As of December 31, 2013, total borrowings amounted to \$1.43 billion as compared to \$1.64 billion and \$1.62 billion as of December 31, 2012 and 2011, respectively.

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

	Weighted Average Rate as of December 31, 2013	As of December 31,		
		2013	2012	2011
(Dollars in thousands)				
Securities sold under agreements to repurchase . . . . .	2.83%	\$ 900,000	\$ 900,000	\$1,000,000
Advances from FHLB . . . . .	1.11%	300,000	508,440	367,440
Notes payable . . . . .	—	—	—	23,342
Other borrowings . . . . .	2.86%	231,959	231,959	231,959
Total <sup>(1)</sup> . . . . .		<u>\$1,431,959</u>	<u>\$1,640,399</u>	<u>\$1,622,741</u>
Weighted average rate during the period . . . . .		2.62%	3.07%	3.64%

- (1) Includes borrowings of \$932.0 million as of December 31, 2013 that have variable interest rates or have maturities within a year

*Securities sold under agreements to repurchase*—The Corporation’s investment portfolio is funded in part with repurchase agreements. The Corporation’s outstanding securities sold under repurchase agreements amounted to \$900 million as of December 31, 2013 and 2012. 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 \$900 million of repurchase agreements outstanding as of December 31, 2013 consisted of structured repurchase agreements. In addition to these repurchase agreements, the Corporation has been able to maintain access to credit by using cost-effective sources such as FHLB advances. Refer to Note 15 in the Corporation’s audited financial statements for the period ended December 31, 2013 included in Item 8 of this Form 10-K for further details about repurchase agreements outstanding by counterparty and maturities.

Under the Corporation’s repurchase agreements, as is the case with derivative contracts, the Corporation is required to pledge cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines due to changes in interest rates, a liquidity crisis or any other factor, the Corporation will be required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity. Given the quality of the collateral pledged, the Corporation recently has not experienced significant margin calls from counterparties arising from credit-quality-related write-downs in valuations and, as of December 31, 2013, it had only \$0.2 million of cash equivalent instruments deposited in connection with collateralized interest rate swap agreements.

*Advances from the FHLB*—The Bank is a member of the FHLB system and obtains advances to fund its operations under a collateral agreement with the FHLB that requires the Bank to maintain qualifying mortgages as collateral for advances taken. As of December 31, 2013 and 2012, the outstanding balance of FHLB advances was \$300.0 million and \$508.4 million, respectively. During 2013, the Corporation repaid \$208.4 million of maturing FHLB advances that carried an average cost of 3.92%. As of December 31, 2013, the Corporation had \$466.2 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 in the future and, if available, will be on comparable terms.

In 2004, FBP Statutory Trust I, a statutory trust that is wholly owned by the Corporation and not consolidated in the Corporation's financial statements, sold to institutional investors \$100 million of its variable rate trust-preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.1 million of FBP Statutory Trust I variable rate common securities, were used by FBP Statutory Trust I to purchase \$103.1 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures.

Also in 2004, FBP Statutory Trust II, a statutory trust that is wholly owned by the Corporation and not consolidated in the Corporation's financial statements, sold to institutional investors \$125 million of its variable rate trust-preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.9 million of FBP Statutory Trust II variable rate common securities, were used by FBP Statutory Trust II to purchase \$128.9 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures.

The cumulative trust-preferred debentures are presented in the Corporation's consolidated statement of financial condition as Other Borrowings. 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 June 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 applicable rules and regulations. The Collins Amendment to the Dodd-Frank Act eliminated certain trust-preferred securities from Tier 1 Capital. Bank holding companies such as the Corporation must fully phase out these instruments from Tier I capital by January 1, 2016, however they may remain in Tier 2 capital until the instruments are redeemed or mature. As of December 31, 2013, the Corporation had \$225 million in trust preferred securities that are subject to the phase-out from Tier 1 Capital under the Basel 3 Final Rule.

With respect to the outstanding subordinated debentures, the Corporation elected to defer the interest payments that were due in March 2012, June 2012, September 2012, December 2012, March 2013, June 2013, September 2013, December 2013, and March 2014. The aggregate amount of payments deferred and accrued approximates \$14.7 million as of December 31, 2013. Future interest payments are subject to Federal Reserve approval.

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 to total loans has increased over time. 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 \$355.5 million of FHA/VA mortgage loans into GNMA MBS during 2013. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.

### *Impact of Credit Ratings on Access to Liquidity and Valuation of Liabilities*

The Corporation's liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation's current credit ratings and any further downgrades in credit ratings can hinder the Corporation's access to new forms of 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 unsecured derivatives that consider the Corporation's own credit risk as part of the valuation.

The Corporation does not have any outstanding debt or derivative agreements that would be affected by credit downgrades. Furthermore, given our non-reliance on corporate debt or other instruments directly linked in terms of pricing or volume to credit ratings, the liquidity of the Corporation so far has not been affected in any material way by downgrades. The Corporation's ability to access new non-deposit sources of funding, however, could be adversely affected by credit downgrades.

The Corporation's credit as a long-term issuer is currently rated B+ by S&P and B- by Fitch. At the FirstBank subsidiary level, long-term issuer ratings are currently B3 by Moody's, six notches below their definition of investment grade; B+ by S&P four notches below their definition of investment grade, and B- by Fitch, six notches below their definition of investment grade. Following the downgrade of the general obligation rating of the Commonwealth of Puerto Rico, Moody's placed on review for downgrade certain ratings of three Puerto Rican banks, including the long-term ratings of FirstBank.

### *Cash Flows*

Cash and cash equivalents were \$655.7 million as of December 31, 2013, a decrease of \$291.2 million when compared to the balance as of December 31, 2012, while as of December 31, 2012 the total balance of cash and cash equivalents amounted to \$946.9 million an increase of \$500.3 million from December 31, 2011. The following discussion highlights the major activities and transactions that affected the Corporation's cash flows during 2013 and 2012.

#### *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 2013 and 2012, net cash provided by operating activities was \$341.7 million and \$228.9 million, respectively. Net cash generated from operating activities was higher than net income reported largely as a result of adjustments for operating items such as the provision for loan and lease losses, depreciation and amortization, and impairments as well as proceeds from sales of loans held for sale.

#### *Cash Flows from Investing Activities*

The Corporation's investing activities primarily relate to originating loans to be held for investment and purchasing and selling of available-for-sale investment securities. For the year ended December 31, 2013, net cash used in investing activities was \$431.5 million, primarily reflecting purchases of investment securities.

For 2012, net cash provided by investing activities was \$305.1 million, primarily reflecting proceeds from loans (including sales and paydowns), proceeds from securities called and matured during 2012, and MBS prepayments. Proceeds from sales of loans and from repayments of loans and MBS were used in part to pay down maturing brokered CDs and other funding sources. The cash provided by investing activities in 2012 was lower than in 2011 due to significant proceeds from sales of loans and securities in 2011 as part of the Corporation's deleveraging strategies executed for capital preservation. In addition, the purchase of the credit card portfolio in 2012 impacted this figure as compared to 2011.

### 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. During 2013, net cash used in financing activities was \$201.4 million, mainly due to repayments of maturing FHLB advances and brokered CDs.

In 2012, net cash used in financing activities was \$33.6 million due to proceeds from new FHLB advances and the increase in non-brokered deposits, partially offset by repayments of repurchase agreements, notes payable and brokered CDs.

### Capital

At December 31, 2013, the Corporation's stockholders' equity was \$1.2 billion, a decrease of \$269.2 million from December 31, 2012. The decrease was mainly driven by the net loss of \$164.5 million recorded in 2013 and a \$107.2 million decrease in other comprehensive income due to unrealized losses on available-for-sale U.S. agency MBS attributable to changes in market interest rates, and the decrease in value of the Puerto Rico government obligations. As a result of the Written Agreement with the New York FED, currently neither First BanCorp., nor FirstBank, is permitted to pay dividends on capital securities without prior approval. Refer to Item 1—Supervision and Regulation—Regulatory Agreements—for a description of the principal provisions of the FDIC Order and the Written Agreement with the FED.

Although, as of December 31, 2013, all of the regulatory capital ratios of the Bank exceeded the established "well capitalized" levels and the minimum capital requirements established by the FDIC Order, because of the FDIC Order, FirstBank cannot be treated as a "well capitalized" institution. Set forth below are First BanCorp.'s and FirstBank's regulatory capital ratios as of December 31, 2013 and December 31, 2012, based on existing established guidelines.

	<u>Banking Subsidiary</u>			
	<u>First BanCorp.</u>	<u>FirstBank</u>	<u>To be well capitalized</u>	<u>Consent Order Requirements over time</u>
<b>As of December 31, 2013</b>				
Total capital (Total capital to risk-weighted assets) . . . . .	17.06%	16.67%	10.00%	12.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) . . . . .	15.78%	15.40%	6.00%	10.00%
Leverage ratio . . . . .	11.71%	11.44%	5.00%	8.00%
<b>As of December 31, 2012</b>				
Total capital (Total capital to risk-weighted assets) . . . . .	17.82%	17.35%	10.00%	12.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) . . . . .	16.51%	16.04%	6.00%	10.00%
Leverage ratio . . . . .	12.60%	12.25%	5.00%	8.00%

The decrease in capital ratios was primarily related to the aggregate loss of \$140.8 million on the two bulk sales of assets completed during the first half of 2013 and the transfer of certain loans to held for sale as well as the \$66.6 million write-off of the collateral pledged to Lehman.

In July 2013, U.S. banking regulators approved a revised regulatory capital framework for U.S. banking organizations (the "Basel 3 rules") that is based on international regulatory capital requirements adopted by the Basel Committee on Banking Supervision over the past several years. The Basel 3 rules introduce new minimum capital ratios and capital conservation buffer requirements, change the composition of regulatory capital, require a number of new adjustments to and deductions from regulatory capital, and introduce a new "Standardized Approach" for the calculation of risk-weighted assets that will replace the risk-weighting requirements under the current U.S. regulatory capital rules. The new minimum regulatory capital requirements and the Standardized Approach for the calculation of risk-weighted assets will become effective for the Corporation and FirstBank on



January 1, 2015. The capital conservation buffer requirements, and the regulatory capital adjustments and deductions under the Basel 3 rules will be phase-in over several years ending as of December 31, 2018.

The Basel 3 rules introduce a new and separate ratio of Common Equity Tier 1 capital (“CET1”) to risk-weighted assets. CET1, a component of total Tier 1 capital, generally consists of common stock and related surplus, retained earnings, accumulated other comprehensive income (“AOCI”), and qualifying minority interests. In addition, the Basel 3 rules also will require the Corporation to maintain an additional CET1 capital conservation buffer of 2.5%. Thus, when the Basel 3 rules are fully phased in as of January 1, 2019, the Corporation will be required to maintain (i) a minimum CET1 to risk-weighted assets ratio of at least 4.5%, plus the 2.5% “capital conservation buffer,” resulting in a required minimum CET1 ratio of at least 7% upon full implementation, (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5% upon full implementation, (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5% upon full implementation, and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets. The phase-in of the capital conversation buffer will begin on January 1, 2016 with a first year requirement of 0.625% of additional CET1, which will be progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reaches the fully-phased in 2.5% CET1 requirement on January 1, 2019.

In addition, the Basel 3 rules require a number of new deductions from and adjustments to CET1, including deductions from CET1 for mortgage servicing rights, and deferred tax assets dependent upon future taxable income. In the case of mortgage servicing assets and deferred tax assets, among others, these items would be required to be deducted to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under current regulatory capital requirements, the effect of AOCI is excluded for the purposes of calculating the required regulatory capital ratios. By comparison, under the Basel 3 rules, the effects of certain AOCI items are not excluded. Certain banking organizations, however, including the Corporation and FirstBank, will be allowed to make a one-time permanent election in early 2015 to continue to exclude AOCI items. The Corporation and FirstBank expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the securities portfolio.

In addition, the Basel 3 rules will require that certain non-qualifying capital instruments, including cumulative preferred stock and trust preferred securities (“TRuPs”), be excluded from Tier 1 capital. In general, banking organizations such as the Corporation and the Bank, must begin to phase out TRuPs from Tier 1 capital by January 1, 2015. The Corporation will be allowed to include 25% of the \$225 million outstanding qualifying TRuPs as Tier 1 capital in 2015 and the TRuPs must be fully phased out from Tier 1 capital by January 1, 2016. However, the Corporation’s TRuPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

The Basel 3 rules also revise the “prompt corrective action” (“PCA”) regulations that apply to depository institutions, including FirstBank, pursuant to Section 38 of the Federal Deposit Insurance Act by (i) introducing a separate CET1 ratio requirement for each PCA capital category (other than critically undercapitalized) with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each PCA capital category with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the current 6%); and (iii) eliminating the current provision that allows a bank with a composite supervisory rating of 1 to have a 3% leverage ratio and still be adequately capitalized and maintaining the minimum leverage ratio for well-capitalized status at 5%. The Basel 3 rules do not change the total risk-based capital requirement (10% for well-capitalized status) for any PCA capital category. The new PCA requirements become effective on January 1, 2015.

The Basel 3 rules separately impose a Standardized Approach for risk-weightings that expands the risk-weighting categories from the four major risk-weighting categories under the current regulatory capital rules

(0%, 20%, 50%, and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets. In a number of cases, the Standardized Approach will result in higher risk weights for a variety of asset categories. Specific changes to the risk-weightings of assets under the current regulatory capital rules include, among other things: (i) applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans, (ii) assigning a 150% risk weight to exposures that are 90 days past due (other than qualifying residential mortgage exposures, which remain at an assigned risk-weighting of 100%), and (iii) establishing a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, in contrast to the 0% risk-weighting under the current rules.

The Corporation's estimated pro-forma CET1 ratio, Tier 1 capital ratio, total capital ratio, and the leverage ratio under the Basel 3 rules, giving effect as of December 31, 2013 to all the provisions that will be phase-in between January 1, 2015 and January 2019, was 11.4%, 12.0%, 15.5%, and 9.8%, respectively. These ratios would exceed the fully phased in minimum capital ratios under Basel 3. Future estimates of the regulatory capital ratios under the Basel 3 rules may change overtime as a result of further federal banking agency rulemaking or clarification.

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, core deposit intangibles, and purchased credit card relationship intangible assets. Tangible assets are total assets less goodwill, core deposit intangibles, and purchased credit card relationship intangible assets. Refer to "Basis of Presentation" section below for additional information.

The following table is a reconciliation of the Corporation's tangible common equity and tangible assets for the years ended December 31, 2013 and 2012, respectively:

(In thousands, except ratios and per share information)	<b>December 31, 2013</b>	<b>December 31, 2012</b>
Total equity—GAAP . . . . .	\$ 1,215,858	\$ 1,485,023
Preferred equity . . . . .	(63,047)	(63,047)
Goodwill . . . . .	(28,098)	(28,098)
Purchased credit card relationship . . . . .	(19,787)	(23,511)
Core deposit intangible . . . . .	(6,981)	(9,335)
<b>Tangible common equity . . . . .</b>	<b>\$ 1,097,945</b>	<b>\$ 1,361,032</b>
Total assets—GAAP . . . . .	\$12,656,925	\$13,099,741
Goodwill . . . . .	(28,098)	(28,098)
Purchased credit card relationship . . . . .	(19,787)	(23,511)
Core deposit intangible . . . . .	(6,981)	(9,335)
<b>Tangible assets . . . . .</b>	<b>\$12,602,059</b>	<b>\$13,038,797</b>
<b>Common shares outstanding . . . . .</b>	<b>207,069</b>	<b>206,235</b>
<b>Tangible common equity ratio . . . . .</b>	<b>8.71%</b>	<b>10.44%</b>
<b>Tangible book value per common share . . . . .</b>	<b>\$ 5.30</b>	<b>\$ 6.60</b>

The Tier 1 common equity to risk-weighted assets ratio is calculated by dividing (a) Tier 1 capital less capital other than common stock, 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. Management is currently monitoring this ratio, along with the other ratios discussed above, in evaluating the Corporation's capital levels and believes that, at this time, the ratio may continue to be of interest to investors.

The following table reconciles stockholders' equity (GAAP) to Tier 1 common equity based on current applicable bank regulatory requirements (known as "Basel I"):

(In thousands)	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Total equity—GAAP .....	\$1,215,858	\$1,485,023
Qualifying preferred stock .....	(63,047)	(63,047)
Unrealized loss (gain) on available-for-sale securities <sup>(1)</sup> .....	78,734	(28,476)
Goodwill .....	(28,098)	(28,098)
Core deposit intangible .....	(6,981)	(9,335)
Other disallowed assets .....	(23)	(4,032)
<b>Tier 1 common equity <sup>(2)</sup> .....</b>	<b><u>\$1,196,443</u></b>	<b><u>\$1,352,035</u></b>
<b>Total risk-weighted assets .....</b>	<b><u>\$9,405,798</u></b>	<b><u>\$9,933,719</u></b>
<b>Tier 1 common equity to risk-weighted assets ratio .....</b>	<b>12.72%</b>	<b>13.61%</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 \$7 and \$11 million of the Corporation's deferred tax assets as of December 31, 2013 and 2012, respectively, was included without limitation in regulatory capital pursuant to the risk-based capital guidelines. 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 \$0.3 million of the Corporation's other net deferred tax asset as of December 31, 2013 and \$6 million of other net deferred tax liability as of December 31, 2012 represents 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 processes used for on-balance-sheet instruments. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. As of December 31, 2013, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately \$1.2 billion (including \$696.4 million pertaining to credit card loans) and \$51.6 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 does not enter into interest rate lock agreements with prospective borrowers in connection with mortgage banking activities.

## 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:

	Contractual Obligations and Commitments As of December 31, 2013				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
	(In thousands)				
Contractual obligations: <sup>(1)</sup>					
Certificates of deposit	\$5,526,401	\$3,069,806	\$2,142,287	\$ 295,300	\$ 19,008
Securities sold under agreements to repurchase	900,000	—	400,000	500,000	—
Advances from FHLB	300,000	—	100,000	200,000	—
Other borrowings	231,959	—	—	—	231,959
Operating leases	67,072	8,257	13,505	10,809	34,501
Other contractual obligations	111,226	29,251	37,896	30,322	13,757
Total contractual obligations	<u>\$7,136,658</u>	<u>\$3,107,314</u>	<u>\$2,693,688</u>	<u>\$1,036,431</u>	<u>\$299,225</u>
Commitments to sell mortgage loans	<u>\$ 123,925</u>	<u>\$ 123,925</u>			
Standby letters of credit	<u>\$ 10,527</u>	<u>\$ 10,527</u>			
Commitments to extend credit:					
Lines of credit	\$1,122,272	\$1,122,272			
Letters of credit	41,081	41,081			
Construction undisbursed funds	65,184	65,184			
Total commercial commitments	<u>\$1,228,537</u>	<u>\$1,228,537</u>			

(1) \$6.7 million of tax liability, including accrued interest of \$2.4 million, associated with UTBs has been excluded due to the high degree of uncertainty regarding the timing of future cash flows associated with such obligations.

The Corporation has obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under other commitments to sell mortgage loans at fair value and to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Other contractual obligations result mainly from contracts for the rental and maintenance of equipment. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. There have been no significant or unexpected draws on existing commitments. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility at any time and without cause.

### *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 scenarios. The MIALCO oversees interest rate risk and MIALCO meetings focus on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, securities market values, recent or proposed changes to the investment portfolio, alternative funding sources and related costs, hedging and the possible purchase of derivatives such as swaps and caps, and any tax or regulatory issues which may be pertinent to these areas. The MIALCO approves funding decisions in light of the Corporation's overall strategies and objectives.

The Corporation performs on a quarterly basis a consolidated net interest income simulation analysis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a one-to-five-year time horizon, assuming upward and downward yield curve shifts. The rate scenarios considered in these disclosures reflect gradual upward and downward interest rate movements of 200 basis points, during a twelve-month period. Simulations are carried out in two ways:

- (1) Using a static balance sheet, as the Corporation had on 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 structure 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, deposit decay and other factors, which may be important in projecting 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 simulations.

These simulations are highly complex, and are based on many 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. Several benchmark and market rate curves were used in the modeling process, primarily the LIBOR/SWAP curve, Prime, Treasury, FHLB rates, brokered CDs rates, repurchase agreements rates and the mortgage commitment rate of 30 years.

The 12-month net interest income is forecasted assuming December 31, 2013 interest rate curves remain constant. Then net interest income is estimated under rising and falling rates scenarios. For rising rates scenarios, a gradual (ramp) parallel upward shift of the yield curves is assumed during the first twelve months (the "+200 ramp" scenario). Conversely, for the falling rates scenario, a gradual (ramp) parallel downward shift of the yield curves is assumed during the first twelve months (the "-200 ramp" scenario). However, given the current low levels of interest rates, a full downward shift of 200 bps would represent an unrealistic scenario. Therefore, under the falling rate scenario, rates move downward up to 200 basis points, but without reaching zero. The resulting scenario is of interest rates close to zero in most cases, reflecting a flattening yield curve instead of a parallel downward scenario.

The Libor/Swap curve for December 2013, as compared to December 2012, showed an average decrease of approximately 13 basis points in the short term horizon, between one to twelve months, while market rates increase an average of 95 basis points in the long term horizon. The Treasury curve remained almost flat in the short term horizon, but showed an increase of 98 basis points in the long term horizon, as compared to December 2012 end of month levels.

The following table presents the results of the simulations as of December 31, 2013 and December 31, 2012. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives and liabilities measured at fair value:

(Dollars in millions)	December 31, 2013 Net Interest Income Risk (Projected for the next 12 months)				December 31, 2012 Net Interest Income Risk (Projected for the next 12 months)			
	Static Simulation		Growing Balance Sheet		Static Simulation		Growing Balance Sheet	
	Change	% Change	Change	% Change	Change	% Change	Change	% Change
+ 200 bps ramp . . . . .	\$ 14.6	2.76 %	\$ 12.1	2.23 %	\$ 13.0	2.53 %	\$ 9.0	1.72 %
- 200 bps ramp . . . . .	\$(10.6)	(2.00)%	\$(10.8)	(1.99)%	\$ (2.5)	(0.48)%	\$(4.5)	(0.85)%

The Corporation continues to manage its balance sheet structure to control the overall interest rate risk. Among the major drivers behind the slight shift in interest income sensitivity to interest rate shifts are the decrease of \$291.2 million in cash and cash equivalents, and the purchase of approximately \$682.9 million of 15-20 Years U.S. agency MBS. The liabilities side was affected mainly by the repayment of \$208.4 million of matured FHLB advances, a reduction of \$232.4 million in brokered CDs, along with an extension in the average life of that portfolio and an increase in both commercial and retail deposits as well as government deposits of approximately \$247.8 million.

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 \$12.1 million in the rising rate scenario when compared against the Corporation’s flat or unchanged interest rate forecast scenario. Under the falling rate, non-static scenario the net interest income is estimated to decrease \$10.8 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.

Interest rate swaps—Interest rate swap agreements generally involve the exchange of fixed-and-floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of December 31, 2013, 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.

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 income (loss).

For detailed information regarding the volume of derivative activities (e.g. notional amounts), location and fair values of derivative instruments in the Statement of Financial Condition and the amount of gains and losses reported in the Statement of Income (Loss), refer to Note 29 in the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K.

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

(In thousands)	<u>Asset Derivatives</u>	<u>Liability Derivatives</u>
	<u>Year Ended December 31, 2013</u>	<u>Year Ended December 31, 2013</u>
Fair value of contracts outstanding at the beginning of the year . . . . .	\$291	\$(5,781)
Fair value of new contracts entered into during the year . . . . .	79	(89)
Changes in fair value during the year . . . .	<u>24</u>	<u>1,847</u>
Fair value of contracts outstanding as of December 31, 2013 . . . . .	<u>\$394</u>	<u>\$(4,023)</u>

#### Sources of Fair Value

(In thousands)	<u>Payment Due by Period</u>				<u>Total Fair Value</u>
	<u>Maturity Less Than One Year</u>	<u>Maturity 1-3 Years</u>	<u>Maturity 3-5 Years</u>	<u>Maturity in Excess of 5 Years</u>	
<b>As of December 31, 2013</b>					
Pricing from observable market inputs—Asset					
Derivatives . . . . .	\$ 174	\$ 220	\$ —	\$—	\$ 394
Pricing from observable market inputs—Liability					
Derivatives . . . . .	<u>—</u>	<u>(221)</u>	<u>(3,802)</u>	<u>—</u>	<u>(4,023)</u>
	<u>\$ 174</u>	<u>\$ (1)</u>	<u>\$(3,802)</u>	<u>\$—</u>	<u>\$(3,629)</u>

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 level of interest rates, as well as expectations for rates in the future.

As of December 31, 2013 and 2012, all of the derivative instruments held by the Corporation were considered undesignated economic 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. 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 29 of the Corporation's audited financial statements for the year ended December 31, 2013 included in Item 8 of this Form 10-K for additional information regarding the fair value determination of derivative instruments.

Set forth below is a detailed analysis of the Corporation's credit exposure by counterparty with respect to derivative instruments outstanding as of December 31, 2013 and December 31, 2012.

(In thousands)

		As of December 31, 2013				
<u>Counterparty</u>	<u>Rating</u> <sup>(1)</sup>	<u>Notional</u>	<u>Total Exposure at Fair Value</u> <sup>(2)</sup>	<u>Negative Fair Value</u>	<u>Total Fair Value</u>	<u>Accrued interest receivable (payable)</u>
Interest rate swaps with rated counterparties:						
JP Morgan	A	\$ 25,640	\$—	\$(3,802)	\$(3,802)	\$(121)
Other Derivatives: <sup>(3)</sup>						
Interest rate swaps		5,440	162	(163)	(1)	(11)
Written and purchase interest rate caps		76,782	58	(58)	—	—
Forward contracts		25,000	174	—	174	—
Total		<u>\$132,862</u>	<u>\$394</u>	<u>\$(4,023)</u>	<u>\$(3,629)</u>	<u>\$(132)</u>

(In thousands)

		As of December 31, 2012				
<u>Counterparty</u>	<u>Rating</u> <sup>(1)</sup>	<u>Notional</u>	<u>Total Exposure at Fair Value</u> <sup>(2)</sup>	<u>Negative Fair Value</u>	<u>Total Fair Values</u>	<u>Accrued Interest receivable (payable)</u>
Interest rate swaps with rated counterparties:						
JP Morgan	A	\$32,658	\$—	\$(5,486)	\$(5,486)	\$ —
Other Derivatives: <sup>(3)</sup>						
Interest rate swaps		5,439	288	(290)	(2)	(128)
Forward contracts		6,000	3	(5)	(2)	—
Total		<u>\$44,097</u>	<u>\$291</u>	<u>\$(5,781)</u>	<u>\$(5,490)</u>	<u>\$(128)</u>

(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 counterparties for which a credit rating is not readily available and forward contracts.

### ***Credit Risk Management***

First BanCorp. is subject to credit risk mainly with respect to its portfolio of loans receivable and off-balance-sheet instruments, mainly derivatives and loan commitments. Loans receivable represents loans that First BanCorp. holds for investment and, therefore, First BanCorp. is at risk for the term of the loan. Loan commitments represent commitments to extend credit, subject to specific conditions, for specific amounts and maturities. These commitments may expose the Corporation to credit risk and are subject to the same review and approval process as for loans. Refer to "Contractual Obligations and Commitments" above for further details. The credit risk of derivatives arises from the potential of the counterparty's default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and

information on the Corporation's derivative credit risk exposure, refer to "—Interest Rate Risk Management" above. The Corporation manages its credit risk through its credit policy, underwriting, independent loan review and quality control procedures, statistical analysis, comprehensive financial analysis, and established management committees. The Corporation also employs proactive collection and loss mitigation efforts. Furthermore, personnel performing structured loan workout functions are responsible for mitigating defaults and minimizing losses upon default within each region and for each business segment. In the case of the 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, short sales, loss mitigation programs, and sales of REO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary.

The Corporation may also have risk of default in the securities portfolio. The securities held by the Corporation are principally fixed-rate U.S. agency 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, consisting 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 collectability 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 judgments 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, the risk profile of a market, industry, or group of customers changes materially, or the allowance is determined to not be adequate, additional provisions for credit losses could be required, which could adversely affect our business, financial condition, liquidity, capital, and results of operations in future periods.

The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and probable losses believed to be inherent in the loan portfolio that have not been specifically identified. Internal risk ratings are assigned to each business loan at the time of approval and are subject to subsequent periodic reviews by the Corporation's senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation's continued evaluation of its asset quality.

The allowance for loan losses to total loans held for investment decreased mainly as a result of the bulk sales of adversely classified and non-performing loans completed during the first half of 2013, the transfer of

non-performing loans to held for sale, charge-offs of impaired commercial loans with previously established adequate reserves, and decreases in historical loss ratios. The allowance to total loans for the C&I portfolio decreased from 4.82% at December 31, 2012 to 2.82% at December 31, 2013; the allowance to total loans for the commercial mortgage portfolio decreased from 5.19% at December 31, 2012 to 4.01% at December 31, 2013; the allowance to total loans for the residential mortgage portfolio decreased from 2.49% at December 31, 2012 to 1.30% at December 31, 2013; and the consumer and finance leases reserve coverage ratio decreased from 3.02% as of December 31, 2012 to 2.83%.

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's real estate market. The real estate market in Puerto Rico experienced readjustments in value driven by the loss of income due to higher unemployment, reduced demand and the general adverse 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 has declined mostly due to the effect of the slow stateside economy and due to the increase in inventory after the closing in 2012 of the Hovensa refinery in St Croix. In Florida, we operate mostly in Miami, where home prices have improved, mostly driven by a higher demand from foreign investors, and a decrease in distressed property sales.

As shown in the following table, the allowance for loan and lease losses amounted to \$285.9 million as of December 31, 2013, or 2.97% of total loans compared with \$435.4 million, or 4.33% of total loans as of December 31, 2012. Refer to "Provision for Loan and Lease Losses" above for additional information.

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

<u>Year Ended December 31,</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	(Dollars in thousands)				
Allowance for loan and lease losses, beginning of year	\$ 435,414	\$ 493,917	\$ 553,025	\$ 528,120	\$ 281,526
Provision (release) for loan and lease losses:					
Residential mortgage <sup>(1)</sup>	92,755	36,531	45,339	93,883	45,010
Commercial mortgage <sup>(2) (3) (11)</sup>	38,048	(778)	54,513	119,815	73,861
Commercial and Industrial <sup>(2) (4) (12)</sup>	43,608	38,773	78,711	68,336	143,697
Construction <sup>(2) (5) (13)</sup>	15,461	10,955	40,174	300,997	264,246
Consumer and finance leases	53,879	35,018	17,612	51,556	53,044
Total provision for loan and lease losses <sup>(6) (14)</sup>	<u>243,751</u>	<u>120,499</u>	<u>236,349</u>	<u>634,587</u>	<u>579,858</u>
Charge-offs:					
Residential mortgage <sup>(7)</sup>	(129,164)	(37,944)	(39,826)	(62,839)	(28,934)
Commercial mortgage <sup>(8) (15)</sup>	(67,457)	(21,779)	(51,207)	(82,708)	(25,871)
Commercial and Industrial <sup>(9) (16)</sup>	(109,849)	(49,521)	(69,783)	(99,724)	(35,696)
Construction <sup>(10) (17)</sup>	(43,323)	(45,008)	(103,131)	(313,511)	(183,800)
Consumer and finance leases	(63,108)	(43,735)	(45,478)	(64,219)	(70,121)
Total charge offs	<u>(412,901)</u>	<u>(197,987)</u>	<u>(309,425)</u>	<u>(623,001)</u>	<u>(344,422)</u>
Recoveries:					
Residential mortgage	1,165	1,089	835	121	73
Commercial mortgage	4,855	810	90	1,288	667
Commercial and Industrial	4,636	3,605	2,921	1,251	1,188
Construction	2,076	4,267	2,371	358	200
Consumer and finance leases	6,862	9,214	7,751	10,301	9,030
Total recoveries	<u>19,594</u>	<u>18,985</u>	<u>13,968</u>	<u>13,319</u>	<u>11,158</u>
Net charge-offs	<u>(393,307)</u>	<u>(179,002)</u>	<u>(295,457)</u>	<u>(609,682)</u>	<u>(333,264)</u>
Allowance for loan and lease losses, end of year	<u>\$ 285,858</u>	<u>\$ 435,414</u>	<u>\$ 493,917</u>	<u>\$ 553,025</u>	<u>\$ 528,120</u>
Allowance for loan and lease losses to year end total loans held for investment	2.97%	4.33%	4.68%	4.74%	3.79%
Net charge-offs to average loans outstanding during the year	4.01%	1.74%	2.68%	4.76%	2.48%
Net charge-offs excluding charge-offs related to the bulk loan sales and loans transferred to held for sale, to average loans outstanding during the period	1.68%	1.74%	2.68%	3.60%	2.48%
Provision for loan and lease losses to net charge-offs during the year	0.62x	0.67x	0.80x	1.04x	1.74x
Provision for loan and lease losses to net charge-offs during the year, excluding impact of the bulk loan sales and the transfer of loans to held for sale	0.69x	0.67x	0.80x	1.20x	1.74x

(1) Includes a provision totaling \$68.8 million associated with the bulk loan sales in 2013.

(2) During the second quarter of 2013, after a comprehensive review of substantially all of the loans in our commercial portfolios, the classification of certain loans was revised to more accurately depict the nature of the underlying loans. This reclassification resulted in a net increase of \$269.0 and \$10.7 million in commercial mortgage loans and related allowance, respectively, since the principal source of repayment of

such loans is derived from the operation of the underlying real estate, with a corresponding decrease of \$246.8 and \$9.4 million in commercial and industrial loans related allowance, respectively, and a \$22.2 million and \$1.3 million decrease in construction loans and related allowance, respectively.

- (3) Includes a provision totaling \$28.7 million associated with the bulk loan sales and the transfer of loans to held for sale in 2013.
- (4) Includes a provision totaling \$20.8 million associated with the bulk loan sales in 2013.
- (5) Includes a provision totaling \$13.6 million associated with the bulk loan sales in 2013.
- (6) Includes a provision totaling of \$132.0 million associated with the bulk loan sales and the transfer of loans to held for sale in 2013.
- (7) Includes charge-offs totaling \$99.0 million associated with the bulk loan sales in 2013.
- (8) Includes charge-offs totaling \$54.6 million associated with the bulk loan sales and the transfer of loans to held for sale in 2013.
- (9) Includes charge-offs totaling \$44.7 million associated with the bulk loan sales in 2013.
- (10) Includes charge-offs totaling \$34.2 million associated with the bulk loan sales and the transfer of loans to held for sale in 2013.
- (11) Includes a provision totaling \$11.3 million associated with loans transferred to held for sale in 2010.
- (12) Includes a provision totaling \$8.6 million associated with loans transferred to held for sale in 2010.
- (13) Includes a provision totaling \$83.0 million associated with loans transferred to held for sale in 2010.
- (14) Includes a provision totaling \$102.9 million associated with loans transferred to held for sale in 2010.
- (15) Includes charge-offs totaling \$29.5 million associated with loans transferred to held for sale in 2010.
- (16) Includes charge-offs totaling \$8.6 million associated with loans transferred to held for sale in 2010.
- (17) Includes charge-offs totaling \$127.0 million associated with loans transferred to held for sale in 2010.

The following table sets forth information concerning the allocation of the Corporation's allowance for loan and lease losses by loan category and the percentage of loan balances in each category to the total of such loans as of December 31 of the years indicated:

<i>(In thousands)</i>	2013		2012		2011		2010		2009	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
	<b>(Dollars in thousands)</b>									
Residential mortgage . . . . .	\$ 33,110	27%	\$ 68,354	27%	\$ 68,678	27%	\$ 62,330	29%	\$ 31,165	26%
Commercial mortgage loans . . . . .	73,138	19%	97,692	19%	108,992	15%	105,596	14%	67,201	11%
Construction loans . . . . .	35,814	2%	61,600	4%	91,386	4%	151,972	6%	164,128	11%
Commercial and Industrial loans (including loans to local financial institutions) . . . . .	85,295	31%	146,900	30%	164,490	39%	152,641	36%	182,778	38%
Consumer loans and finance leases . . . . .	58,501	21%	60,868	20%	60,371	15%	80,486	15%	82,848	14%
	<u>\$285,858</u>	<u>100%</u>	<u>\$435,414</u>	<u>100%</u>	<u>\$493,917</u>	<u>100%</u>	<u>\$553,025</u>	<u>100%</u>	<u>\$528,120</u>	<u>100%</u>



The following table sets forth information concerning the composition of the Corporation's allowance for loan and lease losses as of December 31, 2013 and 2012 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance:

<b>As of December 31, 2013</b> (Dollars in thousands)	<b>Residential Mortgage Loans</b>	<b>Commercial Mortgage Loans</b>	<b>C&amp;I Loans</b>	<b>Construction Loans</b>	<b>Consumer and Finance Leases</b>	<b>Total</b>
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs . . . .	\$ 220,428	\$ 69,484	\$ 32,418	\$ 15,120	\$ 4,035	\$ 341,485
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs . . . .	190,566	149,888	154,686	57,597	24,890	577,627
Allowance for loan and lease losses . . . . .	18,125	32,189	26,686	22,144	3,457	102,601
Allowance for loan and lease losses to principal balance . . . . .	9.51%	21.48%	17.25%	38.45%	13.89%	17.76%
PCI loans:						
Carrying value of PCI loans . . . . .	—	—	—	—	4,791	4,791
Allowance for PCI loans . . . . .	—	—	—	—	—	—
Allowance for PCI loans to carrying value . . . . .	—	—	—	—	—	—
Loans with general allowance:						
Principal balance of loans . . . . .	2,138,014	1,604,236	2,841,218	95,996	2,032,803	8,712,267
Allowance for loan and lease losses . . . . .	14,985	40,949	58,609	13,670	55,044	183,257
Allowance for loan and lease losses to principal balance . . . . .	0.70%	2.55%	2.06%	14.24%	2.71%	2.10%
Total loans held for investment:						
Principal balance of loans . . . . .	\$2,549,008	\$1,823,608	\$3,028,322	\$168,713	\$2,066,519	\$9,636,170
Allowance for loan and lease losses . . . . .	33,110	73,138	85,295	35,814	58,501	285,858
Allowance for loan and lease losses to principal balance <sup>(1)</sup> . . . . .	1.30%	4.01%	2.82%	21.23%	2.83%	2.97%

(Dollars in thousands)	<b>Residential Mortgage Loans</b>	<b>Commercial Mortgage Loans</b>	<b>C&amp;I Loans</b>	<b>Construction Loans</b>	<b>Consumer and Finance Leases</b>	<b>Total</b>
<b>As of December 31, 2012</b>						
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs . . .	\$ 122,056	\$ 44,495	\$ 35,673	\$ 21,179	\$ 2,615	\$ 226,018
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs . . .	462,663	310,030	284,357	159,504	22,722	1,239,276
Allowance for loan and lease losses . . . . .	47,171	50,959	80,167	39,572	3,880	221,749
Allowance for loan and lease losses to principal balance . . . . .	10.20%	16.44%	28.19%	24.81%	17.08%	17.89%
PCI loans:						
Carrying value pf PCI loans . . . . .	—	—	—	—	10,602	10,602
Allowance for PCI loans . . . . .	—	—	—	—	—	—
Allowance for PCI loans to carrying value . . . . .	—	—	—	—	—	—
Loans with general allowance:						
Principal balance of loans . . . . .	2,162,498	1,529,273	2,728,517	181,192	1,976,738	8,578,218
Allowance for loan and lease losses . . . . .	21,183	46,733	66,733	22,028	56,988	213,665
Allowance for loan and lease losses to principal balance . . . . .	0.98%	3.06%	2.45%	12.16%	2.88%	2.49%
Total loans held for investment:						
Principal balance of loans . . . . .	\$2,747,217	\$1,883,798	\$3,048,547	\$361,875	\$2,012,677	\$10,054,114
Allowance for loan and lease losses . . . . .	68,354	97,692	146,900	61,600	60,868	435,414
Allowance for loan and lease losses to principal balance <sup>(1)</sup> . . . . .	2.49%	5.19%	4.82%	17.02%	3.02%	4.33%

(1) Loans used in the denominator include PCI loans of \$4.8 million and \$10.6 million as of December 31, 2013 and 2012, respectively. However, the Corporation separately tracks and reports PCI loans and excludes these loans from delinquent loans, non-performing loans, impaired loans, TDRs and non-performing assets statistics.

The following tables show the activity for impaired loans held for investment and related specific reserve during 2013:

	<u>2013</u>
	<u>(In thousands)</u>
<b>Impaired Loans:</b>	
Balance at beginning of year . . . . .	\$1,465,294
Loans determined impaired during the year . . . . .	280,860
Net charge-offs . . . . .	(307,428)
Loans sold, net of charge-offs . . . . .	(201,409)
Loans transferred to held for sale . . . . .	(145,415)
Increases to impaired loans—additional	
disbursements . . . . .	6,624
Foreclosures . . . . .	(45,094)
Loans no longer considered impaired . . . . .	(49,299)
Paid in full or partial payments . . . . .	(85,021)
Balance at end of year . . . . .	<u>\$ 919,112</u>
	<u>2013</u>
	<u>(In thousands)</u>
<b>Specific Reserve:</b>	
Balance at beginning of year . . . . .	\$ 221,749
Provision for loan losses . . . . .	188,280
Net charge-offs . . . . .	(307,428)
Balance at end of year . . . . .	<u>\$ 102,601</u>

### ***Credit Quality***

The Corporation continues to execute its strategic plan and achieved significant improvements in credit quality metrics. As of December 31, 2013, total non-performing assets were \$725.4 million, a decrease of \$512.8 million from December 31, 2012. The decrease was mainly driven by the two bulk sales of assets completed during the first half of 2013, which included in the aggregate \$382.5 million of non-performing loans (\$178.7 million corresponding to the 2013 first quarter sale of adversely classified and non-performing loans, mainly commercial loans, and \$203.8 million corresponding to the 2013 second quarter sale of non-performing residential loans) and \$25.5 million of OREO. Additional reductions were achieved through the individual sale of a \$40.8 million non-performing commercial mortgage loan that was previously written off and transferred to held for sale, and the write-off of the collateral pledged to Lehman. Total non-performing loans, including non-performing loans held for sale, decreased by \$427.5 million mainly due to the two aforementioned bulk sales, charge-offs of \$36.0 million associated with loans transferred to held for sale, sales of non-performing loans held for sale of \$47.2 million, as well as approximately \$251.7 million of loans brought current or restored to accrual status after a sustained performance period, and foreclosures and repayments. These decreases were partially offset by inflows of loans to non-performing status amounting to \$438.5 million, including two commercial mortgage relationships that aggregated \$85.0 million. As of December 31, 2013, total delinquencies, which include all loans 30 days or more past due and non-accrual loans, decreased \$430.6 million to \$935.2 million from December 31, 2012. The level of adversely classified commercial and construction loans, including non-performing loans held for sale, decreased by \$337.0 million to \$677.8 million, or a 33% decrease, compared to the balance as of December 31, 2012. The net charge-off activity increased to \$393.3 million. The increase reflects the impact of \$196.5 million of charge-offs related to the two bulk sales of assets completed in the first half of 2013, and charge-offs of \$36.0 million related to the transfer of loans to held for sale. Excluding the impact of the bulk sales and the transfer of loans to held for sale, net charge-offs were \$160.9 million, or an annualized 1.68% of average loans, for the year ended December 31, 2013, compared to \$179.0 million, or an annualized 1.74%, for the year ended December 31, 2012. In addition to charge-offs related to the bulk sales, a

\$25.4 million charge-off was recorded in 2013 related to a single C&I relationship restructured through a loan split in the first quarter and for which additional significant reserves were not necessary. Given the prolonged recession and uncertainties in the economic environment in Puerto Rico, the Corporation continued to face pressures related to its non-performing loans and charge-offs levels. The Corporation continues to emphasize its loan resolution and liquidation strategies.

### ***Non-performing Loans and Non-performing Assets***

Total non-performing assets consist of non-performing loans (generally loans held for investment or loans held for sale on which the recognition of interest income has been discontinued when the loan became 90 days past due or earlier if the full and timely collection of interest or principal is uncertain), foreclosed real estate and other repossessed properties, as well as non-performing investment securities. 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 the 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. Credit card loans continue to accrue finance charges and fees until charged-off at 180 days delinquent.

*PCI Loans*—PCI loans were recorded at fair value at acquisition. Since the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the subsequent accounting for PCI loans differs from the accounting for non-PCI loans. The Corporation, therefore, separately tracks and reports PCI loans and excludes these from its delinquency, non-performing loans, impaired, TDRs, and non-performing assets statistics.

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 acquired in settlement of loans is carried at the lower of cost (carrying value of the loan) or fair value less estimated costs to sell off the real estate. Appraisals are obtained periodically, generally, on an annual basis.

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

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

### ***Other Non-Performing Assets***

In the past, this category mainly consisted of assets pledged to Lehman at their book value. During the second quarter of 2013, the Corporation recorded a non-cash charge of \$66.6 million associated with the carrying value of the pledged securities and related accrued interest (\$64.5 million book value and \$2.1 million accrued interest).

### ***Past-Due Loans 90 days and still accruing***

These are accruing loans that are contractually delinquent 90 days or more. These past-due loans are either current as to interest but delinquent as to the payment of principal or are insured or guaranteed under applicable FHA and VA programs.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan.

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	(Dollars in thousands)				
Non-performing loans held for investment:					
Residential mortgage . . . . .	\$161,441	\$ 313,626	\$ 338,208	\$ 392,134	\$ 441,642
Commercial mortgage . . . . .	120,107	214,780	240,414	217,165	196,535
Commercial and industrial . . . . .	114,833	230,090	270,171	317,243	241,316
Construction . . . . .	58,866	178,190	250,022	263,056	634,329
Finance leases . . . . .	3,082	3,182	3,485	3,935	5,207
Consumer . . . . .	37,220	35,693	36,062	45,456	44,834
Total non-performing loans held for investments . . . . .	<u>495,549</u>	<u>975,561</u>	<u>1,138,362</u>	<u>1,238,989</u>	<u>1,563,863</u>
OREO . . . . .	160,193	185,764	114,292	84,897	69,304
Other repossessed property . . . . .	14,865	10,107	15,392	14,023	12,898
Other assets <sup>(1)</sup> . . . . .	—	64,543	64,543	64,543	64,543
Total non-performing assets, excluding loans held for sale . . . . .	670,607	1,235,975	1,332,589	1,402,452	1,710,608
Non-performing loans held for sale . . . . .	<u>54,801</u>	<u>2,243</u>	<u>4,764</u>	<u>159,321</u>	<u>—</u>
Total non-performing assets, including loans held for sale <sup>(2)</sup> . . . . .	<u>\$725,408</u>	<u>\$1,238,218</u>	<u>\$1,337,353</u>	<u>\$1,561,773</u>	<u>\$1,710,608</u>
Past due loans 90 days and still accruing <sup>(3)</sup> . . .	\$120,082	\$ 142,012	\$ 130,816	\$ 144,113	\$ 165,936
Non-performing assets to total assets . . . . .	5.73%	9.45%	10.19%	10.02%	8.71%
Non-performing loans held for investment to total loans held for investment . . . . .	5.14%	9.70%	10.78%	10.63%	11.23%
Allowance for loan and lease losses . . . . .	\$285,858	\$ 435,414	\$ 493,917	\$ 553,025	\$ 528,120
Allowance to total non-performing loans held for investment . . . . .	57.69%	44.63%	43.39%	44.64%	33.77%
Allowance to total non-performing loans held for investment, excluding residential real estate loans . . . . .	85.56%	65.78%	61.73%	65.30%	47.06%

(1) Collateral pledged to Lehman.

(2) Amounts exclude purchased credit impaired loans with a carrying value as of December 31, 2013 of approximately \$4.8 million acquired as part of the credit card portfolio purchased in 2012.

(3) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$37.0 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 18 months delinquent, that are no longer accruing interest as of December 31, 2013.

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

	2013	2012	2011	2010	2009
	(Dollars in thousands)				
<b>Puerto Rico:</b>					
Non-performing loans held for investment:					
Residential mortgage	\$139,771	\$ 281,086	\$ 297,595	\$ 330,737	\$ 376,018
Commercial mortgage	101,255	172,534	170,949	177,617	128,001
Commercial and industrial	109,224	215,985	261,189	307,608	229,039
Construction	43,522	99,383	137,478	196,948	385,259
Finance leases	3,082	3,182	3,485	3,935	5,207
Consumer	34,660	32,529	34,888	43,241	40,132
Total non-performing loans held for investment	431,514	804,699	905,584	1,060,086	1,163,656
OREO	123,851	145,683	85,788	67,488	49,337
Other repossessed property	14,806	10,070	15,283	13,839	12,634
Other Assets	—	64,543	64,543	64,543	64,543
Total non-performing assets, excluding loans held for sale	570,171	1,024,995	1,071,198	1,205,956	1,290,170
Non-performing loans held for sale	14,796	2,243	4,764	159,321	—
Total non-performing assets, including loans held for sale <sup>(1)</sup>	\$584,967	\$1,027,238	\$1,075,962	\$1,365,277	\$1,290,170
Past-due loans 90 days and still accruing	\$118,097	\$ 137,288	\$ 118,888	\$ 142,756	\$ 128,016
<b>Virgin Islands:</b>					
Non-performing loans held for investment:					
Residential mortgage	\$ 8,439	\$ 18,054	\$ 11,470	\$ 9,655	\$ 9,063
Commercial mortgage	6,827	11,232	12,851	7,868	11,727
Commercial and industrial	5,609	12,905	7,276	6,078	8,300
Construction	11,214	72,648	110,594	16,473	2,796
Consumer	514	804	518	927	3,540
Total non-performing loans held for investment	32,603	115,643	142,709	41,001	35,426
OREO	14,894	24,260	7,200	2,899	470
Other repossessed property	5	17	67	108	221
Total non-performing assets, excluding loans held for sale	\$ 47,502	\$ 139,920	\$ 149,976	\$ 44,008	\$ 36,117
Non-performing loans held for sale	40,005	—	—	—	—
Total non-performing assets, including loans held for sale	\$ 87,507	\$ 139,920	\$ 149,976	\$ 44,008	\$ 36,117
Past-due loans 90 days and still accruing	\$ 1,985	\$ 4,068	\$ 11,204	\$ 1,358	\$ 23,876
<b>United States:</b>					
Non-performing loans held for investment:					
Residential mortgage	\$ 13,231	\$ 14,486	\$ 29,143	\$ 51,742	\$ 56,561
Commercial mortgage	12,025	31,014	56,614	31,680	56,807
Commercial and industrial	—	1,200	1,706	3,557	3,977
Construction	4,130	6,159	1,950	49,635	246,274
Consumer	2,046	2,360	656	1,288	1,162
Total non-performing loans held for investment	31,432	55,219	90,069	137,902	364,781
OREO	21,448	15,821	21,304	14,510	19,497
Other repossessed property	54	20	42	76	43
Total non-performing assets	\$ 52,934	\$ 71,060	\$ 111,415	\$ 152,488	\$ 384,321
Past-due loans 90 days and still accruing	\$ —	\$ 656	\$ 724	\$ —	\$ 14,044

(1) Amount excludes purchased credit impaired loans with a carrying value as of December 31, 2013 of approximately \$4.8 million acquired as part of the credit cards portfolio purchased in 2012.



Total non-performing loans, including non-performing loans held for sale, were \$550.4 million as of December 31, 2013. This represents a decrease of \$427.5 million, or 43%, from \$977.8 million as of December 31, 2012. This reduction reflects, among other things, the impact of the two bulk sales completed in 2013 and charge-offs related to the transfer of loans to held for sale, and foreclosures, partially offset by inflows of loans to non-performing status as described below.

Non-performing C&I loans, decreased by \$116.4 million, or 50%, compared to December 31, 2012, driven by the inclusion of non-performing C&I loans with a book value of \$85.3 million in the bulk sale of adversely classified and non-performing assets completed in the first quarter of 2013, a charge-off of \$25.4 million on a single relationship restructured through a loan split in the first quarter of 2013, two non-performing commercial loan participations totaling \$7.6 million liquidated in the fourth quarter of 2013, and the repayment of certain loans. Partially offsetting the aforementioned decreases were inflows of \$49.7 million during 2013, mainly concentrated in Puerto Rico. Most of the inflows were concentrated in eleven relationships in individual amounts that exceeds \$1.0 million during 2013 amounting to \$33.3 million in the aggregate. Total inflows of non-performing C&I loans decreased to \$49.7 million during 2013 compared to inflows of \$90.4 million for the same period in 2012.

Non-performing commercial mortgage loans, including non-performing commercial mortgage loans held for sale, decreased by \$88.7 million, or 41%, from December 31, 2012. The decrease was primarily driven by the inclusion of non-performing commercial mortgage loans with a book value of \$51.1 million in the bulk sale of adversely classified and non-performing assets completed in the first quarter of 2013, charge-offs of \$14.6 million related to the transfer of commercial mortgage loans to held for sale, the individual sale of a \$40.8 million loan that was written off and transferred to held for sale in the first quarter of 2013, an additional reduction of \$41.3 million related to the restructuring of a commercial mortgage loan transferred to held for sale at the beginning of the year in which the Corporation received foreclosed real estate in partial satisfaction of a debt arrangement, and other reductions related to loans restored to accrual status and collections. Non-performing commercial mortgage loans decreased by \$65.3 million in Puerto Rico, led by the aforementioned sales, charge-offs and foreclosures. Non-performing commercial mortgage loans in the Virgin Islands decreased by \$4.4 million, driven by the restoration to accrual status after a sustained period of performance of a \$5.8 million modified loan. The United States non-performing commercial mortgage loan portfolio decreased by \$19.0 million, driven by the foreclosure of collateral underlying a \$13.3 million problem loan. Total inflows of non-performing commercial mortgage loans of \$112.7 million during 2013 increased by \$60.5 million compared to \$52.2 million for the same period in 2012, primarily associated with two relationships that aggregated \$85.0 million.

Non-performing construction loans, including non-performing construction loans held for sale, decreased by \$71.5 million, or 40%, from December 31, 2012, primarily reflecting the inclusion of non-performing construction loans with a book value of \$41.4 million in the bulk sale of adversely classified and non-performing assets completed in the first quarter of 2013 as well as charge-offs of \$21.4 million related to construction loans transferred to held for sale, the repayment of certain construction loan participations amounting to \$6.4 million during the third quarter of 2013 and a \$3.2 million TDR construction loan in the Virgin Islands restored to accrual status after a sustained performance period. The decrease in non-performing construction loans was primarily in Puerto Rico with a reduction of \$48.1 million with the remaining decrease of \$23.5 million mainly related to charge-offs on a single relationship transferred to held for sale in the Virgin Islands and the \$3.2 million TDR loans restored to accrual status in the fourth quarter of 2013. The inflows of non-performing construction loans of \$18.0 million during 2013 decreased compared to inflows of \$21.4 million for the same period in 2012.

The following table presents the activity of commercial and construction non-performing loans held for investment:

(In thousands)	<u>Commercial Mortgage</u>	<u>Commercial &amp; Industrial</u>	<u>Construction</u>
<b>Year ended December 31, 2013</b>			
Beginning balance . . . . .	\$214,780	\$230,090	\$178,190
Plus:			
Additions to non-performing . . . . .	112,709	49,719	18,050
Less:			
Non-performing loans transferred to REO . . . . .	(14,023)	(11,415)	(1,180)
Non-performing loans charged-off . . . . .	(23,896)	(35,148)	(30,813)
Loans returned to accrual status/loan collections . . . . .	(24,884)	(34,977)	(8,288)
Reclassification . . . . .	(2,816)	1,844	(309)
Transfer to loans held for sale, net of charge-offs . . . . .	(90,709)	—	(55,273)
Non-performing loans sold . . . . .	(51,054)	(85,280)	(41,511)
Ending balance . . . . .	<u>\$120,107</u>	<u>\$114,833</u>	<u>\$ 58,866</u>

The following table presents the activity of commercial and construction non-performing loans held for sale:

(In thousands)	<u>Commercial Mortgage</u>	<u>Commercial &amp; Industrial</u>	<u>Construction</u>
<b>Year ended December 31, 2013</b>			
Beginning balance . . . . .	\$ 1,065	\$ 1,178	\$ —
Plus:			
Transfer from held for investment, net of charge- offs . . . . .	90,709	—	55,273
Less:			
Non-performing loans transferred to REO . . . . .	(41,330)	—	—
Loan collections . . . . .	(695)	—	(7,133)
Lower of cost or market adjustment . . . . .	(1,165)	—	(338)
Non-performing loans sold . . . . .	(41,585)	(1,178)	—
Ending balance . . . . .	<u>\$ 6,999</u>	<u>\$ —</u>	<u>\$47,802</u>

Non-performing residential mortgage loans decreased by \$152.2 million, or 48%, from December 31, 2012. The decrease was mainly driven by the \$203.8 million of loans sold as part of the bulk sale of non-performing residential assets completed in the second quarter of 2013, \$94.5 million of loans restored to accrual status, or collected, foreclosures of approximately \$29.1 million, and charge-offs. These decreases were offset by inflows of \$190.0 million during 2013. Non-performing residential mortgage loans decreased by \$141.3 million, or 50%, \$9.6 million, or 53%, and \$1.3 million, or 8%, in Puerto Rico, the Virgin Islands and the United States, respectively, from December 31, 2012. Total inflows of non-performing residential mortgage loans were \$190.0 million during 2013 compared to \$199.3 million for the same period in 2012, a decrease of \$9.3 million. Approximately \$100.2 million, or 62% of total non-performing residential mortgage loans, have been written down to their net realizable value. Most of the loans included in the bulk sale of non-performing residential assets were 180 days or more past due loans, thus, foreclosures and charge-offs that partially offset the inflows of loans to non-performing status significantly decreased during the second half of 2013. This resulted in a net increase of \$27.5 million in non-performing residential mortgage loans after the bulk sale as shown in the following table:

(In thousands)	First six-months ended	Last six-months ended	Year Ended
	June 30, 2013	December 31, 2013	December 31, 2013
Beginning balance . . . . .	\$ 313,626	\$133,937	\$ 313,626
Plus:			
Additions to non-performing . .	101,404	88,547	189,951
Less:			
Non-performing loans			
transferred to REO . . . . .	(24,946)	(4,143)	(29,089)
Non-performing loans charged-			
off . . . . .	(9,628)	(9,211)	(18,839)
Loans returned to accrual status/			
loan collections . . . . .	(46,758)	(47,689)	(94,447)
Reclassification . . . . .	1,281	—	1,281
Non-performing loans sold . . . .	(201,042)	—	(201,042)
Ending balance . . . . .	<u>\$ 133,937</u>	<u>\$161,441</u>	<u>\$ 161,441</u>

The level of non-performing consumer loans, including finance leases, showed a \$1.4 million increase in 2013 mainly related to auto loans. The inflows of non-performing consumer loans of \$68.1 million during 2013 increased \$5.9 million compared to inflows of \$62.2 million for the same period in 2012.

As of December 31, 2013, approximately \$142.1 million of the loans placed in non-accrual status, mainly construction and commercial loans, were current, or had delinquencies of less than 90 days in their interest payments, including \$95.7 million of TDRs maintained in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability. Collections on these loans are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant.

During the year ended December 31, 2013, interest income of approximately \$5.1 million related to non-performing loans with a carrying value of \$302.4 million as of December 31, 2013, mainly non-performing construction and commercial loans, was applied against the related principal balances under the cost-recovery method.

The allowance to non-performing loans held for investment ratio as of December 31, 2013 was 57.69%, compared to 44.63% as of December 31, 2012. As of December 31, 2013, approximately \$141.3 million, or 28.54%, of total non-performing loans held for investment have been charged-off to their net realizable value as shown in the following table.

(Dollars in thousands)	<u>Residential Mortgage Loans</u>	<u>Commercial Mortgage Loans</u>	<u>C&amp;I Loans</u>	<u>Construction Loans</u>	<u>Consumer and Finance Leases</u>	<u>Total</u>
<b>As of December 31, 2013</b>						
Non-performing loans held for investment						
charged off to realizable value . . . . .	\$100,181	\$ 4,790	\$ 32,809	\$ 2,294	\$ 1,192	\$141,266
Other non-performing loans held for investment . . . . .	<u>61,260</u>	<u>115,317</u>	<u>82,024</u>	<u>56,572</u>	<u>39,110</u>	<u>354,283</u>
Total non-performing loans held for investment . . . . .	<u>\$161,441</u>	<u>\$120,107</u>	<u>\$114,833</u>	<u>\$ 58,866</u>	<u>\$40,302</u>	<u>\$495,549</u>
Allowance to non-performing loans held for investments . . . . .	20.51%	60.89%	74.28%	60.84%	145.15%	57.69%
Allowance to non-performing loans held for investments, excluding non-performing loans charged off to realizable value . . . . .	54.05%	63.42%	103.99%	63.31%	151.48%	80.80%
<b>As of December 31, 2012</b>						
Non-performing loans held for investment						
charged off to realizable value . . . . .	\$170,555	\$ 7,194	\$ 25,925	\$ 43,943	\$ 1,219	\$248,836
Other non-performing loans held for investment . . . . .	<u>143,071</u>	<u>207,586</u>	<u>204,165</u>	<u>134,247</u>	<u>37,656</u>	<u>726,725</u>
Total non-performing loans held for investment . . . . .	<u>\$313,626</u>	<u>\$214,780</u>	<u>\$230,090</u>	<u>\$178,190</u>	<u>\$38,875</u>	<u>\$975,561</u>
Allowance to non-performing loans held for investments . . . . .	21.79%	45.48%	63.84%	34.57%	156.57%	44.63%
Allowance to non-performing loans held for investments, excluding non-performing loans charged off to realizable value . . . . .	47.78%	47.06%	71.95%	45.89%	161.64%	59.91%

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program, as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans in the U.S. mainland, fit the definition of TDRs. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of December 31, 2013, the Corporation's total TDR loans of \$630.3 million consisted of \$337.2 million of residential mortgage loans, \$92.0 million of commercial and industrial loans, \$153.6 million of commercial mortgage loans, \$20.1 million of construction loans, and \$27.3 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to \$0.5 million as of December 31, 2013.

The Corporation's loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan

term, deferral of principal payments for a significant period of time, and reduction of interest rates either permanently (offered up to 2010) or for a period of up to two years (step-up rates). Additionally, in certain cases, the restructuring may provide for the forgiveness of contractually due principal or interest. Uncollected interest is added to the end of the loan term at the time of the restructuring and not recognized as income until collected or when the loan is paid off. These programs are available only to those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in the foreclosure action absent some lender concession. Nevertheless, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a six-month period during which the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification. TDR loans that are participating in or that have been offered a binding trial modification are classified as TDR when the trial offer is made and continue to be classified as TDR regardless of whether the borrower enters into a permanent modification. As of December 31, 2013, the Corporation classified an additional \$8.5 million of residential mortgage loans as TDRs that were participating in or had been offered a trial modification.

For the commercial real estate, commercial and industrial, and construction portfolios, at the time of a restructuring, the Corporation determines, on a loan-by-loan basis, whether a concession was granted for economic or legal reasons related to the borrower's financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waivers of borrower covenants; forgiveness of principal or interest; or other contract changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collections function. The function's objective is to minimize both early stage delinquencies and losses upon default of commercial loans. In the case of commercial and industrial, commercial mortgage, and construction loan portfolios, the SAG focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists, and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary. The SAG utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third-party consultants. In the case of residential construction projects and large commercial loans, the function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and assists with the restructuring of large commercial loans. In addition, the Corporation extends, renews, and restructures loans with satisfactory credit profiles. Many commercial loan facilities are structured as lines of credit, which are mainly one year in term and therefore are required to be renewed annually. Other facilities may be restructured or extended from time to time based upon changes in the borrower's business needs, use of funds, the timing of the completion of projects, and other factors. If the borrower is not deemed to have financial difficulties, extensions, renewals, and restructurings are done in the normal course of business and not considered concessions, and the loans continue to be recorded as performing.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation's interest income by returning a non-performing loan to performing

status, if applicable, increase cash flows by providing for payments to be made by the borrower, and avoid increases in foreclosure and OREO costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses.

The following table provides a breakdown between accrual and nonaccrual TDRs:

(In thousands)	December 31, 2013		
	Accrual	Nonaccrual <sup>(1) (2)</sup>	Total TDRs
Non- FHA/VA Residential Mortgage loans . . . . .	\$263,919	\$ 73,324	\$337,243
Commercial Mortgage Loans . . . . .	53,509	38,441	91,950
Commercial and Industrial Loans . . . . .	84,419	69,156	153,575
Construction Loans . . . . .	4,332	15,811	20,143
Consumer Loans—Auto . . . . .	8,512	5,610	14,122
Finance Leases . . . . .	2,275	85	2,360
Consumer Loans—Other . . . . .	8,417	2,448	10,865
Total Troubled Debt Restructurings . . . . .	<u>\$425,383</u>	<u>\$204,875</u>	<u>\$630,258</u>

- (1) Included in non-accrual loans are \$95.7 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectibility.
- (2) Excludes non-accrual TDRs held for sale with a carrying value of \$45.9 million as of December 31, 2013.

The REO portfolio, which is part of non-performing assets, decreased by \$25.6 million driven by OREO properties sold as part of the bulk sales of assets completed in the first and second quarter of 2013, as well as write-downs, partially offset by additions of OREO commercial income-producing properties primarily in Puerto Rico in connection with properties received in partial satisfaction of a commercial mortgage loan held for sale. The following table shows the activity during the year ended December 31, 2013 of the REO portfolio by geographic region and type of property:

(In thousands)	As of December 31, 2013									
	Puerto Rico			Virgin Islands			Florida			Consolidated
	Residential	Commercial	Construction	Residential	Commercial	Construction	Residential	Commercial	Construction	
Beginning										
Balance . . . . .	\$ 66,358	\$ 54,601	\$24,724	\$ 3,802	\$ 3,018	\$17,439	\$ 1,440	\$11,786	\$2,596	\$185,764
Additions . . . . .	30,485	53,653	378	1,662	997	822	3,498	12,649	—	104,144
Sales . . . . .	(52,215)	(19,268)	(1,134)	(2,256)	(830)	(284)	(1,661)	(8,800)	—	(86,448)
Fair value adjustments . . . . .	(9,753)	(16,141)	(7,837)	(1,024)	(1,183)	(7,269)	(50)	(10)	—	(43,267)
	<u>\$ 34,875</u>	<u>\$ 72,845</u>	<u>\$16,131</u>	<u>\$ 2,184</u>	<u>\$ 2,002</u>	<u>\$10,708</u>	<u>\$ 3,227</u>	<u>\$15,625</u>	<u>\$2,596</u>	<u>\$160,193</u>

The over 90-day delinquent, but still accruing loans, excluding loans guaranteed by the U.S. government, decreased during 2013 by \$7.3 million to \$41.4 million, or 0.43% of total loans held for investment as of December 31, 2013. Loans 30 to 89 days delinquent increased during 2013 by \$18.7 million to \$264.8 million as of December 31, 2013.

#### Net Charge-offs and Total Credit Losses

Total net charge-offs in 2013 were \$393.7 million, or 4.01% of average loans on an annualized basis, including \$134.5 million of charge-offs related to the bulk sale of adversely classified assets and the transfer of loans to held for sale during the first quarter of 2013, and \$98.0 million related to the bulk sale of non-performing residential assets during the second quarter of 2013. Excluding the impact of charge-offs related to the bulk sales



and the transfer of loans to held for sale, total net charge offs in 2013 were \$160.9 million, or 1.68% of average loans, compared to \$179.0 million, or 1.74%, of average loans, in 2012.

C&I loan net charge-offs in 2013 were \$105.2 million, or 3.52% of related average loans, including \$44.7 million of charge-offs related to the bulk sale completed during the first quarter of 2013. Excluding the impact of charge-offs related to the first quarter 2013 bulk sale, C&I net charge-offs in 2013 were \$60.5 million, or 2.04% of average loans, up from \$45.9 million, or 1.21% of related average loans, in 2012. Substantially all of the charge-offs recorded in 2013 were in Puerto Rico. The increase was primarily due to a \$25.4 million charge-off related to a single relationship restructured in the first quarter of 2013 into a split Note A/Note B. The charge-offs in 2013 also included an aggregate of \$25.6 million related to eleven relationships in Puerto Rico with individual charge-offs in excess of \$1 million.

Commercial mortgage loan net charge-offs in 2013 were \$62.6 million, or 3.44% of related average loans, including \$54.6 million of charge-offs related to the bulk sale and the transfer of loans to held for sale during the first quarter of 2013. Excluding the impact of charge-offs related to the bulk sale and the transfer of loans to held for sale, commercial mortgage loans net charge-offs in 2013 were \$8.0 million, or 0.45% of average loans, down from \$21.0 million, or 1.41% of related average loans, in 2012. Commercial mortgage loan net charge-offs in 2013 were primarily in Puerto Rico and the United States, an aggregate of \$2.7 million was related to two relationships in Puerto Rico with individual charge-offs in excess of \$1 million and \$5.4 million attributable to two relationship in the United States. Partially offsetting charge-offs in 2013 was a \$4.5 million recovery related to a loan paid-off in Florida.

Construction loan net charge-offs in 2013 were \$41.2 million, or 15.11%, of average loans, including \$34.2 million of charge-offs related to the bulk sale and the transfer of loans to held for sale during the first quarter of 2013. Excluding the impact of charge-offs related to the bulk sale and the transfer of loans to held for sale, construction net charge-offs in 2013 were \$7.1 million, or 2.91% of average loans, down from \$40.7 million, or 10.49% of related average loans, in 2012. The positive variance when compared to the prior year is mainly attributable to an individual charge-off of \$7.6 million recorded on a commercial project in Puerto Rico and \$23.0 million related to one construction relationship in the Virgin Islands recorded in 2012. Construction loan net charge-offs in 2013 included a \$3.1 million charge-off on one residential land loan in Puerto Rico that entered into non-performing status during the first quarter of 2013 and \$1.8 million related to a single relationship in Florida.

Residential mortgage loan net charge-offs in 2013 were \$128.0 million, or 4.77% of related average loans, including \$98.0 million of charge-offs related to the second quarter bulk sale. Excluding the impact of charge-offs related to the bulk sales, residential mortgage loan net charge-offs in 2013 were \$29.0 million, or 1.13% of average loans, down from \$36.9 million, or an annualized 1.32% for the comparable period in 2012. Approximately \$17.2 million of charge-offs in 2013 resulted from valuations for impairment purposes of residential mortgage loan portfolios considered homogeneous given high delinquency and loan-to-value levels, compared to \$19.9 million recorded in 2012. Net charge-offs on residential mortgage loans also included \$7.1 million related to the foreclosure of loans during 2013, compared to \$9.7 million recorded for foreclosures in 2012.

Net charge-offs on consumer loans and finance leases in 2013 were \$56.2 million, 2.76% of related average loans, compared to \$34.5 million, 1.92% of related average loans in 2012. This increase is mainly attributable to a larger portfolio led by the credit cards portfolio acquired in May 2012, and higher auto loan net charge-offs.

The following table shows the ratios of net charge-offs to average loans by loan category for the last five years.

	For the year ended December 31,				
	2013	2012	2011	2010	2009
Residential mortgage <sup>(1) (6)</sup> .....	4.77%	1.32%	1.32%	1.80%	0.82%
Commercial mortgage <sup>(2) (7)</sup> .....	3.44%	1.41%	3.21%	5.02%	1.64%
Commercial and Industrial <sup>(3) (8)</sup> .....	3.52%	1.21%	1.57%	2.16%	0.72%
Construction <sup>(4) (9)</sup> .....	15.11%	10.49%	16.33%	23.80%	11.54%
Consumer loans and finance leases .....	2.76%	1.92%	2.33%	2.98%	3.05%
Total loans <sup>(5) (10)</sup> .....	4.01%	1.74%	2.68%	4.76%	2.48%

- (1) Includes net charge-offs totaling \$99.0 million associated with the bulk sales of assets in 2013. Residential net charge-offs to average loans, excluding charge-offs associated with the bulk loan sales, was 1.13% in 2013.
- (2) Includes net charge-offs totaling \$54.6 million associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale in 2013. The ratio of commercial mortgage net charge-offs to average loans excluding charge-offs associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale, was 0.45% in 2013.
- (3) Includes net charge-offs totaling \$44.7 million associated with the bulk sale of adversely classified commercial assets in 2013. The ratio of commercial and industrial net-charge offs to average loans, excluding charge-offs associated with the bulk sale of adversely classified commercial assets, was 2.04% in 2013.
- (4) Includes net charge-offs totaling \$34.2 million associated with the bulk sales of assets and the transfer of loans to held for sale in 2013. The ratio of construction loans net-charge offs to average loans, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale, was 2.91% in 2013.
- (5) Includes net charge-offs totaling \$232.4 million, associated with the bulk loan sales and the transfer of loans to held for sale in 2013. The ratio of total net-charge offs to average loans, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale was 1.68% in 2013.
- (6) Includes net charge-offs totaling \$7.8 million associated with non-performing residential mortgage loans sold in a bulk sale in 2010.
- (7) Includes net charge-offs totaling \$29.5 million associated with loans transferred to held for sale in the fourth quarter of 2010. Commercial mortgage net charge-offs to average loans, excluding charge-offs associated with such loans transferred to held for sale, was 3.38% in 2010.
- (8) Includes net charge-offs totaling \$8.6 million associated with loans transferred to held for sale in the fourth quarter of 2010. Commercial and industrial net charge-offs to average loans, excluding charge offs associated with such loans transferred to held for sale, was 1.98% in 2010.
- (9) Includes net charge-offs totaling \$127.0 million associated with loans transferred to held for sale in the fourth quarter of 2010. Construction net charge-offs to average loans, excluding charge-offs associated with such loans transferred to held for sale, was 18.93% in 2010.
- (10) Includes net charge-offs totaling \$165.1 million associated with loans transferred to held for sale in the fourth quarter of 2010. Total net charge-offs to average loans, excluding charge-offs associated with such loans transferred to held for sale, was 3.60% in 2010.

The following table presents net charge-offs to average loans held in various portfolios by geographic segment:

	<u>December 31, 2013</u>	<u>December 31, 2012</u>	<u>December 31, 2011</u>
<b>PUERTO RICO:</b>			
Residential mortgage <sup>(1)</sup> . . . . .	5.90%	1.58%	1.32%
Commercial mortgage <sup>(2)</sup> . . . . .	4.26%	1.39%	4.10%
Commercial and Industrial <sup>(3)</sup> . . . . .	3.76%	1.31%	1.64%
Construction <sup>(4)</sup> . . . . .	15.00%	6.34%	11.60%
Consumer and finance leases . . . . .	2.83%	1.91%	2.39%
Total loans <sup>(5)</sup> . . . . .	4.37%	1.64%	2.40%
<b>VIRGIN ISLANDS:</b>			
Residential mortgage <sup>(6)</sup> . . . . .	1.88%	0.15%	0.09%
Commercial mortgage . . . . .	0.11%	0.00%	0.00%
Commercial and Industrial . . . . .	1.63%	0.01%	0.31%
Construction <sup>(7)</sup> . . . . .	18.08%	23.14%	25.87%
Consumer and finance leases . . . . .	0.48%	1.05%	1.08%
Total loans <sup>(8)</sup> . . . . .	3.50%	3.41%	4.79%
<b>FLORIDA:</b>			
Residential mortgage . . . . .	0.35%	0.95%	3.09%
Commercial mortgage . . . . .	0.46%	1.70%	1.56%
Commercial and Industrial <sup>(9)</sup> . . . . .	0.10%	-0.65%	1.83%
Construction <sup>(10)</sup> . . . . .	6.44%	-8.89%	22.35%
Consumer and finance leases . . . . .	1.84%	3.62%	1.66%
Total loans . . . . .	0.61%	1.04%	3.34%

- (1) For 2013, includes net charge-offs totaling \$92.9 million associated with the bulk loan sales. The ratio of residential mortgage net charge-offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk sales, was 1.41%.
- (2) For 2013, includes net charge-offs totaling \$54.6 million associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale. The ratio of commercial mortgage net charge-offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale, was 0.47%.
- (3) For 2013, includes net charge-offs totaling \$44.7 million associated with the bulk sale of adversely classified commercial assets. The ratio of commercial and industrial net charge-offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk sale of adversely classified commercial assets, was 2.15%.
- (4) For 2013, includes net charge-offs totaling \$19.0 million associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale. The ratio of construction net charge-offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale, was 4.29%.
- (5) For 2013, includes net charge-offs totaling \$211.2 million associated with the bulk loan sales and the transfer of loans to held for sale. The ratio of total net charge-offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale, was 1.89%.
- (6) For 2013, includes net charge-offs totaling \$6.1 million associated with the bulk sale of non-performing residential assets. The ratio of residential mortgage net charge-offs to average loans in the Virgin Islands, excluding charge-offs associated with the bulk sale of non-performing residential assets, was 0.22%.
- (7) For 2013, includes net charge-offs totaling \$15.2 million associated with the bulk loan sales and the transfer of loans to held for sale. The ratio of construction loans net charge-offs to average loans in the Virgin Islands, excluding charge-offs associated with the bulk loan sale and the transfer of loans to held for sale, was -0.48%.
- (8) For 2013, includes net charge-offs totaling \$21.3 million, associated with the bulk loan sales and the transfer of loans to held for sale. The ratio of total net-charge offs to average loans in the Virgin Islands, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale, was 0.38%.
- (9) For 2012, recoveries in C&I loans in Florida exceeded charge-offs.
- (10) For 2012, recoveries in Construction loans in Florida exceeded charge-offs.

Total credit losses (equal to net charge-offs plus losses on REO operations) for 2013 amounted to \$435.8 million, or 4.37% to average loans and repossessed assets in contrast to credit losses of \$204.1 million, or a loss rate of 1.96%, for the same period in 2012. Excluding the bulk sales of assets and the transfer of loans to held for sale completed in the first half of 2013, total credit losses for 2013 amounted to \$201.5 million.

The following table presents OREO inventory and credit losses for the periods indicated:

	Year Ended	
	December 31,	
	2013	2012
	(Dollars in thousands)	
<b>OREO</b>		
OREO balances, carrying value:		
Residential .....	\$ 40,286	\$ 71,600
Commercial .....	90,472	70,608
Construction .....	29,435	43,556
Total .....	<u>\$ 160,193</u>	<u>\$ 185,764</u>
OREO activity (number of properties):		
Beginning property inventory .....	716	575
Properties acquired .....	320	536
Properties disposed .....	(540)	(395)
Ending property inventory .....	<u>496</u>	<u>716</u>
Average holding period (in days)		
Residential .....	444	332
Commercial .....	281	305
Construction .....	574	258
	379	304
OREO operations (loss) gain:		
Market adjustments and (losses) gain on sale:		
Residential .....	(10,863)	(7,576)
Commercial .....	(10,670)	(2,915)
Construction .....	(12,371)	(1,190)
	<u>(33,904)</u>	<u>(11,681)</u>
Other OREO operations expenses .....	(8,608)	(13,435)
<b>Net Loss on OREO operations</b> .....	<u>\$ (42,512)</u>	<u>\$ (25,116)</u>
<b>CHARGE-OFFS</b>		
Residential charge offs, net .....	(127,999)	(36,855)
Commercial charge offs, net .....	(167,815)	(66,884)
Construction charge offs, net .....	(41,247)	(40,741)
Consumer and finance leases charge-offs, net .....	(56,246)	(34,522)
Total charge-offs, net .....	<u>(393,307)</u>	<u>(179,002)</u>
<b>TOTAL CREDIT LOSSES</b> <sup>(1)</sup> .....	<u>\$ (435,819)</u>	<u>\$ (204,118)</u>
<b>LOSS RATIO PER CATEGORY</b> <sup>(2)</sup> :		
Residential .....	5.07%	1.55%
Commercial .....	3.67%	1.31%
Construction .....	17.84%	10.09%
Consumer .....	2.74%	1.90%
<b>TOTAL CREDIT LOSS RATIO</b> <sup>(3)</sup> .....	<b>4.37%</b>	<b>1.96%</b>

(1) Equal to OREO operations (losses) plus charge-offs, net.

- (2) Calculated as net charge-offs plus market adjustments and gains (losses) on sale of OREO divided by average loans and repossessed assets.
- (3) Calculated as net charge-offs plus net loss on OREO operations divided by average loans and repossessed assets.

### **Operational Risk**

The Corporation faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products. Coupled with external influences such as market conditions, security risks, and legal risk, the potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Corporation has developed, and continues to enhance, specific internal controls, policies and procedures that are designated to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Corporation's business operations are functioning within the policies and limits established by management.

The Corporation classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate-wide risks, such as information security, business recovery, and legal and compliance, the Corporation has specialized groups, such as the Legal Department, Information Security, Corporate Compliance, 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 noncompliance 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. Of the total gross loans held for investment of \$9.6 billion as of December 31, 2013, approximately 84% have credit risk concentration in Puerto Rico, 9% in the United States, and 7% in the Virgin Islands.

### **Exposure to Puerto Rico Government**

As of December 31, 2013, the Corporation had \$454.6 million of credit facilities granted to the Puerto Rico government, its municipalities and public corporations, of which \$397.8 million was outstanding, compared to \$158.4 million as of December 31, 2012. Approximately \$200.5 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality.

The good faith, credit, and unlimited taxing power of each applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$84.6 million consists of loans to public corporations that receive revenues from the rates they charge for services or products, such as electric power services. Main public corporations have varying degrees of independence from the central government and many receive appropriations or other payments from the Puerto Rico's government general fund. Approximately \$112.7 million consists of loans to the central government or units of the central government. Debt issued by the central government can either carry the full faith, credit, and taxing power of the Commonwealth of Puerto Rico or represent an obligation that is subject to annual budget appropriations. The Commonwealth of Puerto Rico has never defaulted on its debt. Furthermore, the Corporation had \$205.1 million outstanding as of December 31, 2013 in financing to the hotel industry in Puerto Rico guaranteed by the TDF. The TDF is a subsidiary of GDB that works with private-sector financial institutions to structure financings for new hospitality projects. The TDF has a perfect track record of supporting its guarantees.

In addition, as of December 31, 2013, the Corporation held approximately \$71.0 million of obligations of Puerto Rico government and agencies, mainly bonds of the Government Development Bank ("GDB") and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio that were reflected at their aggregate fair value of \$51.3 million.

As of December 31, 2013, the Corporation had \$546.5 million of public sector deposits in Puerto Rico. Approximately 21% come from municipalities and 79% come from public corporations and the central government.

Refer to "Puerto Rico Economic Environment and Exposure to Puerto Rico Government" section above for additional information.

### ***Impact of Inflation and Changing Prices***

The financial statements and related data presented herein have been prepared in conformity with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a greater impact on a financial institution's performance than the effects of general levels of inflation. Interest rate movements are not necessarily correlated with changes in the prices of goods and services.

### **Basis of Presentation**

The Corporation has included in this Form 10-K the following financial measures that are not recognized under generally accepted accounting principles, which are referred to as non-GAAP financial measures: (i) the calculation of net interest income, interest rate spread and net interest margin rate on a tax-equivalent basis and excluding changes in the fair value of derivative instruments and certain financial liabilities; (ii) the calculation of the tangible common equity ratio and the tangible book value per common share, (iii) the Tier 1 common equity to risk-weighted assets ratio, and (iv) certain other financial measures adjusted to exclude the effect of the bulk sales of assets and the transfer of loans to held for sale in the first and second quarters of 2013 as well as excluding the write-off of the collateral pledged to Lehman and the loss contingency for attorneys' fees awarded to the other party in the Lehman litigation. Investors should be aware that non-GAAP financial measures have inherent limitations and should be read only in conjunction with the Corporation's consolidated financial data prepared in accordance with GAAP.

Net interest income, interest rate spread and net interest margin are reported excluding changes in the fair value of derivative instruments and financial liabilities elected to be measured at fair value ("valuations") and on a tax-equivalent basis. The presentation of net interest income excluding valuations provides additional



information about the Corporation's net interest income and facilitates comparability and analysis. The changes in the fair value of derivative instruments and unrealized gains and losses on liabilities measured at fair value have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively. The tax-equivalent adjustment to net interest income recognizes the income tax savings when comparing taxable and tax-exempt assets and assumes a marginal income tax rate. Income from tax-exempt earning assets is increased by an amount equivalent to the taxes that would have been paid if this income had been taxable at statutory rates. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. This adjustment puts all earning assets, most notably tax-exempt securities and certain loans, on a common basis that facilitates comparison of results to results of peers. Refer to *Net Interest Income* above for the table that reconciles the non-GAAP financial measure "net interest income on a tax-equivalent basis and excluding fair value changes" with net interest income calculated and presented in accordance with GAAP. The table also reconciles the non-GAAP financial measures "net interest spread and margin on a tax-equivalent basis and excluding fair value changes" with net interest spread and margin calculated and presented in accordance with GAAP.

The tangible common equity ratio and tangible book value per common share are non-GAAP measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill, core deposit intangibles, and other intangibles, such as the purchased credit card relationship intangible. Tangible assets are total assets less goodwill, core deposit intangibles, and other intangibles, such as the purchased credit card relationship intangible. 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 method of accounting for mergers and acquisitions. Neither tangible common equity nor tangible assets, or the related measures should be considered in isolation or as a substitute for stockholders' equity, total assets, or any other measure calculated in accordance with GAAP. Moreover, the manner in which the Corporation calculates its tangible common equity, tangible assets, and any other related measures may differ from that of other companies reporting measures with similar names. Refer to *Risk Management-Capital* above for a reconciliation of the Corporation's tangible common equity and tangible assets.

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 current applicable bank regulatory requirements (Basel 1). The Tier 1 common equity ratio is not required by GAAP or on a recurring basis by applicable bank regulatory requirements. Management is currently monitoring this ratio, along with the other ratios discussed above, in evaluating the Corporation's capital levels and believes that, at this time, the ratio may be of interest to investors. Refer to *Risk Management-Capital* above for a reconciliation of stockholders' equity (GAAP) to Tier 1 common equity.

To supplement the Corporation's financial statements presented in accordance with GAAP, the Corporation provides additional measures of provision for loan and lease losses, provision for loan and lease losses to net charge-offs, net charge-offs, net charge-offs to average loans, to exclude the impact of the bulk sales of assets and the transfer of non-performing loans to held for sale in the first and second quarters of 2013. In addition, the Corporation provides additional measures of adjusted non-interest income and adjusted non-interest expenses. Adjusted non-interest income excluded the write-off of the collateral pledged to Lehman in 2013 and adjusted non-interest income excludes expenses related to the bulk sales of assets completed in the first half of 2013 and attorneys' fees related to the Lehman litigation recorded in 2013. Management believes that these non-GAAP measures enhance the ability of analysts and investors to analyze trends in the Corporation's business and to better understand the performance of the Corporation. In addition, the Corporation may utilize these non-GAAP financial measures as a guide in its budgeting and long-term planning process. Any analysis of these non-GAAP financial measures should be used only in conjunction with results presented in accordance with GAAP. Refer to *Overview of Results of Operations* discussion above for the reconciliation of these non-GAAP financial measures to the GAAP financial measures, except for the reconciliation with respect to the calculation of the non-GAAP financial measure "provision for loan and lease losses to net charge-offs ratio, excluding the impact of the bulk sales of assets and loans transferred to held for sale" with provision for loan losses to net charge-offs ratio calculated and presented in accordance with GAAP which is included below:

	<b>Provision for Loan and Lease Losses to Net Charge-Off, Provision for Loans (Non GAAP to GAAP reconciliation)</b>	
	<b>Year Ended December 31, 2013</b>	
	<b>Provision for Loan and Lease Losses</b>	<b>Net Charge-Offs</b>
(In thousands)		
Provision for loan and lease losses and net charge-offs, excluding special items (Non-GAAP) .....	\$111,749	\$160,863
Special Items:		
Bulk sales of assets and loans transferred to held for sale .....	<u>132,002</u>	<u>232,444</u>
Provision for loan and lease losses and net charge-offs (GAAP) .....	<u>\$243,751</u>	<u>\$393,307</u>
Provision for loan and lease losses and net charge-offs, excluding special items (Non-GAAP) .....	<u>69.47%</u>	
Provision for loan and lease losses and net charge-offs (GAAP) .....	<u>61.97%</u>	

### Selected Quarterly Financial Data

Financial data showing results of the 2013 and 2012 quarters is presented below. In the opinion of management, all adjustments necessary for a fair presentation have been included. These results are unaudited.

	<b>2013</b>			
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
	(In thousands, except for per share results)			
Interest income .....	\$160,225	\$ 160,670	\$162,203	\$162,690
Net interest income .....	124,493	126,888	130,905	132,659
Provision for loan losses .....	111,123	87,464	22,195	22,969
Net (loss) income .....	(72,633)	(122,583)	15,940	14,789
Net (loss) income attributable to common stockholders—basic .....	(72,633)	(122,583)	15,940	14,789
Net (loss) income attributable to common stockholders—diluted .....	(72,633)	(122,583)	15,940	14,789
(Loss) earnings per common share-basic .....	\$ (0.35)	\$ (0.60)	\$ 0.08	\$ 0.07
(Loss) earnings per common share-diluted .....	\$ (0.35)	\$ (0.60)	\$ 0.08	\$ 0.07

	2012			
	March 31	June 30	September 30	December 31
	(In thousands, except for per share results)			
Interest income . . . . .	\$152,107	\$153,652	\$166,964	\$165,054
Net interest income . . . . .	101,866	108,705	125,503	125,631
Provision for loan losses . . . . .	36,197	24,884	28,952	30,466
Net (loss) income . . . . .	(13,182)	9,356	19,073	14,535
Net (loss) income attributable to common stockholders— basic . . . . .	(13,182)	9,356	19,073	14,535
Net (loss) income attributable to common stockholders— diluted . . . . .	(13,182)	9,356	19,073	14,535
(Loss) earnings per common share-basic . . . . .	\$ (0.06)	\$ 0.05	\$ 0.09	\$ 0.07
(Loss) earnings per common share-diluted . . . . .	\$ (0.06)	\$ 0.05	\$ 0.09	\$ 0.07

Some infrequent transactions that significantly affected quarterly periods include:

During the first quarter of 2013, the bulk sale of adversely classified and non-performing assets, mainly commercial loans, and the transfer of certain non-performing loans to held for sale resulted in a total loss of \$68.0 million, of which \$64.1 million was charged against the provision for loan and lease losses.

During the first quarter of 2013, expenses of approximately \$1.2 million related to the terminated preferred stock exchange offer.

During the second quarter of 2013, the bulk sale of residential non-performing assets resulted in a total loss of \$72.9 million, of which \$67.9 million was charged against the provision for loan and lease losses.

During the second quarter of 2013, the Corporation recorded a loss of \$66.6 million related to the Lehman collateral write-off.

During the third quarter of 2013, the Corporation recorded expenses of approximately \$1.7 million in connection with the secondary offering of the Corporation's common stock by certain of the Corporation's existing stockholders.

During the third quarter of 2013, the Corporation recorded expenses of \$1.7 million related to the conversion of the credit cards processing platform.

During the fourth quarter of 2013, the Corporation recorded a charge of \$1.4 million related to expenses and valuation adjustments in connection with branch consolidations and restructuring efforts.

During the fourth quarter of 2013, the Corporation recorded a loss contingency of \$2.5 million related to attorneys' fees awarded to the other party in connection with the denial of the Corporation's motion for Summary judgment on its claim to recover assets pledged to Lehman.

### ***CEO and CFO Certifications***

First BanCorp.'s Chief Executive Officer and Chief Financial Officer have filed with the SEC certifications required by Section 302 and Section 906 of the Sarbanes-Oxley Act of 2002 as Exhibits 31.1, 31.2, 32.1 and 32.2 to this Annual Report on Form 10-K and the certifications required by Section III(b)(4) of the Emergency Stabilization Act of 2008 as Exhibit 99.1 and 99.2 to this Annual Report on Form 10-K.

In addition, in 2013, First BanCorp.'s Chief Executive Officer certified to the NYSE that he was not aware of any violation by the Corporation of the NYSE corporate governance listing standards.

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

The information required herein is incorporated by reference to the information included under the sub caption “Interest Rate Risk Management” in the Management’s Discussion and Analysis of Financial Condition and Results of Operations section in this Form 10-K.

**Item 8. Financial Statements and Supplementary Data**

**FIRST BANCORP.  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

Report of Independent Registered Public Accounting Firm. . . . .	167
Report of Independent Registered Public Accounting Firm . . . . .	168
Management’s Report on Internal Control over Financial Reporting . . . . .	169
Report of Independent Registered Public Accounting Firm—Internal Control over Financial Reporting . . .	170
Consolidated Statements of Financial Condition . . . . .	171
Consolidated Statements of (Loss) Income . . . . .	172
Consolidated Statements of Comprehensive (Loss) Income . . . . .	173
Consolidated Statements of Cash Flows . . . . .	174
Consolidated Statements of Changes in Stockholders’ Equity . . . . .	175
Notes to Consolidated Financial Statements . . . . .	176

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
First BanCorp.:

We have audited the accompanying consolidated statements of financial condition of First BanCorp. and subsidiaries (the “Corporation”) as of December 31, 2013 and 2012, and the related consolidated statements of (loss) income, comprehensive (loss) income, cash flows, and changes in stockholders’ equity for each of the years in the two-year period ended December 31, 2013. These consolidated financial statements are the responsibility of the Corporation’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First BanCorp. and its subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the two years in the two-year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), First BanCorp. and its subsidiaries’ internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 17, 2014 expressed an unqualified opinion on the effectiveness of the Corporation’s internal control over financial reporting.

/s/ KPMG LLP

San Juan, Puerto Rico  
March 17, 2014

Stamp No. E94617 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of First BanCorp.:

In our opinion, the consolidated statements of loss, of comprehensive loss, of cash flows and of changes in stockholders' equity for the year ended December 31, 2011 present fairly, in all material respects, the results of operations of FirstBancorp and its subsidiaries and their cash flows for the year ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP  
San Juan, Puerto Rico  
March 13, 2012

Stamp E97075 of the P.R. Society of  
Certified Public Accountants has been  
affixed to the file copy of this report

## Management's Report on Internal Control over Financial Reporting

To the Board of Directors and Stockholders of First BanCorp.:

First BanCorp.'s (the "Corporation") internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and financial statements for regulatory reporting purposes prepared in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). The Corporation's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation; (2) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with GAAP and financial statements for regulatory reporting purposes, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the Corporation's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management is responsible for establishing and maintaining effective internal control over financial reporting, including controls over the preparation of regulatory financial statements. Management assessed the effectiveness of the Corporation's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2013, based on the framework set forth by the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (1992). Based upon its assessment, management has concluded that, as of December 31, 2013, the Corporation's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), is effective based on the criteria established in Internal-Control Integrated Framework.

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2013, has been audited by KPMG LLP, an independent public accounting firm, as stated in their report dated March 17, 2014.

### **First BanCorp.**

/s/ Aurelio Alemán

---

Aurelio Alemán  
President and Chief Executive Officer  
Date: March 17, 2014

/s/ Orlando Berges

---

Orlando Berges  
Executive Vice President  
and Chief Financial Officer  
Date: March 17, 2014

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM –  
INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Board of Directors and Stockholders  
First Bancorp.:

We have audited First Bancorp.'s (the "Corporation") internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, First Bancorp. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control-Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of First Bancorp. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of (loss) income, comprehensive (loss) income, cash flows, and changes in stockholders' equity, for each of the years in the two-year period ended December 31, 2013, and our report dated March 17, 2014, expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

San Juan, Puerto Rico  
March 17, 2014

Stamp No. E94618 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.

**FIRST BANCORP.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
	(In thousands, except for share information)	
<b>ASSETS</b>		
Cash and due from banks . . . . .	\$ 454,302	\$ 730,016
Money market investments:		
Time deposits with other financial institutions . . . . .	300	505
Other short-term investments . . . . .	201,069	216,330
Total money market investments . . . . .	<u>201,369</u>	<u>216,835</u>
Investment securities available for sale, at fair value:		
Securities pledged that can be repledged . . . . .	1,042,482	1,070,968
Other investment securities . . . . .	935,800	660,109
Total investment securities available for sale . . . . .	<u>1,978,282</u>	<u>1,731,077</u>
Other equity securities . . . . .	28,691	38,757
Investment in unconsolidated entity . . . . .	7,279	23,970
Loans, net of allowance for loan and lease losses of \$285,858 (2012—\$435,414)	9,350,312	9,618,700
Loans held for sale, at lower of cost or market . . . . .	75,969	85,394
Total loans, net . . . . .	<u>9,426,281</u>	<u>9,704,094</u>
Premises and equipment, net . . . . .	166,946	181,363
Other real estate owned . . . . .	160,193	185,764
Accrued interest receivable on loans and investments . . . . .	54,012	51,671
Other assets . . . . .	179,570	236,194
Total assets . . . . .	<u>\$12,656,925</u>	<u>\$13,099,741</u>
<b>LIABILITIES</b>		
Non-interest-bearing deposits . . . . .	\$ 851,212	\$ 837,387
Interest-bearing deposits . . . . .	9,028,712	9,027,159
Total deposits . . . . .	9,879,924	9,864,546
Securities sold under agreements to repurchase . . . . .	900,000	900,000
Advances from the Federal Home Loan Bank (FHLB) . . . . .	300,000	508,440
Other borrowings . . . . .	231,959	231,959
Accounts payable and other liabilities . . . . .	129,184	109,773
Total liabilities . . . . .	<u>11,441,067</u>	<u>11,614,718</u>
Commitments and Contingencies (Notes 25 and 28)		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, authorized, 50,000,000 shares:		
Non-cumulative Perpetual Monthly Income Preferred Stock: issued 22,004,000 shares, outstanding 2,521,872 shares, aggregate liquidation value of \$63,047 . . . . .	63,047	63,047
Common stock, \$0.10 par value, authorized, 2,000,000,000 shares; issued, 207,635,157 shares (2012—206,730,318 shares issued) . . . . .	20,764	20,673
Less: Treasury stock (at par value) . . . . .	(57)	(49)
Common stock outstanding, 207,068,978 shares outstanding (2012—206,235,465 shares outstanding) . . . . .	<u>20,707</u>	<u>20,624</u>
Additional paid-in capital . . . . .	888,161	885,754
Retained earnings . . . . .	322,679	487,166
Accumulated other comprehensive (loss) income, net of tax expense of \$7,755 (2012—\$7,749) . . . . .	(78,736)	28,432
Total stockholders' equity . . . . .	<u>1,215,858</u>	<u>1,485,023</u>
Total liabilities and stockholders' equity . . . . .	<u>\$12,656,925</u>	<u>\$13,099,741</u>

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.**  
**CONSOLIDATED STATEMENTS OF (LOSS) INCOME**

	Year Ended December 31,		
	2013	2012	2011
	(In thousands, except per share information)		
<b>Interest and dividend income:</b>			
Loans	\$ 590,334	\$590,656	\$593,961
Investment securities	53,527	45,294	64,099
Money market investments	1,927	1,827	1,555
Total interest income	645,788	637,777	659,615
<b>Interest expense:</b>			
Deposits	91,787	128,259	191,727
Securities sold under agreements to repurchase	25,933	28,432	45,382
Advances from FHLB	6,031	12,142	16,335
Notes payable and other borrowings	7,092	7,239	12,659
Total interest expense	130,843	176,072	266,103
Net interest income	514,945	461,705	393,512
<b>Provision for loan and lease losses</b>	243,751	120,499	236,349
Net interest income after provision for loan and lease losses	271,194	341,206	157,163
<b>Non-interest (loss) income:</b>			
Service charges on deposit accounts	12,797	12,982	12,472
Mortgage banking activities	16,830	19,960	23,320
Net (loss) gain on sale of investments (includes \$42 accumulated other comprehensive income reclassification for other-than-temporary impairment on equity securities for the year ended December 31, 2013)	(42)	36	53,796
Other-than-temporary impairment losses on available-for-sale debt securities:			
Total other-than-temporary impairment losses	—	—	(987)
Portion of other-than-temporary impairment losses recognized in other comprehensive income	(117)	(2,002)	(984)
Net impairment losses on available-for-sale debt securities	(117)	(2,002)	(1,971)
Loss on early extinguishment of borrowings	—	—	(10,835)
Equity in loss of unconsolidated entity	(16,691)	(19,256)	(4,227)
Impairment of collateral pledged to Lehman	(66,574)	—	—
Insurance income	5,955	5,549	4,456
Other non-interest income	32,353	32,122	30,970
Total non-interest (loss) income	(15,489)	49,391	107,981
<b>Non-interest expenses:</b>			
Employees' compensation and benefits	130,969	125,610	118,475
Occupancy and equipment	60,858	61,037	61,924
Business promotion	15,977	14,093	12,283
Professional fees	47,952	26,727	24,721
Taxes, other than income taxes	17,997	13,363	13,395
Insurance and supervisory fees	48,470	52,596	57,923
Net loss on other real estate owned (OREO) and OREO operations	42,512	25,116	25,025
Credit and debit card processing expenses	12,909	6,005	1,073
Communications	7,401	7,085	7,117
Other non-interest expenses	29,983	23,251	16,118
Total non-interest expenses	415,028	354,883	338,054
<b>(Loss) income before income taxes</b>	(159,323)	35,714	(72,910)
<b>Income tax expense</b>	(5,164)	(5,932)	(9,322)
<b>Net (loss) income</b>	\$(164,487)	\$ 29,782	\$(82,232)
<b>Net (loss) income attributable to common stockholders—basic</b>	\$(164,487)	\$ 29,782	\$173,226
<b>Net (loss) income attributable to common stockholders—diluted</b>	\$(164,487)	\$ 29,782	\$195,763
<b>Net (loss) income per common share:</b>			
Basic	\$ (0.80)	\$ 0.15	\$ 2.69
Diluted	\$ (0.80)	\$ 0.14	\$ 2.18
<b>Dividends declared per common share</b>	\$ —	\$ —	\$ —

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME**

	Year Ended December 31,		
	<u>2013</u>	<u>2012</u>	<u>2011</u>
	(In thousands)		
Net (loss) income . . . . .	<u>\$(164,487)</u>	<u>\$29,782</u>	<u>\$(82,232)</u>
Available-for-sale debt securities on which an other-than-temporary impairment has been recognized:			
Subsequent unrealized gain on debt securities on which an other-than-temporary impairment has been recognized . . . . .	4,060	3,754	2,587
Noncredit-related impairment portion on debt securities not expected to be sold . . . . .	—	—	(434)
Reclassification adjustment for other-than-temporary impairment on debt securities included in net income . . . . .	117	2,002	1,418
All other unrealized gains and losses on available-for-sale securities:			
All other unrealized holding (losses) gains arising during the period . . . . .	(111,381)	3,476	31,222
Reclassification adjustments for net gain included in net income . . . . .	—	—	(34,453)
Reclassification adjustments for other-than-temporary impairment on equity securities . . . . .	42	—	—
Net unrealized gains on securities reclassified from held to maturity to available for sale . . . . .	—	—	3,540
Income tax (expense) benefit related to items of other comprehensive income . . . . .	<u>(6)</u>	<u>2</u>	<u>(2,400)</u>
Other comprehensive (loss) income for the year, net of tax . . . . .	<u>(107,168)</u>	<u>9,234</u>	<u>1,480</u>
Total comprehensive (loss) income . . . . .	<u>\$(271,655)</u>	<u>\$39,016</u>	<u>\$(80,752)</u>

The accompanying notes are an integral part of these statements.



**FIRST BANCORP.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
<b>Cash flows from operating activities:</b>			
Net (loss) income	\$ (164,487)	\$ 29,782	\$ (82,232)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation	23,980	24,217	24,543
Amortization of intangible assets	6,078	3,306	2,354
Provision for loan and lease losses	243,751	120,499	236,349
Deferred income tax (benefit) expense	(2,783)	575	1,426
Stock-based compensation	2,930	826	50
Gain on sales of investments, net	—	—	(53,115)
Loss on early extinguishment of borrowings	—	—	10,835
Other-than-temporary impairments on debt securities	117	2,002	1,971
Other-than-temporary impairments on equity securities	42	—	—
Equity in loss of unconsolidated entity	16,691	19,256	4,227
Impairment of collateral pledged to Lehman	66,574	—	—
Derivative instruments and financial liabilities measured at fair value, (gain) loss	(1,871)	(1,557)	5,883
(Gain) loss on sale of premises and equipment and other assets	(4)	283	(2,733)
Net gain on sales of loans	(7,317)	(10,953)	(13,803)
Net amortization of premiums, discounts, and deferred loan fees and costs	(4,203)	(2,930)	(771)
Originations and purchases of loans held for sale	(467,365)	(451,124)	(100,756)
Sales and repayments of loans held for sale	547,404	441,474	103,911
Loans held for sale valuation adjustment	1,503	—	—
Amortization of broker placement fees	7,900	9,869	16,314
Net amortization of premium and discounts on investment securities	6,840	12,222	7,085
Increase in accrued income tax payable	657	497	6,141
(Increase) decrease in accrued interest receivable	(2,341)	636	7,074
Increase (decrease) in accrued interest payable	3,631	696	(11,510)
Decrease in other assets	43,023	29,355	5,377
Increase (decrease) in other liabilities	20,935	(79)	(11,697)
Net cash provided by operating activities	341,685	228,852	156,923
<b>Cash flows from investing activities:</b>			
Principal collected on loans	2,800,471	3,048,549	2,421,867
Loans originated and purchased	(3,263,973)	(3,037,480)	(2,440,817)
Proceeds from sales of loans held for investment	314,282	38,608	719,852
Proceeds from sales of repossessed assets	80,032	74,680	100,117
Proceeds from sales of available-for-sale securities	—	1,878	1,247,069
Proceeds from sales of held-to-maturity securities	—	—	348,750
Purchases of securities available for sale	(690,377)	(1,012,527)	(1,010,104)
Proceeds from principal repayments and maturities of securities available for sale	330,336	1,203,065	894,897
Proceeds from principal repayments and maturities of securities held to maturity	—	—	33,726
Additions to premises and equipment	(11,789)	(11,937)	(13,376)
Proceeds from sales of premises and equipments and other assets	4	1,016	5,107
Proceeds from securities litigation settlement and other proceeds	—	36	679
Net redemptions/sales (purchases) of other equity securities	9,566	(806)	17,981
Net cash (used in) provided by investing activities	(431,448)	305,082	2,325,748
<b>Cash flows from financing activities:</b>			
Net increase (decrease) in deposits	7,478	(53,729)	(2,169,439)
Net repayments and cancellation costs of securities sold under agreements to repurchase	—	(100,000)	(410,587)
Net FHLB advances (paid) proceeds and cancellation costs	(208,440)	141,000	(286,248)
Repurchase of outstanding common stock	(455)	—	—
Repayments of medium-term notes	—	(21,957)	(7,000)
Dividends paid	—	—	(26,388)
Proceeds from common stock sold, net of costs	—	1,037	493,274
Net cash used in financing activities	(201,417)	(33,649)	(2,406,388)
Net (decrease) increase in cash and cash equivalents	(291,180)	500,285	76,283
Cash and cash equivalents at beginning of year	946,851	446,566	370,283
Cash and cash equivalents at end of year	\$ 655,671	\$ 946,851	\$ 446,566
Cash and cash equivalents include:			
Cash and due from banks	\$ 454,302	\$ 730,016	\$ 206,897
Money market instruments	201,369	216,835	239,669
	\$ 655,671	\$ 946,851	\$ 446,566

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
<b>Preferred Stock:</b>			
Balance at beginning of year	\$ 63,047	\$ 63,047	\$ 425,009
Accretion of preferred stock discount—Series G	—	—	5,634
Reversal of unaccreted preferred stock discount—Series G	—	—	56,578
Conversion of preferred stock—Series G	—	—	(424,174)
Balance at end of year	<u>63,047</u>	<u>63,047</u>	<u>63,047</u>
<b>Common Stock outstanding:</b>			
Balance at beginning of year	20,624	20,513	2,130
Common stock issued as compensation	22	—	—
Repurchase of common stock	(7)	—	—
Common stock sold	—	29	15,089
Common stock issued in conversion of Series G preferred stock	—	—	3,294
Restricted stock grants	74	82	—
Restricted Stock forfeited	(6)	—	—
Balance at end of year	<u>20,707</u>	<u>20,624</u>	<u>20,513</u>
<b>Additional Paid-In Capital:</b>			
Balance at beginning of year	885,754	884,002	319,459
Stock-based compensation	2,930	826	50
Repurchase of common stock	(455)	—	—
Common stock sold	—	1,008	513,022
Common stock issued in exchange for Series G preferred stock	—	—	86,308
Issuance costs of common stock	—	—	(34,837)
Restricted stock grants	(74)	(82)	—
Restricted Stock forfeited	6	—	—
Balance at end of year	<u>888,161</u>	<u>885,754</u>	<u>884,002</u>
<b>Retained Earnings:</b>			
Balance at beginning of year	487,166	457,384	293,643
Net (loss) income	(164,487)	29,782	(82,232)
Cash dividends declared on preferred stock	—	—	(26,388)
Accretion of preferred stock discount—Series G	—	—	(5,634)
Excess of carrying amount of Series G preferred stock converted over fair value of new shares of common stock	—	—	277,995
Balance at end of year	<u>322,679</u>	<u>487,166</u>	<u>457,384</u>
<b>Accumulated Other Comprehensive Income (Loss), net of tax:</b>			
Balance at beginning of year	28,432	19,198	17,718
Other comprehensive (loss) income, net of tax	(107,168)	9,234	1,480
Balance at end of year	<u>(78,736)</u>	<u>28,432</u>	<u>19,198</u>
Total stockholders' equity	<u>\$1,215,858</u>	<u>\$1,485,023</u>	<u>\$1,444,144</u>

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1—NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The following is a description of First BanCorp.’s (“First BanCorp.” or “the Corporation”) most significant policies:

*Nature of business*

First BanCorp. is a publicly owned, Puerto Rico-chartered financial holding company that is subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”). The Corporation is a full service provider of financial services and products with operations in Puerto Rico, the United States, the U.S. Virgin Islands (USVI), and the British Virgin Islands (BVI).

The Corporation provides a wide range of financial services for retail, commercial, and institutional clients. As of December 31, 2013, the Corporation controlled two wholly owned subsidiaries: FirstBank Puerto Rico (“FirstBank” or the “Bank”), and FirstBank Insurance Agency, Inc. (“FirstBank Insurance Agency”). FirstBank is a Puerto Rico-chartered commercial bank, and FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency. FirstBank is subject to the supervision, examination, and regulation of both the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico (“OCIF”) and the Federal Deposit Insurance Corporation (the “FDIC”). Deposits are insured through the FDIC Deposit Insurance Fund. FirstBank also operates in the state of Florida (USA), subject to regulation and examination by the Florida Office of Financial Regulation and the FDIC, in the USVI, subject to regulation and examination by the United States Virgin Islands Banking Board, and in the BVI, subject to regulation by the British Virgin Islands Financial Services Commission.

FirstBank Insurance Agency is subject to the supervision, examination, and regulation of the Office of the Insurance Commissioner of the Commonwealth of Puerto Rico.

FirstBank conducts its business through its main office located in San Juan, Puerto Rico, 47 full service banking branches in Puerto Rico, 10 branches in the USVI and BVI, and 10 branches in the state of Florida (USA). FirstBank had 5 wholly owned subsidiaries with operations in Puerto Rico: First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance company specializing in the origination of small loans with 26 offices in Puerto Rico; First Mortgage, Inc. (“First Mortgage”), a residential mortgage loan origination company with 37 offices in FirstBank branches and at stand-alone sites; First Management of Puerto Rico, a domestic corporation, which holds tax-exempt assets; FirstBank Puerto Rico Securities Corp., a broker-dealer subsidiary engaged in municipal bond underwriting and financial advisory services on structured financings, principally provided to government entities in the Commonwealth of Puerto Rico; and FirstBank Overseas Corporation, an international banking entity organized under the International Banking Entity Act of Puerto Rico. FirstBank had one active subsidiary with operations outside of Puerto Rico: First Express, a finance company specializing in the origination of small loans with 2 offices in the USVI.

*Principles of consolidation*

The consolidated financial statements include the accounts of the Corporation and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Statutory business trusts that are wholly owned by the Corporation and are issuers of trust-preferred securities, and entities in which the Corporation has a non controlling interest are not consolidated in the Corporation’s consolidated financial statements in accordance with authoritative guidance issued by the Financial Accounting Standards Board (“FASB”) for consolidation of variable interest entities. See “Variable Interest Entities” below for further details regarding the Corporation’s accounting policy for these entities.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

***Reclassifications***

For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2013 presentation. These reclassifications include, but are not limited to, the presentation of expenses on outsourcing of technology services that were previously presented as servicing and processing expenses and were reclassified to the professional fees expenses caption, and certain loan fees presented as other service charges that were reclassified as part of other non-interest income. These reclassifications had no impact on previously reported statements of financial condition, results of operations, or cash flows.

***Use of estimates in the preparation of financial statements***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has made significant estimates in several areas, including the allowance for loan and lease losses, valuations of investment securities, the fair value of assets acquired including purchased credit-impaired (PCI) loans, valuations of residential mortgage servicing rights, valuations of other real estate owned (OREO) properties, and income taxes.

***Cash and cash equivalents***

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from the Federal Reserve Bank of New York (the “New York FED” or “Federal Reserve”) and other depository institutions, and short-term investments with original maturities of three months or less.

***Investment securities***

The Corporation classifies its investments in debt and equity securities into one of four categories:

*Held-to-maturity*—Securities that the entity has the intent and ability to hold to maturity. These securities are carried at amortized cost. The Corporation may not sell or transfer held-to-maturity securities without calling into question its intent to hold other debt securities to maturity, unless a nonrecurring or unusual event that could not have been reasonably anticipated has occurred. During 2011, the Corporation sold \$330 million of mortgage-backed securities (“MBS”) that were originally intended to be held to maturity, consistent with deleveraging initiatives executed to preserve capital and meet minimum regulatory capital ratios required by a Consent Order entered into with the FDIC. After the sale, in line with the Corporation’s ongoing capital management strategy, the remaining held-to-maturity securities portfolio was reclassified to the available-for-sale portfolio; thus, as of December 31, 2013 and 2012, the Corporation did not hold held-to-maturity investment securities. Refer to Note 28 for additional information about agreements entered into with the Corporation’s primary regulators.

*Trading*—Securities that are bought and held principally for the purpose of selling them in the near term. These securities are carried at fair value, with unrealized gains and losses reported in earnings. As of December 31, 2013 and 2012, the Corporation did not hold investment securities for trading purposes.

*Available-for-sale*—Securities not classified as held-to-maturity or trading. These securities are carried at fair value, with unrealized holding gains and losses, net of deferred taxes, reported in other comprehensive income (“OCI”) as a separate component of stockholders’ equity, and do not affect earnings until they are realized or are deemed to be other-than-temporarily impaired.

*Other equity securities*—Equity securities that do not have readily available fair values are classified as other equity securities in the consolidated statements of financial condition. These securities are stated at

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

the lower of cost or realizable value. This category is principally composed of stock that is owned by the Corporation to comply with Federal Home Loan Bank (FHLB) regulatory requirements. Their realizable value equals their cost.

Premiums and discounts on investment securities are amortized as an adjustment to interest income on investments over the life of the related securities under the interest method. Net realized gains and losses and valuation adjustments considered other-than-temporary, if any, related to investment securities are determined using the specific identification method and are reported in noninterest income as net gain (loss) on sale of investments and net impairment losses on debt securities, respectively. Purchases and sales of securities are recognized on a trade-date basis.

***Evaluation of other-than-temporary impairment (“OTTI”) on held-to-maturity and available-for-sale securities***

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

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

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

The impairment analysis of equity securities is performed and reviewed on an ongoing basis based on the latest financial information and any supporting research report made by a major brokerage firm. This analysis is very subjective and based, among other things, on relevant financial data such as capitalization, cash flow,

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

liquidity, systematic risk, and debt outstanding of the issuer. Management also considers the issuer's industry trends, the historical performance of the stock, credit ratings, as well as the Corporation's intent to hold the security for an extended period. If management believes there is a low probability of recovering book value in a reasonable time frame, it records an impairment by writing the security down to market value. As previously mentioned, equity securities are monitored on an ongoing basis but special attention is given to those securities that have experienced a decline in fair value for six months or more. An impairment charge is generally recognized when the fair value of an equity security has remained significantly below cost for a period of 12 consecutive months or more.

***Variable interest entities ("VIE")***

A VIE is an entity in which the Corporation holds an equity interest. An institution that has a controlling financial interest in a VIE is referred to as the primary beneficiary and consolidates the VIE. The Corporation is deemed to have a controlling financial interest and is the primary beneficiary of a VIE if it has both the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and an obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE.

In connection with a sale of loans with a book value of \$269.3 million to CPG/GS PR NPL, LLC ("CPG/GS") completed on February 16, 2011, the Bank received a 35% subordinated interest in CPG/GS, as further discussed in Note 13. The Corporation's investment in this unconsolidated entity was considered significant under Rule 3-09 of Regulation S-X for the year ended December 31, 2012. This rule looks to Rule 1-02(w) of Regulation S-X to determine the materiality of the investee. The materiality threshold for Rule 3-09 is 20% of assets or income for the presentation of full financial statements. The Corporation must provide full financial information for unconsolidated subsidiaries and 50%-or-less owned entities accounted for by the equity method if the entities are significant, for any fiscal year presented, under the Rule 1-02(w) tests (investment or income tests) in Regulation S-X.

The Corporation accounts for its investment in CPG/GS under the equity method and includes the investment as part of investment in unconsolidated entity in the consolidated statements of financial condition. When applying the equity method, the Corporation follows the hypothetical liquidation book value ("HLBV") method to determine its share of earnings or losses of the unconsolidated entity. Under the HLBV method, the Corporation determines its share of earnings or losses by determining the difference between its "claim on the entity's book value" at the end of the period as compared to the beginning of the period. This claim is calculated as the amount the Corporation would receive if the entity were to liquidate all of its assets at recorded amounts determined in accordance with GAAP and distribute the resulting cash to the investors.

***Loans held for investment***

Loans that the Corporation has the ability and intent to hold for the foreseeable future are classified as held for investment. The substantial majority of the Corporation's loans are classified as held for investment. Loans are stated at the principal outstanding balance, net of unearned interest, cumulative charge-offs, unamortized deferred origination fees and costs, and unamortized premiums and discounts. Fees collected and costs incurred in the origination of new loans are deferred and amortized using the interest method or a method that approximates the interest method over the term of the loan as an adjustment to interest yield. Unearned interest on certain personal and auto loans and finance leases and discounts and premiums are recognized as income under a method that approximates the interest method. When a loan is paid off or sold, any unamortized net deferred fee (cost) is credited (charged) to income. Credit card loans are reported at their outstanding unpaid principal balance plus uncollected billed interest and fees net of amounts deemed uncollectible. PCI loans are reported net of any remaining purchase accounting adjustments. See "Loans acquired" below for the accounting policy for PCI loans.



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Non-Performing and Past-Due Loans*—Loans on which the recognition of interest income has been discontinued are designated as non-performing. Loans are classified as non-performing when interest and principal have not been received for a period of 90 days or more, with the exception of residential mortgage loans guaranteed by the Federal Housing Administration (the “FHA”) or the Veterans Administration (the “VA”) and credit cards. It is the Corporation’s policy to report delinquent mortgage loans insured by the FHA or guaranteed by the VA as loans past due 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. However, the Corporation discontinues the recognition of income for FHA/VA loans when such loans are over 18 months delinquent. As permitted by regulatory guidance issued by the Federal Financial Institutions Examination Council (“FFIEC”), credit card loans are generally charged off in the period in which the account becomes 180 days past due. Credit card loans continue to accrue finance charges and fees until charged off at 180 days. Loans generally may be placed on non-performing status prior to when required by the policies described above when there are doubts about the potential to collect all of the principal based on collateral deficiencies or, in other situations, when collection of all of the principal or interest is not expected due to deterioration in the financial condition of the borrower. When a loan is placed on non-performing status, any accrued but uncollected interest income is reversed and charged against interest income. In the case of credit card loans, the Corporation generally continues to accrue interest and fees on delinquent loans until the loans are charged off. Interest income on non-performing loans is recognized only to the extent it is received in cash. However, when there is doubt regarding the ultimate collectibility of loan principal, all cash thereafter received is applied to reduce the carrying value of such loans (i.e., the cost recovery method). Generally, the Corporation returns a loan to accrual status when all delinquent interest and principal becomes current under the terms of the loan agreement or when the loan is well secured and in process of collection, and collectibility of the remaining interest and principal is no longer doubtful. Loans that are past due 30 days or more as to principal or interest are considered delinquent, with the exception of residential mortgage, commercial mortgage, and construction loans, which are considered past due when the borrower is in arrears two or more monthly payments.

*Impaired Loans*—A loan is considered impaired when, based upon current information and events, it is probable that the Corporation will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the loan agreement. Loans with insignificant delays or insignificant shortfalls in the amounts of payments expected to be collected are not considered to be impaired. The Corporation measures impairment individually for those loans in the construction, commercial mortgage, and commercial and industrial portfolios with a principal balance of \$1 million or more, including loans for which a charge-off has been recorded based upon the fair value of the underlying collateral and loans that have been modified in a troubled debt restructuring (“TDRs”). The Corporation also evaluates for impairment purposes certain residential mortgage loans and home equity lines of credit with high delinquency and loan-to-value levels. Generally, consumer loans are not individually evaluated for impairment on a regular basis except for impaired marine financing loans in amounts that exceed \$1 million, home equity lines with high delinquency and loan-to-value levels and TDRs. Held-for-sale loans are not reported as impaired, as these loans are recorded at the lower of cost or fair value.

A restructuring of a loan constitutes a TDR if the creditor, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession to the debtor that it would not otherwise consider. TDRs typically result from the Corporation’s loss mitigation activities and residential mortgage loans modified in accordance with guidelines similar to those of the U.S. government’s Home Affordable Mortgage Program, and could include rate reductions, principal forgiveness, forbearance, refinancing of any past-due amounts, including interest, escrow, and late charges and fees, extensions of maturities, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

generally for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are evaluated in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Refer to Note 7 for additional qualitative and quantitative information about TDRs.

In connection with commercial restructurings, the decision to maintain a loan that has been restructured on accrual status is based on a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation includes consideration of the borrower's current capacity to pay, which, among other things, may include a review of the borrower's current financial statements, an analysis of global cash flow sufficient to pay all debt obligations, and an evaluation of secondary sources of payment from the client and any guarantors. This evaluation also includes an evaluation of the borrower's current willingness to pay, which may include a review of past payment history, an evaluation of the borrower's willingness to provide information on a timely basis, and consideration of offers from the borrower to provide additional collateral or guarantor support. The credit evaluation also reflects consideration of the borrower's future capacity and willingness to pay, which may include evaluation of cash flow projections, consideration of the adequacy of collateral to cover all principal and interest, and trends indicating improving profitability and collectibility of receivables.

The evaluation of mortgage and consumer loans for restructurings includes an evaluation of the client's disposable income and credit report, the value of the property, the loan to value relationship, and certain other client-specific factors that have impacted the borrower's ability to make timely principal and interest payments on the loan. In connection with retail restructurings, a nonperforming loan will be returned to accrual status when current as to principal and interest and upon sustained historical repayment performance.

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

- (i) The loan is in compliance with the terms of the restructuring agreement and, therefore, is not considered impaired under the revised terms; and
- (ii) The loan yields a market interest rate at the time of the restructuring. In other words, the loan was restructured with an interest rate equal to or greater than what the Corporation would have been willing to accept at the time of the restructuring for a new loan with comparable risk.

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

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

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

All individually impaired loans are evaluated for a specific allowance. The Corporation generally measures impairment and the related specific allowance for individually impaired loans based on the difference between

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

the recorded investment of the loan and the present value of the loans' expected future cash flows, discounted at the effective original interest rate of the loan at the time of modification, or the loan's observable market price. If the loan is collateral dependent, the Corporation measures impairment based upon the fair value of the underlying collateral, which the Corporation determines based on the current fair value of the collateral less estimated selling costs, instead of discounted cash flows, regardless of whether foreclosure is probable. Loans are identified as collateral dependent if the repayment is expected to be provided solely by the underlying collateral, through liquidation or operation of the collateral. If the fair value of the loan is less than the recorded investment, the Corporation recognizes impairment by either a direct write-down or establishing an allowance for the loan or by adjusting an allowance for the impaired loan. For an impaired loan that is collateral dependent, charge-offs are taken in the period in which the loan, or portion of the loan, is deemed uncollectible, and any portion of the loan not charged off is adversely credit risk rated no worse than substandard.

*Loans Acquired*—All purchased loans are recorded at fair value at the date of acquisition. Loans acquired with evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments are considered PCI loans. In connection with the acquisition of an approximate \$406 million portfolio of FirstBank-branded credit card loans from FIA Card Services (FIA) in 2012, the Corporation concluded that a portion of such loans were PCI loans. See Note 7, "Loans Held for Investment," for additional information. In accounting for PCI loans, the difference between contractually required payments and the cash flows expected to be collected at acquisition, is referred to as the nonaccretable difference. The nonaccretable difference, which is neither accreted into income nor recorded on the consolidated statement of financial condition, reflects estimated future credit losses expected to be incurred over the life of the loans. The excess of cash flows expected to be collected over the estimated fair value of PCI loans is referred to as the accretable yield. This amount is not recorded on the statement of financial condition, but is accreted into interest income over the remaining life of the loans, using the effective-yield method.

Subsequent to acquisition, the Corporation completes quarterly evaluations of expected cash flows. Decreases in expected cash flows attributable to credit will generally result in an impairment charge to the provision for loan and lease losses and the establishment of an allowance for loan and lease losses. Increases in expected cash flows will generally result in a reduction in any allowance for loan and lease losses established subsequent to acquisition and an increase in the accretable yield. The adjusted accretable yield is recognized in interest income over the remaining life of the loans.

Because the initial fair value of PCI loans recorded at acquisition includes an estimate of credit losses expected to be realized over the remaining lives of the loans, the Corporation separately tracks and reports PCI loans and excludes these loans from its delinquency and non-performing loan statistics.

For acquired loans that are not deemed impaired at acquisition, subsequent to acquisition the Corporation recognizes the difference between the initial fair value at acquisition and the undiscounted expected cash flows in interest income over the period in which substantially all of the inherent losses associated with the non-PCI loans at the acquisition date are estimated to occur.

*Charge-off of Uncollectible Loans*—Net charge-offs consist of the unpaid principal balances of loans held for investment that the Corporation determines are uncollectible, net of recovered amounts. Charge-offs are recorded as a reduction to the allowance for loan and lease losses and subsequent recoveries of previously charged off amounts are credited to the allowance for loan and lease losses. Collateral dependent loans in the construction, commercial mortgage, and commercial and industrial loan portfolios are charged off to their fair value when loans are considered impaired. Within the consumer loan portfolio, loans in the auto and finance leases are reserved once they are 120 days delinquent and are charged off to their estimated net realizable value when collateral deficiency is deemed uncollectible (i.e., when foreclosure/repossession is probable) or when the

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

loan is 365 days past due. 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, including credit card loans, are charged off when payments are 180 days in arrears. On a quarterly basis, residential mortgage loans that are 120 days delinquent and have a loan-to-value ratio that is higher than 60% are charged-off to their fair value when there is a collateral deficiency. Generally, all loans 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 when the asset is the sole source of repayment. The Corporation does not record charge-offs on PCI loans that are performing in accordance with or better than expectations as of the date of acquisition, as the fair value of these loans already reflects a credit component. The Corporation records charge-offs on PCI loans only if actual losses exceed estimated losses incorporated into the fair value recorded at acquisition.

***Loans held for sale***

Loans that the Corporation intends to sell or that the Corporation does not have the ability and intent to hold for the foreseeable future are classified as held-for-sale loans. Loans held for sale are stated at the lower-of-cost-or-market. Generally, the loans held-for-sale portfolio consists of conforming residential mortgage loans that the Corporation intends to sell to the Government National Mortgage Association (GNMA) and government sponsored entities (GSEs) such as the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). Generally, residential mortgage loans held for sale are valued on an aggregate portfolio basis and the value is primarily derived from quotations based on the mortgage-backed securities market. The amount by which cost exceeds market value in the aggregate portfolio of loans held for sale, if any, is accounted for as a valuation allowance with changes therein included in the determination of net income and reported as part of mortgage banking activities in the consolidated statement of income (loss). The fair value of commercial mortgage and construction loans held for sale is primarily derived from external appraisals with changes in the valuation allowance reported as part of other non-interest income in the consolidated statement of income (loss). In certain circumstances, the Corporation transfers loans to/from held for sale or held for investment based on a change in strategy. In particular, although no decision to sell any portion of its non-performing loan portfolio has been made, the Corporation continues to evaluate options to further reduce non-performing loan levels. These options could include bulk loan sales. If such a change in holding strategy is made, significant adjustments to the loans' carrying values may be necessary. These loans are transferred to held for sale the lower of cost or fair value on the date of transfer and establish a new cost basis upon transfer. Write-downs of loans transferred from held for investment to held for sale are recorded as charge-offs at the time of transfer.

***Allowance for loan and lease losses***

The Corporation maintains the allowance for loan and lease losses at a level considered adequate to absorb losses currently inherent in the loan and lease portfolio. The Corporation does not maintain an allowance for held-for-sale loans or PCI loans that are performing in accordance with or better than expectations as of the date of acquisition, as the fair values of these loans already reflects a credit component. The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable losses believed to be inherent in the loan portfolio that have not been specifically identified. The determination of the allowance for loan and lease losses requires significant estimates, including the timing and amounts of expected future cash flows on impaired loans, consideration of current economic conditions, and historical loss experience pertaining to the portfolios and pools of homogeneous loans, all of which may be susceptible to change.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Corporation aggregates loans with similar credit risk characteristics into portfolio segments: commercial mortgage, construction, commercial and industrial, residential mortgage, and consumer loans. Classes are usually disaggregations of the portfolio segments. The classes within the residential mortgage segment are residential mortgages guaranteed by the U.S. government and other loans. The classes within the consumer portfolio are: auto, finance leases, and other consumer loans. Other consumer loans mainly include unsecured personal loans, credit cards, home equity lines, lines of credits, and marine financing. The classes within the construction loan portfolio are: land loans, construction of commercial projects, and construction of residential projects. The commercial mortgage and commercial and industrial segments are not further segmented into classes. The adequacy of the allowance for loan and lease losses is based on judgments related to the credit quality of the loan portfolio. These judgments consider ongoing evaluations of the loan portfolio, including such factors as the economic risks associated with each loan class, the financial condition of specific borrowers, the level of delinquent loans, historical loss experience, the value of any collateral and, where applicable, the existence of any guarantees or other documented support. In addition to the general economic conditions and other factors described above, additional factors also considered include the internal risk ratings assigned to the loan. Internal risk ratings are assigned to each commercial loan at the time of approval and are subject to subsequent periodic review by the Corporation's senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation's continued evaluation of its asset quality.

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

The allowance for loan and lease losses consists of specific reserves based upon valuations of loans considered to be impaired and general reserves. A specific valuation allowance is established for individual impaired loans in the commercial mortgage, construction, commercial and industrial, and residential mortgage loan portfolios, 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 for impaired commercial mortgage, construction, commercial and industrial, and real estate loans with individual principal balances of \$1 million or more, TDRs, 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 and for collateral dependent loans, 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 a collateral dependent loan over the resulting fair value of the collateral is charged-off when deemed uncollectible.

For all other loans, which include small, homogeneous loans, such as auto loans, all classes in the consumer loan portfolio, residential mortgages in amounts under \$1 million and commercial and construction loans not considered impaired, the Corporation maintains a general valuation allowance established through a process that begins with estimates of incurred losses based upon various statistical analyses. The general reserve is primarily determined by applying loss factors according to the loan type and assigned risk category (pass, special mention, and substandard not considered impaired; all doubtful loans are considered impaired).

The Corporation uses a roll-rate methodology to estimate losses on its consumer loan portfolio based on delinquencies and considering credit bureau score bands. The Corporation tracks the historical portfolio performance, generally over a 24-month loss period (12 months for credit cards), to arrive at a weighted average distribution in each subgroup of each delinquency bucket. Roll-to-loss rates (loss factors) are calculated by



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

multiplying the roll rates from each subgroup within the delinquency buckets forward through loss. Once roll rates are calculated, the resulting loss factor is applied to the existing receivables in the applicable subgroups within the delinquency buckets and the end results are aggregated to arrive at the required allowance level. The Corporation's assessment also involves evaluating key qualitative and environmental factors, which include credit and macroeconomic indicators such as unemployment, bankruptcy trends, recent market transactions, and collateral values to account for current market conditions that are likely to cause estimated credit losses to differ from historical loss experience. The Corporation analyzes the expected delinquency migration to determine the future volume of delinquencies. The Corporation reflects the effect of these environmental factors on each delinquency bucket as an adjustment that increases the historical loss rate applied to each group.

The non-PCI portion of the credit card portfolio acquired from FIA in 2012 was recorded at the fair value on the acquisition date of \$353.2 million, net of a discount of \$18.2 million. The discount at acquisition is attributable to uncertainties in the cash flows of this portfolio based on an estimation of inherent credit losses. As previously discussed, the discount recorded at acquisition is accreted and recognized in interest income over the period in which substantially all of the inherent losses associated with the non-PCI loans at the acquisition date were estimated to occur. Subsequent to acquisition, the Corporation evaluates its estimate of embedded losses on a quarterly basis. The allowance for non-PCI loans acquired is determined considering the outstanding balance of the portfolio net of the unaccreted discount. To the extent the required allowance exceeds the unaccreted discount, a provision is required. The provision recorded during 2012 and 2013 relates to new purchases on these non-PCI credit card loans and to the allowance methodology described above. The provision in 2012 and 2013 was not related to changes in expected loan losses assumed in the accounting for the acquisition of the portfolio. In the case of the PCI portion of the portfolio acquired from FIA, recorded at the fair value on the acquisition date of \$15.7 million (and having an unpaid principal and interest balance of \$34.6 million), the accounting guidance prohibits the carryover or creation of valuation allowances in the initial accounting for impaired loans acquired in a transfer. Subsequent to acquisition, decreases in expected principal cash flows of PCI loans due to further credit deterioration will generally result in an impairment charge recognized in the Corporation's provision for loan and lease losses, resulting in an increase to the allowance for loan losses. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loans.

The residential mortgage pools cash flow analyses are performed at the individual loan level and then aggregated to the pool level in determining the overall expected loss ratio. The model applies risk-adjusted prepayment curves, default curves, and severity curves to each loan in the pool. For loan restructuring pools, the present value of expected future cash flows under new terms, at the loan's effective interest rate, are taken into consideration. Additionally, the default risk and prepayments related to loan restructurings are based on, among other things, the historical experience of these loans. Loss severity is affected by the expected house price scenario, which is based in part on recent house price trends. Default curves are used in the model to determine expected delinquency levels. The risk-adjusted timing of liquidations and associated costs are used in the model, and are risk-adjusted for the geographic area in which each property is located (Puerto Rico, Florida, or the Virgin Islands). For residential mortgage loans, the determination of reserves includes the incorporation of updated loss factors applicable to loans expected to liquidate over the next twelve months, considering the expected realization of similarly valued assets at disposition. The allowance determination for residential mortgage loans also takes into consideration other qualitative factors, such as changes in business strategies, including loan resolution and liquidation procedures that might result in an overall adjustment applied to this portfolio segment.

For commercial loans, including construction loans, the general reserve is based on historical loss ratios supplemented by management judgment and interpretation. The loss ratios are derived from a migration analysis, which tracks the historical net charge-offs experienced over a historical 24-month loss period on loans according



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

to their internal risk rating, applying adjustments, as necessary, to each loss rate based on assessments of recent loss ratio trends (12 months). Historical loss rates may be adjusted for certain qualitative factors that, in management's judgment, are necessary to reflect losses inherent in the portfolio. Qualitative factors that management considers in the general reserve analysis include general economic conditions, and geographic trends impacting expected losses, collateral value trends, asset quality trends, concentrations, risk management and loan administration, and changes in lending practices. The methodology of accounting for all probable losses in loans not individually measured for impairment purposes is made in accordance with authoritative accounting guidance that requires that losses be accrued when they are probable of occurring and estimable.

***Transfers and servicing of financial assets and extinguishment of liabilities***

After a transfer of financial assets that qualifies for sale accounting, the Corporation derecognizes the financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

The transfer of financial assets in which the Corporation surrenders control over the assets is accounted for as a sale to the extent that consideration other than beneficial interests is received in exchange. The criteria that must be met to determine that the control over transferred assets has been surrendered include: (1) the assets must be isolated from creditors of the transferor, (2) the transferee must obtain the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the transferor cannot maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. When the Corporation transfers financial assets and the transfer fails any one of the above criteria, the Corporation is prevented from derecognizing the transferred financial assets and the transaction is accounted for as a secured borrowing.

***Servicing Assets***

The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased. The Corporation is actively involved in the securitization of pools of FHA-insured and VA-guaranteed mortgages for the issuance of GNMA mortgage-backed securities. Also, certain conventional conforming loans are sold to FNMA or FHLMC with servicing retained. When the Corporation securitizes or sells mortgage loans, it recognizes any retained interest, based on its fair value.

Servicing assets ("MSRs") retained in a sale or securitization arise from contractual agreements between the Corporation and investors in mortgage securities and mortgage loans. The value of MSRs is derived from the net positive cash flows associated with the servicing contracts. Under these contracts, the Corporation performs loan-servicing functions in exchange for fees and other remuneration. The servicing functions typically include: collecting and remitting loan payments, responding to borrower inquiries, accounting for principal and interest, holding custodial funds for payment of property taxes and insurance premiums, supervising foreclosures and property dispositions, and generally administering the loans. The servicing rights, included as part of other assets in the statements of financial condition, entitle the Corporation to annual servicing fees based on the outstanding principal balance of the mortgage loans and the contractual servicing rate. The servicing fees are credited to income on a monthly basis when collected and recorded as part of mortgage banking activities in the consolidated statements of income (loss). In addition, the Corporation generally receives other remuneration consisting of mortgagor-contracted fees such as late charges and prepayment penalties, which are credited to income when collected.

Considerable judgment is required to determine the fair value of the Corporation's servicing assets. Unlike highly liquid investments, the market value of servicing assets cannot be readily determined because these assets are not actively traded in securities markets. The initial carrying value of the servicing assets is generally determined based on its fair value. The fair value of the MSRs is determined based on a combination of market

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

information on trading activity (MSR trades and broker valuations), benchmarking of servicing assets (valuation surveys), and cash flow modeling. The valuation of the Corporation's MSRs incorporates two sets of assumptions: (1) market derived assumptions for discount rates, servicing costs, escrow earnings rates, floating earnings rates, and the cost of funds and (2) market assumptions calibrated to the Corporation's loan characteristics and portfolio behavior for escrow balances, delinquencies and foreclosures, late fees, prepayments, and prepayment penalties.

Once recorded, MSRs are periodically evaluated for impairment. Impairment occurs when the current fair value of the MSRs is less than its carrying value. If MSRs are impaired, the impairment is recognized in current-period earnings and the carrying value of the MSRs is adjusted through a valuation allowance. If the value of the MSRs subsequently increases, the recovery in value is recognized in current period earnings and the carrying value of the MSRs is adjusted through a reduction in the valuation allowance. For purposes of performing the MSR impairment evaluation, the servicing portfolio is stratified on the basis of certain risk characteristics such as region, terms, and coupons. An other-than-temporary impairment analysis is prepared to evaluate whether a loss in the value of the MSRs, if any, is other than temporary or not. When the recovery of the value is unlikely in the foreseeable future, a write-down of the MSRs in the stratum to its estimated recoverable value is charged to the valuation allowance.

The servicing assets are amortized over the estimated life of the underlying loans based on an income forecast method as a reduction of servicing income. The income forecast method of amortization is based on projected cash flows. A particular periodic amortization is calculated by applying to the carrying amount of the MSRs the ratio of the cash flows projected for the current period to total remaining net MSR forecasted cash flow.

***Premises and equipment***

Premises and equipment are carried at cost, net of accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful life of each type of asset. Amortization of leasehold improvements is computed over the terms of the leases (contractual term plus lease renewals that are "reasonably assured") or the estimated useful lives of the improvements, whichever is shorter. Costs of maintenance and repairs that do not improve or extend the life of the respective assets are expensed as incurred. Costs of renewals and betterments are capitalized. When assets are sold or disposed of, their cost and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in earnings as part of other non-interest income in the statement of income (loss). When the asset is no longer used in operations, and the Corporation intends to sell it, the asset is reclassified to other assets held-for-sale and is reported at the lower of carrying amount of fair value less cost to sell.

The Corporation has operating lease agreements primarily associated with the rental of premises to support the branch network or for general office space. Certain of these arrangements are noncancelable and provide for rent escalation and renewal options. Rent expense on noncancelable operating leases with scheduled rent increases is recognized on a straight-line basis over the lease term.

***Other real estate owned (OREO)***

OREO, which consists of real estate acquired in settlement of loans, is recorded at the lower of cost (carrying value of the loan) or fair value minus estimated cost to sell the real estate acquired. Generally, loans have been written down to their net realizable value prior to foreclosure. Any further reduction to their net realizable value is recorded with a charge to the allowance for loan losses at foreclosure. Thereafter, gains or losses resulting from the sale of these properties and losses recognized on the periodic reevaluations of these

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

properties are credited or charged to earnings and are included as part of net loss on other real estate owned (“OREO”) operations in the statements of income (loss). The cost of maintaining and operating these properties is expensed as incurred. The Corporation estimates fair values primarily based on appraisals, when available, and the net realizable value is reviewed and updated periodically depending of the type of property.

***Goodwill and other intangible assets***

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

Goodwill

The Corporation evaluates goodwill for impairment on an annual basis, generally during the fourth quarter, or more often if events or circumstances indicate there may be impairment. The Corporation evaluated goodwill for impairment as of October 1, 2013. Goodwill impairment testing is performed at the segment (or “reporting unit”) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to a reporting unit, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill. The Corporation’s goodwill is related to the acquisition of FirstBank Florida in 2005.

The Corporation bypassed the qualitative assessment in 2013 and proceeded directly to perform the first step of the two-step goodwill impairment test. The first step (“Step 1”) involves a comparison of the estimated fair value of the reporting unit to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is not considered impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of the impairment.

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

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

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

- a selection of comparable publicly traded companies, based on size, performance, and asset quality;

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- the discount rate applied to future earnings, based on an estimate of the cost of equity;
- the potential future earnings of the reporting unit; and
- the market growth and new business assumptions.

For purposes of the market comparable approach, valuation was determined based on market multiples for comparable companies and market participant assumptions applied to the reporting unit to derive an implied value of equity.

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

The Step 1 evaluation of goodwill allocated to the Florida reporting unit, which is one level below the United States business segment, under both valuation approaches (market and DCF) indicated that the fair value of the unit was above the carrying amount of its equity book value as of the valuation date (October 1), which meant that Step 2 was not undertaken. Based on the analysis under both the income and market approaches, the estimated fair value of the reporting units exceeds the carrying amount of the unit, including goodwill, at the evaluation date.

The Corporation engaged a third-party valuator to assist management in the annual evaluation of the Florida unit's goodwill as of the October 1 valuation date. In reaching its conclusion on impairment, management discussed with the valuator the methodologies, assumptions, and results supporting the relevant values for the goodwill and determined that they were reasonable.

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

Goodwill was not impaired as of December 31, 2013 or 2012, nor was any goodwill written off due to impairment during 2013, 2012, and 2011.

Other Intangibles

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

The Corporation performed impairment tests for the years ended December 31, 2013, 2012, and 2011 and determined that no impairment was needed to be recognized for other intangible assets.

In connection with the acquisition of the FirstBank-branded credit card loan portfolio in 2012, the Corporation recognized at acquisition a purchased credit card relationship intangible of \$24.5 million (\$19.8 million and \$23.5 million as of December 31, 2013 and 2012, respectively) which is being amortized on an

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

accelerated basis based on the estimated attrition rate of the purchased credit card accounts, which reflects the pattern in which the economic benefits of the intangible asset are consumed. These benefits are consumed as the revenue stream generated by the cardholder relationship is realized. For further disclosures, refer to Note 12 to the consolidated financial statements.

***Securities sold under agreements to repurchase***

The Corporation sells securities under agreements to repurchase the same or similar securities. Generally, similar securities are securities from the same issuer, with identical form and type, similar maturity, identical contractual interest rates, similar assets as collateral, and the same aggregate unpaid principal amount. The Corporation retains control over the securities sold under these agreements. Accordingly, these agreements are considered financing transactions and the securities underlying the agreements remain in the asset accounts. The counterparty to certain agreements may have the right to repledge the collateral by contract or custom. Such assets are presented separately in the statements of financial condition as securities pledged to creditors that can be repledged.

From time to time, the Corporation modifies repurchase agreements to take advantage of prevailing interest rates. Following applicable GAAP guidance, if the Corporation determines that the debt under the modified terms is substantially different from the original terms, the modification must be accounted for as an extinguishment of debt. Modified terms are considered substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10% different from the present value of the remaining cash flows under the terms of the original instrument. The new debt instrument shall be initially recorded at fair value, and that amount shall be used to determine the debt extinguishment gain or loss to be recognized through the statement of income (loss) and the effective rate of the new instrument. If the Corporation determines that the debt under the modified terms is not substantially different, then the new effective interest rate shall be determined based on the carrying amount of the original debt instrument. None of the repurchase agreements modified in the past were considered to be substantially different from the original terms, and therefore, these modifications were not accounted for as extinguishments of debt.

***Rewards Liability***

The Corporation offers products, primarily credit cards, that offer reward program members with various rewards, such as airline tickets, cash, or merchandise, based on account activity. The Corporation generally recognizes the cost of rewards as part of business promotion expenses when the rewards are earned by the customer and records the corresponding rewards liability. The reward liability is computed based on points earned to date that are expected to be redeemed and the average cost per point redemption. The reward liability is reduced as points are redeemed. In estimating the reward liability, the Corporation considers historical reward redemption behavior, the terms of the current reward program, and the card purchase activity. The reward liability is sensitive to changes in the reward redemption type and redemption rate, which is based on the expectation that the vast majority of all points earned will eventually be redeemed. The reward liability, which is included in other liabilities in the consolidated statement of financial condition, totaled \$8.1 million and \$8.4 million as of December 31, 2013 and 2012, respectively.

***Income taxes***

The Corporation uses the asset and liability method for the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Corporation's financial statements or tax returns. Deferred income tax assets and liabilities are determined for differences between financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. The computation is based on enacted tax laws and rates applicable to periods in which the temporary

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. In making such assessment, significant weight is given to evidence that can be objectively verified, including both positive and negative evidence. The authoritative guidance for accounting for income taxes requires the consideration of all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, 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. Refer to Note 24 to the consolidated financial statements for additional information.

Under the authoritative accounting guidance, income tax benefits are recognized and measured based on a two-step analysis: 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 at 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 analysis and the tax benefit claimed on a tax return is referred to as an Unrecognized Tax Benefit (“UTB”). The Corporation classifies interest and penalties, if any, related to UTBs as components of income tax expense. Refer to Note 24 for required disclosures and further information.

***Treasury stock***

The Corporation accounts for treasury stock at par value. Under this method, the treasury stock account is increased by the par value of each share of common stock reacquired. Any excess paid per share over the par value is debited to additional paid-in capital for the amount per share that was originally credited. Any remaining excess is charged to retained earnings.

***Stock-based compensation***

Compensation cost is recognized in the financial statements for all share-based payment grants. Between 1997 and 2007, the Corporation had a stock option plan (the “1997 stock option plan”) covering eligible employees. On January 21, 2007, the 1997 stock option plan expired; all outstanding awards under this plan continue to be in full force and effect, subject to their original terms. No awards for shares could be granted under the 1997 stock option plan as of its expiration.

On April 29, 2008, the Corporation’s stockholders approved the First BanCorp 2008 Omnibus Incentive Plan, as amended (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. The compensation cost for an award, determined based on the estimate of the fair value at the grant date (considering forfeitures and any postvesting restrictions), is recognized over the period during which an employee or director is required to provide services in exchange for an award, which is the vesting period.

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 in the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase in the expense recognized in the financial statements.



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

When unvested options or shares of restricted stock are forfeited, any compensation expense previously recognized on the forfeited awards is reversed in the period of the forfeiture. For additional information regarding the Corporation's equity-based compensation and awards granted, refer to Note 19.

***Comprehensive income***

Comprehensive income for First BanCorp. includes net income and the unrealized gain (loss) on available-for-sale securities, net of estimated tax effects.

***Segment Information***

The Corporation reports financial and descriptive information about its reportable segments (see Note 31). Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by management in deciding how to allocate resources and in assessing performance. The Corporation's management determined that the segregation that best fulfills the segment definition described above is by lines of business for its operations in Puerto Rico, the Corporation's principal market, and by geographic areas for its operations outside of Puerto Rico. As of December 31, 2013, the Corporation had six operating segments that are all reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments; United States Operations; and Virgin Islands Operations. Refer to Note 31 for additional information.

***Valuation of financial instruments***

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

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 for classifying financial instruments. The hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Three levels of inputs may be used to measure fair value:

- Level 1** Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3** Valuations are observed from unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Under the fair value accounting guidance, an entity has the irrevocable option to elect, on a contract-by-contract basis, to measure certain financial assets and liabilities at fair value at inception of the contract and, thereafter, to reflect any changes in fair value in current earnings. The Corporation did not make any fair value option election as of December 31, 2013 or 2012. See Note 26 for additional information.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

***Income recognition— Insurance agency***

Commission revenue is recognized as of the effective date of the insurance policy or the date the customer is billed, whichever is later. The Corporation also receives contingent commissions from insurance companies as additional incentive for achieving specified premium volume goals and/or the loss experience of the insurance placed by the Corporation. Contingent commissions from insurance companies are recognized when determinable, which is generally when such commissions are received or when the Corporation receives data from the insurance companies that allows the reasonable estimation of these amounts.

***Advertising costs***

Advertising costs for all reporting periods are expensed as incurred.

***Earnings per common share***

Earnings (loss) per share-basic is calculated by dividing net income (loss) attributable to common stockholders by the weighted average number of outstanding common shares. Net income (loss) attributable to common stockholders represents net income (loss) adjusted for any preferred stock dividends, including dividends declared, cumulative dividends related to the current dividend period that have not been declared as of the end of the period, if any, and the accretion of discounts on preferred stock issuances, if any. Basic weighted average common shares outstanding exclude unvested shares of restricted stock. For 2011, the net income (loss) attributable to common stockholders also includes the one-time effect of the issuance of common stock in the conversion of the Series G preferred stock. This transaction is further discussed in Note 20. The computation of earnings per share-diluted is similar to the computation of earnings per share-basic except that the number of weighted average common shares is increased to include the number of additional common shares that would have been outstanding if the dilutive common shares had been issued, referred to as potential common shares.

Potential common shares consist of common stock issuable upon the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect in earnings per share.

The dilutive effect of convertible securities is reflected in the computation of diluted earnings per share using the if-converted method. The Series G preferred stock converted in the fourth quarter of 2011 was included in the denominator for the period prior to actual conversion and common shares issued upon conversion were included in the weighted average shares outstanding for the period from their date of issuance through period-end.

***Recently issued accounting pronouncements***

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

In December 2011, the FASB updated the Accounting Standards Codification ("the Codification") to enhance and require converged disclosures about financial and derivative instruments that are either offset on the balance sheet, or are subject to an enforceable master netting arrangement (or other similar arrangement). Entities

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. In January 2013, the FASB updated the Codification to clarify the scope of the disclosure to include only derivatives, including bifurcated embedded derivatives, repurchase agreements, reverse repurchase agreements, and securities lending that are either offset or subject to an enforceable master netting agreement or similar agreement. The amendments in this Update were effective for interim and annual periods beginning on or after January 1, 2013. The Corporation adopted this guidance in 2013. Refer to Note 30 for required disclosures about offsetting assets and liabilities.

In February 2013, the FASB updated the Codification to improve the reporting of reclassifications out of accumulated OCI. The amendments in this Update seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated OCI on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated OCI is reclassified to a balance sheet account (for example, inventory) instead of directly to income or expense in the same reporting period. The amendments in this Update were effective prospectively for reporting periods beginning after December 31, 2012. The Corporation adopted this guidance in 2013 with no effect on the Corporation's financial condition or results of operations since it impacted presentation only. The reclassifications out of accumulated OCI of the Corporation during 2013 and 2012 were primarily related to credit losses on debt securities for which OTTI was previously recognized. The disclosure of credit losses on debt securities, and required identification in the statement of (loss) income, is already required by Accounting Standard Codification (ASC) 320-10-50.

In July 2013, the FASB updated the Codification to add the Fed Funds Effective Swap Rates (or Overnight Index Swap Rate) as a U.S. benchmark interest rate for hedge accounting purposes. Previously, only the direct Treasury obligations of the U.S. government and the London Interbank Offered Rate (LIBOR) swap rate were used. This Update was effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this guidance did not have an effect on the Corporation's financial condition or results of operations as the Corporation's derivative instruments are not designated or do not qualify for hedge accounting.

In July 2013, the FASB updated the Codification to provide explicit guidelines on how to present an unrecognized tax benefit in financial statements when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments are effective for public entities with fiscal periods beginning after December 15, 2013. Early adoption is permitted. The Corporation is currently evaluating the impact of the adoption of this guidance on its financial statements.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

In January 2014, the FASB updated the Codification to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan so that the loan should be derecognized and the real estate property recognized in the financial statements. The Update clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan upon either: (i) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or (ii) the borrower conveying all interest in the residential real estate property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. In addition, creditors are required to disclose on an annual and interim basis both (i) the amount of the foreclosed residential real estate property held and (ii) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for public business entities for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 31, 2015. Early adoption is permitted. The guidance can be implemented using either a modified retrospective transition method or a prospective transition method. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its financial statements.

**NOTE 2—RESTRICTIONS ON CASH DUE AND DUE FROM BANKS**

The Corporation's bank subsidiary, FirstBank, is required by law to maintain minimum average weekly reserve balances to cover demand deposits. The amount of those minimum average reserve balances for the week that covered December 31, 2013 was \$101.1 million (2012 — \$108.3 million). As of December 31, 2013 and 2012, the Bank complied with the requirement. Cash and due from banks as well as other short-term, highly liquid securities are used to cover the required average reserve balances.

As of December 31, 2013, and as required by the Puerto Rico International Banking Law, the Corporation maintained \$300,000 in time deposits, which were considered restricted assets related to FirstBank Overseas Corporation, an international banking entity that is a subsidiary of FirstBank.

**NOTE 3—MONEY MARKET INVESTMENTS**

Money market investments are composed of time deposits with other financial institutions and short-term investments with original maturities of three months or less.

Money market investments as of December 31, 2013 and 2012 were as follows:

	<b>2013</b>	<b>2012</b>
	<b>Balance</b>	
	(Dollars in thousands)	
Time deposits with other financial institutions, weighted average interest rate 0.20% (2012- 0.37%) . . . . .	\$ 300	\$ 505
Other short-term investments, weighted average interest rate of 0.34% (2012—weighted average interest rate of 0.34%) . . . . .	<u>201,069</u>	<u>216,330</u>
	<u>\$201,369</u>	<u>\$216,835</u>

As of December 31, 2013 and 2012, the Corporation's money market investments that were pledged as collateral for interest rate swaps amounted to \$0.20 million and \$0.45 million, respectively.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 4—INVESTMENT SECURITIES**

*Investment Securities Available for Sale*

The amortized cost, non-credit loss component of OTTI recorded in OCI, gross unrealized gains and losses recorded in OCI, approximate fair value, weighted average yield and contractual maturities of investment securities available for sale as of December 31, 2013 and 2012 were as follows:

	December 31, 2013					
	Amortized cost	Noncredit Loss Component of OTTI Recorded in OCI	Gross Unrealized		Fair value	Weighted average yield %
			Gains	Losses		
			(Dollars in thousands)			
U.S. Treasury securities:						
Due within one year	\$ 7,498	\$ —	\$ 1	\$ —	\$ 7,499	0.12
Obligations of U.S. government-sponsored agencies:						
After 1 to 5 years	50,000	—	—	1,408	48,592	1.05
After 5 to 10 years	214,271	—	—	13,368	200,903	1.31
Puerto Rico government obligations:						
Due within one year	10,000	—	—	210	9,790	3.50
After 5 to 10 years	40,699	—	—	12,962	27,737	4.51
After 10 years	20,309	—	—	6,506	13,803	5.82
United States and Puerto Rico government obligations	342,777	—	1	34,454	308,324	1.96
Mortgage-backed securities:						
FHLMC certificates:						
After 10 years	332,766	—	133	10,712	322,187	2.16
GNMA certificates:						
After 1 to 5 years	86	—	4	—	90	3.48
After 5 to 10 years	800	—	37	—	837	2.47
After 10 years	425,589	—	18,492	—	444,081	3.82
	426,475	—	18,533	—	445,008	3.82
FNMA certificates:						
After 1 to 5 years	1,389	—	84	—	1,473	4.82
After 5 to 10 years	7,765	—	389	—	8,154	4.09
After 10 years	882,798	—	2,984	33,626	852,156	2.36
	891,952	—	3,457	33,626	861,783	2.38
Collateralized mortgage obligations issued or guaranteed by the FHLMC:						
After 1 to 5 years	82	—	—	1	81	3.01
Other mortgage pass-through trust certificates:						
Over 5 to 10 years	127	—	1	—	128	7.27
After 10 years	55,048	14,310	—	—	40,738	2.24
	55,175	14,310	1	—	40,866	2.24
Total mortgage-backed securities	1,706,450	14,310	22,124	44,339	1,669,925	2.69
Equity securities (without contractual maturity)(1)	35	—	—	2	33	—
Total investment securities available for sale	\$2,049,262	\$14,310	\$22,125	\$78,795	\$1,978,282	2.57

(1) Represents common shares of another financial institution in Puerto Rico.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

December 31, 2012

	Amortized cost	Noncredit Loss Component of OTTI Recorded in OCI	Gross Unrealized		Fair value	Weighted average yield %
			Gains	Losses		
(Dollars in thousands)						
U.S. Treasury securities:						
Due within one year	\$ 7,497	\$ —	\$ 2	\$ —	\$ 7,499	0.17
Obligations of U.S. government-sponsored agencies:						
After 1 to 5 years	25,650	—	7	—	25,657	0.35
After 5 to 10 years	214,323	—	8	415	213,916	1.31
Puerto Rico government obligations:						
After 1 to 5 years	10,000	—	—	—	10,000	3.50
After 5 to 10 years	39,753	—	—	553	39,200	4.49
After 10 years	21,099	—	948	47	22,000	5.78
United States and Puerto Rico government obligations	318,322	—	965	1,015	318,272	1.97
Mortgage-backed securities:						
FHLMC certificates:						
Due within one year	63	—	—	—	63	3.34
After 10 years	125,747	—	3,430	—	129,177	2.13
	125,810	—	3,430	—	129,240	2.13
GNMA certificates:						
After 1 to 5 years	143	—	7	—	150	3.57
After 5 to 10 years	479	—	37	—	516	3.52
After 10 years	564,376	—	39,630	—	604,006	3.98
	564,998	—	39,674	—	604,672	3.98
FNMA certificates:						
Due within one year	119	—	—	—	119	2.93
After 1 to 5 years	2,270	—	149	—	2,419	4.88
After 5 to 10 years	10,963	—	874	—	11,837	3.91
After 10 years	602,623	—	10,638	—	613,261	2.49
	615,975	—	11,661	—	627,636	2.52
Collateralized mortgage obligations issued or guaranteed by the FHLMC:						
After 5 to 10 years	301	—	—	1	300	3.01
Other mortgage pass-through trust certificates:						
Over 5 to 10 years	143	—	1	—	144	7.27
After 10 years	69,269	18,487	—	—	50,782	2.29
	69,412	18,487	1	—	50,926	2.29
Total mortgage-backed securities	1,376,496	18,487	54,766	1	1,412,774	3.07
Equity securities (without contractual maturity)(1)	77	—	—	46	31	—
Total investment securities available for sale	\$1,694,895	\$18,487	\$55,731	\$1,062	\$1,731,077	2.87

(1) Represents common shares of another financial institution in Puerto Rico.

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options, as was the case with approximately \$25.7 million and \$194.5 million of investment securities called during 2013 and 2012, respectively. The weighted average yield on investment



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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 noncredit loss component of OTTI are presented as part of OCI.

The aggregate amortized cost and approximate market value of investment securities available for sale as of December 31, 2013 by contractual maturity, are shown below:

	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In thousands)	
Within 1 year . . . . .	\$ 17,498	\$ 17,289
After 1 to 5 years . . . . .	51,557	50,236
After 5 to 10 years . . . . .	263,662	237,759
After 10 years . . . . .	1,716,510	1,672,965
Total . . . . .	<u>2,049,227</u>	<u>1,978,249</u>
Equity securities . . . . .	<u>35</u>	<u>33</u>
Total investment securities available for sale . . . . .	<u>\$2,049,262</u>	<u>\$1,978,282</u>

The following tables show the Corporation's available-for-sale investments' fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2013 and 2012. It also includes debt securities for which an OTTI was recognized and only the amount related to a credit loss was recognized in earnings. Unrealized losses for which OTTI had been recognized have been reduced by any subsequent recoveries in fair value.

	As of December 31, 2013					
	Less than 12 months		12 months or more		Total	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
	(In thousands)					
<b>Debt securities:</b>						
Puerto Rico government obligations . . . . .	\$ 23,156	\$ 5,977	\$ 28,174	\$13,701	\$ 51,330	\$19,678
U.S. government agencies obligations . . . . .	175,369	8,913	74,126	5,863	249,495	14,776
<b>Mortgage-backed securities:</b>						
FNMA . . . . .	748,215	33,626	—	—	748,215	33,626
FHLMC . . . . .	286,208	10,712	—	—	286,208	10,712
Collateralized mortgage obligations issued or guaranteed by FHLMC . . . . .	—	—	81	1	81	1
Other mortgage pass-through trust certificates . . . . .	—	—	40,738	14,310	40,738	14,310
<b>Equity securities . . . . .</b>	<u>33</u>	<u>2</u>	<u>—</u>	<u>—</u>	<u>33</u>	<u>2</u>
	<u>\$1,232,981</u>	<u>\$59,230</u>	<u>\$143,119</u>	<u>\$33,875</u>	<u>\$1,376,100</u>	<u>\$93,105</u>

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

	As of December 31, 2012					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands)						
<b>Debt securities:</b>						
Puerto Rico government obligations .....	\$ 41,243	\$ 600	\$ —	\$ —	\$ 41,243	\$ 600
U.S. government agencies obligations .....	183,709	415	—	—	183,709	415
<b>Mortgage-backed securities:</b>						
Collateralized mortgage obligations issued or guaranteed by FHLMC ..	300	1	—	—	300	1
Other mortgage pass-through trust certificates .....	—	—	50,782	18,487	50,782	18,487
<b>Equity securities</b> .....	<u>31</u>	<u>46</u>	<u>—</u>	<u>—</u>	<u>31</u>	<u>46</u>
	<u>\$225,283</u>	<u>\$1,062</u>	<u>\$50,782</u>	<u>\$18,487</u>	<u>\$276,065</u>	<u>\$19,549</u>

**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 an 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 must be recognized in earnings if an investor has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if an investor does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI, if any, is recorded as a component of net impairment losses on investment securities in the accompanying consolidated statements of income (loss), while the remaining portion of the impairment loss is recognized in OCI, provided the Corporation does not intend to sell the underlying debt security and it is “more likely than not” that the Corporation will not have to sell the debt security prior to recovery.

Debt securities issued by U.S. government agencies, government-sponsored entities, and the U.S. Department of the Treasury (the “Treasury”) accounted for approximately 95% of the total available-for-sale portfolio as of December 31, 2013 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 with an amortized cost of \$55.0 million for which credit losses are evaluated on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis;
- Changes in the near term prospects of the underlying collateral of a security such as changes in default rates, loss severity given default, and significant changes in prepayment assumptions;

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- 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.

The Corporation recorded OTTI losses on available-for-sale debt securities as follows:

	<u>Private label MBS</u>	
	<u>2013</u>	<u>2012</u>
(In thousands)		
Total other-than-temporary impairment losses . . . . .	\$ —	\$ —
Portion of other-than-temporary impairment losses recognized in OCI . . . . .	<u>(117)</u>	<u>(2,002)</u>
Net impairment losses recognized in earnings . . . . .	<u>\$(117)</u>	<u>\$(2,002)</u>

The following table summarizes the rollforward of credit losses on debt securities held by the Corporation for which a portion of an OTTI is recognized in OCI:

	<u>2013</u>	<u>2012</u>
(In thousands)		
Credit losses at the beginning of the year . . . . .	\$5,272	\$3,823
Additions:		
Credit losses on debt securities for which an OTTI was previously recognized . . . . .	117	2,002
Reductions:		
Securities sold during the period (realized loss) . . . . .	<u>—</u>	<u>(553)</u>
Ending balance of credit losses on debt securities held for which a portion of an OTTI was recognized in OCI . . . . .	<u>\$5,389</u>	<u>\$5,272</u>

During 2013, the \$0.1 million credit-related impairment loss is related to private label MBS, which are collateralized by fixed-rate mortgages on single-family, residential properties in the United States. The interest rate on these private-label MBS is variable, tied to 3-month LIBOR and limited to the weighted average coupon of the underlying collateral. The underlying mortgages are fixed-rate single-family loans with original high FICO scores (over 700) and moderate original loan-to-value ratios (under 80%), as well as moderate delinquency levels.

Based on the expected cash flows derived from the model, and since the Corporation does not have the intention to sell the securities and has sufficient capital and liquidity to hold these securities until a recovery of the fair value occurs, only the credit loss component was reflected in earnings. Significant assumptions in the valuation of the private label MBS were as follows:

	<u>December 31, 2013</u>		<u>December 31, 2012</u>	
	<u>Weighted Average</u>	<u>Range</u>	<u>Weighted Average</u>	<u>Range</u>
Discount rate . . . . .	14.5%	14.5%	14.5%	14.5%
Prepayment rate . . . . .	29%	15.86% - 100.00%	32%	21.85% - 69.97%
Projected Cumulative Loss Rate . .	6.8%	0.58% - 38.16%	8%	0.73% - 38.79%

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Corporation recorded OTTI losses of \$42,000 on equity securities held in the available-for-sale investment portfolio for the year ended December 31, 2013. No OTTI losses on equity securities were recognized for the year ended December 31, 2012 or 2011.

No sales of securities available for sale were completed in 2013. Total proceeds from the sale of securities available for sale during 2012 and 2011 amounted to approximately \$1.9 million, and \$1.2 billion, respectively. No gains or losses were realized on the sale of securities available for sale in 2013 and 2012. The Corporation realized gains on sales of securities available for sale for the year ended December 31, 2011 in the amount of \$34.4 million, including a \$3.5 million gain attributable to a tender offer by the Puerto Rico Housing Finance Authority to purchase certain of its outstanding bonds. Bonds held by the Corporation with a book value of \$19.8 million were exchanged for cash as part of the tender offer and the difference between the cash received and the book value of such instruments was recorded as part of “Gain on sale of investment” in the Statement of (loss) income.

As part of its balance sheet restructuring strategies, the Corporation sold during 2011 approximately \$500 million of low-yielding U.S. Treasury Notes and \$105 million of floating rate U.S. agency collateralized mortgage obligations (“CMOs”) and used the proceeds, in part, to prepay \$400 million of repurchase agreements that carried an average rate of 2.74%. The prepayment penalties of \$10.6 million were offset with gains of \$11.0 million from the sale of U.S. Treasury Notes and floating rates U.S. agency CMOs.

The following table states the names of issuers, and the aggregate amortized cost and market value of the securities of such issuers, when the aggregate amortized cost of such securities exceeds 10% of stockholders’ equity. This information excludes securities of the U.S. and Puerto Rico government. Investments in obligations issued by a state of the U.S. and its political subdivisions and agencies that are payable and secured by the same source of revenue or taxing authority, other than the U.S. government, are considered securities of a single issuer and include debt and mortgage-backed securities.

	2013		2012	
	Amortized Costs	Fair Value	Amortized Costs	Fair Value
	(In thousands)		(In thousands)	
FHLMC .....	\$332,848	\$322,268	\$126,111	\$129,540
GNMA .....	426,475	445,008	564,998	604,672
FNMA .....	891,952	861,783	615,975	627,636
FHLB .....	264,271	249,495	239,973	239,573

As of December 31, 2013, the Corporation held approximately \$71.0 million of Puerto Rico government and agencies bond obligations, mainly bonds of the Government Development Bank (“GDB”) and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio, which were reflected at their aggregate fair value of \$51.3 million. In February 2014, Standard & Poor’s (“S&P”), Moody’s Investor Service (“Moody’s”) and Fitch Ratings (“Fitch”) downgraded the Commonwealth of Puerto Rico general obligations bonds and other obligations of Puerto Rico instrumentalities to non-investment grade categories. The issuers of Puerto Rico government and agencies bonds held by the Corporation have not defaulted, and the contractual payments on these securities have been made as scheduled. The Corporation has the ability and intent to hold these securities until a recovery of the fair value occurs, and is not more likely than not that the Corporation will have to sell the securities prior to such recovery. It is uncertain how the financial markets may react to any potential further rating downgrade of Puerto Rico’s debt. However, further deterioration in the fiscal situation, could further adversely affect the value of Puerto Rico’s government obligations. The Corporation will continue to closely monitor Puerto Rico’s political and economic status and evaluate the portfolio for any declines in value that could be considered other-than-temporary.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

***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 in order to preserve capital and meet minimum regulatory capital ratios established in the Consent Order entered into with the Bank's principal regulators. Refer to Note 28 for additional information. 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.

From time to time, the Corporation has securities held to maturity with an original maturity of three months or less that are considered cash and cash equivalents and classified as money market investments in the consolidated statements of financial condition. As of December 31, 2013 and 2012, the Corporation had no outstanding securities held to maturity that were classified as cash and cash equivalents.

**NOTE 5—OTHER EQUITY SECURITIES**

Institutions that are members of the FHLB system are required to maintain a minimum investment in FHLB stock. Such minimum is calculated as a percentage of aggregate outstanding mortgages, and an additional investment is required that is calculated as a percentage of total FHLB advances, letters of credit, and the collateralized portion of interest-rate swaps outstanding. The stock is capital stock issued at \$100 par value. Both stock and cash dividends may be received on FHLB stock.

As of December 31, 2013 and 2012, the Corporation had investments in FHLB stock with a book value of \$28.4 and \$37.5 million, respectively. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for 2013, 2012, and 2011 amounted to \$1.4 million, \$1.4 million, and \$1.9 million, respectively.

The shares of FHLB stock owned by the Corporation were issued by the FHLB of New York. The FHLB of New York is 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 Federal 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 December 31, 2013 and 2012 was \$0.3 and \$1.3 million, respectively.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 6—INTEREST AND DIVIDEND ON INVESTMENTS AND MONEY MARKET INSTRUMENTS**

The following provides information about interest on investments and FHLB dividend income:

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
Mortgage-backed securities:			
Taxable .....	\$19,566	\$23,989	\$32,599
Exempt .....	25,955	11,543	10,511
	<u>45,521</u>	<u>35,532</u>	<u>43,110</u>
PR government obligations, U.S. Treasury securities, and U.S. government agencies:			
Taxable .....	1,218	1,468	3,705
Exempt .....	5,429	6,785	15,282
	<u>6,647</u>	<u>8,253</u>	<u>18,987</u>
Equity securities:			
Taxable .....	—	6	1
Other investment securities (including FHLB dividends)			
Taxable .....	1,359	1,503	2,001
<b>Total interest income investment securities</b> .....	<u>53,527</u>	<u>45,294</u>	<u>64,099</u>
Interest on money market instruments:			
Taxable .....	1,231	1,137	1,107
Exempt .....	696	690	448
<b>Total interest income money market instruments</b> ....	<u>1,927</u>	<u>1,827</u>	<u>1,555</u>
<b>Total interest and dividend income in investments and money market instruments</b> .....	<u>\$55,454</u>	<u>\$47,121</u>	<u>\$65,654</u>

The following table summarizes the components of interest and dividend income on investments:

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
Interest income on investment securities and money market investments .....	\$54,095	\$45,694	\$63,769
Dividends on FHLB stock .....	1,359	1,427	1,885
<b>Total interest income and dividends on investments</b> ....	<u>\$55,454</u>	<u>\$47,121</u>	<u>\$65,654</u>



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 7—LOANS HELD FOR INVESTMENT**

The following provides information about the loan portfolio held for investment:

	<u>December 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
	(In thousands)	
Residential mortgage loans, mainly secured by first mortgages . . . . .	\$2,549,008	\$ 2,747,217
Commercial loans:		
Construction loans <sup>(1)</sup> . . . . .	168,713	361,875
Commercial mortgage loans <sup>(1)</sup> . . . . .	1,823,608	1,883,798
Commercial and Industrial loans <sup>(1)(2)</sup> . . . . .	2,788,250	2,793,157
Loans to local financial institution collateralized by real estate mortgages . . . . .	240,072	255,390
Commercial loans . . . . .	<u>5,020,643</u>	<u>5,294,220</u>
Finance leases . . . . .	245,323	236,926
Consumer loans . . . . .	<u>1,821,196</u>	<u>1,775,751</u>
Loans held for investment . . . . .	9,636,170	10,054,114
Allowance for loan and lease losses . . . . .	<u>(285,858)</u>	<u>(435,414)</u>
Loans held for investment, net <sup>(3)</sup> . . . . .	<u>\$9,350,312</u>	<u>\$ 9,618,700</u>

- (1) During the second quarter of 2013, after a comprehensive review of substantially all of the loans in the commercial portfolios, the classification of certain loans was revised to more accurately depict the nature of the underlying loans. This reclassification resulted in a net increase of \$269.0 million in commercial mortgage loans, since the principal source of repayment for such loans is derived primarily from the operation of the underlying real estate, with a corresponding decrease of \$246.8 million in commercial and industrial loans and a \$22.2 million decrease in construction loans. The Corporation evaluated the impact of this reclassification on the provision for loan losses and determined that the effect of this adjustment was not material to any previously reported results.
- (2) As of December 31, 2013, includes \$1.2 billion of commercial loans that are secured by real estate (owner-occupied commercial loans secured by real estate) but are not dependent upon the real estate for repayment.
- (3) During the first half of 2013, the Corporation completed two separate bulk sales of assets including: (i) non-performing residential mortgage loans with a book value before allowance for loan losses of \$203.8 million, and (ii) adversely classified loans, mainly commercial loans, with a book value before allowance for loan losses of \$211.4 million. In addition, the Corporation transferred \$181.6 million of commercial non-performing loans to held for sale as further discussed below.

As of December 31, 2013 and 2012, the Corporation had net deferred origination fees on its loan portfolio amounting to \$7.6 million and \$8.5 million, respectively. The total loan portfolio is net of unearned income of \$40.4 million and \$38.8 million as of December 31, 2013 and 2012, respectively.

As of December 31, 2013, the Corporation was servicing residential mortgage loans owned by others aggregating \$2.1 billion (2012—\$1.9 billion), construction and commercial loans owned by others aggregating \$2.8 million (2012—\$2.8 million), and commercial loan participations owned by others aggregating \$615.6 million (2012—\$457.9 million).

Various loans secured by first mortgages were assigned as collateral for CDs, individual retirement accounts, and advances from the FHLB. The mortgages pledged as collateral amounted to \$1.0 billion as of December 31, 2013 (2012—\$1.1 billion).

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Loans held for investment on which accrual of interest income had been discontinued were as follows:

(In thousands)	December 31, 2013	December 31, 2012
Non-performing loans:		
Residential mortgage .....	\$161,441	\$313,626
Commercial mortgage .....	120,107	214,780
Commercial and Industrial .....	114,833	230,090
Construction:		
Land .....	27,834	63,342
Construction-commercial .....	3,924	65,759
Construction-residential .....	27,108	49,089
Consumer:		
Auto loans .....	21,316	19,210
Finance leases .....	3,082	3,182
Other consumer loans .....	15,904	16,483
Total non-performing loans held for investment <sup>(1) (2)</sup> .....	\$495,549	\$975,561

- (1) As of December 31, 2013 and 2012, excludes \$54.8 million and \$2.2 million, respectively, in non-performing loans held for sale.
- (2) Amount excludes PCI loans with a carrying value of approximately \$4.8 million and \$10.6 million as of December 31, 2013 and 2012, respectively, acquired as part of the credit card portfolio purchased in 2012, as further discussed below.

If these loans were accruing interest, the additional interest income realized would have been \$40.3 million (2012—\$75.1 million; 2011—\$64.0 million).

The Corporation's aging of the loans held for investment portfolio is as follows:

As of December 31, 2013 (In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 days or more Past Due <sup>(1)</sup>	Total Past Due <sup>(4)</sup>	Purchased Credit- Impaired Loans <sup>(4)</sup>	Current	Total loans held for investment	90 days past due and still accruing <sup>(5)</sup>
Residential mortgage:								
FHA/VA and other government-guaranteed loans <sup>(2) (3) (5)</sup> .....	\$ —	\$ 12,180	\$ 78,645	\$ 90,825	\$ —	\$ 104,401	\$ 195,226	\$ 78,645
Other residential mortgage loans <sup>(3)</sup> .....	—	88,898	172,286	261,184	—	2,092,598	2,353,782	10,845
Commercial:								
Commercial and Industrial loans .....	21,029	5,454	134,233	160,716	—	2,867,606	3,028,322	19,400
Commercial mortgage loans <sup>(3)</sup> .....	—	5,428	126,674	132,102	—	1,691,506	1,823,608	6,567
Construction:								
Land <sup>(3)</sup> .....	—	358	27,871	28,229	—	52,145	80,374	37
Construction-commercial <sup>(3)</sup> .....	—	—	3,924	3,924	—	12,907	16,831	—
Construction-residential <sup>(3)</sup> .....	—	—	27,108	27,108	—	44,400	71,508	—
Consumer:								
Auto loans .....	79,279	17,944	21,316	118,539	—	993,781	1,112,320	—
Finance leases .....	10,275	3,536	3,082	16,893	—	228,430	245,323	—
Other consumer loans .....	11,710	8,691	20,492	40,893	4,791	663,192	708,876	4,588
Total loans held for investment .....	\$122,293	\$142,489	\$615,631	\$880,413	\$4,791	\$8,750,966	\$9,636,170	\$120,082

- (1) Includes non-performing loans and accruing loans that are contractually delinquent 90 days or more (i.e., FHA/VA guaranteed loans and credit cards). Credit card loans continue to accrue finance charges and fees until charged off at 180 days.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- (2) As of December 31, 2013, includes \$11.5 million of defaulted loans collateralizing GNMA securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.
- (3) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA government guaranteed loans, other residential mortgage loans, commercial mortgage loans, land loans, and construction-residential loans past due 30-59 days amounted to \$23.9 million, \$166.7 million, \$18.4 million, \$0.9 million, and \$2.5 million, respectively.
- (4) Purchased credit-impaired loans are excluded from delinquency and non-performing statistics as further discussed below.
- (5) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$37.0 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 18 months delinquent, that are no longer accruing interest as of December 31, 2013.

As of December 31, 2012 (In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 days or more Past Due <sup>(1)</sup>	Total Past Due <sup>(4)</sup>	Purchased Credit- Impaired Loans <sup>(4)</sup>	Current	Total loans held for investment	90 days past due and still accruing <sup>(5)</sup>
Residential mortgage:								
FHA/VA and other government-guaranteed loans <sup>(2) (3) (5)</sup> .....	\$ —	\$ 10,592	\$ 93,298	\$ 103,890	\$ —	\$ 104,723	\$ 208,613	\$ 93,298
Other residential mortgage loans <sup>(3)</sup> .....	—	83,807	324,965	408,772	—	2,129,832	2,538,604	11,339
Commercial:								
Commercial and Industrial loans .....	22,323	8,952	258,989	290,264	—	2,758,283	3,048,547	28,899
Commercial mortgage loans <sup>(3)</sup> .....	—	6,367	218,379	224,746	—	1,659,052	1,883,798	3,599
Construction:								
Land .....	—	843	63,372	64,215	—	77,012	141,227	30
Construction-commercial ..	—	—	65,759	65,759	—	70,160	135,919	—
Construction-residential ...	—	—	49,745	49,745	—	34,984	84,729	656
Consumer:								
Auto loans .....	64,991	15,446	19,210	99,647	—	926,579	1,026,226	—
Finance leases .....	10,938	2,682	3,182	16,802	—	220,124	236,926	—
Other consumer loans ....	12,268	6,850	20,674	39,792	10,602	699,131	749,525	4,191
Total loans held for investment .....	<u>\$110,520</u>	<u>\$135,539</u>	<u>\$1,117,573</u>	<u>\$1,363,632</u>	<u>\$10,602</u>	<u>\$8,679,880</u>	<u>\$10,054,114</u>	<u>\$142,012</u>

- (1) Includes non-performing loans and accruing loans that are contractually delinquent 90 days or more (i.e., FHA/VA and other guaranteed loans and credit cards). Credit card loans continue to accrue finance charges and fees until charged off at 180 days.
- (2) As of December 31, 2012, includes \$14.8 million of defaulted loans collateralizing GNMA securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.
- (3) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA government-guaranteed loans, other residential mortgage loans, commercial mortgage loans, land loans, and construction-residential loans past-due 30-59 days amounted to \$22.2 million, \$186.3 million, \$164.9 million, \$15.6 million, and \$5.5 million, respectively.
- (4) Purchased credit-impaired loans are excluded from delinquency and non-performing statistics as further discussed below.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- (5) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$35.3 million of residential mortgage loans insured by the FHA or guaranteed by the VA, that are over 18 month delinquent, and are no longer accruing interest as of December 31, 2012.

The Corporation's credit quality indicators by loan type as of December 31, 2013 and 2012 are summarized below:

<b>Commercial Credit Exposure-Credit Risk Profile based on Creditworthiness Category:</b>					
<b>December 31, 2013</b>	<b>Substandard</b>	<b>Doubtful</b>	<b>Loss</b>	<b>Total Adversely Classified<sup>(1)(2)</sup></b>	<b>Total Portfolio</b>
	(In thousands)				
Commercial Mortgage .....	\$317,365	\$ 9,160	\$ 234	\$326,759	\$1,823,608
Construction:					
Land .....	31,777	3,308	52	35,137	80,373
Construction-commercial .....	16,022	—	—	16,022	16,831
Construction-residential .....	27,829	2,209	241	30,279	71,509
Commercial and Industrial .....	205,807	7,998	973	214,778	3,028,322

<b>Commercial Credit Exposure-Credit Risk Profile based on Creditworthiness Category:</b>					
<b>December 31, 2012</b>	<b>Substandard</b>	<b>Doubtful</b>	<b>Loss</b>	<b>Total Adversely Classified<sup>(1)(2)</sup></b>	<b>Total Portfolio</b>
	(In thousands)				
Commercial Mortgage .....	\$401,597	\$ 6,867	\$ —	\$408,464	\$1,883,798
Construction:					
Land .....	37,087	6,371	605	44,063	141,227
Construction-commercial .....	72,401	5,754	—	78,155	135,919
Construction-residential .....	75,489	2,431	—	77,920	84,729
Commercial and Industrial .....	372,100	30,651	1,143	403,894	3,048,547

- (1) During the first quarter of 2013, the Corporation completed a bulk sale of assets, mainly commercial adversely classified loans with a book value before allowance for loan losses of \$211.4 million and, in addition, transferred \$181.6 million of non-performing loans to held for sale as further discussed below.
- (2) Excludes \$54.8 million (\$7.8 million land, \$39.1 million construction-commercial, \$0.9 million construction-residential, and \$7.0 million commercial mortgage) and \$2.2 million (\$1.1 million commercial mortgage and \$1.1 million commercial and industrial) as of December 31, 2013 and 2012, respectively, of non-performing 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.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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>Consumer Credit Exposure-Credit Risk Profile Based on Payment Activity</b>				
	<b>Residential Real-Estate</b>		<b>Consumer</b>		
	<b>FHA/VA/ Guaranteed <sup>(1)</sup></b>	<b>Other residential loans</b>	<b>Auto</b>	<b>Finance Leases</b>	<b>Other Consumer</b>
<b>December 31, 2013</b>					
			(In thousands)		
Performing . . . . .	\$195,226	\$2,192,341	\$1,091,004	\$242,241	\$688,181
Purchased Credit-Impaired . . . . .	—	—	—	—	4,791
Non-performing . . . . .	—	161,441	21,316	3,082	15,904
Total . . . . .	<u>\$195,226</u>	<u>\$2,353,782</u>	<u>\$1,112,320</u>	<u>\$245,323</u>	<u>\$708,876</u>

- (1) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$37.0 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 18 months delinquent and are no longer accruing interest as of December 31, 2013.

	<b>Consumer Credit Exposure-Credit Risk Profile Based on Payment Activity</b>				
	<b>Residential Real-Estate</b>		<b>Consumer</b>		
	<b>FHA/VA/ Guaranteed <sup>(1)</sup></b>	<b>Other residential loans</b>	<b>Auto</b>	<b>Finance Leases</b>	<b>Other Consumer</b>
<b>December 31, 2012</b>					
			(In thousands)		
Performing . . . . .	\$208,613	\$2,224,978	\$1,007,016	\$233,744	\$722,440
Purchased Credit-Impaired . . . . .	—	—	—	—	10,602
Non-performing . . . . .	—	313,626	19,210	3,182	16,483
Total . . . . .	<u>\$208,613</u>	<u>\$2,538,604</u>	<u>\$1,026,226</u>	<u>\$236,926</u>	<u>\$749,525</u>

- (1) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$35.3 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 18 months delinquent and are no longer accruing interest as of December 31, 2012.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following tables present information about impaired loans excluding PCI loans, which are reported separately as discussed below:

Impaired Loans (In thousands)	Recorded Investment	Unpaid Principal Balance	Related Specific Allowance	Average Recorded Investment	Interest Income Recognized Accrual Basis	Interest Income Recognized Cash Basis
<b>As of December 31, 2013</b>						
<b>With no related allowance recorded:</b>						
FHA/VA-Guaranteed loans . . . . .	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Other residential mortgage loans . . . . .	220,428	237,709	—	222,617	9,513	1,041
Commercial:						
Commercial mortgage loans . . . . .	69,484	73,723	—	71,367	1,494	148
Commercial and Industrial Loans . . . . .	32,418	56,831	—	37,946	31	52
Construction Loans:						
Land . . . . .	359	366	—	360	8	2
Construction-Commercial . . . . .	—	—	—	—	—	—
Construction-Residential . . . . .	14,761	19,313	—	17,334	52	—
Consumer:						
Auto loans . . . . .	—	—	—	—	—	—
Finance leases . . . . .	—	—	—	—	—	—
Other consumer loans . . . . .	4,035	4,450	—	3,325	139	30
	<u>\$341,485</u>	<u>\$ 392,392</u>	<u>\$ —</u>	<u>\$352,949</u>	<u>\$11,237</u>	<u>\$1,273</u>
<b>With an allowance recorded:</b>						
FHA/VA-Guaranteed loans . . . . .	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Other residential mortgage loans . . . . .	190,566	212,028	18,125	193,372	5,623	647
Commercial:						
Commercial mortgage loans . . . . .	149,888	163,656	32,189	153,992	2,114	1,293
Commercial and Industrial Loans . . . . .	154,686	170,191	26,686	162,786	4,005	139
Construction Loans:						
Land . . . . .	27,711	40,348	10,455	28,906	350	44
Construction-Commercial . . . . .	16,022	16,238	8,873	16,157	527	—
Construction-Residential . . . . .	13,864	13,973	2,816	13,640	—	50
Consumer:						
Auto loans . . . . .	14,121	14,122	1,829	12,937	1,017	—
Finance leases . . . . .	2,359	2,359	73	2,219	281	—
Other consumer loans . . . . .	8,410	8,919	1,555	8,919	1,239	1
	<u>\$577,627</u>	<u>\$ 641,834</u>	<u>\$102,601</u>	<u>\$592,928</u>	<u>\$15,156</u>	<u>\$2,174</u>
<b>Total:</b>						
FHA/VA-Guaranteed loans . . . . .	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Other residential mortgage loans . . . . .	410,994	449,737	18,125	415,989	15,136	1,688
Commercial:						
Commercial mortgage loans . . . . .	219,372	237,379	32,189	225,359	3,608	1,441
Commercial and Industrial loans . . . . .	187,104	227,022	26,686	200,732	4,036	191
Construction Loans:						
Land . . . . .	28,070	40,714	10,455	29,266	358	46
Construction-Commercial . . . . .	16,022	16,238	8,873	16,157	527	—
Construction-Residential . . . . .	28,625	33,286	2,816	30,974	52	50
Consumer:						
Auto loans . . . . .	14,121	14,122	1,829	12,937	1,017	—
Finance leases . . . . .	2,359	2,359	73	2,219	281	—
Other consumer loans . . . . .	12,445	13,369	1,555	12,244	1,378	31
	<u>\$919,112</u>	<u>\$1,034,226</u>	<u>\$102,601</u>	<u>\$945,877</u>	<u>\$26,393</u>	<u>\$3,447</u>



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

(In thousands)	<u>Recorded Investments</u>	<u>Unpaid Principal Balance</u>	<u>Related Specific Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized Accrual Basis</u>	<u>Interest Income Recognized Cash Basis</u>
<b>As of December 31, 2012</b>						
<b>With no related allowance recorded:</b>						
FHA/VA-Guaranteed loans . . . . .	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Other residential mortgage loans . . . . .	122,056	130,306	—	148,125	3,480	1,585
Commercial:						
Commercial mortgage loans . . . . .	44,495	54,753	—	45,420	796	217
Commercial and Industrial Loans . . . . .	35,673	41,637	—	22,780	340	29
Construction Loans:						
Land . . . . .	3,715	8,017	—	5,120	50	14
Construction-Commercial . . . . .	—	—	—	—	—	—
Construction-Residential . . . . .	17,464	36,780	—	30,259	—	2
Consumer:						
Auto loans . . . . .	—	—	—	—	—	—
Finance leases . . . . .	—	—	—	—	—	—
Other consumer loans . . . . .	2,615	3,570	—	2,443	174	48
	<u>\$ 226,018</u>	<u>\$ 275,063</u>	<u>\$ —</u>	<u>\$ 254,147</u>	<u>\$ 4,840</u>	<u>\$ 1,895</u>
<b>With an allowance recorded:</b>						
FHA/VA-Guaranteed loans . . . . .	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Other residential mortgage loans . . . . .	462,663	518,446	47,171	447,491	11,367	2,160
Commercial:						
Commercial mortgage loans . . . . .	310,030	330,117	50,959	316,535	6,404	1,024
Commercial and Industrial Loans . . . . .	284,357	363,012	80,167	239,757	2,307	291
Construction Loans:						
Land . . . . .	52,113	88,749	14,104	54,727	53	70
Construction-Commercial . . . . .	78,156	144,226	22,587	74,498	47	100
Construction-Residential . . . . .	29,235	42,423	2,881	25,455	31	—
Consumer:						
Auto loans . . . . .	11,432	11,432	1,456	11,090	827	—
Finance leases . . . . .	2,019	2,019	78	1,987	180	—
Other consumer loans . . . . .	9,271	10,047	2,346	8,912	1,116	31
	<u>\$1,239,276</u>	<u>\$1,510,471</u>	<u>\$221,749</u>	<u>\$1,180,452</u>	<u>\$22,332</u>	<u>\$3,676</u>
<b>Total:</b>						
FHA/VA-Guaranteed loans . . . . .	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Other residential mortgage loans . . . . .	584,719	648,752	47,171	595,616	14,847	3,745
Commercial:						
Commercial mortgage loans . . . . .	354,525	384,870	50,959	361,955	7,200	1,241
Commercial and Industrial Loans . . . . .	320,030	404,649	80,167	262,537	2,647	320
Construction Loans:						
Land . . . . .	55,828	96,766	14,104	59,847	103	84
Construction-Commercial . . . . .	78,156	144,226	22,587	74,498	47	100
Construction-Residential . . . . .	46,699	79,203	2,881	55,714	31	2
Consumer:						
Auto loans . . . . .	11,432	11,432	1,456	11,090	827	—
Finance leases . . . . .	2,019	2,019	78	1,987	180	—
Other consumer loans . . . . .	11,886	13,617	2,346	11,355	1,290	79
	<u>\$1,465,294</u>	<u>\$1,785,534</u>	<u>\$221,749</u>	<u>\$1,434,599</u>	<u>\$27,172</u>	<u>\$5,571</u>

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following tables show the activity for impaired loans and the related specific reserve during 2013:

	<b>2013</b>
<b>Impaired Loans:</b>	(In thousands)
Balance at beginning of year . . . . .	\$1,465,294
Loans determined impaired during the year . . . . .	280,860
Net charge-offs . . . . .	(307,428)
Loans sold, net of charge-offs . . . . .	(201,409)
Loans transferred to held for sale . . . . .	(145,415)
Increases to impaired loans—additional disbursements . . . . .	6,624
Foreclosures . . . . .	(45,094)
Loans no longer considered impaired . . . . .	(49,299)
Paid in full or partial payments . . . . .	(85,021)
Balance at end of year . . . . .	\$ 919,112
<b>Specific Reserve:</b>	
	(In thousands)
Balance at beginning of year . . . . .	\$ 221,749
Provision for loan losses . . . . .	188,280
Net charge-offs . . . . .	(307,428)
Balance at end of year . . . . .	\$ 102,601

**Acquired loans including PCI Loans**

On May 30, 2012, the Corporation reentered the credit card business with the acquisition of an approximate \$406 million portfolio of FirstBank-branded credit card loans from FIA. These loans were recorded on the consolidated statement of financial condition at estimated fair value on the acquisition date of \$368.9 million. The Corporation concluded that a portion of these acquired loans were PCI loans. PCI loans are acquired loans with evidence of credit quality deterioration since origination for which it is probable at the date of purchase that the Corporation will be unable to collect all contractually required payments. The loans that the Corporation concluded were credit impaired had a contractual outstanding unpaid principal and interest balance at acquisition of \$34.6 million and an estimated fair value of \$15.7 million. Given that the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the Corporation's subsequent accounting for PCI loans differs from the accounting for non-PCI loans; therefore, the Corporation separately tracks and reports PCI loans and excludes these loans from delinquency and nonperforming loan statistics. Refer to Note 1 for additional information about accounting policies for loans held for investment and the allowance for loan losses, including discussions of the accounting for credit card loans.

*Initial fair value and accretable yield of PCI loans*

At acquisition, the Corporation estimated the cash flows the Corporation expected to collect on credit card loans acquired with a deteriorated credit quality. Under the accounting guidance for PCI loans, the difference between the contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. This difference is neither accreted into income nor recorded on the Corporation's consolidated statement of financial condition. The excess of cash flows expected to be collected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loans, using the effective-yield method. The table below displays the contractually required

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

principal and interest, cash flows expected to be collected and the fair value at acquisition related to the PCI loans the Corporation acquired. The table also displays the nonaccretable difference and the accretable yield at acquisition.

(In thousands)	<u>At acquisition</u> <u>Purchased Credit-</u> <u>Impaired Loans</u>
Contractually outstanding principal and interest at acquisition .....	\$ 34,577
Less: Nonaccretable difference .....	<u>(15,408)</u>
Cash flows expected to be collected at acquisition ....	19,169
Less: Accretable yield .....	<u>(3,451)</u>
Fair value of loans acquired .....	<u>\$ 15,718</u>

*Outstanding balance and carrying value of PCI loans*

The table below presents the outstanding contractual principal balance and carrying value of the PCI loans as of December 31, 2013 and 2012:

(In thousands)	<u>Purchased Credit</u> <u>Impaired Loans</u> <u>(December 31, 2013)</u>	<u>Purchased Credit</u> <u>Impaired Loans</u> <u>(December 31, 2012)</u>
Contractual balance .....	\$22,748	\$28,778
Carrying value .....	4,791	10,602

*Changes in accretable yield of acquired loans*

Subsequent to acquisition, the Corporation is required to periodically evaluate its estimate of cash flows expected to be collected. These evaluations, performed quarterly, require the continued use of key assumptions and estimates, similar to the initial estimate of fair value. Subsequent changes in the estimated cash flows expected to be collected may result in changes in the accretable yield and nonaccretable difference or reclassifications from nonaccretable yield to accretable. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loan or pool of loans. Decreases in expected cash flows due to further credit deterioration will generally result in an impairment charge recognized in the Corporation's provision for loan and lease losses, resulting in an increase to the allowance for loan losses. During 2013 and 2012, the Corporation did not record charges to the provision for loan losses related to PCI loans.

The following table presents changes in the accretable yield related to the PCI loans acquired from FIA:

(In thousands)	<u>PCI Loans</u>
Accretable yield at acquisition .....	\$ 3,451
Accretion recognized in earnings .....	<u>(1,280)</u>
Accretable yield as of December 31, 2012 .....	2,171
Reclassification to nonaccretable .....	(1,352)
Accretion recognized in earnings .....	<u>(819)</u>
Accretable yield as of December 31, 2013 .....	<u>\$ —</u>

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

During 2013, the Corporation purchased \$224.6 million of residential mortgage loans consistent with a strategic program established by the Corporation in 2005 to purchase ongoing residential mortgage loan production from mortgage bankers in Puerto Rico. Generally, the loans purchased from mortgage bankers were conforming residential mortgage loans. Purchases of conforming residential mortgage loans provide the Corporation the flexibility to retain or sell the loans, including through securitization transactions depending upon the Corporation's interest rate risk management strategies. When the Corporation sells such loans, it generally keeps the servicing of the loans.

In the ordinary course of business, the Corporation sells residential mortgage loans (originated or purchased) to GNMA and GSEs. GNMA and GSEs, such as FNMA and FHLMC, generally securitize the transferred loans into mortgage-backed securities for sale into the secondary market. The Corporation sold approximately \$224.3 million of performing residential mortgage loans to FNMA and FHLMC during 2013. Also, the Corporation securitized approximately \$355.5 million of FHA/VA mortgage loans into GNMA mortgage-backed securities during 2013. The Corporation's continuing involvement in these loan sales consists primarily of servicing the loans. In addition, the Corporation agreed to repurchase loans when it breaches any of the representations and warranties included in the sale agreement. These representations and warranties are consistent with the GSEs' selling and servicing guidelines (i.e., ensuring that the mortgage was properly underwritten according to established guidelines).

For loans sold to GNMA, the Corporation holds an option to repurchase individual delinquent loans issued on or after January 1, 2003 when the borrower fails to make any payment for three consecutive months. This option gives the Corporation the ability, but not the obligation, to repurchase the delinquent loans at par without prior authorization from GNMA.

Under ASC Topic 860, Transfers and Servicing, once the Corporation has the unilateral ability to repurchase a delinquent loan, it is considered to have regained effective control over the loan and is required to recognize the loan and a corresponding repurchase liability on the balance sheet regardless of the Corporation's intent to repurchase the loan.

During 2013, 2012, and 2011, the Corporation repurchased pursuant to its repurchase option with GNMA \$28.3 million, \$53.9 million, and \$35.2 million, respectively, of loans previously sold to GNMA. The principal balance of these loans is fully guaranteed and the risk of loss related to repurchases is generally limited to the difference between the delinquent interest payment advanced to GNMA computed at the loan's interest rate and the interest payments reimbursed by FHA, which are computed at a predetermined debenture rate. Repurchases of GNMA loans allow the Corporation, among other things, to maintain acceptable delinquency rates on outstanding GNMA pools and remain as a seller and servicer in good standing with GNMA. The Corporation generally remediates any breach of representations and warranties related to the underwriting of such loans according to established GNMA guidelines without incurring losses. The Corporation does not maintain a liability for estimated losses as a result of breaches in representations and warranties.

Loan sales to FNMA and FHLMC are without recourse in relation to the future performance of the loans. The Corporation repurchased at par loans previously sold to FNMA and FHLMC in the amounts of \$6.1 million, \$3.0 million, and \$3.5 million during 2013, 2012, and 2011, respectively. The Corporation's risk of loss with respect to these loans is also minimal as these repurchased loans are generally performing loans with documentation deficiencies. The amount of these loan repurchases represents less than 2% of total sales of loans to FNMA and FHLMC over the last three years and no subsequent losses have been experienced on these loans. As a consequence, the Corporation does not maintain a liability for estimated losses on loans expected to be repurchased as a result of breaches in loan and servicer representations and warranties.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Bulks Sales of Assets and Transfers of Loans to Held For Sale**

On March 28, 2013, the Corporation completed the sale of adversely classified loans with a book value of \$211.4 million (\$100.1 million of commercial and industrial loans, \$68.8 million of commercial mortgage loans, \$41.3 million of construction loans, and \$1.2 million of residential mortgage loans), and \$6.3 million of OREO properties in a cash transaction. Included in the bulk sale was \$185.0 million of non-performing assets. The sales price of this bulk sale was \$120.2 million. Approximately \$39.9 million of reserves had already been allocated to the loans. This transaction resulted in total charge-offs of \$98.5 million and an incremental loss of \$58.9 million, reflected in the provision for loan and lease losses for the year 2013. In addition, the Corporation recorded \$3.9 million of professional fees specifically related to this bulk sale of assets. This transaction resulted in a total pretax loss of \$62.8 million.

In addition, during the first quarter of 2013, the Corporation transferred to held for sale non-performing loans with an aggregate book value of \$181.6 million. These transfers resulted in charge-offs of \$36.0 million and an incremental loss of \$5.2 million reflected in the provision for loan and lease losses for the year 2013.

During the second quarter of 2013, the Corporation completed the sale of a \$40.8 million non-performing commercial mortgage loan that was among the loans transferred to held for sale in the first quarter without incurring additional losses.

On June 21, 2013, the Corporation announced that it had completed a sale of non-performing residential mortgage loans with a book value of \$203.8 million and OREO properties with a book value of \$19.2 million in a cash transaction. The sales price of this bulk sale was \$128.3 million. Approximately \$30.1 million of reserves had already been allocated to the loans. This transaction resulted in total charge-offs of \$98.0 million and an incremental loss of \$69.8 million, reflected in the provision for loan and lease losses for the year 2013. In addition, the Corporation recorded \$3.1 million of professional service fees specifically related to this bulk sale of non-performing residential assets. This transaction resulted in a total pretax loss of \$72.9 million.

In separate transactions during 2013, the Corporation foreclosed on the collateral underlying \$39.2 million related to one of the loans written-off and transferred to held for sale in the first quarter. The Corporation recorded losses of \$4.9 million in 2013 related to this loan after the transfer to held for sale (\$1.7 million or lower of cost or market adjustment and \$3.2 million of write-downs to the value of foreclosed properties, recorded as part of net loss on OREO and OREO operations in the statement of (loss) income).

Furthermore, in the third quarter of 2013, approximately \$6.4 million of construction loan held for sale participations were paid off, resulting in a gain of \$0.3 million included as part of "Other income" in the statement of (loss) income.

The Corporation's primary goal with respect to these sales has been to accelerate the disposition of non-performing assets, which is the main priority of the Corporation's Strategic Plan. The opportunistic sale of distressed assets is a pivotal and tactical step in the Corporation's efforts to reduce balance sheet risk, improve earnings in the future through reductions of credit-related-costs, and enhance credit quality consistent with regulators' expectations of adequate levels of adversely classified assets for financial institutions.

**Loan Portfolio Concentration**

The Corporation's primary lending area is Puerto Rico. The Corporation's banking subsidiary, FirstBank, also lends in the USVI and BVI markets and in the United States (principally in the state of Florida). Of the total gross loans held for investment of \$9.6 billion as of December 31, 2013, approximately 84% have credit risk concentration in Puerto Rico, 9% in the United States, and 7% in the USVI and BVI.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

As of December 31, 2013, the Corporation had \$454.6 million of credit facilities granted to the Puerto Rico government, its municipalities and public corporations, of which \$397.8 million was outstanding, compared to \$158.4 million outstanding as of December 31, 2012, and \$60.6 million outstanding in credit facilities granted to the government of the Virgin Islands, compared to \$35.5 million as of December 31, 2012. Approximately \$200.5 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality. The good faith, credit, and unlimited taxing power of each applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$84.6 million consists of loans to public corporations that receive revenues from the rates they charge for services or products, such as electric power services, including credit extended to the Puerto Rico Electric Power Authority for fuel purchases that have priority over senior bonds and other debt. Main public corporations have varying degrees of independence from the central government and many receive appropriations or other payments from the Puerto Rico's government general fund. Approximately \$112.7 million consists of loans to the central government or units of the central government. Debt issued by the central government can either carry the full faith, credit, and taxing power of the Commonwealth of Puerto Rico or represent an obligation, that is subject to annual budget appropriations. Furthermore, the Corporation had \$205.1 million outstanding as of December 31, 2013 in financing to the hotel industry in Puerto Rico guaranteed by the Puerto Rico Tourism Development Fund ("TDF"). The TDF is a subsidiary of the GDB that works with private-sector financial institutions to structure financings for new hospitality projects.

As disclosed in Note 4, S&P, Moody's and Fitch downgraded the credit rating of the Commonwealth of Puerto Rico's debt to non-investment grade categories. The Corporation cannot predict at this time the impact that the current fiscal situation of the Commonwealth of Puerto Rico and the various legislative and other measures adopted and to be adopted by the Puerto Rico government in response to such fiscal situation will have on the Puerto Rico economy and on the Corporation's financial condition and results of operations.

In addition to loans extended to government entities, the largest loan to one borrower as of December 31, 2013 in the amount of \$240.1 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 single-family residential mortgage loans in Puerto Rico. This loan is subject to collateral substitution that requires the borrower to substitute defaulted mortgages.

### **Troubled Debt Restructurings**

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program, as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans in the U.S. mainland, fit the definition of TDRs. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of December 31, 2013, the Corporation's total TDR loans of \$630.3 million consisted of \$337.2 million of residential mortgage loans, \$92.0 million of commercial and industrial loans, \$153.6 million of commercial mortgage loans, \$20.1 million of construction loans, and \$27.3 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to \$0.5 million as of December 31, 2013.



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Corporation's loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments for a significant period of time, and reduction of interest rates either permanently (offered up to 2010) or for a period of up to two years (step-up rates). Additionally, in certain cases, the restructuring may provide for the forgiveness of contractually due principal or interest. Uncollected interest is added to the end of the loan term at the time of the restructuring and not recognized as income until collected or when the loan is paid off. These programs are available only to those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in the foreclosure action absent some lender concession. Nevertheless, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a six-month period during which the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification. TDR loans that are participating in or that have been offered a binding trial modification are classified as TDR when the trial offer is made and continue to be classified as TDR regardless of whether the borrower enters into a permanent modification. As of December 31, 2013, the Corporation classified an additional \$8.5 million of residential mortgage loans as TDRs that were participating in or had been offered a trial modification.

For the commercial real estate, commercial and industrial, and construction portfolios, at the time of a restructuring, the Corporation determines, on a loan-by-loan basis, whether a concession was granted for economic or legal reasons related to the borrower's financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waivers of borrower covenants; forgiveness of principal or interest; or other contract changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collection function. The function's objective is to minimize both early stage delinquencies and losses upon default of commercial loans. In the case of commercial and industrial, 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, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists, and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary. The SAG utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third-party consultants. In the case of residential construction projects and large commercial loans, the function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and assists with the restructuring of large commercial loans. In addition, the Corporation extends, renews, and restructures loans with satisfactory credit profiles. Many commercial loan facilities are structured as lines of credit, which are mainly one year in term and therefore are required to be renewed annually. Other facilities may be restructured or extended from time to time based upon changes in the borrower's business needs, use of funds, the timing of the completion of projects, and other factors. If the borrower is not deemed to have financial difficulties, extensions, renewals, and restructurings are done in the normal course of business and not considered concessions, and the loans continue to be recorded as performing.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Selected information on TDRs that includes the recorded investment by loan class and modification type is summarized in the following tables. This information reflects all TDRs:

		December 31, 2013				
(In thousands)	<u>Interest rate below market</u>	<u>Maturity or term extension</u>	<u>Combination of reduction in interest rate and extension of maturity</u>	<u>Forgiveness of principal and/or interest</u>	<u>Other <sup>(1)</sup></u>	<u>Total</u>
Troubled Debt Restructurings:						
Non-FHA/VA Residential						
Mortgage loans . . . . .	\$23,428	\$ 6,059	\$274,562	\$ —	\$ 33,195	\$337,244
Commercial Mortgage						
Loans . . . . .	36,543	12,985	83,993	7	20,048	153,576
Commercial and Industrial						
Loans . . . . .	12,099	11,341	12,835	3,122	52,554	91,951
Construction Loans:						
Land . . . . .	878	2,012	1,760	—	675	5,325
Construction-Commercial . . . .	—	—	3,924	—	—	3,924
Construction-Residential . . . .	6,054	160	3,173	994	513	10,894
Consumer Loans—Auto . . . . .	—	706	8,350	—	5,066	14,122
Finance Leases . . . . .	—	1,286	1,072	—	—	2,358
Consumer Loans—Other . . . . .	<u>227</u>	<u>256</u>	<u>8,638</u>	<u>—</u>	<u>1,743</u>	<u>10,864</u>
Total Troubled Debt Restructurings <sup>(2)</sup> . . . . .	<u>\$79,229</u>	<u>\$34,805</u>	<u>\$398,307</u>	<u>\$4,123</u>	<u>\$113,794</u>	<u>\$630,258</u>

- (1) Other concessions granted by the Corporation include deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation, or a combination of the concessions listed in the table.
- (2) Included in the bulk sales of assets completed during the first half of 2013 was \$188.1 million of TDRs, and the transfer of loans to held for sale included TDRs with a book value of \$158.4 million at the time of the transfer. The carrying value of TDRs held for sale amounted to \$45.9 million as of December 31, 2013.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

December 31, 2012

(In thousands)	Interest rate below market	Maturity or term extension	Combination of reduction in interest rate and extension of maturity	Forgiveness of principal and/or interest	Forbearance agreement <sup>(1)</sup>	Other <sup>(2)</sup>	Total
Troubled Debt Restructurings:							
Non-FHA/VA Residential							
Mortgage loans . . . . .	\$ 21,288	\$ 4,178	\$338,731	\$ —	\$ —	\$ 47,687	\$411,884
Commercial Mortgage							
Loans . . . . .	103,203	15,578	105,695	46,855	—	16,332	287,663
Commercial and Industrial							
Loans . . . . .	28,761	15,567	26,054	11,951	9,492	41,244	133,069
Construction Loans:							
Land . . . . .	964	2,207	1,738	—	—	570	5,479
Construction-Commercial . . .	—	—	4,085	—	56,363	—	60,448
Construction-Residential . . . .	5,477	1,988	3,337	—	5,535	3,929	20,266
Consumer Loans—Auto . . . . .	—	1,012	7,452	—	—	2,968	11,432
Finance Leases . . . . .	—	1,512	507	—	—	—	2,019
Consumer Loans—Other . . . . .	451	438	6,472	—	—	2,109	9,470
Total Troubled Debt							
Restructurings . . . . .	<u>\$160,144</u>	<u>\$42,480</u>	<u>\$494,071</u>	<u>\$58,806</u>	<u>\$71,390</u>	<u>\$114,839</u>	<u>\$941,730</u>

- (1) Mainly related to one construction relationship amounting to \$53.4 million transferred to held for sale in 2013.
- (2) Other concessions granted by the Corporation include deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation, or a combination of the concessions listed in the table above.

The following table presents the Corporation's TDR activity:

(In thousands)	Year Ended December 31, 2013
Beginning balance of TDRs . . . . .	\$ 941,730
New TDRs . . . . .	124,424
Increases to existing TDRs—additional disbursements . . . . .	2,864
Charge-offs post modification . . . . .	(132,595)
Sales, net of charge-offs . . . . .	(104,915)
Foreclosures . . . . .	(11,886)
Removed from TDR classification . . . . .	(6,764)
TDRs transferred to held for sale . . . . .	(129,964)
Paid-off and partial payments . . . . .	<u>(52,636)</u>
Ending balance of TDRs . . . . .	<u>\$ 630,258</u>

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation's interest income by returning a non-performing loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and avoid increases in foreclosure and OREO costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses. A TDR loan that specifies an interest rate that at the time of the restructuring is greater than or equal to the rate the Corporation is willing to accept for a new loan with comparable risk may not be reported as a TDR, or an impaired loan in the calendar years subsequent to the restructuring, if it is in compliance with its modified terms. During the year ended December 31, 2013, \$6.8 million of loans was removed from the TDR classification, as reflected in the table above.

The following table provides a breakdown between accrual and nonaccrual of TDRs:

(In thousands)	December 31, 2013		
	Accrual	Nonaccrual <sup>(1) (2)</sup>	Total TDRs
Non-FHA/VA Residential Mortgage loans . . . . .	\$263,919	\$ 73,324	\$337,243
Commercial Mortgage Loans . . . . .	53,509	38,441	91,950
Commercial and Industrial Loans . . . . .	84,419	69,156	153,575
Construction Loans:			
Land . . . . .	1,000	4,325	5,325
Construction-commercial . . . . .	—	3,924	3,924
Construction-residential . . . . .	3,332	7,562	10,894
Consumer Loans—Auto . . . . .	8,512	5,610	14,122
Finance Leases . . . . .	2,275	85	2,360
Consumer Loans—Other . . . . .	8,417	2,448	10,865
Total Troubled Debt Restructurings . . . . .	<u>\$425,383</u>	<u>\$204,875</u>	<u>\$630,258</u>

- (1) Included in non-accrual loans are \$95.7 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectibility.
- (2) Excludes non-accrual TDRs held for sale with a carrying value of \$45.9 million as of December 31, 2013.

(In thousands)	December 31, 2012		
	Accrual	Nonaccrual <sup>(1)</sup>	Total TDRs
Non-FHA/VA Residential Mortgage loans . . . . .	\$287,198	\$124,686	\$411,884
Commercial Mortgage Loans . . . . .	163,079	124,584	287,663
Commercial and Industrial Loans . . . . .	36,688	96,381	133,069
Construction Loans:			
Land . . . . .	1,607	3,873	5,480
Construction-commercial . . . . .	—	61,488	61,488
Construction-residential . . . . .	947	18,278	19,225
Consumer Loans—Auto . . . . .	6,615	4,817	11,432
Finance Leases . . . . .	1,900	119	2,019
Consumer Loans—Other . . . . .	6,744	2,726	9,470
Total Troubled Debt Restructurings . . . . .	<u>\$504,778</u>	<u>\$436,952</u>	<u>\$941,730</u>

- (1) Included in non-accrual loans are \$197.2 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectibility.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

TDRs exclude restructured mortgage loans that are government-guaranteed (i.e., FHA/VA loans) totaling \$90.6 million. The Corporation excludes government-guaranteed loans from TDRs given that in the event that the borrower defaults on the loan, the principal and interest (debenture rate) are guaranteed by the U.S. government; therefore, the risk of loss on these types of loans is very low. The Corporation does not consider loans with government guarantees to be impaired loans for the purpose of calculating the allowance for loan and lease losses.

Loan modifications that are considered TDRs completed during 2013 and 2012 were as follows:

		<b>Year ended December 31, 2013</b>		
(In thousands)	<b>Number of contracts</b>	<b>Premodification Outstanding Recorded Investment</b>	<b>Postmodification Outstanding Recorded Investment</b>	
<b>Troubled Debt Restructurings:</b>				
Non-FHA/VA Residential Mortgage				
loans . . . . .	292	\$ 48,181	\$ 48,664	
Commercial Mortgage Loans . . . . .	17	6,000	6,161	
Commercial and Industrial Loans . . . . .	27	79,531	53,525	
<b>Construction Loans:</b>				
Land . . . . .	7	341	344	
Construction-Commercial . . . . .	—	—	—	
Construction-Residential . . . . .	1	195	195	
Consumer Loans—Auto . . . . .	557	7,582	7,582	
Finance Leases . . . . .	75	1,435	1,435	
Consumer Loans—Other . . . . .	<u>1,452</u>	<u>6,518</u>	<u>6,518</u>	
<b>Total Troubled Debt Restructurings . . . . .</b>	<b><u>2,428</u></b>	<b><u>\$149,783</u></b>	<b><u>\$124,424</u></b>	
		<b>Year ended December 31, 2012</b>		
(in thousands)	<b>Number of contracts</b>	<b>Premodification Outstanding Recorded Investment</b>	<b>Postmodification Outstanding Recorded Investment</b>	
<b>Troubled Debt Restructurings:</b>				
Non-FHA/VA Residential Mortgage				
loans . . . . .	491	\$ 80,000	\$ 80,368	
Commercial Mortgage Loans . . . . .	43	103,930	103,912	
Commercial and Industrial Loans . . . . .	72	90,639	71,039	
<b>Construction Loans:</b>				
Land . . . . .	7	2,654	2,655	
Construction-Commercial . . . . .	4	5,257	5,247	
Construction-Residential . . . . .	1	4,179	4,180	
Consumer Loans—Auto . . . . .	486	6,036	5,993	
Finance Leases . . . . .	86	1,579	1,579	
Consumer Loans—Other . . . . .	<u>1,122</u>	<u>7,033</u>	<u>7,033</u>	
<b>Total Troubled Debt Restructurings . . . . .</b>	<b><u>2,312</u></b>	<b><u>\$301,307</u></b>	<b><u>\$282,006</u></b>	

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Recidivism, or the borrower defaulting on its obligation pursuant to a modified loan, results in the loan once again becoming a non-performing loan. Recidivism occurs at a notably higher rate than do defaults on new origination loans, so modified loans present a higher risk of loss than do new origination loans. The Corporation considers a loan to have defaulted if the borrower has failed to make payments of either principal, interest, or both for a period of 90 days or more.

Loan modifications considered TDRs that defaulted during the years ended 2013 and 2012, and had become TDRs during the 12 months preceding the default date, were as follows:

(In thousands)	Year ended December 31,			
	2013		2012	
	Number of contracts	Recorded Investment	Number of contracts	Recorded Investment
Non-FHA/VA Residential Mortgage loans . . . . .	81	\$13,415	166	\$26,669
Commercial Mortgage Loans . . . . .	1	46,102	11	6,057
Commercial and Industrial Loans . . . . .	2	3,829	13	30,629
Construction Loans				
Land . . . . .	2	66	—	—
Construction-commercial . . . . .	—	—	1	2,999
Construction-Residential . . . . .	1	186	1	5,383
Consumer Loans—Auto . . . . .	9	86	43	448
Consumer Loans—Other . . . . .	40	219	73	410
Finance Leases . . . . .	3	38	3	70
Total . . . . .	139	\$63,941	311	\$72,665

For certain TDRs, the Corporation splits the loans into two new notes, A and B notes. The A note is restructured to comply with the Corporation's lending standards at current market rates, and is tailored to suit the customer's ability to make timely interest and principal payments. The B note includes the granting of the concession to the borrower and varies by situation. The B note is charged off but the borrower's obligation is not forgiven, and any payments collected are accounted for as recoveries. At the time of the restructuring, the A note is identified and classified as a TDR. If the loan performs for at least six months according to the modified terms, the A note may be returned to accrual status. The borrower's payment performance prior to the restructuring is included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual status at the time of the restructuring. In the periods following the calendar year in which a loan is restructured, the A note may no longer be reported as a TDR if it is on accrual, complies with its modified terms, and yields a market rate (as determined and documented at the time of the restructure).

The recorded investment in loans restructured using the A/B note restructure workout strategy was approximately \$78.3 million and \$129.4 million at December 31, 2013 and 2012, respectively. The following table provides additional information about the volume of this type of loan restructuring and the effect on the allowance for loan and lease losses in 2013 and 2012:

(In thousands)	December 31, 2013	December 31, 2012
Principal balance deemed collectible at end of year . . . . .	\$78,342	\$129,405
Amount charged off, net . . . . .	\$20,889	\$ 2,735
(Reductions) charges to the provision for loan losses <sup>(1)</sup> . . . . .	\$ (4,084)	\$ 1,090
Allowance for loan losses at end of year . . . . .	\$ 1,436	\$ 5,318

(1) During 2013, the Corporation recorded a recovery of \$4.5 million related to a restructured loan that was repaid.



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Of the loans comprising the \$78.3 million that has been deemed to be collectible, approximately \$76.6 million was placed in accruing status as the borrowers have exhibited a period of sustained performance. These loans continue to be individually evaluated for impairment purposes.

**NOTE 8 – ALLOWANCE FOR LOAN AND LEASE LOSSES**

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

(In thousands) Year Ended December 31, 2013	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial and Industrial Loans	Construction Loans	Consumer Loans	Total
<b>Allowance for loan and lease losses:</b>						
Beginning balance . . . . .	\$ 68,354	\$ 97,692	\$ 146,900	\$ 61,600	\$ 60,868	\$ 435,414
Charge-offs . . . . .	(30,192)	(27,400)	(65,171)	(30,539)	(63,108)	(216,410)
Charge-offs related to bulk sales . . . . .	(98,972)	(40,057)	(44,678)	(12,784)	—	(196,491)
Recoveries . . . . .	1,165	4,855	4,636	2,076	6,862	19,594
Provision . . . . .	92,755	27,357	53,048	16,712	53,879	243,751
Reclassification <sup>(1)</sup> . . . . .	—	10,691	(9,440)	(1,251)	—	—
Ending balance . . . . .	<u>\$ 33,110</u>	<u>\$ 73,138</u>	<u>\$ 85,295</u>	<u>\$ 35,814</u>	<u>\$ 58,501</u>	<u>\$ 285,858</u>
Ending balance: specific reserve for impaired loans . . . . .	<u>\$ 18,125</u>	<u>\$ 32,189</u>	<u>\$ 26,686</u>	<u>\$ 22,144</u>	<u>\$ 3,457</u>	<u>\$ 102,601</u>
Ending balance: purchased credit-impaired loans . . . . .	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Ending balance: general allowance . . . . .	<u>\$ 14,985</u>	<u>\$ 40,949</u>	<u>\$ 58,609</u>	<u>\$ 13,670</u>	<u>\$ 55,044</u>	<u>\$ 183,257</u>
<b>Loans held for investment:</b>						
Ending balance . . . . .	<u>\$2,549,008</u>	<u>\$1,823,608</u>	<u>\$3,028,322</u>	<u>\$168,713</u>	<u>\$2,066,519</u>	<u>\$9,636,170</u>
Ending balance: impaired loans . . . . .	\$ 410,994	\$ 219,372	\$ 187,104	\$ 72,717	\$ 28,925	\$ 919,112
Ending balance: purchased credit-impaired loans . . . . .	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,791</u>	<u>\$ 4,791</u>
Ending balance: loans with general allowance . . . . .	<u>\$2,138,014</u>	<u>\$1,604,236</u>	<u>\$2,841,218</u>	<u>\$ 95,996</u>	<u>\$2,032,803</u>	<u>\$8,712,267</u>

(1) Refer to Note 7 for information about the reclassification of certain loans between commercial and industrial and commercial mortgage made in the second quarter 2013.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

(In thousands) Year Ended December 31, 2012	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial and Industrial Loans	Construction Loans	Consumer Loans	Total
<b>Allowance for loan and lease losses:</b>						
Beginning balance . . . . .	\$ 68,678	\$ 108,992	\$ 164,490	\$ 91,386	\$ 60,371	\$ 493,917
Charge-offs . . . . .	(37,944)	(21,779)	(49,521)	(45,008)	(43,735)	(197,987)
Recoveries . . . . .	1,089	810	3,605	4,267	9,214	18,985
Provision (release) . . . . .	36,531	(778)	38,773	10,955	35,018	120,499
Reclassification . . . . .	—	10,447	(10,447)	—	—	—
Ending balance . . . . .	<u>\$ 68,354</u>	<u>\$ 97,692</u>	<u>\$ 146,900</u>	<u>\$ 61,600</u>	<u>\$ 60,868</u>	<u>\$ 435,414</u>
Ending balance: specific reserve for impaired loans . . . . .	<u>\$ 47,171</u>	<u>\$ 50,959</u>	<u>\$ 80,167</u>	<u>\$ 39,572</u>	<u>\$ 3,880</u>	<u>\$ 221,749</u>
Ending balance: purchased credit-impaired loans . . . . .	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Ending balance: general allowance . . . . .	<u>\$ 21,183</u>	<u>\$ 46,733</u>	<u>\$ 66,733</u>	<u>\$ 22,028</u>	<u>\$ 56,988</u>	<u>\$ 213,665</u>
<b>Loans held for investment:</b>						
Ending balance . . . . .	<u>\$2,747,217</u>	<u>\$1,883,798</u>	<u>\$3,048,547</u>	<u>\$361,875</u>	<u>\$2,012,677</u>	<u>\$10,054,114</u>
Ending balance: impaired loans . . . . .	\$ 584,719	\$ 354,525	\$ 320,030	\$180,683	\$ 25,337	\$ 1,465,294
Ending balance: purchased credit-impaired loans . . . . .	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 10,602</u>	<u>\$ 10,602</u>
Ending balance: loans with general allowance . . . . .	<u>\$2,162,498</u>	<u>\$1,529,273</u>	<u>\$2,728,517</u>	<u>\$181,192</u>	<u>\$1,976,738</u>	<u>\$ 8,578,218</u>

The bulk sale of approximately \$217.7 million of adversely classified assets in the first quarter of 2013, mainly commercial loans, resulted in charge-offs of approximately \$98.5 million. In determining the historical loss rate for the computation of the general reserve for commercial loans, the Corporation includes the portion of these charge-offs that was related to the acceleration of previously reserved credit losses amounting to approximately \$39.9 million. The Corporation considered that the portion not deemed to be credit-related losses was not indicative of the ultimate losses that might have occurred had the assets been resolved on an individual basis, over time and not in a steeply discounted bulk sale. A transaction, such as this one, entered into to expedite the reduction of non-performing and adversely classified assets, can result in charge-offs that are not reflective of the true credit-related charge-off history since there is a component related to the discounted value realized on a bulk sale basis. Accordingly, the Corporation concluded that it is reasonable to exclude the component related to the discounted value from its historical charge-offs analysis used in estimating its allowance for loan losses.

As of December 31, 2013, the Corporation maintains a \$0.4 million reserve for unfunded loan commitments mainly related to outstanding construction and commercial and industrial loan commitments. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments to borrowers that are experiencing financial difficulties 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.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 9—LOANS HELD FOR SALE**

The Corporation’s loans held-for-sale portfolio was composed of:

	December 31, 2013	2012
	(In thousands)	
Residential mortgage loans . . . . .	\$21,168	\$82,753
Construction loans . . . . .	47,802	—
Commercial and Industrial loans . . . . .	—	1,178
Commercial mortgage loans . . . . .	6,999	1,463
Total . . . . .	\$75,969	\$85,394

Non-performing loans held for sale totaled \$54.8 million as of December 31, 2013 (\$7.0 million commercial mortgage and \$47.8 million construction loans) and \$2.2 million (\$1.1 million commercial and industrial and \$1.1 million commercial mortgage) as of December 31, 2012.

As previously discussed, during the first quarter of 2013, the Corporation transferred to held for sale \$181.6 million of non-performing loans. In connection with the transfer, the Corporation recorded charge-offs of \$36.0 million in the first quarter of 2013.

During the second quarter of 2013, the Corporation completed the sale of a \$40.8 million non-performing commercial mortgage loan that was among the loans transferred to held for sale in the first quarter without incurring additional losses.

In addition, during 2013, the Corporation foreclosed on the collateral underlying \$39.2 million related to one of the loans written-off and transferred to held for sale in the first quarter of 2013. The Corporation recorded losses of \$4.9 million in 2013 related to this loan after the transfer to held for sale (\$1.7 million mainly of lower of cost of market adjustment, recorded as part of “Other income” in the Statement of (loss) income, and \$3.2 million of write-downs to the value of foreclosed properties recorded as part of “Net loss on OREO and OREO operations in the statement of (loss) income.

Furthermore, in the third quarter of 2013 approximately \$6.4 million of construction loan held for sale participations were paid-off, resulting in a gain of \$0.3 million, recorded as part of “Other income.”

The Corporation continues to seek to resolve and dispose of its non-performing commercial and construction loans held for sale.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 10—RELATED-PARTY TRANSACTIONS**

The Corporation granted loans to its directors, executive officers, and certain related individuals or entities in the ordinary of business. The movement and balance of these loans were as follows:

	<b>Amount</b>
	(In thousands)
<b>Balance at December 31, 2011</b> .....	\$ 6,155
New loans .....	71
Payments .....	(147)
Other changes .....	(1,986)
<b>Balance at December 31, 2012</b> .....	4,093
New loans .....	51
Payments .....	(750)
Other changes .....	(1,999)
<b>Balance at December 31, 2013</b> .....	\$ 1,395

These loans do not involve more than normal risk of collectibility and management considers that they present terms that are no more favorable than those that would have been obtained if the transactions had been with unrelated parties. The amounts reported as other changes include changes in the status of those who are considered related parties, which, for 2013, was mainly related to the resignation of one independent director and, for 2012, was mainly due to the resignation of five independent directors of the Corporation.

From time to time, the Corporation, in the ordinary course of its business, obtains services from related parties or makes contributions to non-profit organizations that have some association with the Corporation. Management believes the terms of such arrangements are consistent with arrangements entered into with independent third parties.

**NOTE 11—PREMISES AND EQUIPMENT**

Premises and equipment comprise:

	<b>Useful Life In Years</b>	<b>As of December 31,</b>	
		<b>2013</b>	<b>2012</b>
(Dollars in thousands)			
Buildings and improvements .....	10-40	\$ 141,836	\$ 143,611
Leasehold improvements .....	1-15	57,833	59,670
Furniture and equipment .....	3-10	147,640	144,441
		347,309	347,722
Accumulated depreciation .....		(216,170)	(196,770)
		131,139	150,952
Land .....		25,655	27,920
Projects in progress .....		10,152	2,491
Total premises and equipment, net .....		\$ 166,946	\$ 181,363

Depreciation and amortization expense amounted to \$ 24.0 million, \$24.2 million, and \$24.5 million for the years ended December 31, 2013, 2012, and 2011, respectively. During 2013, the Corporation reclassified at fair

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

value approximately \$2.2 million to other assets held for sale certain fixed assets no longer being used for operations after the consolidation of certain bank branches. This resulted in a charge of \$0.5 million recorded as part of “other non-interest income” on the statement of (loss) income.

**NOTE 12—GOODWILL AND OTHER INTANGIBLES**

Goodwill as of December 31, 2013 and 2012 amounted to \$28.1 million, recognized as part of “Other Assets” in the consolidated statement of financial condition. The Corporation conducted its annual evaluation of goodwill and other intangibles during the fourth quarter of 2013. The Corporation’s goodwill is related to the acquisition of FirstBank Florida in 2005.

The Corporation bypassed the qualitative assessment in 2013 and proceeded directly to perform the first step of the two-step goodwill impairment test. The Step 1 involves a comparison of the estimated fair value of the reporting unit to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is not considered impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step should be performed to measure the amount of the impairment.

The Step 1 evaluation of goodwill allocated to the Florida reporting unit under both valuation approaches (market and discounted cash flow analysis) indicated that the fair value of the unit was above the carrying amount of its equity book value as of the valuation date (October 1); therefore, the completion of Step 2 was not required. Based on the analysis under both the market and discounted cash flow analysis, the estimated fair value of equity of the reporting unit exceeded the carrying amount of the entity, including goodwill at the evaluation date. Goodwill was not impaired as of December 31, 2013 or 2012, nor was any goodwill written off due to impairment during 2013, 2012, and 2011.

In connection with the acquisition of the FirstBank-branded credit card loan portfolio, in the second quarter of 2012, the Corporation recognized a purchased credit card relationship intangible of \$24.5 million, which is being amortized over the next eight years on an accelerated basis based on the estimated attrition rate of the purchased credit card accounts, which reflects the pattern in which the economic benefits of the intangible asset are consumed. These benefits are consumed as the revenue stream generated by the cardholder relationship is realized.

The following tables show the gross amount and accumulated amortization of the Corporation’s intangible assets recognized as part of Other Assets in the consolidated statement of financial condition:

(Dollars in thousands)	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Core deposit intangible:		
Gross amount . . . . .	\$ 45,844	\$ 45,844
Accumulated amortization . . . . .	(38,863)	(36,509)
Net carrying amount . . . . .	<u>\$ 6,981</u>	<u>\$ 9,335</u>
Remaining amortization period . . . . .	9.8 years	10.4 years
Purchased credit card relationship intangible:		
Gross amount . . . . .	\$ 24,465	\$ 24,465
Accumulated amortization . . . . .	(4,678)	(954)
Net carrying amount . . . . .	<u>\$ 19,787</u>	<u>\$ 23,511</u>
Remaining amortization period . . . . .	8.0 Years	9.0 years

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table presents the estimated aggregate annual amortization expense for intangible assets:

	<b>Amount</b>
	(In thousands)
2014 .....	\$ 4,943
2015 .....	4,631
2016 .....	4,089
2017 .....	3,471
2018 and after .....	9,634

**NOTE 13—NON CONSOLIDATED VARIABLE INTEREST ENTITIES AND SERVICING ASSETS**

The Corporation transfers residential mortgage loans in sale or securitization transactions in which it has continuing involvement, including servicing responsibilities and guarantee arrangements. All such transfers have been accounted for as sales as required by applicable accounting guidance.

When evaluating transfers and other transactions with Variable Interest Entities (“VIEs”) for consolidation, 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 GNMA securitization transactions in which the loans are exchanged for cash or securities that are readily redeemed for cash proceeds and servicing rights. The securities issued through these transactions are guaranteed by the issuer and, as such, under seller/servicer agreements, the Corporation is required to service the loans in accordance with the issuers’ servicing guidelines and standards. As of December 31, 2013, the Corporation serviced loans securitized through GNMA with a principal balance of \$1.0 billion.

**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 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 June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Deferrable Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust-preferred



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

securities). The trust-preferred securities, subject to certain limitations, qualify as Tier I regulatory capital under current applicable 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. Bank holding companies, such as the Corporation, must fully phase out these instruments from Tier 1 capital by January 1, 2016 (25% allowed in 2015 and 0% in 2016); however, these instruments may remain in Tier 2 capital until the instruments are redeemed or mature.

#### 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 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, which has an interest only strip ("IO") tied to the cash flows of the underlying loans and is entitled to receive the excess of the interest income less a servicing fee over the variable rate income that the Bank earns on the securities. This IO is limited to the weighted average coupon of the securities. The FDIC became the owner of the IO upon the intervention of the seller, a failed financial institution. No recourse agreement exists and the risk from losses on non accruing loans and repossessed collateral are absorbed by the Bank as the sole holder of the certificates. As of December 31, 2013, the amortized balance and carrying value of the Grantor Trusts amounted to \$55.0 million and \$40.7 million, respectively, with a weighted average yield of 2.24%.

#### Investment in unconsolidated entities

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage, and commercial and industrial loans with an aggregate book value of \$269.3 million to CPG/GS, an entity organized under the laws of the Commonwealth of Puerto Rico and majority owned by PRLP Ventures LLC ("PRLP"), a company created by Goldman, Sachs & Co. and Caribbean Property Group. In connection with the sale, the Corporation received \$88.5 million in cash and a 35% interest in CPG/GS, and made a loan in the amount of \$136.1 million representing seller financing provided by FirstBank. The loan has a seven-year maturity and bears variable interest at 30-day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity's assets as well as the PRLP's 65% ownership interest in CPG/GS. As of December 31, 2013, the carrying amount of the loan was \$43.8 million, which was included in the Corporation's Commercial and Industrial loans held for investment portfolio; the carrying value of FirstBank's equity interest in CPG/GS was \$7.3 million as of December 31, 2013, accounted for under the equity method and included as part of Investment in unconsolidated entity in the Consolidated Statements of Financial Condition. When applying the equity method, the Bank follows the HLBV method to determine its share in CPG/GS's earnings or loss. Under HLBV, the Bank determines its share in CPG/GS's earnings or loss 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. The Bank reports its share of CPG/GS's operating results on a one-quarter lag basis. In addition, as a result of using HLBV, the difference between the Bank's investment in CPG/GS and its claim on the book value of CPG/GS at the date of the investment, known as the basis difference, is amortized over the estimated life of the investment, or five

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

years. CPG/GS records its loans receivable under the fair value option. Equity in loss of unconsolidated entity for the year ended December 31, 2013 of \$16.7 million includes \$4.5 million related to the amortization of the basis differential, compared to equity in loss of unconsolidated entity of \$19.3 million for 2012.

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 2011, and a \$20 million working capital line of credit to fund certain expenses of CPG/GS. During 2013, the working capital line of credit was renewed and reduced to \$7 million for a period of two years expiring September 2015. During 2012, CPG/GS repaid the outstanding balance of the advance facility to fund unfunded commitments, and the funds became available to redraw under a one-time revolver agreement. These loans bear variable interest at 30-day LIBOR plus 300 basis points. As of December 31, 2013, the carrying value of the revolver agreement and working capital line were \$25.6 million and \$0, respectively, and are included in the Corporation's commercial and industrial loans held for investment portfolio.

Cash proceeds received by CPG/GS are first used to cover operating expenses and debt service payments, including the note receivable, the advanced facility, and the working capital line described above, which must be substantially 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. Since CPG/GS is not a consolidated subsidiary of the Bank and 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.

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 other information about similar structures and/or of distressed asset sales) and determined reasonable ranges of expected returns for FirstBank's equity interest.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The rate of return of 17.57% was used as the discount factor to estimate the value of FirstBank's equity interest and represents the Bank's estimate of the yield a market participant would require. A reasonable range of equity returns was assessed based on consideration of a range of company-specific risk premiums. The valuation of this type of equity interest is highly subjective and somewhat dependent on nonobservable 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.

The changes in servicing assets are shown below:

	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	(In thousands)		
Balance at beginning of year . . . . .	\$17,524	\$15,226	\$15,163
Capitalization of servicing assets . . . . .	7,649	6,348	5,150
Amortization . . . . .	(3,289)	(3,014)	(2,491)
Adjustment to servicing assets for loans repurchased <sup>(1)</sup> . . . . .	(357)	(642)	(305)
Adjustment to fair value . . . . .	460	(394)	(2,291)
Balance at end of year . . . . .	<u>\$21,987</u>	<u>\$17,524</u>	<u>\$15,226</u>

(1) Amount represents the adjustment to fair value related to the repurchase 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.

Changes in the impairment allowance were as follows:

	<b>Year ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	(In thousands)		
Balance at beginning of year . . . . .	\$ 672	\$ 2,725	\$ 434
Temporary impairment charges . . . . .	277	763	2,732
OTTI of servicing assets . . . . .	—	(2,447)	—
Recoveries . . . . .	(737)	(369)	(441)
Balance at end of year . . . . .	<u>\$ 212</u>	<u>\$ 672</u>	<u>\$2,725</u>

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The components of net servicing income are shown below:

	Year ended December 31,		
	2013	2012	2011
	(In thousands)		
Servicing fees . . . . .	\$ 7,164	\$ 5,650	\$ 5,268
Late charges and prepayment penalties . . . . .	701	642	751
Adjustment for loans repurchased . . . . .	(357)	(642)	(305)
Other . . . . .	(407)	—	—
	7,101	5,650	5,714
Servicing income, gross . . . . .	7,101	5,650	5,714
Amortization and impairment of servicing assets . . . . .	(2,829)	(3,408)	(4,782)
	\$ 4,272	\$ 2,242	\$ 932
Servicing income, net . . . . .			

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:

	<u>Maximum</u>	<u>Minimum</u>
<b>2013:</b>		
<b>Constant prepayment rate:</b>		
Government-guaranteed mortgage loans . . . . .	10.5%	8.9%
Conventional conforming mortgage loans . . . . .	10.9%	8.7%
Conventional non-conforming mortgage loans . . . . .	14.3%	12.3%
<b>Discount rate:</b>		
Government-guaranteed mortgage loans . . . . .	12.0%	11.5%
Conventional conforming mortgage loans . . . . .	10.0%	9.5%
Conventional non-conforming mortgage loans . . . . .	14.3%	13.8%
<b>2012:</b>		
<b>Constant prepayment rate:</b>		
Government-guaranteed mortgage loans . . . . .	12.4%	11.6%
Conventional conforming mortgage loans . . . . .	12.8%	12.3%
Conventional non-conforming mortgage loans . . . . .	13.8%	13.3%
<b>Discount rate:</b>		
Government-guaranteed mortgage loans . . . . .	12.0%	12.0%
Conventional conforming mortgage loans . . . . .	10.0%	10.0%
Conventional non-conforming mortgage loans . . . . .	14.3%	14.3%
<b>2011:</b>		
<b>Constant prepayment rate:</b>		
Government-guaranteed mortgage loans . . . . .	12.9%	10.6%
Conventional conforming mortgage loans . . . . .	14.3%	12.7%
Conventional non-conforming mortgage loans . . . . .	13.9%	11.7%
<b>Discount rate:</b>		
Government-guaranteed mortgage loans . . . . .	12.0%	11.3%
Conventional conforming mortgage loans . . . . .	11.5%	9.3%
Conventional non-conforming mortgage loans . . . . .	15.0%	13.8%

At December 31, 2013, fair values of the Corporation's servicing assets were based on a valuation model that incorporates market driven assumptions regarding discount rates and mortgage prepayment rates, adjusted by the particular characteristics of the Corporation's servicing portfolio. The weighted averages of the key economic

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

assumptions used by the Corporation in its valuation model and the sensitivity of the current fair value to immediate 10% and 20% adverse changes in those assumptions for mortgage loans as of December 31, 2013 were as follows:

	(Dollars in thousands)
Carrying amount of servicing assets .....	\$21,987
Fair value .....	\$24,679
Weighted average expected life (in years) .....	9.84
<b>Constant prepayment rate (weighted average annual rate)</b> .....	<b>8.90%</b>
Decrease in fair value due to 10% adverse change .....	\$ 897
Decrease in fair value due to 20% adverse change .....	\$ 1,739
<b>Discount rate (weighted average annual rate)</b> .....	<b>10.60%</b>
Decrease in fair value due to 10% adverse change .....	\$ 1,046
Decrease in fair value due to 20% adverse change .....	\$ 2,012

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship between the change in assumption and the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the servicing asset is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which may magnify or counteract the sensitivities.

**NOTE 14—DEPOSITS AND RELATED INTEREST**

The following table summarizes deposit balances:

	December 31,	
	2013	2012
	(In thousands)	
Type of account and interest rate:		
Non-interest-bearing checking accounts .....	\$ 851,212	\$ 837,387
Savings accounts—0.20% to 1.00% (2012—0.25% to 1.21%) .....	2,334,831	2,295,766
Interest-bearing checking accounts—0.25% to 1.06% (2012—0.25% to 1.16%) .....	1,167,480	1,108,053
Certificates of deposit- 0.10% to 5.05% (2012—0.10% to 5.43%) .....	2,384,378	2,248,896
Brokered certificates of deposit—0.45% to 4.94% (2012—0.40% to 5.32%) .....	3,142,023	3,374,444
	\$9,879,924	\$9,864,546

The weighted average interest rate on total interest-bearing deposits as of December 31, 2013 and 2012 was 0.93% and 1.10%, respectively.

As of December 31, 2013, the aggregate amount of overdrafts in demand deposits that were reclassified as loans amounted to \$2.6 million (2012—\$18.6 million).

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table presents a summary of CDs, including brokered CDs, with a remaining term of more than one year as of December 31, 2013:

	<b>Total</b>
	(In thousands)
Over one year to two years . . . . .	\$1,643,085
Over two years to three years . . . . .	499,202
Over three years to four years . . . . .	159,750
Over four years to five years . . . . .	135,550
Over five years . . . . .	19,008
Total . . . . .	<u>\$2,456,595</u>

As of December 31, 2013, CDs in denominations of \$100,000 or higher amounted to \$4.7 billion (2012—\$4.7 billion) including brokered CDs of \$3.1 billion (2012—\$3.4 billion) at a weighted average cost of 0.97% (2012—1.50%) issued to deposit brokers in the form of large (\$100,000 or more) certificates of deposit that are generally participated out by brokers in shares of less than \$100,000. As of December 31, 2013, unamortized broker placement fees amounted to \$9.1 million (2012— \$9.2 million), which are amortized over the contractual maturity of the brokered CDs under the interest method.

Brokered certificates of deposit mature as follows:

	<b>December 31,</b>
	<b>2013</b>
	(In thousands)
One to ninety days . . . . .	\$ 351,371
Over ninety days to one year . . . . .	1,359,550
One to three years . . . . .	1,242,731
Three to five years . . . . .	169,888
Over five years . . . . .	18,483
Total . . . . .	<u>\$3,142,023</u>

As of December 31, 2013, deposit accounts issued to government agencies with a carrying value of \$705.8 million (2012—\$529.4 million) were collateralized by securities and loans with an amortized cost of \$784.0 million (2012—\$561.1 million) and an estimated market value of \$761.9 million (2012—\$570.1 million). As of December 31, 2013, the Corporation had \$546.5 million of government deposits in Puerto Rico (2012—\$346.4 million) and \$159.3 million in the Virgin Islands (2012—\$183.0 million).

In 2014, Act 24-2014 was approved by the Puerto Rico Legislature, seeking to further strengthen the liquidity of the Government Development Bank of Puerto Rico (“GDB”) and the GDB’s oversight of public funds. The GDB has identified approximately \$450 million in public funds deposited in private financial institutions in Puerto Rico that the GDB’s management currently expects to capture in the first half of calendar year 2014. The Corporation believes that \$250 million in public deposits held by the Corporation are at high risk of migration. Current and future liquidity levels have been planned considering that risk. As such, no material adverse effects are expected as a result of the potential reduction in public funds.



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

A table showing interest expense on deposits follows:

	Year Ended December 31,		
	2013	2012	2011
		(In thousands)	
Interest-bearing checking accounts . . . . .	\$ 8,419	\$ 9,421	\$ 13,760
Savings . . . . .	15,852	17,382	20,530
Certificates of deposit . . . . .	29,264	34,602	45,960
Brokered certificates of deposit . . . . .	38,252	66,854	111,477
Total . . . . .	<u>\$91,787</u>	<u>\$128,259</u>	<u>\$191,727</u>

The interest expense on deposits includes the amortization of broker placement fees related to brokered CDs amounting to \$7.9 million, \$9.9 million, and \$16.3 million for 2013, 2012, and 2011, respectively.

**NOTE 15—SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE**

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

	December, 31	
	2013	2012
	(Dollars in thousands)	
Repurchase agreements, interest ranging from 2.45% to 3.32% (December 31, 2012 -2.45% to 3.39%) <sup>(1)</sup> . . . . .	\$900,000	\$900,000

(1) As of December 31, 2013, includes \$700.0 million with an average rate of 2.90%, that lenders have the right to call before their contractual maturities at various dates beginning on January 9, 2014. Also includes \$700 million, which are currently tied to variable rates.

The weighted average interest rates on repurchase agreements as of December 31, 2013 and 2012 were 2.83% and 2.86%, respectively. Accrued interest payable on repurchase agreements amounted to \$4.5 million and \$4.6 million as of December 31, 2013 and 2012, respectively.

Repurchase agreements mature as follows:

	December 31, 2013
	(In thousands)
Two to three years . . . . .	\$400,000
Three to five years . . . . .	500,000
Total . . . . .	<u>\$900,000</u>

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following securities were sold under agreements to repurchase:

December 31, 2013				
Underlying Securities	Amortized Cost of Underlying Securities	Balance of Borrowing	Approximate Fair Value of Underlying Securities	Weighted Average Interest Rate of Security
(In thousands)				
U.S. government-sponsored agencies . . . . .	\$ 212,218	\$ 178,360	\$ 198,968	1.31%
Mortgage-backed securities . . . . .	858,626	721,640	843,514	2.59%
Total . . . . .	\$1,070,844	\$ 900,000	\$1,042,482	
Accrued interest receivable . . . . .	\$ 2,925			

December 31, 2012				
Underlying Securities	Amortized Cost of Underlying Securities	Balance of Borrowing	Approximate Fair Value of Underlying Securities	Weighted Average Interest Rate of Security
(In thousands)				
U.S. government-sponsored agencies . . . . .	\$ 75,075	\$ 64,856	\$ 75,041	1.02%
Mortgage-backed securities . . . . .	966,732	835,144	995,927	2.79%
Total . . . . .	\$1,041,807	\$ 900,000	\$1,070,968	
Accrued interest receivable . . . . .	\$ 2,916			

The maximum aggregate balance outstanding at any month-end during 2013 was \$900 million (2012—\$1.0 billion). The average balance during 2013 was \$900.0 million (2012—\$932.7 million). The weighted-average interest rate during 2013 and 2012 was 2.88% and 3.05%, respectively.

As of December 31, 2013 and 2012, the securities underlying such agreements were delivered to the dealers with which the repurchase agreements were transacted.

Repurchase agreements as of December 31, 2013, grouped by counterparty, were as follows:

(Dollars in thousands) Counterparty	Amount	Weighted Average Maturity (In Months)
Citigroup Global Markets . . . . .	\$300,000	34
JP Morgan Chase . . . . .	200,000	38
Dean Witter / Morgan Stanley . . . . .	100,000	46
Credit Suisse First Boston . . . . .	300,000	48
	\$900,000	

As part of the Corporation's balance sheet restructuring strategies, approximately \$400 million of repurchase agreements were repaid prior to maturity during 2011, realizing a loss of \$10.6 million on the early extinguishment of debt. The repaid repurchase agreements were scheduled to mature at various dates between September 2011 and September 2012 and had a weighted-average cost of 2.74%. Prepayment penalties of \$10.6 million for the early termination of the repurchase agreements were offset with gains of \$11.0 million from the sale of low-yielding investment securities.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 16—ADVANCES FROM FEDERAL HOME LOAN BANK (FHLB)**

The following is a summary of the advances from the FHLB:

	<b>December 31, 2013</b>	<b>December 31, 2012</b>
	(In thousands)	
Fixed-rate advances from FHLB, with a weighted average interest rate of 1.11% (December 31, 2012—2.26%) .....	\$300,000	\$508,440

Advances from FHLB mature as follows:

	<b>December 31, 2013</b>
	(In thousands)
Over one to three years .....	\$100,000
Three to Four years .....	<u>200,000</u>
Total .....	<u>\$300,000</u>

Advances are received from the FHLB under an Advances, Collateral Pledge, and Security Agreement (the “Collateral Agreement”). Under the Collateral Agreement, the Corporation is required to maintain a minimum amount of qualifying mortgage collateral with a market value of generally 125% or higher than the outstanding advances. As of December 31, 2013, the estimated value of specific mortgage loans pledged as collateral amounted to \$764.6 million (2012—\$768.1 million), as computed by the FHLB for collateral purposes. The carrying value of such loans as of December 31, 2013 amounted to \$988.0 million (2012—\$1.1 billion). In addition, securities with an approximate estimated value of \$1.6 million (2012—\$48.0 million) and a carrying value of \$1.6 million (2012—\$49.5 million) were pledged to the FHLB. As of December 31, 2013, the Corporation had additional capacity of approximately \$466.2 million on this credit facility based on collateral pledged at the FHLB, including a haircut reflecting the perceived risk associated with holding the collateral. Haircut refers to the percentage by which an asset’s market value is reduced for the purpose of collateral levels. Advances may be repaid prior to maturity, in whole or in part, at the option of the borrower upon payment of any applicable fee specified in the contract governing such advance. In calculating the fee, due consideration is given to (i) all relevant factors, including but not limited to, any and all applicable costs of repurchasing and/or prepaying any associated liabilities and/or hedges entered into with respect to the applicable advance; (ii) the financial characteristics, in their entirety, of the advance being prepaid; and (iii), in the case of adjustable-rate advances, the expected future earnings of the replacement borrowing as long as the replacement borrowing is at least equal to the original advance’s par amount and the replacement borrowing’s tenor is at least equal to the remaining maturity of the prepaid advance.

Also, as part of the Corporation’s deleveraging strategies, \$100 million of advances from FHLB was repaid prior to maturity during the second quarter of 2011, which resulted in a \$0.2 million loss on early extinguishment. The \$100 million was scheduled to mature in July 2011 and had an interest rate of 1.62%.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 17—OTHER BORROWINGS**

Other borrowings consist of:

	December 31, 2013	December 31, 2012
	(In thousands)	
Junior subordinated debentures due in 2034, interest-bearing at a floating rate of 2.75% over 3-month LIBOR (2.99% as of December 31, 2013 and 3.06% as of December 31, 2012) . . . . .	\$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 December 31, 2013 and 2.81% as of December 31, 2012) . . . . .	128,866	128,866
	\$231,959	\$231,959

**NOTE 18—EARNINGS PER COMMON SHARE**

The calculation of earnings per common share for the years ended December 31, 2013, 2012, and 2011 is as follows:

	Year Ended December 31,		
	2013	2012	2011
(In thousands, except per share information)			
Net (loss) income . . . . .	\$(164,487)	\$ 29,782	\$(82,232)
Cumulative convertible preferred stock dividend (Series G) . . . . .	—	—	(16,903)
Preferred stock discount accretion (Series G) <sup>(1)</sup> . . . . .	—	—	(5,634)
Favorable impact from issuing common stock in exchange for Series G mandatorily convertible preferred stock (Refer to Note 20) <sup>(2)</sup> . . . . .	—	—	277,995
Net (loss) income attributable to common stockholders- basic . . . . .	(164,487)	29,782	173,226
Convertible preferred stock dividends and accretion . . . . .	—	—	22,537
Net income (loss) attributable to common stockholders- diluted . . . . .	\$(164,487)	\$ 29,782	\$195,763
Average common shares outstanding . . . . .	205,542	205,366	64,466
Average potential common shares . . . . .	—	462	25,192
Average common shares outstanding—assuming dilution . . . . .	205,542	205,828	89,658
Basic (loss) earnings per common share . . . . .	\$ (0.80)	\$ 0.15	\$ 2.69
Diluted (loss) earnings per common share . . . . .	\$ (0.80)	\$ 0.14	\$ 2.18

- (1) Includes a noncash adjustment of \$0.2 million for the year ended December 31, 2011 as an acceleration of the Series G preferred stock discount accretion pursuant to amendments to the exchange agreement with the Treasury, the sole holder of the Series G preferred stock.
- (2) Excess of carrying amount of the Series G preferred stock exchanged over the fair value of new common shares issued in 2011.

Earnings (loss) per common share is computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares issued and outstanding. Net income (loss) attributable to common stockholders represents net income (loss) adjusted for any preferred stock dividends, including any dividends declared, any cumulative dividends related to the current dividend period that have not been declared as of the end of the period, and the accretion of the discount on preferred stock issuances, if any. For 2011, the net income attributable to common stockholders also includes the one-time effect of the issuance of

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

common stock in the conversion of the Series G preferred stock. This transaction is discussed in Note 20 to the consolidated financial statements. 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 diluted earnings per share since their inclusion would have an antidilutive effect on earnings per share. Stock options not included in the computation of outstanding shares because they were antidilutive amounted to 101,435; 113,158, and 129,934 for the years ended December 31, 2013, 2012, and 2011, respectively. Warrants outstanding to purchase 1,285,899 shares of common stock and 1,411,185 unvested shares of restricted stock were excluded from the computation of diluted earnings per share for the year 2013 because the Corporation reported a net loss attributable to common stockholders for the period and their inclusion would have an antidilutive effect.

The dilutive effect of convertible securities is reflected in the computation of diluted earnings per share using the if-converted method. The Series G preferred stock converted in the fourth quarter of 2011 was included in the denominator for the period prior to actual conversion and 32,941,797 common shares issued upon conversion were included in the weighted average shares outstanding for the period from their date of issuance through period-end.

**NOTE 19—STOCK-BASED COMPENSATION**

Between 1997 and January 2007, the Corporation had 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 these options is 10 years. The 1997 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.

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 of shares could be granted under the 1997 stock option plan as of its expiration.

The activity of stock options granted under the 1997 stock option plan for the year ended December 31, 2013 is set forth below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Beginning of year . . . . .	113,158	\$206.96		
Options expired . . . . .	(7,795)	192.20		
Options cancelled . . . . .	(3,928)	236.59		
End of year outstanding and exercisable . . . .	<u>101,435</u>	<u>\$206.95</u>	<u>2.1</u>	<u>\$—</u>

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

No stock options have been granted under the 1997 stock plan since its expiration on January 21, 2007; therefore, no compensation associated with stock options was recorded during 2013, 2012 and 2011.

On April 29, 2008, the Corporation’s stockholders approved the First Bancorp. 2008 Omnibus Incentive Plan, as amended (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. The Omnibus Plan authorizes the issuance of up to 8,169,807 shares of common stock, subject to adjustments for stock splits, reorganizations, and other similar events. The Corporation’s Board of Directors, upon receiving the relevant recommendation of the Compensation Committee, has the power and authority to determine those eligible to receive awards and to establish the terms and conditions of any awards, subject to various limits and vesting restrictions that apply to individual and aggregate awards.

Under the Omnibus Plan, during 2013, 26,780 shares of restricted stock were awarded to the Corporation’s independent directors subject to a one-year vesting period. In addition, during 2013, the Corporation issued 716,405 shares of restricted stock that will vest based on the employees’ continued service with the Corporation. Fifty percent (50%) of those shares vest in two years from the grant date and the remaining 50% vest in three years from the grant date. Included in those 716,405 shares of restricted stock are 582,905 shares granted to certain senior officers consistent with the requirements of the Troubled Asset Relief Program (“TARP”) Interim Final Rule, which permit TARP recipients to grant “long-term restricted stock” without violating the prohibition on paying or accruing a bonus payment if it satisfies certain requirements: (i) the value of the grant may not exceed one-third of the amount of the employee’s annual compensation, (ii) no portion of the grant may vest before two years after the grant date, and (iii) the grant must be subject to a further restriction on transfer or payment as described below. Hence, notwithstanding the vesting period mentioned above, the employees covered by TARP are restricted from transferring the shares. Specifically, the stock that has otherwise vested may not become transferable at any time earlier than as permitted under the schedule set forth by TARP, which is based on the repayment in 25% increments of the aggregate financial assistance received from the Treasury.

The fair value of the shares of restricted stock granted in 2013 was based on the market price of the Corporation’s outstanding common stock on the date of the grant. For the 582,905 shares of restricted stock granted under the TARP requirements, the market price was discounted due to postvesting restrictions. For purposes of computing the discount, the Corporation estimated an appreciation of 13% in the value of the common stock using the Capital Asset Pricing Model as a basis of what would be a market participant’s expected return on the Corporation’s stock and assumed that the Treasury would hold its outstanding common stock of the Corporation for two years, resulting in a fair value of \$3.02 for restricted shares granted under the TARP requirements. Also, the Corporation used empirical data to estimate employee termination; separate groups of employees that have similar historical exercise behavior were considered separately for valuation purposes.

The following table summarizes the restricted stock activity in 2013 under the Omnibus Plan for both executive officers covered by the TARP requirements and other employees as well as for the independent directors:

	2013	
	Number of shares of restricted stock	Weighted Average Grant Date Fair Value
Non-vested shares at beginning of year	770,507	\$2.51
Granted	743,185	3.70
Forfeited	(58,985)	4.23
Vested	(43,522)	3.45
Non-vested shares at end of year	<u>1,411,185</u>	<u>\$3.04</u>



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

For the years ended December 31, 2013 and 2012, the Corporation recognized \$1.6 million and \$0.9 million, respectively, of stock-based compensation expense related to restricted stock awards. During 2011, the Corporation recognized \$50 thousand related to 1,874 shares of restricted stock granted to independent directors in 2008, which vested as of December 31, 2011. As of December 31, 2013, there was \$2.2 million of total unrecognized compensation cost related to non-vested shares of restricted stock. The weighted average period over which the Corporation expects to recognize such cost is 1.6 years.

In 2012, the Corporation granted 51,007 shares of restricted stock to the independent directors subject to a one-year vesting period. In addition, during 2012, the Corporation granted 769,500 shares of restricted stock to certain senior officers and certain other employees. The restrictions on such restricted stock will lapse with respect to 50% of the restricted stock over a two-year period and 50% over a three-year period, except for 50,000 shares of restricted stock that already vested in 2012. Included in the shares of restricted stock granted in 2012 are 557,000 shares granted to certain senior officers consistent with the requirements of TARP. The employees covered by TARP are restricted from transferring the shares, subject to certain conditions as explained above.

The fair value of the shares of restricted stock granted in 2012 was based on the market price of the Corporation's outstanding common stock on the date of the grant, or a weighted average market price of \$3.98. However, for the 557,000 shares of restricted stock granted under the TARP requirements, the market price was discounted due to postvesting restrictions. For purposes of computing the discount, the Corporation assumed appreciation of 25% in the value of the common stock and a holding period by the Treasury of its outstanding common stock of the Corporation of (3) three years, resulting in a fair value of \$2.00 for restricted shares granted under the TARP requirements in 2012. Also, the Corporation uses empirical data to estimate employee termination; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes.

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 in the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase in 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. Approximately, \$0.1 million of compensation expense was reversed in 2013 related to forfeited awards; no compensation expense was reversed in 2012.

Also, under the Omnibus Plan, effective April 1, 2013, the Corporation's Board of Directors determined to increase the salary amounts paid to certain executive officers for fiscal year 2013 primarily by paying the increased salary amounts in the form of shares of the Corporation's common stock, instead of cash. During 2013, the Corporation issued 220,639 shares of common stock with a weighted average market value of \$6.23 for compensation according to this determination. This resulted in a compensation expense of \$1.4 million recorded in 2013. The Corporation withheld 71,326 shares from the common stock paid to certain senior officers as additional compensation to cover employees' payroll and income tax withholding liabilities; these shares are held as treasury shares. The Corporation paid any fractional share of salary stock that the officer was entitled to in cash.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 20—STOCKHOLDERS' EQUITY**

As of December 31, 2013 and 2012, the Corporation had 2,000,000,000 authorized shares of common stock with a par value of \$0.10 per share. As of December 31, 2013 and 2012, there were 207,635,157 and 206,730,318 shares issued, respectively, and 207,068,978 and 206,235,465, shares outstanding, respectively. On July 30, 2009, the Corporation announced the suspension of common and preferred stock dividends effective with the preferred dividend for the month of August 2009.

In 2013 and 2012, the Corporation granted 26,780 shares and 51,007 shares, respectively, of restricted stock under the Omnibus Plan, as amended, to the independent directors subject to a one-year vesting period. Also in 2013 and 2012, the Corporation granted 716,405 shares and 769,500 shares, respectively, of restricted stock, to certain senior officers and certain other employees. The restrictions on such restricted stock will lapse 50% over a two-year period and 50% over a three-year period, except for 50,000 shares that already vested in 2012. Included in the shares of restricted stock granted in 2013 and 2012 are 582,905 shares and 557,000 shares, respectively, granted to certain senior officers consistent with the requirements of TARP, refer to Note 19 for additional details. 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 upon the termination of a holder of restricted stock, the Corporation's Board of Directors may, with the recommendation of the Compensation Committee, accelerate the vesting of the restricted stock held by such holder 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.

In addition, in 2013 the Corporation issued 220,639 shares of common stock as increased compensation to certain executive officers. Refer to Note 19 for additional details. As of December 31, 2013 and December 31, 2012, there were 1,411,185 and 770,507 shares of unvested restricted stock outstanding. During 2013, 58,985 shares of restricted stock were forfeited and the restrictions on 43,522 shares of restricted stock lapsed.

During 2012, the Corporation sold 165,000 shares of treasury stock to a director at a purchase price of \$3.79 and issued 115,787 shares of common stock sold to institutional investors that exercised their antidilution rights.

On October 7, 2011, the Corporation successfully completed a private placement of \$525 million in shares of common stock (the "capital raise"). The Corporation issued 150 million shares of common stock at \$3.50 per share to institutional investors in the capital raise. The proceeds from the capital raise amounted to approximately \$490 million (net of offering costs), of which \$435 million were contributed to the Corporation's wholly owned banking subsidiary, FirstBank. Lead investors include funds affiliated with Thomas H. Lee Partners, L.P. ("THL") and Oaktree Capital Management, L.P. ("Oaktree"), which purchased from the Corporation an aggregate of \$348.2 million (\$174.1 million each investor) of shares of the Corporation's common stock.

Upon the completion of this transaction and the conversion into common stock of the Series G preferred stock held by the Treasury, each of THL and Oaktree became owners of 24.36% of the Corporation's shares of common stock outstanding. Subsequent to the completion of the capital raise, in related transactions, on October 12, 2011 and October 26, 2011, each of THL and Oaktree, respectively, purchased in the aggregate 937,493 shares of common stock from certain of the institutional investors who participated in the capital raise transaction.

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

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

On August 16, 2013, certain of the Corporation's existing stockholders completed a secondary offering of the Corporation's common stock. The Treasury sold 12 million shares of common stock, funds affiliated with THL sold 8 million shares of common stock, and funds managed by Oaktree sold 8 million shares of common stock. Subsequently, on September 11, 2013, the underwriters in the secondary offering exercised their option to purchase an additional 2.9 million shares of common stock from the selling stockholders (1,261,356 shares from the Treasury, and 840,903 shares from THL and 840,904 shares from Oaktree). The Corporation did not receive any proceeds from the offering. Non-interest expenses for 2013 included approximately \$1.7 million in costs associated with the secondary offering, including \$1.1 million paid by the Corporation for underwriting discounts and commissions. As of March 7, 2014, each of THL and Oaktree owns 20.21% of the Corporation's outstanding common stock and the Treasury owns 9.50% of such stock, excluding the common shares underlying the warrant owned by the Treasury.

***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 are fixed by the Board of Directors when authorizing the issuance of that particular series. As of December 31, 2013, the Corporation has five outstanding series of nonconvertible, noncumulative preferred stock: 7.125% noncumulative perpetual monthly income preferred stock, Series A; 8.35% noncumulative perpetual monthly income preferred stock, Series B; 7.40% noncumulative perpetual monthly income preferred stock, Series C; 7.25% noncumulative perpetual monthly income preferred stock, Series D; and 7.00% noncumulative perpetual monthly income preferred stock, Series E. The liquidation value per share is \$25.

Effective January 17, 2012, the Corporation delisted all of its outstanding series of nonconvertible, noncumulative preferred stock from the New York Stock Exchange. The Corporation has not arranged for listing and/or registration on another national securities exchange or for quotation of the Series A through E Preferred Stock in a quotation medium. During the first quarter of 2013, the Corporation commenced an offer to issue shares of its common stock in exchange for any and all of the remaining issued and outstanding shares of Series A through E non-cumulative perpetual monthly income preferred stock. The offer was terminated on April 9 2013 given that the Corporation did not receive the consent required from holders of shares of the Series A through E preferred stock to amend the certificate of designation of each series of the Series A through E Preferred Stock (the Preferred Stock Amendment). The Preferred Stock Amendment was a condition to the completion of the exchange offer. In addition, the consent solicitation was terminated, and no consent fee became payable with respect to consents granted in favor of the Preferred Stock Amendment. All shares of the Series A through E Preferred Stock that were tendered were returned promptly to the tendering holders.

***Exchange Agreement with the U.S. Treasury***

The completion of the capital raise on October 7, 2011 enabled the Corporation to compel the conversion of the 424,174 shares of the Corporation's Series G Preferred Stock, held by the Treasury, into 32.9 million shares of common stock at a conversion price of \$9.66. In connection with the conversion, the Corporation paid to the Treasury \$26.4 million for past-due undeclared cumulative dividends on the Series G Preferred Stock. The book value of the Series G Preferred Stock was approximately \$277 million greater than the \$89.6 million fair value of the common stock issued to the Treasury in the exchange. Although the excess book value of approximately \$277 million was treated as a noncash increase in income available to common stockholders in the fourth quarter of 2011, it has no effect on the Corporation's overall equity or its regulatory capital.

Additionally, in 2010, the Corporation issued an amended 10-year warrant (the "Warrant") to the 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 was adjusted as a result of

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

the capital raise to provide for the issuance of approximately 1,285,899 shares of common stock at an exercise price of \$3.29 per share for a 10-year term, exercisable at any time. The exercise price and the number of shares issuable upon exercise of the Warrant are subject to certain anti-dilution adjustments.

The possible future issuance of equity securities through the exercise of the Warrant could affect the Corporation's current stockholders in a number of ways, including by:

- diluting the voting power of the current holders of common stock (the shares underlying the Warrant represent approximately 0.62% of the Corporation's shares of common stock outstanding as of December 31, 2013);
- 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 on its common stock and all its outstanding series of preferred stock. This suspension was effective with the dividends for the month of August 2009.

***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. During 2013, the Corporation withheld approximately 71,326 shares from the common stock paid to certain senior officers as additional compensation to cover employees' payroll and income tax withholding liabilities; these shares are also held as treasury shares. In 2012, the Corporation sold 165,000 shares of treasury stock at a purchase price of \$3.79 per share to a director. As of December 31, 2013 and 2012, the Corporation had 566,179 and 494,853 shares held as treasury stock, respectively.

***FirstBank Statutory Reserve***

The Banking Act of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank's net income for the year be transferred to legal surplus until such surplus equals the total of paid-in capital on common and preferred stock. Amounts transferred to the legal surplus account from the retained earnings account are not available for distribution to the stockholders without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The net loss experienced in 2013 exhausted FirstBank's statutory reserve fund. The Bank cannot pay dividends until it can replenish the reserve fund to an amount equal to at least 20% of the original capital contributed.

**NOTE 21—EMPLOYEES' BENEFIT PLAN**

FirstBank provides contributory retirement plans pursuant to Section 1081.01 of the Puerto Rico Internal Revenue Code of 2011 for Puerto Rico employees and Section 401(k) of the U.S. Internal Revenue Code for USVI and U.S. employees (the "Plans"). All employees are eligible to participate in the Plans after three months of service for purposes of making elective deferral contributions and one year of service for purposes of sharing in the Bank's matching, qualified matching, and qualified nonelective contributions. Under the provisions of the Plans, the Bank contributes 25% of the first 4% of the participant's compensation contributed to the Plans on a pretax basis. Participants were permitted to contribute up to \$10,000 for 2011, \$13,000 for 2012, and \$15,000 for 2013 (\$16,500 for 2011, \$17,000 for 2012, and \$17,500 for 2013 for USVI and U.S. employees). Additional contributions to the Plans are voluntarily made by the Bank as determined by its Board of Directors. No additional discretionary contributions were made for the years ended December 31, 2013, 2012 and 2011. The Bank had a total plan expense of \$0.8 million for the year ended December 31, 2013, \$0.7 million for 2012, and \$0.6 million for 2011.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 22—OTHER NON-INTEREST INCOME**

A detail of other non-interest income is as follows:

	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	(In thousands)		
Non-deferrable loan fees . . . . .	\$ 2,384	\$ 5,335	\$ 6,775
Commissions and fees-broker-dealer-related . . . . .	97	2,630	1,735
Gain on sale of assets First Bank Insurance VI . . . . .	—	—	2,845
Lower of cost or market adjustment-commercial loans held for sale . . . . .	(1,165)	—	—
Credit card loans interchange and other fees . . . . .	6,694	7,239	—
Other . . . . .	24,343	16,918	19,615
<b>Total . . . . .</b>	<b>\$32,353</b>	<b>\$32,122</b>	<b>\$30,970</b>

**NOTE 23—OTHER NON-INTEREST EXPENSE**

A detail of non-interest expenses is as follows:

	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	(In thousands)		
Supplies and printing . . . . .	\$ 3,014	\$ 2,811	\$ 2,168
Contingency adjustment-tax credits . . . . .	—	2,489	—
Reserve release for off-balance sheet exposures . . . . .	(443)	(1,914)	(6,230)
Contingency for attorney’s fees-Lehman . . . . .	2,500	—	—
Amortization of intangible assets . . . . .	6,078	3,306	2,354
Other . . . . .	18,834	16,559	17,826
<b>Total . . . . .</b>	<b>\$29,983</b>	<b>\$23,251</b>	<b>\$16,118</b>

**NOTE 24—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 U.S. income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is also creditable against the Corporation’s Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 2011 as amended (the “2011 PR Code”), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax return 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 (“NOL”), a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carryforward period. In the case of losses incurred during tax years that commenced after December 31, 2004 and ended before January 1, 2013, the carryforward period is extended to 12 years. The carryover period for a NOL incurred during taxable years

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

commencing after December 31, 2012 is 10 years. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from “controlled” subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

Under the 2011 PR Code, First BanCorp. is subject to a maximum statutory tax rate of 39%. The 2011 PR Code also includes an alternative minimum tax of 30% that applies if the Corporation’s regular income tax liability is less than the alternative minimum tax requirements. Prior to the approval of Act No. 40 (“Act 40”), known as the “Tax Burden Adjustment and Redistribution Act,” which amended the 2011 PR Code as explained below, First Bancorp.’s maximum statutory tax rate was 30% for the years that ended December 31, 2012 and 2011.

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 an International Banking Entity (“IBE”) of the Bank and through the Bank’s subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which Act No.7 imposed a special 5% tax on all IBEs. The 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 IBE’s net income exceeds 20% of the bank’s total net taxable income.

On June 30, 2013, the Puerto Rico Government approved Act 40, which amended the 2011 PR Code, and Act No. 46 (“Act 46”), which changes the sales and use tax regime. The main provisions of Act 40 that impacted financial institutions include:

- (i) A new national gross receipts tax that in the case of financial institutions is 1% of gross income that is not deductible for purposes of computing net taxable income and is not part of the alternative minimum tax (“AMT”). This provision was retroactive to January 1, 2013. An expense of \$5.9 million was recorded during the year 2013 related to the national gross receipts tax. This expense is included as part of “Taxes, other than income taxes” in the consolidated statement of (loss) income. Subject to certain limitations, a financial institution will be able to claim a credit of 0.5% of its gross income against its regular income tax or the alternative minimum tax. A \$3.0 million benefit related to this credit was recorded as a reduction to the provision for income taxes in 2013.
- (ii) A decrease in the deduction available to corporations for the computation of the additional surtax from \$750,000 to \$25,000 and a change in the surtax rate to rates that range from 5% to 19%, resulting in an increase in the maximum statutory tax rate from 30% to 39%. This provision was also retroactive to January 1, 2013. The effect on operating results in 2013 related to these changes was a net benefit of approximately \$1.3 million, mainly due to the increase in the deferred tax asset of profitable subsidiaries. The deferred tax valuation allowance increased to \$522.7 million as of December 31, 2013 from \$359.9 million at December 31, 2012 as a result of changes in tax rates and operating results for the year.
- (iii) A higher AMT rate (30% of the alternative minimum net income, as compared to 20% previously) and various parallel computations required to be made before determining whether an AMT liability exists. This change did not have an impact on the Corporation’s provision for income taxes recorded in 2013.
- (iv) The NOL carryover period increased from 10 years to 12 years for losses incurred in taxable years that commenced after December 31, 2004 and ended before January 1, 2013. The carryover period



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

for NOLs incurred during taxable years commencing after December 31, 2012 is 10 years. The NOL deduction is now limited to 90% of taxable income for regular income tax purposes and 80% for AMT purposes.

The significant changes to the sales and use tax regime include adjustments to the business to business exclusion. The business to business exclusion applicable to services rendered from one registered business to another registered business remains in effect, except for certain services that will be taxable including, among others, service charges imposed by financial institutions on other businesses (commercial clients), collection services, repairs and maintenance services related to real and personal property, and computer programming including modifications to previously designed systems. The sales and use tax provisions were effective beginning on July 1, 2013.

In addition, on October 14, 2013, Act No.117 (“Act 117”) implemented technical amendments to various income tax laws, including the 2011 PR Code. The main provisions of Act 117 that impacted financial institutions are the exemption from the imposition of the national gross receipts tax on foreign source income and the temporary requirement of an estimated tax payment in mid-October. On November 26, 2013, Act No.36 was enacted to, among other things, require the payment of estimated taxes related to the personal property tax returns. These amendment of Act No. 36 will be effective during the year 2014.

The components of income tax expense are summarized below:

	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
	(In thousands)		
Current income tax expense . . . . .	\$ 7,947	\$5,357	\$7,896
Deferred income tax (benefit) expense . . . . .	(2,783)	575	1,426
Total . . . . .	<u>\$ 5,164</u>	<u>\$5,932</u>	<u>\$9,322</u>

The differences between the income tax expense applicable to income before provision for income taxes and the amount computed by applying the statutory tax rate in Puerto Rico were as follows:

	<b>Year Ended December 31,</b>					
	<b>2013</b>		<b>2012</b>		<b>2011</b>	
	<b>Amount</b>	<b>% of Pretax Income</b>	<b>Amount</b>	<b>% of Pretax Income</b>	<b>Amount</b>	<b>% of Pretax Income</b>
	(Dollars in thousands)					
Computed income tax at statutory rate . . . . .	\$ (62,136)	(39.0)%	\$10,714	30.0%	\$ (21,873)	(30.0)%
Federal and state taxes . . . . .	136	0.1%	—	—	179	0.3%
Adjustment in deferred tax due to change in tax rate . . .	(107,249)	(67.3)%	—	—	101,955	139.8%
Benefit of net exempt income . . . . .	13,320	8.4%	3,627	10.1%	(2,466)	(3.4)%
Deferred tax valuation allowance . . . . .	157,981	99.1%	(9,602)	(26.9)%	(78,009)	(107.0)%
Recognition of unrecognized tax benefits, including						
interest . . . . .	3,218	2.0%	238	0.7%	3,247	4.5%
National receipt tax, net . . . . .	(649)	(0.4)%	—	—	—	—
Nontax deductible expenses . . . . .	146	0.1%	2,417	6.8%	4,092	5.6%
Other-net . . . . .	397	0.2%	(1,462)	(4.1)%	2,197	3.0%
Total income tax provision . . . . .	<u>\$ 5,164</u>	<u>3.2%</u>	<u>\$ 5,932</u>	<u>16.6%</u>	<u>\$ 9,322</u>	<u>12.8%</u>

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Significant components of the Corporation's deferred tax assets and liabilities as of December 31, 2013 and 2012 were as follows:

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
	(In thousands)	
Deferred tax asset:		
Allowance for loan and lease losses . . . . .	\$ 108,811	\$ 130,652
Unrealized losses on derivatives activities . . . . .	1,483	1,647
Legal reserve . . . . .	756	452
Reserve for insurance premium cancellations . . . . .	687	427
Net operating loss and charitable contribution carryforward available . . . . .	373,253	213,566
Impairment on investment . . . . .	2,409	2,409
Tax credits available for carryforward available . . . . .	6,293	3,420
Unrealized net loss on equity investment . . . . .	5,003	2,594
Unrealized loss on available-for-sale securities, net . . . . .	337	—
Settlement payment-closing agreement . . . . .	7,313	5,625
Unrealized loss on OREO valuation . . . . .	13,104	6,724
Other . . . . .	19,790	10,650
Gross deferred tax assets . . . . .	539,239	378,166
Valuation allowance . . . . .	(522,708)	(359,947)
Total deferred tax assets, net of valuation allowance . . . . .	16,531	18,219
Deferred tax liabilities:		
Unrealized gain on available-for-sale securities, net . . . . .	—	6,524
Differences between the assigned values and tax bases of asset and liabilities recognized in purchase business combinations . . . . .	1,034	1,771
Unrealized gain on other investments . . . . .	625	360
Other . . . . .	7,228	4,697
Gross deferred tax liabilities . . . . .	8,887	13,352
Net deferred tax assets . . . . .	\$ 7,644	\$ 4,867

For 2013, the Corporation recorded an income tax expense of \$5.2 million compared to an income tax expense of \$5.9 million for 2012. The income tax expense for 2013 mainly consisted of an income tax expense of \$3.2 million due to the principal and accrued interest of uncertain tax benefits (“UTBs”) (discussed in detail below) and the income tax expense of profitable subsidiaries, partially offset by the benefit of \$1.3 million due to the change of the statutory tax rate from 30% to 39% in 2013 and by the credit available for the gross national receipt tax of \$3.0 million. As of December 31, 2013, the deferred tax asset, net of a valuation allowance of \$522.7 million, amounted to \$7.6 million compared to \$4.9 million as of December 31, 2012. The main driver of the increased deferred tax assets was the credit available for the national gross receipt tax together with the increase in the statutory applicable tax rate from 30% to 39% per Act 40 enacted during the second quarter of 2013.

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on an assessment of the amount of the deferred tax asset that is “more likely than not” to be realized. 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

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

is 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.

In assessing the weight of positive and negative evidence, a significant negative factor that resulted in the maintenance of the valuation allowance was that the Corporation's banking subsidiary, FirstBank Puerto Rico, continues in a three-year historical cumulative loss position as of the end of the year 2013, mainly due to charges to the provision for loan and lease losses in prior years as a result of the economic downturn and more recently as a result of the bulk loan sales transactions completed in 2013. As of December 31, 2013, the Corporation had a gross deferred tax asset of \$539.2 million, including \$371.7 million associated with NOLs. The Bank incurred all of the NOLs after 2009. The Corporation maintained a valuation allowance of \$522.7 million as of December 31, 2013 against the deferred tax asset. As of December 31, 2013, management concluded that \$7.6 million of the deferred tax asset will be realized as it relates 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 that 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.

As of December 31, 2013, the Corporation's gross deferred tax asset related to loss and other carryforwards was \$380.8 million. This comprised net operating loss carryforwards of \$371.7 million, which will begin expiring in 2021, an alternative minimum tax credit carryforward of \$1.3 million, an extraordinary tax credit carryover of \$3.3 million, a gross national receipts tax credit carryforward of \$3.0 million and a charitable contribution carryforward of \$1.5 million, which will begin expiring in 2014.

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 analysis: 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 under this analysis and the tax benefit claimed on a tax return is referred to as UTB.

The following table reconciles the balance of UTBs:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
		(In thousands)	
Balance at beginning of year	\$2,374	\$2,374	\$ —
Increases related to positions taken during prior years	1,936	—	2,374
Balance at end of year	<u>\$4,310</u>	<u>\$2,374</u>	<u>\$2,374</u>

The Corporation recorded UTBs of \$4.3 million, all of which would, if recognized, affect the Corporations effective tax rate. The Corporation classified all interest and penalties, if any, related to tax uncertainties as

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

income tax expense. As of December 31, 2013, the Corporation's accrued interest that relates to tax uncertainties amounted to \$2.4 million and there is no need to accrue for the payment of penalties. For 2013, the total amount of interest recognized by the Corporation as part of income tax expense related to tax uncertainties was \$1.3 million. The years 2007 through 2009 have been examined by the United States Internal Revenue Service ("IRS") and disputed issues were taken to administrative appeals in 2011. During the third and fourth quarter of 2013, the Corporation reassessed its UTBs mainly due to changes in management judgment given the lengthy administrative appeals process, communications with the IRS and expectations as to resolution. During October 2013, the Corporation filed a mediation request with the IRS appeals office in an effort to expedite the resolution of the audits under their examination. Subsequent to the filing of the mediation request, the Corporation has exchanged communications with the IRS and management expects the prompt resolution of this matter. However, the Corporation currently cannot reasonably estimate a range of possible changes to the existing reserves. The amount of the Corporation's UTBs may increase or decrease for various reasons, including changes in the amounts for current tax year positions, the expiration of open income tax returns due to the expiration of statutes of limitations, changes in management's judgment about the level of uncertainty, the status of examinations, litigation and legislative activity, and the addition, or elimination, of uncertain tax positions.

The Corporation's liability for income taxes includes its liability for UTBs, and interest that relates to tax years still subject to review by taxing authorities. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the 2011 PR Code is four years; the statutes of limitations for the Virgin Islands and for U.S. income tax purposes are each three years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation's liability for income taxes. Any such adjustment could be material to results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For Puerto Rico and Virgin Islands income tax purposes, all tax years subsequent to 2009 and 2010, respectively, remain open to examination. Tax year 2010 is currently under examination by the Puerto Rico Department of Treasury. The examination is at a preliminary stage. Taxable years from 2007 remain open to examination for U.S. income tax purposes.

**NOTE 25—LEASE COMMITMENTS**

As of December 31, 2013, certain premises are leased with terms expiring through the year 2036. The Corporation has the option to renew or extend certain leases beyond the original term. Some of these leases require the payment of insurance, increases in property taxes, and other incidental costs. As of December 31, 2013, the obligation under various leases is as follows:

	<b>Amount</b>
	<b>(In thousands)</b>
2014 .....	\$ 8,257
2015 .....	7,088
2016 .....	6,417
2017 .....	5,690
2018 .....	5,119
2019 and later years .....	34,501
Total .....	\$67,072

Rental expense included in occupancy and equipment expense was \$10.2 million in 2013 (2012—\$9.7 million; 2011—\$10.0 million).

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 26—FAIR VALUE**

*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 for classifying financial instruments. The hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Three levels of inputs may be used to measure fair value:

- Level 1** Valuations of Level 1 assets and liabilities are obtained from readily available pricing sources for market transactions involving identical assets or liabilities. Level 1 assets and liabilities include equity securities that trade in an active exchange market, as well as certain U.S. Treasury and other U.S. government and agency securities and corporate debt securities that are traded by dealers or brokers in active markets.
- Level 2** Valuations of Level 2 assets and liabilities are based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on the value of identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments, and (iii) derivative contracts and financial liabilities (e.g., medium-term notes elected to be measured at fair value) whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3** Valuations of Level 3 assets and liabilities are based on unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models for which the determination of fair value requires significant management judgment or estimation.

For 2013, there have been no transfers into or out of Level 1, Level 2, or Level 3 measurement of the fair value hierarchy.

*Financial Instruments Recorded at Fair Value on a Recurring Basis*

*Investment securities available for sale*

The fair value of investment securities was the market value based on quoted market prices (as is the case with equity securities, Treasury notes, and non callable U.S. Agency debt securities), when available (Level 1), 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 (Level 2). 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 (Level 3).

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 three-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

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

observed floating spreads over LIBOR, with a widening spread based on a nonrated security. The market valuation is derived from a model that utilizes relevant assumptions such as the 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, and 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 three-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, and other) to provide an estimate of default and loss severity. Refer to the table below for further information regarding qualitative information for all asset and liabilities measured at fair value using significant unobservable inputs (Level 3).

*Derivative instruments*

The fair value of most of the Corporation's 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 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 marked-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 in 2013 was immaterial.

The information about the estimated fair value of financial instruments required by GAAP is presented hereunder. The fair value amounts presented do not necessarily represent management's estimate of the underlying value of the Corporation.



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Assets and liabilities measures at fair value on a recurring basis, are summarized below:

(In thousands)	As of December 31, 2013				As of December 31, 2012			
	Fair Value Measurements Using			Assets/Liabilities at Fair Value	Fair Value Measurements Using			Assets/Liabilities at Fair Value
	Level 1	Level 2	Level 3		Level 1	Level 2	Level 3	
<b>Assets:</b>								
Securities available for sale :								
Equity securities . . . . .	\$ 33	\$ —	\$ —	\$ 33	\$ 31	\$ —	\$ —	\$ 31
U.S. Treasury Securities . . .	7,499	—	—	7,499	7,499	—	—	7,499
Noncallable U.S. agency debt . . . . .	—	200,903	—	200,903	—	159,252	—	159,252
Callable U.S. agency debt and MBS . . . . .	—	1,677,651	—	1,677,651	—	1,442,169	—	1,442,169
Puerto Rico government obligations . . . . .	—	48,904	2,426	51,330	—	67,509	3,691	71,200
Private label MBS . . . . .	—	—	40,866	40,866	—	—	50,926	50,926
Derivatives, included in assets:								
Interest rate swap agreements . . . . .	—	162	—	162	—	288	—	288
Purchased interest rate cap agreements . . . . .	—	58	—	58	—	—	—	—
Forward contracts . . . . .	—	174	—	174	—	3	—	3
Liabilities:								
Derivatives, included in liabilities:								
Interest rate swap agreements . . . . .	—	3,965	—	3,965	—	5,776	—	5,776
Written interest rate cap agreement . . . . .	—	58	—	58	—	—	—	—
Forward contracts . . . . .	—	—	—	—	—	5	—	5

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2013, 2012, and 2011:

Level 3 Instruments Only (In thousands)	2013 Securities Available for Sale <sup>(1)</sup>	2012 Securities Available for Sale <sup>(1)</sup>	2011 Securities Available for Sale <sup>(1)</sup>
Beginning balance . . . . .	\$ 54,617	\$ 65,463	\$ 74,993
Total gain (losses) realized/unrealized:			
Including in earnings . . . . .	(117)	(2,002)	(1,971)
Including in other comprehensive income . . .	2,795	6,036	3,946
Held-to-maturity investment securities reclassified to available-for-sale . . . . .	—	—	2,000
Sales . . . . .	—	(1,450)	—
Principal repayments and amortization . . . . .	(14,003)	(13,430)	(13,505)
Ending balance . . . . .	<u>\$ 43,292</u>	<u>\$ 54,617</u>	<u>\$ 65,463</u>

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

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The table below presents qualitative information for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2013:

(In thousands)	December 31, 2013			
	Fair Value	Valuation Technique	Unobservable Input	Range
<b>Investment securities available for sale:</b>				
Private label MBS . . . . .	\$40,866	Discounted cash flow	Discount rate	14.5%
			Prepayment rate	15.86%—100% (Weighted Average 29%)
			Projected Cumulative Loss Rate	0.58%—38.16% (Weighted Average 6.8%)
Puerto Rico Government Obligations . . . . .	2,426	Discounted cash flow	Prepayment Speed	5.61%

***Information about Sensitivity to Changes in Significant Unobservable Inputs***

Private label MBS: The significant unobservable inputs in the valuation include probability of default, the loss severity assumption, and prepayment rates. Shifts in those inputs would result in different fair value measurements. Increases in the probability of default, loss severity assumptions, and prepayments rates in isolation would generally result in an adverse effect on the fair value of the instruments. Meaningful and possible shifts of each input were modeled to assess the effect on the fair value estimation.

Puerto Rico Government Obligations: The significant unobservable input used in the fair value measurement is the assumed prepayment rate. A significant increase (decrease) in the assumed rate would lead to a higher (lower) fair value estimate. Loss severity and probability of default are not included as significant unobservable variables because the note is guaranteed by the Puerto Rico Housing Finance Authority (“PRHFA”). The PRHFA credit risk is modeled by discounting the cash flows using a curve appropriate to the PRHFA credit rating.

The table below summarizes changes in unrealized gains and losses recorded in earnings for the years ended December 31, 2013, 2012, and 2011 for Level 3 assets and liabilities that are still held at the end of each year:

Level 3 Instruments Only (In thousands)	Changes in Unrealized Losses (Year Ended December 31, 2013) Securities Available for Sale	Changes in Unrealized Losses (Year Ended December 31, 2012) Securities Available for Sale	Changes in Unrealized Losses (Year Ended December 31, 2011) Securities Available for Sale
<b>Changes in unrealized losses relating to assets still held at reporting date:</b>			
Net impairment losses on investment securities (credit component) . . . . .	\$(117)	\$(2,002)	\$(1,971)

Additionally, fair value is used on a nonrecurring 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).

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

As of December 31, 2013, impairment or valuation adjustments were recorded for assets recognized at fair value on a nonrecurring basis as shown in the following table:

	Carrying value as of December 31, 2013			(Losses) gain recorded for the Year Ended December 31, 2013
	Level 1	Level 2	Level 3	
	(In thousands)			
Loans receivable <sup>(1)</sup> . . . . .	\$—	\$—	\$465,191	\$(13,928)
OREO <sup>(2)</sup> . . . . .	—	—	160,193	(25,698)
Mortgage servicing rights <sup>(3)</sup> . . . . .	—	—	21,987	460
Loans Held for Sale <sup>(4)</sup> . . . . .	—	—	54,801	(338)

- (1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair values was derived from external 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 was 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, income producing properties net operating income), which are not market observable. Losses were related to market valuation adjustments after the transfer of the loan to the OREO portfolio.
- (3) Fair value adjustments to mortgage servicing rights were mainly due to assumptions associated with mortgage prepayment rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, and accordingly, they are measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights included: prepayment rate 8.90% and discount rate 10.60%.
- (4) The value of these loans was derived from external appraisals, adjusted for specific characteristics of the loans, and for loans with signed sale agreements, the value was determined based on the sales price on such agreements.

As of December 31, 2012, impairment or valuation adjustments were recorded for assets recognized at fair value on a nonrecurring basis as shown in the following table:

	Carrying value as of December 31, 2012			(Losses) recorded for the Year Ended December 31, 2012
	Level 1	Level 2	Level 3	
	(In thousands)			
Loans receivable <sup>(1)</sup> . . . . .	\$—	\$—	\$757,152	\$(110,457)
Other Real Estate Owned <sup>(2)</sup> . . . . .	—	—	185,764	(8,851)
Mortgage servicing rights <sup>(3)</sup> . . . . .	—	—	17,524	(394)
Loans Held For Sale <sup>(4)</sup> . . . . .	—	—	2,641	(2,168)

- (1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair values was derived from external 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 was 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, income producing properties net operating income), which are not market observable. Losses were related to market valuation adjustments after the transfer of the loan to the OREO portfolio.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- (3) Fair value adjustments to the mortgage servicing rights were mainly due to assumptions associated with mortgage prepayments rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, and, accordingly, they are measured at fair value on a non-recurring basis. Assumptions for the value mortgage servicing rights included: prepayment rate 12.15% and discount rate 11.08%.
- (4) Level 3 Loans Held for Sale are the \$5.2 million Commercial and Industrial and Commercial Mortgage loans transferred to held for sale during the fourth quarter of 2012, which were recorded at a value of \$2.6 million.

As of December 31, 2011, impairment or valuation adjustments were recorded for assets recognized at fair value on a nonrecurring basis as shown in the following table:

	<u>Carrying value as of December 31, 2011</u>			<u>(Losses) recorded for the Year Ended December 31, 2011</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
	(In thousands)			
Loans receivable <sup>(1)</sup> . . . . .	\$—	\$—	\$703,855	\$(200,263)
Other Real Estate Owned <sup>(2)</sup> . . .	—	—	114,292	(10,855)
Mortgage Servicing Rights <sup>(3)</sup> . . . . .	—	—	15,226	(2,291)

- (1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair values was derived from external 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 was 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, income producing properties net operating income), which are not market observable. Losses were related to market valuation adjustments after the transfer of the loan to the OREO portfolio.
- (3) Fair value adjustments to the mortgage servicing rights were mainly due to assumptions associated with mortgage prepayments rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, accordingly, they are measured at fair value on a non-recurring basis. Assumptions for the value mortgage servicing rights included: prepayment rate 12.5% and discount rate 11.10%.

Qualitative information regarding the fair value measurements for Level 3 financial instruments is as follows:

	<u>December 31, 2013</u>	
	<u>Method</u>	<u>Inputs</u>
Loans	Income, Market, Comparable Sales, Discounted Cash Flows	External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors
OREO	Income, Market, Comparable Sales, Discounted Cash Flows	External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors
Mortgage servicing rights	Discounted Cash Flows	Weighted average prepayment rate of 8.90%; weighted average discount rate of 10.60%

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following is a description of the valuation methodologies used for instruments that are not measured or reported at fair value on a recurring basis or reported at fair value on a non-recurring basis. The estimated fair value was calculated using certain facts and assumptions, which vary depending on the specific financial instrument.

*Cash and due from banks and money market investments*

The carrying amounts of cash and due from banks and money market investments are reasonable estimates of their fair value. Money market investments include held-to-maturity securities, 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.

*Other equity securities*

Equity or other securities that do not have a readily available fair value are stated at their 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. The realizable value of the FHLB stock equals its cost as this stock can be freely redeemed at par.

*Loans receivable, including loans held for sale*

The fair value of loans held for investment and of 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. Valuations are carried out based on categories and not on a loan-by-loan basis. The fair values of performing fixed-rate and adjustable-rate loans were calculated by discounting expected cash flows through the estimated maturity date. This fair value is not currently an indication of an exit price as that type of assumption could result in a different fair value estimate. The fair value of credit card loans was estimated using a discounted cash flow method and excludes any value related to a customer account relationship. Other loans with no stated maturity, like credit lines, were valued at book value. Prepayment assumptions were considered for nonresidential loans. For residential mortgage loans, prepayment estimates were based on a prepayments model that combined both a historical calibration and current market prepayments expectations. 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.

*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 were 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.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The fair value of brokered CDs, which are included within deposits, is determined using discounted cash flow analyses over the full term of the CDs. The fair value of the CDs is computed using the outstanding principal amount. The discount rates used were based on brokered CD market rates as of December 31, 2013. 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. The brokers who are the counterparties provide these indications. 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. Advances from FHLB are fully collateralized by mortgage loans and, to a lesser extent, investment securities.

*Other borrowings*

Other borrowings consist of junior subordinated debentures. Projected cash flows from the debentures were discounted using the Bloomberg BB Finance 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.



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table presents the estimated fair value and carrying value of financial instruments as of December 31, 2013 and 2012:

	<b>Total Carrying Amount in Statement of Financial Condition December 31, 2013</b>	<b>Fair Value Estimated December 31, 2013</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
	(In thousands)				
<b>Assets:</b>					
Cash and due from banks and money market investments . . . . .	\$ 655,671	\$ 655,671	\$655,671	\$ —	\$ —
Investment securities available for sale . . . . .	1,978,282	1,978,282	7,532	1,927,458	43,292
Other equity securities . . . . .	28,691	28,691	—	28,691	—
Loans held for sale . . . . .	75,969	76,684	—	21,883	54,801
Loans held for investment . . . . .	9,636,170	—	—	—	—
Less: allowance for loan and lease losses . . . . .	(285,858)				
Loans held for investment, net of allowance . . . . .	<u>\$ 9,350,312</u>	9,127,234	—	—	9,127,234
Derivatives included in assets . . . . .	394	394	—	394	—
<b>Liabilities:</b>					
Deposits . . . . .	9,879,924	9,898,615	—	9,898,615	—
Securities sold under agreements to repurchase . . . . .	900,000	976,151	—	976,151	—
Advances from FHLB . . . . .	300,000	297,523	—	297,523	—
Other borrowings . . . . .	231,959	106,772	—	—	106,772
Derivatives included in liabilities . . . . .	4,023	4,023	—	4,023	—
<b>Total Carrying Amount in Statement of Financial Condition December 31, 2012</b>					
(In thousands)					
<b>Assets:</b>					
Cash and due from banks and money market investments . . . . .	\$ 946,851	\$ 946,851	\$946,851	\$ —	\$ —
Investment securities available for sale . . . . .	1,731,077	1,731,077	7,530	1,668,930	54,617
Other equity securities . . . . .	38,757	38,757	—	38,757	—
Loans held for sale . . . . .	85,394	87,995	—	85,354	2,641
Loans held for investment . . . . .	10,054,114				
Less: allowance for loan and lease losses . . . . .	(435,414)				
Loans held for investment, net of allowance . . . . .	<u>\$ 9,618,700</u>	9,545,505	—	—	9,545,505
Derivatives included in assets . . . . .	291	291	—	291	—
<b>Liabilities:</b>					
Deposits . . . . .	9,864,546	9,901,297	—	9,901,297	—
Securities sold under agreements to repurchase . . . . .	900,000	999,663	—	999,663	—
Advances from FHLB . . . . .	508,440	512,089	—	512,089	—
Other borrowings . . . . .	231,959	134,058	—	—	134,058
Derivatives included in liabilities . . . . .	5,781	5,781	—	5,781	—

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 27—SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental cash flow information is as follows:

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
Cash paid for:			
Interest on borrowings . . . . .	\$119,312	\$164,364	\$255,363
Income tax . . . . .	4,447	8,603	2,852
Noncash investing and financing activities:			
Additions to other real estate owned . . . . .	104,144	169,432	155,621
Additions to auto and other repossessed assets . .	69,069	48,910	65,049
Capitalization of servicing assets . . . . .	7,649	6,348	5,150
Loan securitizations . . . . .	355,506	239,766	214,399
Loans held for investment transferred to held for sale . . . . .	181,620	2,641	—
Property plant and equipment transferred to other assets . . . . .	2,225	—	—
Preferred stock exchanged for new common stock issued:			
Preferred stock exchanged (Series G) . . . . .	—	—	361,962
New common stock issued . . . . .	—	—	89,602
Loans sold to CPG/GS in exchange for an acquisition loan and an equity interest in CPG/GS	—	—	183,709
Reclassification of held-to-maturity investment securities to available for sale	—	—	88,751

**NOTE 28—REGULATORY MATTERS, COMMITMENTS, AND CONTINGENCIES**

The Corporation is subject to various regulatory capital requirements imposed by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation must meet specific capital guidelines that involve quantitative measures of the Corporation's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation's capital amounts and classification are also subject to qualitative judgment and adjustment by the regulators with respect to minimum capital requirements, components, risk weightings, and other factors.

Capital standards established by regulations require the Corporation to maintain minimum amounts and ratios for Leverage (Tier 1 capital to average total assets) and ratios of Tier 1 Capital to Risk-Weighted Assets and Total Capital to Risk-Weighted Assets as defined in the regulations. The total amount of risk-weighted assets is computed by applying risk-weighting factors to the Corporation's assets and certain off-balance sheet items, which generally vary from 0% to 100% depending on the nature of the asset.

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into a Consent Order (the "FDIC Order") with the FDIC and OCIF. The FDIC 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

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

a leverage ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 10% and a total risk-based capital ratio of at least 12%; (4) adoption and implementation of strategic, liquidity, and fund management and profit and budget plans and related projects within certain timetables set forth in the FDIC Order and on an ongoing basis; (5) adoption and implementation of plans for reducing FirstBank's positions in certain classified assets and delinquent and non-accrual loans within timeframes set forth in the FDIC Order; (6) refraining from lending to delinquent or classified borrowers already obligated to FirstBank on any extensions of credit so long as such credit remains uncollected, except where FirstBank's failure to extend further credit to a particular borrower would be detrimental to the best interests of FirstBank, and any such additional credit is approved by 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 of the regulatory capital ratios exceeded the minimum capital ratios for "well-capitalized" levels, as well as the minimum capital ratios required by the FDIC Order, as of December 31, 2013, FirstBank cannot be treated as a "well-capitalized" institution under regulatory guidance while operating under the FDIC Order.

Effective June 3, 2010, First BanCorp. entered into the Written Agreement with the New York FED. The Written Agreement provides, among other things, that the holding company must serve as a source of strength to FirstBank, and that, except with the consent generally of the New York FED and Federal Reserve Board, (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 that reflects sufficient capital at First BanCorp. on a consolidated basis, which must be acceptable to the New York 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.

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. As of December 31, 2013, the Corporation had completed all of the items included in the Capital Plan and is continuing to work on reducing non-performing loans. Further, the Corporation has reviewed and enhanced the Corporation's loan review program, various credit policies, the Corporation's treasury and investment policy, the Corporation's asset classification and allowance for loan and lease losses and non-accrual policies, the Corporation's charge-off policy and the Corporation's appraisal program. The Regulatory Agreements also require the submission to the regulators of quarterly progress reports.

The FDIC Order imposes no other restrictions on FirstBank's products or services offered to customers, nor does it or the Written Agreement impose any type of penalties or fines upon FirstBank or the Corporation. Concurrent with the FDIC Order, the FDIC has granted FirstBank temporary waivers to enable it to continue accessing the brokered CD market through March 31, 2014. FirstBank will request approvals for future periods.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

In July 2013, U.S. banking regulators approved a revised regulatory capital framework for U.S. banking organizations (the “Basel 3 rules”) that is based on international regulatory capital requirements adopted by the Basel Committee on Banking Supervision over the past several years. The Basel 3 rules introduce new minimum capital ratios and capital conservation buffer requirements, change the composition of regulatory capital, require a number of new adjustments to and deductions from regulatory capital, and introduce a new “Standardized Approach” for the calculation of risk-weighted assets that will replace the risk-weighting requirements under the current U.S. regulatory capital rules. The new minimum regulatory capital requirements and the Standardized Approach for the calculation of risk-weighted assets will become effective for the Corporation and FirstBank on January 1, 2015. The capital conservation buffer requirements, and the regulatory capital adjustments and deductions under the Basel 3 rules will be phase-in over several years ending as of December 31, 2018.

The Basel 3 rules introduce a new and separate ratio of Common Equity Tier 1 capital (“CET1”) to risk-weighted assets. CET1, a component of total Tier 1 capital, generally consists of common stock and related surplus, retained earnings, accumulated other comprehensive income (“AOCI”), and qualifying minority interests. In addition, the Basel 3 rules also will require the Corporation to maintain an additional CET1 capital conservation buffer of 2.5%. Thus, when the Basel 3 rules are fully phased in as of January 1, 2019, the Corporation will be required to maintain (i) a minimum CET1 to risk-weighted assets ratio of at least 4.5%, plus the 2.5% “capital conservation buffer,” resulting in a required minimum CET1 ratio of at least 7% upon full implementation, (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5% upon full implementation, (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5% upon full implementation, and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets. The phase-in of the capital conservation buffer will begin on January 1, 2016 with a first year requirement of 0.625% of additional CET1, which will be progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reaches the fully-phased in 2.5% CET1 requirement on January 1, 2019.

In addition, the Basel 3 rules require a number of new deductions from and adjustments to CET1, including deductions from CET1 for mortgage servicing rights, and deferred tax assets dependent upon future taxable income. In the case of mortgage servicing assets and deferred tax assets, among others, these items would be required to be deducted to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under current regulatory capital requirements, the effect of AOCI is excluded for the purposes of calculating the required regulatory capital ratios. By comparison, under the Basel 3 rules, the effects of certain AOCI items are not excluded. Certain banking organizations, however, including the Corporation and FirstBank, will be allowed to make a one-time permanent election in early 2015 to continue to exclude AOCI items. The Corporation and FirstBank expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the securities portfolio.

In addition, the Basel 3 rules will require that certain non-qualifying capital instruments, including cumulative preferred stock and trust preferred securities (“TRuPs”), be excluded from Tier 1 capital. In general, banking organizations such as the Corporation and the Bank, must begin to phase out TRuPs from Tier 1 capital by January 1, 2015. The Corporation will be allowed to include 25% of the \$225 million outstanding qualifying TRuPs as Tier 1 capital in 2015 and the TRuPs must be fully phased out from Tier 1 capital by January 1, 2016. However, the Corporation’s TRuPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Basel 3 rules also revise the “prompt corrective action” (“PCA”) regulations that apply to depository institutions, including FirstBank, pursuant to Section 38 of the Federal Deposit Insurance Act by (i) introducing a separate CET1 ratio requirement for each PCA capital category (other than critically undercapitalized) with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each PCA capital category with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the current 6%); and (iii) eliminating the current provision that allows a bank with a composite supervisory rating of 1 to have a 3% leverage ratio and still be adequately capitalized and maintaining the minimum leverage ratio for well-capitalized status at 5%. The Basel 3 rules do not change the total risk-based capital requirement (10% for well-capitalized status) for any PCA capital category. The new PCA requirements become effective on January 1, 2015.

The Basel 3 rules separately impose a Standardized Approach for risk-weightings that expands the risk-weighting categories from the four major risk-weighting categories under the current regulatory capital rules (0%, 20%, 50%, and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets. In a number of cases, the Standardized Approach will result in higher risk weights for a variety of asset categories. Specific changes to the risk-weightings of assets under the current regulatory capital rules include, among other things: (i) applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans, (ii) assigning a 150% risk weight to exposures that are 90 days past due (other than qualifying residential mortgage exposures, which remain at an assigned risk-weighting of 100%), and (iii) establishing a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, in contrast to the 0% risk-weighting under the current rules.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Corporation's and its banking subsidiary's regulatory capital positions as of December 31, 2013 and 2012 were as follows:

	Regulatory Requirements							
	Actual		For Capital Adequacy Purposes		To be Well-Capitalized- Regular Thresholds		Consent Order Capital requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)							
<b>At December 31, 2013</b>								
Total Capital (to Risk-Weighted Assets)								
First BanCorp. . . . .	\$1,604,548	17.06%	\$752,464	8%	N/A	N/A	N/A	N/A
FirstBank . . . . .	\$1,567,232	16.67%	\$751,978	8%	\$939,972	10%	\$1,127,966	12%
Tier I Capital (to Risk-Weighted Assets)								
First BanCorp. . . . .	\$1,484,490	15.78%	\$376,232	4%	N/A	N/A	N/A	N/A
FirstBank . . . . .	\$1,447,262	15.40%	\$375,989	4%	\$563,983	6%	\$ 939,972	10%
Leverage ratio								
First BanCorp. . . . .	\$1,484,490	11.71%	\$506,878	4%	N/A	N/A	N/A	N/A
FirstBank . . . . .	\$1,447,262	11.44%	\$506,210	4%	\$632,763	5%	\$1,012,420	8%
<b>At December 31, 2012</b>								
Total Capital (to Risk-Weighted Assets)								
First BanCorp. . . . .	\$1,770,003	17.82%	\$794,698	8%	N/A	N/A	N/A	N/A
FirstBank . . . . .	\$1,723,085	17.35%	\$794,594	8%	\$993,243	10%	\$1,191,891	12%
Tier I Capital (to Risk-Weighted Assets)								
First BanCorp. . . . .	\$1,640,082	16.51%	\$397,349	4%	N/A	N/A	N/A	N/A
FirstBank . . . . .	\$1,593,225	16.04%	\$399,297	4%	\$595,946	6%	\$ 993,243	10%
Leverage ratio								
First BanCorp. . . . .	\$1,640,082	12.60%	\$520,664	4%	N/A	N/A	N/A	N/A
FirstBank . . . . .	\$1,593,225	12.25%	\$520,056	4%	\$650,069	5%	\$1,040,111	8%

The following table presents a detail of commitments to extend credit and standby letters of credit, and commitments to sell loans:

	December 31,	
	2013	2012
	(In thousands)	
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit: . . . . .		
Construction undisbursed funds . . . . .	\$ 65,184	\$ 86,623
Unused personal lines of credit . . . . .	735,331	1,057,006
Commercial lines of credit . . . . .	386,941	440,181
Commercial letters of credit . . . . .	41,081	41,759
Standby letters of credit . . . . .	10,527	17,956
Commitments to sell loans . . . . .	123,925	29,614



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. Management uses the same credit policies and approval process in entering into commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility at any time and without cause. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with prospective borrowers. The amount of any collateral obtained if deemed necessary by the Corporation upon an extension of credit is based on management's credit evaluation of the borrower. Rates charged on loans that are finally disbursed are the rates being offered at the time the loans are closed; therefore, no fee is charged on these commitments.

In general, commercial and standby letters of credit are issued to facilitate foreign and domestic trade transactions. Normally, commercial and standby letters of credit are short-term commitments used to finance commercial contracts for the shipment of goods. The collateral for these letters of credit includes cash or available commercial lines of credit. The fair value of commercial and standby letters of credit is based on the fees currently charged for such agreements, which, as of December 31, 2013 and 2012, was not significant.

The Corporation obtained from GNMA commitment authority to issue GNMA mortgage-backed securities. Under this program, for 2013, the Corporation securitized approximately \$355.5 million of FHA/VA mortgage loan production into GNMA mortgage-backed securities.

Lehman Brothers Special Financing, Inc. ("Lehman") was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which constituted an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement 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 with a \$63.6 million face value to guarantee its performance under the swap agreements in the event payment thereunder was required.

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. ("LBI"), 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, the Corporation filed a lawsuit against Barclays in federal court in New York demanding the return of the securities in December 2009. 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,

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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, contained allegations that sufficiently pled 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. On May 10, 2013, the Bankruptcy Court issued a decision denying the Bank's Motion for Summary Judgment and granting the Motion for Summary Judgment of Barclay's. The Bank has filed a notice of appeal of that decision, which appeal is now pending. The Corporation may not succeed in its litigation against Barclays to recover all or a substantial portion of the securities.

Because of the Bankruptcy Court's May 10, 2013 decision, the Corporation has determined that it is probable that the asset has been impaired and recognized in the second quarter of 2013 a non-cash charge of \$66.6 million associated with the write-off of the carrying value of the pledged securities and related accrued interest. The Corporation does not anticipate that this impairment charge will result in future cash expenditures by the Corporation other than additional costs relating to the appeal of the Bankruptcy Court's decision.

On September 13, 2012, Barclays filed a motion in the Bankruptcy Court in an effort to impose sanctions on the Bank for seeking the relief sought in the litigation, which motion the Bank opposed. On December 3, 2013, the Bankruptcy Court issued a memorandum decision granting Barclays' motion for civil contempt sanctions, in which the Bankruptcy Court granted Barclays entitlement to an award of sanctions from the Bank and directed the parties to meet and confer in an attempt to reach consensus on the award of sanctions. The parties have agreed that \$2.5 million represents an appropriate compromise as to the amount of reasonable counsel fees to which Barclays would be entitled to in the event that the Bankruptcy Court's decision to award Barclays attorneys' fees is affirmed through the appeals process.

Additionally, the Corporation continues to pursue its claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to LBI in the United States Bankruptcy Court for the Southern District of New York.

As of December 31, 2013, 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, to the extent not previously provided for, will not have a material adverse effect, individually or in the aggregate, on the Corporation's financial position, results of operations or cash flows.

**NOTE 29—DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

One of the market risks facing the Corporation is interest rate risk, which includes the risk that changes in interest rates will result in changes in the value of the Corporation's assets or liabilities and the risk that net interest income from its loan and investment portfolios will be adversely affected by changes in interest rates. The overall objective of the Corporation's interest rate risk management activities is to reduce the variability of earnings caused by changes in interest rates.

The Corporation designates a derivative as a fair value hedge, cash flow hedge or as an economic undesignated hedge when it enters into the derivative contract. As of December 31, 2013 and 2012, all derivatives held by the Corporation were considered economic undesignated hedges. These undesignated hedges are recorded at fair value with the resulting gain or loss recognized in current earnings.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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.

*Interest rate swaps*—Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of December 31, 2013 and 2012, 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.

*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 that have no net settlement provision and no market mechanism to facilitate net settlement and that 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 economically hedge the FHA/VA residential mortgage loan 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 nonhedging 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 nonhedging derivative instrument.

The following table summarizes the notional amounts of all derivative instruments:

	<b>Notional Amounts</b>	
	<b>December 31, 2013</b>	<b>December 31, 2012</b>
	(In thousands)	
<b>Undesignated economic hedges:</b>		
Interest rate contracts:		
Interest rate swap agreements . . . . .	\$ 31,080	\$38,097
Written interest rate cap agreements . . . . .	38,391	—
Purchased interest rate cap agreements . . . . .	38,391	—
Forward Contracts:		
Sale of TBA GNMA MBS pools . . . . .	25,000	6,000
	\$132,862	\$44,097

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Notional amounts are presented on a gross basis with no netting of offsetting exposure positions.

The following table summarizes the fair value of derivative instruments and the location of the derivative instruments in the statement of financial condition:

	Asset Derivatives			Liability Derivatives		
	Statement of Financial Condition Location	December 31, 2013 Fair Value	December 31, 2012 Fair Value	Statement of Financial Condition Location	December 31, 2013 Fair Value	December 31, 2012 Fair Value
				(In thousands)		
<b>Undesignated economic hedges:</b>						
Interest rate contracts:						
Interest rate swap agreements . . . . .	Other assets	\$162	\$288	Accounts payable and other liabilities	\$3,965	\$5,776
Written interest rate cap agreements . . . . .	Other assets	—	—	Accounts payable and other liabilities	58	—
Purchased interest rate cap agreements . . . . .	Other assets	58	—	Accounts payable and other liabilities	—	—
Forward Contracts:						
Sales of TBA GNMA MBS pools . . . . .	Other assets	174	3	Accounts payable and other liabilities	—	5
		<u>\$394</u>	<u>\$291</u>		<u>\$4,023</u>	<u>\$5,781</u>

The following table summarizes the effect of derivative instruments on the statement of income (loss):

	Location of Gain (or loss) Recognized in Income on Derivatives	Gain (or Loss) Year ended December 31,		
		2013	2012	2011
		(In thousands)		
<b>ECONOMIC UNDESIGNATED HEDGES:</b>				
Interest rate contracts:				
Interest rate swap agreements . . . . .	Interest income—Loans	\$1,685	\$ 901	\$(1,548)
Written and purchased interest rate cap agreements . . . . .	Interest income—Loans	10	—	—
Equity contracts:				
Embedded written and purchased options on stock index notes payable . . . . .	Interest expense—Notes payable and other borrowings	—	—	(45)
Forward contracts:				
Sales of TBA GNMA MBS pools . . . . .	Mortgage Banking Activities	176	166	(168)
Total gain (loss) on derivatives . . . . .		<u>\$1,871</u>	<u>\$1,067</u>	<u>\$(1,761)</u>

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.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

A summary of interest rate swaps is as follows:

	December 31, 2013	December 31, 2012
	(Dollars in thousands)	
Pay fixed/receive floating:		
Notional amount . . . . .	\$31,080	\$38,097
Weighted average receive rate at period-end . . . . .	1.85%	2.06%
Weighted average pay rate at period-end . . . . .	6.77%	6.82%
Floating rates range from 167 to 187 basis points over 3-month LIBOR		

As of December 31, 2013, the Corporation has not entered into any derivative instrument containing credit-risk-related contingent features.

***Credit and Market Risk of Derivatives***

The Corporation uses derivative instruments to manage interest rate risk. By using derivative instruments, the Corporation is exposed to credit and market risk. If the counterparty fails to perform, credit risk is equal to the extent of the Corporation’s fair value gain in the derivative. When the fair value of a derivative instrument contract is positive, this generally indicates that the counterparty owes the Corporation and, therefore, creates a credit risk for the Corporation. When the fair value of a derivative instrument contract is negative, the Corporation owes the counterparty and, therefore, it has no credit risk. The Corporation minimizes the credit risk in derivative instruments by entering into transactions with reputable broker dealers (financial institutions) that are reviewed periodically by the Corporation’s Management’s Investment and Asset Liability Committee and by the Board of Directors. The Corporation also maintains a policy of requiring that all derivative instrument contracts be governed by an International Swaps and Derivatives Association Master Agreement, which includes a provision for netting; most of the Corporation’s agreements with derivative counterparties include bilateral collateral arrangements. The bilateral collateral arrangement permits the counterparties to perform margin calls in the form of cash or securities in the event that the fair market value of the derivative favors either counterparty. The book value and aggregate market value of securities pledged as collateral for interest rate swaps as of December 31, 2013 was \$4.0 million and \$4.3 million, respectively (2012—\$5.7 million and \$6.1 million, respectively). The Corporation has a policy of diversifying derivatives counterparties to reduce the consequences of counterparty default.

The Corporation has credit risk of \$0.4 million (2012—\$0.3 million) related to derivative instruments with positive fair values. The credit risk does not consider the value of any collateral and the effects of legally enforceable master netting agreements. There were no credit losses associated with derivative instruments recognized in 2013, 2012, or 2011. As of December 31, 2013, the Corporation had a total net interest settlement payable of \$0.1 million (2012—net interest settlement payable of \$0.1 million) related to the swap transactions. The net settlements receivable and net settlements payable on interest rate swaps are included as part of “Other Assets” and “Accounts payable and other liabilities,” respectively, on the consolidated statements of financial condition.

Market risk is the adverse effect that a change in interest rates or implied volatility rates has on the value of a financial instrument. The Corporation manages the market risk associated with interest rate contracts by establishing and monitoring limits as to the types and degree of risk that may be undertaken.

The Corporation’s derivative activities are monitored by the MIALCO as part of its risk-management oversight of the Corporation’s treasury functions.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 30—OFFSETTING OF ASSETS AND LIABILITIES**

The Corporation enters into master agreements with counterparties that may allow for netting of exposures in the event of default, primarily related to derivatives and repurchase agreements. In an event of default each party has a right of set-off against the other party for amounts owed in the related agreement and any other amount or obligation owed in respect of any other agreement or transaction between them. The following table presents information about the offsetting of financial assets and liabilities as well as derivative assets and liabilities:

**Offsetting of Financial Assets and Derivative Assets**

In thousands As of December 31, 2013	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
				Financial Instruments	Cash Collateral	
<b>Description</b>						
Derivatives .....	\$ 58	\$—	\$ 58	\$(58)	\$—	\$—

In thousands As of December 31, 2012	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
				Financial Instruments	Cash Collateral	
<b>Description</b>						
Derivatives .....	\$—	\$—	\$—	\$—	\$—	\$—

**Offsetting of Financial Liabilities and Derivative Liabilities**

In thousands As of December 31, 2013	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
				Financial Instruments	Cash Collateral	
<b>Description</b>						
Derivatives .....	\$ 3,965	\$—	\$ 3,965	\$ (3,965)	\$—	\$—
Repurchase agreements .....	600,000	—	600,000	(600,000)	—	—
Total .....	<u>\$603,965</u>	<u>\$—</u>	<u>\$603,965</u>	<u>\$(603,965)</u>	<u>\$—</u>	<u>\$—</u>

In thousands As of December 31, 2012	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
				Financial Instruments	Cash Collateral	
<b>Description</b>						
Derivatives .....	\$ 5,486	\$—	\$ 5,486	\$ (5,486)	\$—	\$—
Repurchase agreements .....	600,000	—	600,000	(600,000)	—	—
Total .....	<u>\$605,486</u>	<u>\$—</u>	<u>\$605,486</u>	<u>\$(605,486)</u>	<u>\$—</u>	<u>\$—</u>



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 31—SEGMENT INFORMATION**

Based upon the Corporation's organizational structure and the information provided to the Chief Executive Officer of the Corporation and, to a lesser extent, the Board of Directors, the operating segments are driven primarily by the Corporation's lines of business for its operations in Puerto Rico, the Corporation's principal market, and by geographic areas for its operations outside of Puerto Rico. As of December 31, 2013, the Corporation had six reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments; United States Operations; and Virgin Islands Operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation's organizational chart, nature of the products, distribution channels, and the economic characteristics of the product were also considered in the determination of the reportable segments.

The Commercial and Corporate Banking segment consists of the Corporation's lending and other services for large customers represented by specialized and middle-market clients and the public sector. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings, as well as other products, such as cash management and business management services. The Mortgage Banking segment operations consist of the origination, sale, and servicing of a variety of residential mortgage loans. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. In addition, the Mortgage Banking segment includes mortgage loans purchased from other local banks and mortgage bankers. The Consumer (Retail) Banking segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. The Treasury and Investments segment is responsible for the Corporation's investment portfolio and treasury functions executed to manage and enhance liquidity. This segment lends funds to the Commercial and Corporate Banking, Mortgage Banking and Consumer (Retail) Banking segments to finance their lending activities and borrows from those segments and from the United States Operations segment. The Consumer (Retail) Banking and the United States Operations segments also lend funds to other segments. The interest rates charged or credited by Treasury and Investments, the Consumer (Retail) Banking, and the United States Operations segments are allocated based on market rates. The difference between the allocated interest income or expense and the Corporation's actual net interest income from centralized management of funding costs is reported in the Treasury and Investments segment. The United States Operations segment consists of all banking activities conducted by FirstBank in the United States mainland, including commercial and retail banking services. The Virgin Islands Operations segment consists of all banking activities conducted by the Corporation in the USVI and BVI, 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- "Nature of Business and Summary of Significant Accounting Policies."

The Corporation evaluates the performance of the segments based on net interest income, the estimated provision for loan and lease losses, non-interest income, and direct non-interest expenses. The segments are also evaluated based on the average volume of their interest-earning assets less the allowance for loan and lease losses.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table presents information about the reportable segments:

(In thousands)	<u>Mortgage Banking</u>	<u>Consumer (Retail) Banking</u>	<u>Commercial and Corporate Banking</u>	<u>Treasury and Investments</u>	<u>United States Operations</u>	<u>Virgin Islands Operations</u>	<u>Total</u>
<b>For the year ended</b>							
<b>December 31, 2013:</b>							
Interest income . . . . .	\$ 109,074	\$ 231,077	\$ 171,972	\$ 55,075	\$ 36,999	\$ 41,591	\$ 645,788
Net (charge) credit for transfer of funds . . . . .	(37,611)	1,549	(14,280)	41,074	9,268	—	—
Interest expense . . . . .	—	(27,834)	—	(77,366)	(21,748)	(3,895)	(130,843)
Net interest income (loss) . . . .	71,463	204,792	157,692	18,783	24,519	37,696	514,945
(Provision) release for loan and lease losses . . . . .	(89,439)	(54,240)	(101,971)	—	10,709	(8,810)	(243,751)
Non-interest income (loss) . . . .	15,826	38,968	3,904	(66,635)	1,284	7,855	1,202
Direct non-interest expenses . . . . .	(48,941)	(122,560)	(64,611)	(10,629)	(28,554)	(45,680)	(320,975)
Segment (loss) income . . . . .	<u>\$ (51,091)</u>	<u>\$ 66,960</u>	<u>\$ (4,986)</u>	<u>\$ (58,481)</u>	<u>\$ 7,958</u>	<u>\$ (8,939)</u>	<u>\$ (48,579)</u>
Average earnings assets . . . . .	\$2,030,120	\$1,954,307	\$4,068,942	\$2,698,559	\$748,209	\$664,051	\$12,164,188

(In thousands)	<u>Mortgage Banking</u>	<u>Consumer (Retail) Banking</u>	<u>Commercial and Corporate Banking</u>	<u>Treasury and Investments</u>	<u>United States Operations</u>	<u>Virgin Islands Operations</u>	<u>Total</u>
<b>For the year ended</b>							
<b>December 31, 2012:</b>							
Interest income . . . . .	\$ 110,164	\$ 207,001	\$ 187,860	\$ 46,313	\$ 37,376	\$ 49,063	\$ 637,777
Net (charge) credit for transfer of funds . . . . .	(48,830)	474	(23,706)	59,970	12,092	—	—
Interest expense . . . . .	—	(30,904)	—	(111,209)	(29,340)	(4,619)	(176,072)
Net interest income (loss) . . . .	61,334	176,571	164,154	(4,926)	20,128	44,444	461,705
(Provision) release for loan and lease losses . . . . .	(36,553)	(32,924)	(42,940)	—	9,061	(17,143)	(120,499)
Non-interest income (loss) . . . .	18,080	33,362	10,140	(1,623)	1,803	6,885	68,647
Direct non-interest expenses . . . . .	(43,058)	(102,364)	(50,364)	(6,296)	(27,734)	(37,751)	(267,567)
Segment (loss) income . . . . .	<u>\$ (197)</u>	<u>\$ 74,645</u>	<u>\$ 80,990</u>	<u>\$ (12,845)</u>	<u>\$ 3,258</u>	<u>\$ (3,565)</u>	<u>\$ 142,286</u>
Average earnings assets . . . . .	\$2,067,304	\$1,637,729	\$4,571,779	\$2,426,091	\$727,556	\$805,720	\$12,236,179

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate Banking	Treasury and Investments	United States Operations	Virgin Islands Operations	Total
<b>For the year ended</b>							
<b>December 31, 2011:</b>							
Interest income . . . . .	\$ 118,346	\$ 168,520	\$ 206,494	\$ 64,536	\$ 45,095	\$ 56,624	\$ 659,615
Net (charge) credit for transfer of funds . . . . .	(61,466)	11,769	(16,002)	49,430	16,269	—	—
Interest expense . . . . .	—	(41,902)	—	(177,599)	(39,906)	(6,696)	(266,103)
Net interest income . . . . .	<u>56,880</u>	<u>138,387</u>	<u>190,492</u>	<u>(63,633)</u>	<u>21,458</u>	<u>49,928</u>	<u>393,512</u>
Provision for loan and lease losses . . . . .	(33,663)	(17,927)	(118,510)	—	(28,211)	(38,038)	(236,349)
Non-interest income . . . . .	22,272	27,719	8,644	41,588	1,304	10,681	112,208
Direct non-interest expenses . . . . .	(38,254)	(92,539)	(50,018)	(5,704)	(30,513)	(36,485)	(253,513)
Segment income (loss) . . . . .	<u>\$ 7,235</u>	<u>\$ 55,640</u>	<u>\$ 30,608</u>	<u>\$ (27,749)</u>	<u>\$ (35,962)</u>	<u>\$ (13,914)</u>	<u>\$ 15,858</u>
Average earnings assets . . . . .	\$2,154,543	\$1,448,520	\$5,163,940	\$3,123,323	\$851,608	\$889,906	\$13,631,840

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

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
<b>Net (loss) income:</b>			
Total (loss) income for segments and other . . .	\$ (48,579)	\$ 142,286	\$ 15,858
Other non-interest loss <sup>(1)</sup> . . . . .	(16,691)	(19,256)	(4,227)
Other operating expenses <sup>(2)</sup> . . . . .	(94,053)	(87,316)	(84,541)
(Loss) income before income taxes . . . . .	(159,323)	35,714	(72,910)
Income tax expense . . . . .	(5,164)	(5,932)	(9,322)
Total consolidated net (loss) income . . . . .	<u>\$ (164,487)</u>	<u>\$ 29,782</u>	<u>\$ (82,232)</u>
<b>Average assets:</b>			
Total average earning assets for segments . . . . .	\$12,164,188	\$12,236,179	\$13,631,840
Other average earning assets <sup>(1)</sup> . . . . .	18,089	36,706	39,747
Average non-earning assets . . . . .	630,184	693,489	684,129
Total consolidated average assets . . . . .	<u>\$12,812,461</u>	<u>\$12,966,374</u>	<u>\$14,355,716</u>

- (1) The activities related to the Bank's equity interest in CPG/GS are presented as an Other non-interest loss and as Other average earning assets in the table above.
- (2) Expenses pertaining to corporate administrative functions that support the operating segment but are not specifically attributable to or managed by any segment are not included in the reported financial results of the operating segments. The unallocated corporate expenses include certain general and administrative expenses and related depreciation and amortization expenses.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table presents revenues and selected balance sheet data by geography based on the location in which the transaction is originated:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
		(In thousands)	
<b>Revenues:</b>			
Puerto Rico .....	\$ 533,302	\$ 579,949	\$ 637,623
United States .....	47,551	51,271	62,668
Virgin Islands .....	49,446	55,948	67,305
Total consolidated revenues .....	<u>\$ 630,299</u>	<u>\$ 687,168</u>	<u>\$ 767,596</u>
<b>Selected Balance Sheet Information:</b>			
Total assets:			
Puerto Rico .....	\$10,993,743	\$11,421,073	\$11,069,279
United States .....	940,590	913,831	1,129,846
Virgin Islands .....	722,592	764,837	928,150
Loans:			
Puerto Rico .....	\$ 8,173,873	\$ 8,706,428	\$ 8,844,885
United States .....	865,414	714,234	821,652
Virgin Islands .....	672,852	718,846	908,677
Deposits:			
Puerto Rico <sup>(1)</sup> .....	\$ 7,053,053	\$ 7,004,301	\$ 7,015,700
United States .....	1,895,394	1,921,066	1,964,447
Virgin Islands .....	931,477	939,179	927,607

(1) For 2013, 2012, and 2011, includes \$3.1 billion, \$3.4 billion, and \$3.7 billion, respectively, of brokered CDs allocated to Puerto Rico operations.

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 32—FIRST BANCORP. (HOLDING COMPANY ONLY) FINANCIAL INFORMATION**

The following condensed financial information presents the financial position of the Holding Company only as of December 31, 2013 and 2012, and the results of its operations and cash flows for the years ended on December 31, 2013, 2012, and 2011:

**Statements of Financial Condition**

	<u>As of December 31,</u>	
	<u>2013</u>	<u>2012</u>
	(In thousands)	
<b>Assets</b>		
Cash and due from banks . . . . .	\$ 31,957	\$ 35,139
Money market investments . . . . .	6,111	6,111
Investment securities available for sale, at market:		
Equity investments . . . . .	33	31
Other investment securities . . . . .	285	1,300
Loans held for investment, net . . . . .	356	—
Investment in First Bank Puerto Rico, at equity . . . . .	1,403,612	1,663,139
Investment in First Bank Insurance Agency, at equity . . . . .	9,834	7,697
Investment in FBP Statutory Trust I . . . . .	3,093	3,093
Investment in FBP Statutory Trust II . . . . .	3,866	3,866
Other assets . . . . .	4,101	4,891
Total assets . . . . .	<u>\$1,463,248</u>	<u>\$1,725,267</u>
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Other borrowings . . . . .	\$ 231,959	\$ 231,959
Accounts payable and other liabilities . . . . .	15,431	8,285
Total liabilities . . . . .	<u>247,390</u>	<u>240,244</u>
Stockholders' equity . . . . .	<u>1,215,858</u>	<u>1,485,023</u>
Total liabilities and stockholders' equity . . . . .	<u>\$1,463,248</u>	<u>\$1,725,267</u>

**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Statements of (Loss) Income**

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
<b>Income</b>			
Interest income on investment securities .....	\$ —	\$ 6	\$ —
Interest income on other investments .....	22	17	1
Dividend from subsidiaries .....	—	—	3,000
Other income .....	88	220	212
	<u>110</u>	<u>243</u>	<u>3,213</u>
<b>Expense</b>			
Notes payable and other borrowings .....	7,092	7,342	7,042
Other operating expenses .....	5,813	3,398	3,335
	<u>12,905</u>	<u>10,740</u>	<u>10,377</u>
Investment-related proceeds and (impairments) on equity securities . . . .	<u>(42)</u>	<u>—</u>	<u>679</u>
<b>Loss before income taxes and equity in undistributed (losses) earnings of subsidiaries</b> .....	(12,837)	(10,497)	(6,485)
<b>Equity in undistributed (losses) earnings of subsidiaries</b> .....	<u>(151,650)</u>	<u>40,279</u>	<u>(75,747)</u>
<b>Net (Loss) income</b> .....	<u>(164,487)</u>	<u>29,782</u>	<u>(82,232)</u>
Other comprehensive (loss) income, net of tax .....	(107,168)	9,234	1,480
Comprehensive (loss) income .....	<u><u>\$(271,655)</u></u>	<u><u>\$ 39,016</u></u>	<u><u>\$(80,752)</u></u>



**FIRST BANCORP.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Statements of Cash Flows**

	Year Ended December 31,		
	2013	2012	2011
	(In thousands)		
Cash flows from operating activities:			
Net (loss) income	\$(164,487)	\$ 29,782	\$ (82,232)
Adjustments to reconcile net (loss) income to net cash used in operating activities:			
Stock-based compensation	1,471	155	38
Equity in undistributed losses (earnings) of subsidiaries	151,650	(40,279)	75,747
Loss on impairment/sales of investment securities	186	—	—
Net decrease (increase) in other assets	774	(1,403)	1,228
Net increase (decrease) in other liabilities	7,146	7,166	(2,984)
Net cash used in operating activities	(3,260)	(4,579)	(8,203)
Cash flows from investing activities:			
Proceeds from sale/redemption of other investment securities	533	—	—
Capital contribution to subsidiaries	—	—	(457,000)
Proceeds from securities litigation settlement	—	—	679
Net cash provided by (used in) investing activities	533	—	(456,321)
Cash flows from financing activities:			
Proceeds from common stock issued, net of costs	—	1,037	493,274
Dividends paid	—	—	(26,388)
Repurchase of common stock	(455)	—	—
Net cash (used in) provided by financing activities	(455)	1,037	466,886
Net (decrease) increase in cash and cash equivalents	(3,182)	(3,542)	2,362
Cash and cash equivalents at beginning of the year	41,250	44,792	42,430
Cash and cash equivalents at end of year	\$ 38,068	\$ 41,250	\$ 44,792
Cash and cash equivalents include:			
Cash and due from banks	\$ 31,957	\$ 35,139	\$ 41,681
Money market instruments	6,111	6,111	3,111
	\$ 38,068	\$ 41,250	\$ 44,792

**NOTE 33—SUBSEQUENT EVENTS**

The Corporation has performed an evaluation of events occurring subsequent to December 31, 2013; management has determined that there are no additional events occurring in this period that required disclosure in or adjustment to the accompanying financial statements.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures****Disclosure Controls and Procedures**

First BanCorp.'s management, under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of First BanCorp.'s disclosure controls and procedures as such term is defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our CEO and CFO concluded that, as of December 31, 2013, the Corporation's disclosure controls and procedures were effective and provide reasonable assurance that the information required to be disclosed by the Corporation in reports that the Corporation files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and reported to the Corporation's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

**Management's Report on Internal Control over Financial Reporting**

Our management's report on Internal Control over Financial Reporting is included in Item 8 and incorporated herein by reference.

The effectiveness of the Corporation's internal control over financial reporting as of December 31, 2013 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report included in Item 8 of this form 10K.

**Changes in Internal Control over Financial Reporting**

There have been no changes to the Corporation's internal control over financial reporting during our most recent quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Item 9B. Other Information.**

None.

### **PART III**

#### **Item 10. Directors, Executive Officers and Corporate Governance**

Information in response to this Item is incorporated herein by reference from the sections entitled “Information with Respect to Nominees Standing for Election as Directors and with respect to Executive Officers of the Corporation,” “Corporate Governance and Related Matters” and “Section 16(a) Beneficial Ownership Reporting Compliance” contained in First BanCorp.’s definitive Proxy Statement for use in connection with its 2014 Annual Meeting of Stockholders (the “Proxy Statement”) to be filed with the SEC within 120 days of the close of First BanCorp.’s 2013 fiscal year.

#### **Item 11. Executive Compensation.**

Information in response to this Item is incorporated herein by reference from the sections entitled “Compensation Committee Interlocks and Insider Participation”, “Compensation of Directors,” “Compensation Discussion and Analysis,” “Executive Compensation Disclosure” and “Compensation Committee Report” in First BanCorp.’s Proxy Statement to be filed with the SEC within 120 days of the close of First BanCorp.’s 2013 fiscal year.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information in response to this Item is incorporated herein by reference from the section entitled “Security Ownership of Certain Beneficial Owners and Management” in First BanCorp.’s Proxy Statement to be filed with the SEC within 120 days of the close of First BanCorp.’s 2013 fiscal year and by reference to the section entitled “Securities authorized for issuance under equity compensation plans” in Part II, Item 5 of this Form 10-K.

#### **Item 13. Certain Relationships and Related Transactions, and Director Independence**

Information in response to this Item is incorporated herein by reference from the sections entitled “Certain Relationships and Related Person Transactions” and “Corporate Governance and Related Matters” in First BanCorp.’s Proxy Statement to be filed with the SEC within 120 days of the close of First BanCorp.’s 2013 fiscal year.

#### **Item 14. Principal Accounting Fees and Services.**

##### **Audit Fees**

Information in response to this Item is incorporated herein by reference from the section entitled “Audit Fees” and “Audit Committee Report” in First BanCorp.’s Proxy Statement to be filed with the SEC within 120 days of the close of First BanCorp.’s 2013 fiscal year.

## PART IV

### **Item 15. Exhibits, Financial Statement Schedules**

(a) List of documents filed as part of this report.

(1) *Financial Statements.*

The following consolidated financial statements of First BanCorp., together with the report thereon of First BanCorp.'s independent registered public accounting firm, KPMG LLP, dated March 17, 2014, and First BanCorp.'s prior independent registered public accounting firm, PricewaterhouseCoopers LLP, dated March 13, 2012 are included in Item 8 of this report:

- Report of KPMG LLP, Independent Registered Public Accounting Firm.
- Report of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm.
- Attestation Report of KPMG LLP, Independent Registered Public Accounting Firm on Internal Control over Financial Reporting
- Consolidated Statements of Financial Condition as of December 31, 2013 and 2012.
- Consolidated Statements of (Loss) Income for Each of the Three Years in the Period Ended December 31, 2013.
- Consolidated Statements of Comprehensive (Loss) Income for each of the Three Years in the Period Ended December 31, 2013.
- Consolidated Statements of Cash Flows for Each of the Three Years in the Period Ended December 31, 2013.
- Consolidated Statements of Changes in Stockholders' Equity for Each of the Three Years in the Period Ended December 31, 2013.
- Notes to the Consolidated Financial Statements.

(2) Financial statement schedules.

All financial schedules have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

(b) Exhibits listed below are filed herewith as part of this Form 10-K or are incorporated herein by reference.

(c) The separate financial statements of CPG/GS PR NPL, LLC as of December 31, 2013 and 2012 and for the fiscal years ended December 31, 2013, 2012, and 2011, required to be filed pursuant to Rule 3-09 of Regulation S-X, are filed as Exhibit 99.3 hereto.

## EXHIBIT INDEX

Exhibit No.	Description
3.1	Restated Articles of Incorporation, incorporated by reference from Exhibit 3.1 of the Registration Statement on Form S-1/A filed by First BanCorp on October 20, 2011.
3.2	By-Laws, incorporated by reference from Exhibit 3.2 of the Registration Statement on Form S-1/A filed by First BanCorp on October 20, 2011.
3.3	Certificate of Designation creating the 7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A, incorporated by reference from Exhibit 4(B) to the Form S-3 filed by First BanCorp on March 30, 1999.
3.4	Certificate of Designation creating the 8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B, incorporated by reference from Exhibit 4(B) to Form S-3 filed by First BanCorp on September 8, 2000.
3.5	Certificate of Designation creating the 7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C, incorporated by reference from Exhibit 4(B) to the Form S-3 filed by First BanCorp on May 18, 2001.
3.6	Certificate of Designation creating the 7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D, incorporated by reference from Exhibit 4(B) to the Form S-3/A filed by First BanCorp on January 16, 2002.
3.7	Certificate of Designation creating the 7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E, incorporated by reference from Exhibit 4.2 to the Form 8-K filed by First BanCorp on September 5, 2003.
3.8	Certificate of Designation creating the fixed-rate cumulative perpetual preferred stock, Series F, incorporated by reference from Exhibit 3.1 of the Form 8-K filed by the Corporation on January 20, 2009.
3.9	Certificate of Designation creating the fixed-rate cumulative perpetual preferred stock, Series G, incorporated by reference from Exhibit 10.3 to the Form 8-K filed by First BanCorp on July 7, 2010.
3.10	First Amendment to Certificate of Designation creating the Fixed-Rate Cumulative Mandatorily Convertible Preferred Stock, Series G, incorporated by reference from Exhibit 3.1 to the Form 8-K filed by First BanCorp on December 2, 2010.
3.11	Second Amendment to Certificate of Designation creating the Fixed-Rate Cumulative Mandatorily Convertible Preferred Stock, Series G, incorporated by reference from Exhibit 3.1 to the Form 8-K filed by First BanCorp on April 15, 2011.
4.1	Form of Common Stock Certificate, incorporated by reference from Form 8-A/A filed by First BanCorp on May 3, 2012.
4.2	Form of Stock Certificate for 7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A, incorporated by reference from Exhibit 4(A) to the Form S-3 filed by First BanCorp on March 30, 1999.
4.3	Form of Stock Certificate for 8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B, incorporated by reference from Exhibit 4(A) to the Form S-3 filed by First BanCorp on September 8, 2000.
4.4	Form of Stock Certificate for 7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C, incorporated by reference from Exhibit 4(A) to the Form S-3 filed by First BanCorp on May 18, 2001.

<b>Exhibit No.</b>	<b>Description</b>
4.5	Form of Stock Certificate for 7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D, incorporated by reference from Exhibit 4(A) to the Form S-3/A filed by First BanCorp on January 16, 2002.
4.6	Form of Stock Certificate for 7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E, incorporated by reference from Exhibit 4.1 to the Form 8-K filed by First BanCorp on September 5, 2003.
4.7	Warrant dated January 16, 2009 to purchase shares of First BanCorp, incorporated by reference from Exhibit 4.1 to the Form 8-K filed by First BanCorp on January 20, 2009.
4.8	Amended and Restated Warrant, Annex A to the Exchange Agreement by and between First BanCorp and the United States Treasury dated as of July 7, 2010, incorporated by reference from Exhibit 10.2 of the Form 8-K filed on July 7, 2010.
4.9	Letter Agreement, dated January 16, 2009, including Securities Purchase Agreement—Standard Terms attached thereto as Exhibit A, between First BanCorp and the United States Department of the Treasury, incorporated by reference from Exhibit 10.1 to the Form 8-K filed by First BanCorp on January 20, 2009.
10.1	FirstBank's 1997 Stock Option Plan, incorporated by reference from the Form 10-K for the year ended December 31, 1998 filed by First BanCorp on March 26, 1999.
10.2	First BanCorp's 2008 Omnibus Incentive Plan, as amended, incorporated by reference from Exhibit 99.1 to the Form S-8 filed by First BanCorp on May 4, 2012.
10.3	Investment Agreement between The Bank of Nova Scotia and First BanCorp dated February 15, 2007, including the Form of Stockholder Agreement, incorporated by reference from Exhibit 10.01 to the Form 8-K filed by First BanCorp on February 22, 2007.
10.4	Amendment No. 1 to Stockholder Agreement, dated as of October 13, 2010, by and between First BanCorp and The Bank of Nova Scotia, incorporated by reference to Exhibit 10.1 to the Form 8-K filed on November 24, 2010.
10.5	Employment Agreement—Aurelio Alemán, incorporated by reference from the Form 10-K for the year ended December 31, 1998 filed by First BanCorp on March 26, 1999.
10.6	Amendment No. 1 to Employment Agreement—Aurelio Alemán, incorporated by reference from the Form 10-Q for the quarter ended March 31, 2009 filed by First BanCorp on May 11, 2009.
10.7	Amendment No. 2 to Employment Agreement—Aurelio Alemán, incorporated by reference from Exhibit 10.6 of the Form 10-K for the year ended December 31, 2009 filed by First BanCorp on March 2, 2010.
10.8	Employment Agreement—Lawrence Odell, incorporated by reference from the Form 10-K for the year ended December 31, 2005 filed by First BanCorp on February 9, 2007.
10.9	Amendment No. 1 to Employment Agreement—Lawrence Odell, incorporated by reference from the Form 10-K for the year ended December 31, 2005 filed by First BanCorp on February 9, 2007.
10.10	Amendment No. 2 to Employment Agreement—Lawrence Odell, incorporated by reference from the Form 10-Q for the quarter ended March 31, 2009 filed by First BanCorp on May 11, 2009.
10.11	Amendment No. 3 to Employment Agreement—Lawrence Odell, incorporated by reference from Exhibit 10.13 of the Form 10-K for the year ended December 31, 2009 filed by First BanCorp on March 2, 2010.
10.12	Amended and Restated Employment Agreement—Lawrence Odell, incorporated by reference from Exhibit 10.1 of the Form 10-Q for the quarter ended June 30, 2012 filed by First BanCorp on August 9, 2012.



<b>Exhibit No.</b>	<b>Description</b>
10.13	Employment Agreement—Victor Barreras, incorporated by reference from Exhibit 10.2 of the Form 10-Q for the quarter ended June 30, 2012 filed by First BanCorp on August 9, 2012.
10.14	Employment Agreement—Orlando Berges, incorporated by reference from the Form 10-Q for the quarter ended June 30, 2009 filed by First BanCorp on August 11, 2009.
10.15	Service Agreement Martinez Odell & Calabria, incorporated by reference from the Form 10-K for the year ended December 31, 2005 filed by First BanCorp on February 9, 2007.
10.16	Amendment No. 1 to Service Agreement Martinez Odell & Calabria, incorporated by reference from the Form 10-K for the year ended December 31, 2005 filed by First BanCorp on February 9, 2007.
10.17	Amendment No. 2 to Service Agreement Martinez Odell & Calabria, incorporated by reference from Exhibit 10.17 of the Form 10-K for the year ended December 31, 2009 filed by First BanCorp on March 2, 2010.
10.18	Amendment No. 3 to Service Agreement Martinez Odell & Calabria, incorporated by reference from Exhibit 10.20 of the Form 10-K for the year ended December 31, 2010 filed by First BanCorp on April 15, 2011.
10.19	Consent Order, dated June 2, 2010, incorporated by reference from Exhibit 10.1 of the Form 8-K filed on June 4, 2010.
10.20	Written Agreement, dated June 3, 2010, incorporated by reference from Exhibit 10.2 of the Form 8-K filed on June 4, 2010.
10.21	Exchange Agreement by and between First BanCorp and the United States Treasury dated as of July 7, 2010, incorporated by reference from Exhibit 10.1 of the Form 8-K filed on July 7, 2010.
10.22	First Amendment to Exchange Agreement, dated as of December 1, 2010, by and between First BanCorp and The United States Department of the Treasury, incorporated by reference from Exhibit 10.1 to the Form 8-K filed by First BanCorp on December 2, 2010.
10.23	Form of Restricted Stock Award Agreement incorporated by reference from Exhibit 10.23 to the Form S-1/A filed by First BanCorp on July 16, 2010.
10.24	Form of Stock Option Agreement for Officers and Other Employees incorporated by reference from Exhibit 10.24 to the Form S-1/A filed by First BanCorp on July 16, 2010.
10.25	Letter Agreement, dated as of January 16, 2009, and Securities Purchase Agreement, dated as of January 16, 2009, by and between First BanCorp and the United States Department of the Treasury, incorporated by reference from Exhibit 10.1 of the Form 8-K filed on January 20, 2009.
10.26	Amended and Restated Investment Agreement between First BanCorp and Thomas H. Lee Partners, L.P., incorporated by reference from Exhibit 10.1 of the Form 8-K filed on July 19, 2011.
10.27	Agreement Regarding Additional Shares between First BanCorp and Thomas H. Lee Partners, L.P., incorporated by reference from Exhibit 10.25 of the Registration Statement on Form S-1/A filed by First BanCorp on October 20, 2011.
10.28	Amended and Restated Investment Agreement between First BanCorp and Oaktree Capital Management, L.P., incorporated by reference from Exhibit 10.2 of the Form 8-K filed on July 19, 2011.
10.29	Agreement Regarding Additional Shares between First BanCorp and Oaktree Capital Management, L.P. dated October 26, 2011 incorporated by reference from Exhibit 10.27 of the Form S-1 filed by First BanCorp on December 20, 2011.
10.30	Investment Agreement between First BanCorp and funds advised by Wellington Management Company LLP, as amended, incorporated by reference from Exhibit 10.2 of the Form 8-K/A filed on July 19, 2011, and Exhibit 10.3 of the Form 8-K filed on July 19, 2011.

<b>Exhibit No.</b>	<b>Description</b>
10.31	Amendment No. 2 to Investment Agreement between First BanCorp and funds advised by Wellington Management Company LLP, incorporated by reference from Exhibit 10.28 to the Form S-1/A filed by First BanCorp on October 20, 2011.
10.32	Form of Subscription Agreement between First BanCorp and private placement investors, incorporated by reference from Exhibit 10.3 of the Form 8-K filed on June 29, 2011.
10.33	Expense Reimbursement Agreement between First BanCorp and Oaktree Capital Management, L.P., incorporated by reference from Exhibit 10.4 of the Form 8-K/A filed on July 21, 2011.
10.34	Expense Reimbursement Agreement between First BanCorp and Thomas H. Lee Partners, L.P., incorporated by reference from Exhibit 10.2 of the Form 8-K/A filed on July 21, 2011.
10.35	Letter Agreement with the U.S. Department of the Treasury dated as of October 3, 2011, incorporated by reference from Exhibit 10.1 of the Form 8-K filed on October 7, 2011.
10.36	Letter Agreement between First BanCorp. and Roberto R. Herencia, incorporated by reference from the Form 8-K filed by First BanCorp on November 2, 2011.
10.37	Stock Purchase Agreement between First BanCorp and Roberto Herencia dated February 17, 2012, incorporated by reference from Exhibit 10.36 of the Form 10-k for the fiscal year ended December 31, 2011 filed by First BanCorp. on March 13, 2012.
10.38	Non – Employee Director Compensation Structure, incorporated by reference from Exhibit 10.3 of the Form 10-Q for the quarter ended June 30, 2012 filed by First BanCorp on August 9, 2012.
10.39	Offer Letter between First BanCorp and Robert T. Gormley incorporated by reference from Exhibit 10.1 of the Form 8-K filed on November 2, 2012.
10.40	Offer Letter between First BanCorp and David I. Matson incorporated by reference from Exhibit 10.1 of the Form 8-K filed on October 1, 2013.
12.1	Ratio of Earnings to Fixed Charges
12.2	Ratio of Earnings to Fixed Charges and Preference Dividends
14.1	Code of Ethics for CEO and Senior Financial Officers, incorporated by reference from Exhibit 3.2 of the Form 10-K for the fiscal year ended December 31, 2008 filed by First BanCorp on March 2, 2009.
21.1	List of First BanCorp’s subsidiaries
23.1	Consent of KPMG LLP
23.2	Consent of PricewaterhouseCoopers LLP
23.3	Consent of PricewaterhouseCoopers LLP – Financial statements of CPG/GS PR NPL, LLC
31.1	Section 302 Certification of the CEO
31.2	Section 302 Certification of the CFO
32.1	Section 906 Certification of the CEO
32.2	Section 906 Certification of the CFO
99.1	Certification of the CEO Pursuant to Section III(b)(4) of the Emergency Stabilization Act of 2008 and 31 CFR § 30.15.
99.2	Certification of the CFO Pursuant to Section III(b)(4) of the Emergency Stabilization Act of 2008 and 31 CFR § 30.15.

<b>Exhibit No.</b>	<b>Description</b>
99.3	Financial statements of CPG/GS PR NPL, LLC as of December 31, 2013 and 2012 and for the fiscal years ended December 31, 2013, 2012, and 2011.
Exhibit 101.INS	XBRL Instance Document, filed herewith.
Exhibit 101.SCH	XBRL Taxonomy Extension Schema Document, filed herewith.
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document, filed herewith.
Exhibit 101.LAB	XBRL Taxonomy Extension Label Linkbase Document, filed herewith.
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document, filed herewith.
Exhibit 101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document, filed herewith.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 the Corporation has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

### FIRST BANCORP.

By: /s/ Aurelio Alemán Date: 3/17/14  
Aurelio Alemán  
President, Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Aurelio Alemán Date: 3/17/14  
Aurelio Alemán  
President, Chief Executive Officer and Director

/s/ Orlando Berges Date: 3/17/14  
Orlando Berges, CPA  
Executive Vice President and Chief Financial Officer

/s/ Roberto R. Herencia Date: 3/17/14  
Roberto R. Herencia,  
Director and Chairman of the Board

/s/ José Menéndez-Cortada Date: 3/17/14  
José Menéndez-Cortada,  
Director

/s/ Fernando Rodríguez-Amaro Date: 3/17/14  
Fernando Rodríguez Amaro,  
Director

/s/ Thomas Martin Hagerty Date: 3/17/14  
Thomas Martin Hagerty,  
Director

/s/ Robert T. Gormley Date: 3/17/14  
Robert T. Gormley,  
Director

/s/ Michael P. Harmon Date: 3/17/14  
Michael P. Harmon,  
Director

/s/ David Matson Date: 3/17/14  
David Matson,  
Director

/s/ Pedro Romero Date: 3/17/14  
Pedro Romero, CPA  
Senior Vice President and Chief Accounting Officer

[THIS PAGE INTENTIONALLY LEFT BLANK]

CPG/GS PR NPL, LLC and Subsidiaries

***Consolidated Financial Statements***  
***For The Year Ended December 31, 2013***  
*(Not covered by report included herein)*



CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET — DECEMBER 31, 2013

(Not covered by report included herein)

ASSETS

INVESTMENT IN LOANS RECEIVABLE, at fair value (cost \$63,457,792) .....	\$112,541,820
REAL ESTATE .....	64,679,010
CASH AND CASH EQUIVALENTS .....	624,195
RESTRICTED CASH .....	8,051,962
DEFERRED FINANCING COSTS, net of accumulated amortization of \$462,073 .....	328,422
ACCOUNTS RECEIVABLE .....	115,890
OTHER ASSETS .....	133,304
Total assets .....	<u>\$186,474,603</u>

LIABILITIES AND MEMBERS' EQUITY

NOTES PAYABLE, related party .....	\$ 69,399,374
OTHER LIABILITIES: .....	
Accounts payable and accrued liabilities .....	5,265,217
Mortgage loan escrow .....	687,865
Accrued interest payable, related party .....	186,872
Total liabilities .....	75,539,328
COMMITMENTS AND CONTINGENCIES (Note 10) .....	
MEMBERS' EQUITY .....	<u>110,935,275</u>
Total liabilities and members' equity .....	<u>\$186,474,603</u>

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2013

(Not covered by report included herein)

INCOME:	
Rental Income .....	\$ 662,257
Straight line rent .....	61,847
Other .....	<u>100</u>
Total income .....	724,204
OPERATING EXPENSES:	
Repairs and maintenance .....	621,278
Utilities .....	450,462
Management and administrative .....	614,075
Real estate taxes .....	528,258
Insurance .....	<u>479,050</u>
Total operating expenses .....	2,693,123
EXPENSES:	
Interest .....	2,243,345
Amortization of deferred financing costs .....	91,415
Fair value adjustment of derivative instruments .....	4,000
Legal .....	2,011,957
Professional fees .....	545,650
Servicing fees to related parties .....	3,235,087
Other ownership .....	<u>1,402,514</u>
Total expenses .....	<u>9,533,968</u>
LOSS BEFORE REALIZED/UNREALIZED GAIN ON INVESTMENTS IN LOANS AND REALIZED LOSS ON REAL ESTATE .....	(11,502,887)
NET UNREALIZED GAIN ON INVESTMENTS IN LOANS RECEIVABLE CARRIED AT FAIR VALUE UNDER THE FAIR VALUE OPTION .....	7,759,201
NET REALIZED LOSS ON SETTLEMENT OF INVESTMENTS IN LOANS RECEIVABLE AT FAIR VALUE UNDER THE FAIR VALUE OPTION .....	(1,000,115)
WRITEDOWN ON REAL ESTATE .....	(4,007,435)
NET GAIN ON SALE OF REAL ESTATE .....	<u>2,520,899</u>
NET LOSS .....	<u>\$ (6,230,337)</u>

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF MEMBERS' EQUITY

FOR THE YEAR ENDED DECEMBER 31, 2013

(Not covered by report included herein)

	<u>PRLP Ventures, LLC</u>	<u>First Bank Puerto Rico</u>	<u>Members' Equity</u>
BALANCE AT DECEMBER 31, 2012 .....	\$113,893,690	\$ 3,654,867	\$117,548,557
Cash distributions .....	(382,945)	—	(382,945)
Net loss .....	<u>(2,575,470)</u>	<u>(3,654,867)</u>	<u>(6,230,337)</u>
BALANCE AT DECEMBER 31, 2013 .....	<u>\$110,935,275</u>	<u>\$ —</u>	<u>\$110,935,275</u>

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2013

(Not covered by report included herein)

CASH FLOWS FROM OPERATING ACTIVITIES:

Net loss	\$ (6,230,337)
Adjustments to reconcile net loss to net cash used in operating activities:	
Amortization of deferred financing costs	91,415
Fair value adjustment of derivative instruments	4,000
Net gain on sale of real estate	(2,520,899)
Unrealized gain on investments in loans receivable	(7,759,201)
Write-down of loss from other real estate	4,007,435
Realized loss on loan settlements	1,000,115
Change in operating assets and liabilities:	
Other assets	56,504
Accounts receivable	94,111
Accounts payable and accrued liabilities	3,834,740
Accrued interest payable	(30,785)
Net cash used in operating activities	<u>(7,452,902)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Additions to real estate	(12,098,166)
Fundings to investments in loans receivable	(11,234,190)
Collections on loans receivable	21,662,125
Change in restricted cash	3,201,710
Net proceeds from sale of other real estate	<u>12,874,669</u>
Net cash from investing activities	<u>14,406,148</u>

CASH FLOWS FROM FINANCING ACTIVITIES:

Cash distributions	(382,945)
Proceeds from notes payable	19,486,846
Principal payments made on notes payable	(29,490,195)
Purchase of interest rate derivative instruments	(4,000)
Payment of deferred financing costs	(72,313)
Change in escrow liability	<u>(21,520)</u>
Net cash used in financing activities	<u>(10,484,127)</u>

NET CHANGE IN CASH AND CASH EQUIVALENTS (3,530,811)

CASH AND CASH EQUIVALENTS, beginning of year 4,155,076

CASH AND CASH EQUIVALENTS, end of year \$ 624,195

SUPPLEMENTAL DISCLOSURES:

Interest paid	\$ 2,274,130
Investment of loans receivable transferred to other real estate	\$ 15,309,921

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2013

(Not covered by report included herein)

1. ORGANIZATION:

CPG/GS PR NPL, LLC (the Parent Company), a Puerto Rico limited liability company, was organized effective January 20, 2011, to directly or indirectly acquire, own, hold, manage, finance, mortgage, pledge, lease and assign any assets, advance funds, enter into such acquisition agreements, servicing agreements, leases, assignments, financing agreements, security agreements and other instruments and agreements of any kind, enter into partnerships, limited partnerships, limited liability companies and joint ventures, and do any and all other acts and things that may be necessary or useful for the conduct of its business or the winding up thereof. The Parent Company owns 100% of the equity interests in CPG/GS Island Properties I, LLC, CPG/GS Island Properties II, LLC, CPG/GS Island Properties III, LLC, CPG/GS Island Properties IV, LLC, CPG/GS Island Properties V, LLC, CPG/GS Island Properties VI, LLC and CPG/GS Island Properties VII, LLC, (the Subsidiaries). The Subsidiaries, Puerto Rico limited liability companies, were organized primarily to hold any real estate assets the Parent Company obtains through foreclosure of its investments in loans receivable.

Collectively, the Parent Company and the Subsidiaries are the “Company”. The members of the Parent Company are PRLP Ventures, LLC (PRLP) and First Bank Puerto Rico (First Bank) (collectively, the Members). The members of PRLP are FBLP Group Holding, LLC (FBLP) and Goldman, Sachs & Co. (GS).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of consolidation

The consolidated financial statements include the accounts of the Parent Company and its wholly owned Subsidiaries. These consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America and present the Company’s consolidated financial position, results of operations and cash flows. Intercompany transactions have been eliminated in consolidation.

Basis of accounting and use of estimates

The Company prepares its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. This requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has evaluated subsequent events through March 11, 2014, the date which the consolidated financial statements were available to be issued.

Fair value measurements

Fair value measurements are market-based measurements, not entity-specific measurements. Fair value measurements are determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, management uses a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and management’s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is

based on the lowest level input that is significant to the fair value measurement in its entirety. Management's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

#### Investments in loans receivable, at fair value

Management elected to carry the Company's investments in loans receivable at fair value due to the fair value option being operationally less complex for the Company to manage. Fair value is an exit price, representing the amount that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The Company's private investments, by their nature, have little to no price transparency.

The Company's investments in loans receivable are either non-performing or sub-performing in relation to the original terms of the loans. The fair value of the Company's investments in loans receivable are determined based on an income approach that uses cash flows at the loan level from the highest and best use of the assets by a market participant. In reaching its determination of fair value, management considers many factors including, but not limited to, broker quotations to support inputs used in the valuations of the underlying collateral, the operating cash flows and financial performance of the investments considered relevant to a market participant, taxes associated with owning the investments, trends within sectors and/or regions, historical events, the expected hold period and strategy anticipated to be employed by a market participant and any other specific rights or terms associated with the investment that management believes would be a relevant factor impacting the exit price. Such investments are classified within level 3 of the fair value hierarchy.

Management's judgment is also required to determine the appropriate risk-adjusted discount rate for investments that are classified within level 3 of the fair value hierarchy. In such situations, management estimates the rates based on available market information adjusted to rates which market participants would likely consider appropriate for risks associated with a particular investment.

Investments in loans receivable are on nonaccrual status and all cash payments are first applied to the loans' principal balances. All income or loss is recognized at the valuation date in net change in unrealized appreciation/depreciation from investments in loans receivable on the consolidated statement of operations. Interest income on performing loans is recognized on an accrual basis. The recognition of income on a performing loan is discontinued when interest or principal payments become 90 days past due. Cash payments subsequently received on investments in loans receivable are applied to the principal balance or recorded as interest income, depending upon management's assessment of the ultimate collectability of the loan.

Loan modifications and restructurings may occur when the borrower experiences financial difficulty and needs temporary or permanent relief from the original contractual terms of the loan and the lender grants a concession. These modifications are structured on either a loan-by-loan or borrower group basis, and depending on the circumstances, may extend payment terms, modify interest rates, reduce principal owed, or other concessions. When this occurs, the loan may be considered a troubled debt restructuring. Once a loan is restructured and the borrower is not in default of the renegotiated terms, the Company accrues interest earned. When a loan is settled, the difference between the proceeds received and the loan basis is recorded to gain or loss on loan settlement in the income statement.

#### Real estate

When real estate assets are acquired through foreclosure or repossession they are initially recorded at the fair value of the property and included in investments in real estate owned in the accompanying consolidated balance sheet. Estimated fair value is based on the underlying collateral value which is estimated using an income approach that uses cash flows from the eventual disposition of the collateral and the estimated cash flows during the hold period, if any. Immediately preceding the foreclosure or repossession, any adjustments to the loan's fair value will be reflected as a gain or loss on investments in loans receivable carried at fair value under the fair value option on the consolidated statement of operations. With the foreclosure, the entity changes from holding a



financial asset to a hard asset, therefore, a realized event has occurred. As of December 31, 2013, the Company had foreclosed on a total of eleven loans held by six borrower groups. The real estate assets are held in the Subsidiaries of the Company.

Upon foreclosure of a loan in full satisfaction of a loan receivable, the Company accounts for those assets at their fair value less cost to sell and the assets are classified as held for sale. In subsequent periods, such long-lived assets are measured at the lower of carrying amount or fair value less cost to sell. As of December 31, 2013 the Company considers all foreclosed assets as long-lived assets held for sale and are accounted for at the lower of cost or fair value less cost to sell.

#### Cash and cash equivalents

The Company considers all highly liquid investments with an original maturity of three months or less that are not restricted to be cash equivalents. Cash equivalents are placed with reputable institutions and the balances may at times exceed federally insured deposit levels; however, the Company has not experienced any losses in such accounts.

As cash and cash equivalents have a maturity of less than three months, the carrying value of cash equivalents approximates fair value.

#### Deferred financing costs

Deferred financing costs incurred in connection with the receipt of the notes payable are capitalized and amortized over the term of the debt using a method which approximates the interest method.

#### Interest rate derivative instrument

The Company's derivative transaction consists of an interest rate cap agreement entered into to mitigate the Company's exposure to increasing borrowing costs in the event of a rising interest rate environment (see Note 6). The Company has elected not to designate its interest rate cap agreement as a designated accounting hedge. Changes in the fair value of the interest rate cap are recorded in the accompanying consolidated statement of operations.

The valuation of the interest rate cap is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows. This analysis reflects the contractual terms of the derivative, including the period to maturity, and uses observable market-based inputs such as interest rate curves and volatility assumptions. The fair value of the interest rate cap is determined using the market standard methodology of discounted future cash receipts. The cash receipts are based on an expectation of future interest rates using a forward curve that is derived from observable market interest rate curves.

The analysis has incorporated credit valuation adjustments to appropriately reflect the respective counterparty's nonperformance risk in the fair value measurements. Management evaluated the counterparty's nonperformance risk based on the counterparty's most recent credit rating and any changes in credit rating over the past year. In adjusting the fair value of the derivative contract for the effect of nonperformance risk, management has considered the impact of collateral netting and any applicable credit enhancements. Management concluded that the nonperformance risk is insignificant, and no adjustment to the value was necessary for this input. Therefore, all inputs used to value the derivative falls within Level 2 of the fair value hierarchy and the derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

#### Accounts receivable

Accounts receivable at December 31, 2013 is comprised of real estate tax and insurance receivables and straight line rent receivable of \$115,890.

### Other Assets

Other assets at December 31, 2013 are comprised of prepaid real estate taxes and property insurance of \$133,304.

The Puerto Rico Insurance Code prohibits a lender from placing insurance on behalf of a borrower and charging the borrower for the premium payment. However, the lender may protect its own interests without transferring the costs to the borrower. For the period ended December 31, 2013, the Company paid property insurance premiums on certain collateral. These premiums are reflected as insurance expense in the consolidated statement of operations.

### Income taxes

Under U.S. federal income tax law and Puerto Rico income tax law, limited liability companies are not taxable entities. Therefore, no provision has been made in the accompanying consolidated financial statements for income taxes due by the Company. Each member is individually responsible for reporting its share of the Company's income or loss.

Accounting Standards Codification (ASC) 740, Income Taxes, requires management to determine whether a tax position is more likely than not to be sustained upon examination by the applicable tax authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets this recognition threshold, the position is measured to determine the amount of tax benefit or expense to be recognized. The Company does not have any uncertain tax positions that would require accrual under ASC 740. No interest or penalty related to uncertain taxes has been recognized on the accompanying statement of operations. Management does not expect a significant change in uncertain tax positions during the twelve months subsequent to December 31, 2013.

The Company files U.S. and Puerto Rico tax returns. In the normal course of business, the Company may be audited by either taxing authority. As of December 31, 2013, the Company is not currently undergoing any tax examinations, nor has the Company agreed to extend the statute of limitations beyond the prescribed expiration date. The Company remains subject to examination by various taxing authorities for tax years beginning 2011 and upon completion of any examination, tax adjustments may be necessary.

### Accounts payable and accrued liabilities

Accounts payable and accrued liabilities at December 31, 2013 are comprised of the following:

Unearned income	46,667
Accounts payable	121,751
Accrued servicing fees	236,422
Real estate tax liability	407,247
Accrued professional fees	465,114
Other liabilities	3,803,632
Deferred maintenance liability (Note 5)	121,254
Borrower deposits liability (Note 5)	63,130
	<u>\$5,265,217</u>

### Other comprehensive income

Since there are no transactions requiring presentation in other comprehensive income, but not in net income, the Company's net income equates to comprehensive income.

### Recent accounting and other developments

In February 2013, the FASB issued ASU 2013-03, which exempts nonpublic entities from the requirement in ASC 825 (amended by ASU 2011-04) to disclose the fair value hierarchy level (i.e., Level 1, 2, or 3) for fair value measurements of financial assets and financial liabilities that are disclosed in the footnotes to the financial statements but not reported at fair value in the statement of financial position. The ASU does not change any other fair value disclosure requirements in ASC 820 or ASC 825. The amendments in ASU 2013-03 became effective upon issuance. As the Company's financial assets are reported at fair value on the consolidated balance sheet, the adoption of this guidance did not have a material impact on the Company's consolidated financial statements or disclosures.

In December 2013, the Puerto Rican government signed into law House Bill 1524 (Act 163-2013), known as the Act of Effective Mechanisms for Tax Fiscalization (the Act). The purpose of the Act is to modify the content of the supplemental information that accompanies the audited financials statements that are required to be filed with the income tax return. The Act is effective for taxable years commencing after December 31, 2012 and requires additional supplemental schedules to be included with the consolidated financial statements. The Company is currently evaluating the impact of the Act and the additional reporting requirements related to the new supplemental schedules; however, it did not impact these consolidated financial statements or disclosures.

### 3. INVESTMENTS IN LOANS RECEIVABLE, AT FAIR VALUE:

The Company's investments in loans receivable are summarized as follows at December 31, 2013 by collateral type:

<u>Collateral Type</u>	<u>Number of Loans</u>	<u>Unpaid Principal Balance</u>	<u>Fair Value</u>
Condo .....	24	\$126,437,294	\$ 46,365,954
Hotel .....	1	23,500,000	21,225,094
Retail .....	11	29,717,031	21,986,968
Commercial .....	3	22,376,486	11,742,966
Land .....	2	6,385,071	2,420,883
Marina .....	3	8,506,354	8,799,955
Total investments .....	44	<u>\$216,922,236</u>	<u>\$112,541,820</u>

The concentration of the Company's investments in loans receivable by collateral type at December 31, 2013 is 41% condo, 20% retail, 19% hotel, 10% commercial, 8% marina and 2% land.

The concentration of the Company's investments in loans receivable by borrower group at December 31, 2013 is as follows:

<u>Borrower Group</u>	<u>Number of Loans</u>	<u>Unpaid Principal Balance</u>	<u>Fair Value</u>
Eduardo Ferrer .....	14	\$ 29,078,683	\$ 26,114,608
Swiss Chalet .....	1	23,500,000	21,225,094
San Geronimo Caribe .....	4	27,565,115	18,155,805
Jorge Pulpeiro .....	5	20,786,288	12,191,883
Enin .....	1	13,363,135	7,062,219
Michael Redondo .....	3	37,362,908	6,317,693
Desarrolladora Los Filtros .....	2	6,135,014	3,873,555
Other Borrowers .....	14	59,131,093	17,600,963
Total investments .....	44	<u>\$216,922,236</u>	<u>\$112,541,820</u>

The concentration of the Company's investment in loans receivable by borrower group at December 31, 2013 is 23% Eduardo Ferrer, 19% Swiss Chalet 16% San Geronimo Caribe, and 42% other borrower groups.

The Company's investments in loans receivable are all collateralized by real estate assets geographically located in Puerto Rico.

The following table sets forth the Company's investments in loans receivable, at fair value that were measured on a recurring basis as of December 31, 2013 by level within the fair value hierarchy (see Note 2):

	Investments in Loans Receivable, at Fair Value			
	Level 1	Level 2	Level 3	Total
Investments in loans receivable, at fair value . . .	\$—	\$—	\$112,541,820	\$112,541,820

The following table sets forth a summary of changes in the fair value of the Company's level 3 investments in loans receivable for the year ended December 31, 2013:

	Level 3 Investments in Loans Receivable, at Fair Value
Balance, beginning of year . . . . .	\$131,520,590
Contractual advances . . . . .	11,234,190
Contractual loan collections . . . . .	(21,662,125)
Purchases . . . . .	—
Sales . . . . .	—
Unrealized fair value gains . . . . .	7,759,201
Realized loss on loan settlement . . . . .	(1,000,115)
Foreclosure into real estate owned assets . .	(15,309,921)
Transfers in and/or out of level 3 . . . . .	—
Balance, end of year . . . . .	<u>\$112,541,820</u>
Net change in unrealized gains/(losses) from investments in loans receivable still held at the reporting date . . . . .	<u>\$ 3,670,796</u>

Transfers in and/or out of level 3 represents transfers from/(to) level 2. Transfers from level 2 are the result of investment valuations whose significant inputs have become unobservable, causing less transparency in prices of the investments. Transfers to level 2 are the result of investment dispositions or offers to purchase investments. There have been no transfers in and/or out of level 3 for the period ended December 31, 2013.

The following table presents information about significant unobservable inputs related to the Company's categories of Level 3 financial assets at December 31, 2013.

Collateral Type	Number of Loans	Fair Value	Valuation Technique	Significant Unobservable Inputs	Inputs or Ranges of Inputs
Condo . . . . .	24	\$ 46,365,954	Discounted cash flows	Discount Rate	12-17%
				Discount Rate	9.5%
Hotel . . . . .	1	21,225,094	Discounted cash flows	Cap Rate	8.5%
				Discount Rate	9.5-17%
Retail . . . . .	11	21,986,968	Discounted cash flows	Cap Rate	9-12%
				Discount Rate	9.5%
Commercial . . . . .	3	11,742,966	Discounted cash flows	Cap Rate	9-12%
Land . . . . .	2	2,420,883	Discounted cash flows	Discount Rate	13.5%
				Discount Rate	9.5%
Marina . . . . .	3	8,799,955	Discounted cash flows	Cap Rate	10%
Total investments . . . . .	<u>44</u>	<u>\$112,541,820</u>			

The significant unobservable inputs used in the fair value measurement of the Company's investments in loans receivable are stated above. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. At each valuation date, the key inputs and assumptions are updated to reflect changes in the market, the performance of the asset and expectation of a market participant. However, there have been no fundamental changes in valuation techniques utilized by management in estimating fair value. Because of the inherent uncertainties of valuation, the values reflected in the accompanying consolidated financial statements may differ materially from the value determined upon the sale of those investments.

All net realized and unrealized gains in the table above are reflected on the accompanying consolidated statement of operations. In prior years, fifteen borrower groups that totaled \$60,509,925 of the investments in loan receivable as of December 31, 2013, were refinanced. The original loan terms were modified granting extended terms, reduced principal, lower interest rates, and/or deferment of interest and principal payments. In the case of some, collateral was relinquished to the Company. The restructures were considered TDR's. Unfunded commitments on restructured loans considered TDR's as of December 31, 2013 are approximately \$42,014,000.

#### 4. REAL ESTATE:

The Company holds investments in real estate that are subsequently measured at the lower of cost or fair value less costs to sell. Accordingly, fair value measurements related to real estate is considered non-recurring. The amounts below represent only balances measured at fair value at December 31, 2013, subsequent to foreclosure, and still held as of the reporting date (see Note 2).

	December 31, 2013			
	Level 1	Level 2	Level 3	Total
Real estate .....	\$—	\$—	\$35,783,510	\$35,783,510

The table below presents information, by collateral type, about significant unobservable inputs related to the Company's non-recurring Level 3 financial assets at December 31, 2013.

Collateral Type	Lower of Cost or Fair Value	Valuation Technique	Significant Unobservable Inputs	Inputs or Ranges of Inputs
Condo .....	\$42,246,901	Discounted cash flows	Discount Rate	12%
			Discount Rate	17-20%
Commercial .....	17,615,100	Discounted cash flows	Cap Rate	9-12%
Land .....	4,817,009	Discounted cash flows	Discount Rate	15-20%
Total investments .....	\$64,679,010			

#### 5. RESTRICTED CASH:

As of December 31, 2013, restricted cash consists of the following:

Advance account .....	\$ 100
Servicing depository account .....	216,549
Deferred maintenance account .....	121,239
Collections account .....	2,966,505
Interest reserve account .....	1,800,000
Working capital account .....	2,196,198
Marginal account .....	63,507
Real estate tax reserve .....	687,864
	<u>\$8,051,962</u>

The advance account, servicing depository account, collections account, interest reserve account and working capital account are required and restricted by the loan agreement with First Bank.

All payments from borrowers are sent to the servicing depository account and then moved to the collections account. The funds in the collections account are used by the Company as follows: (i) first, pays outstanding interest due on the three notes payable facilities (see Note 6); (ii) second, can elect to fund the interest reserve account, up to \$5,000,000; (iii) third, funds the working capital account to cover budgeted operating expenses of the Company; and (iv) fourth, pays the outstanding principal on first the working capital line and then the acquisition loan and advance facility (see Note 6).

The marginal account is a lockbox that collects rents from certain borrowers who are in default of their loans. The real estate tax reserve is comprised of funds collected from certain borrowers who are in default to cover real estate tax due on loan collateral. Accounts payable and accrued liabilities include \$184,385, representing the liability to the borrowers for the marginal account.

Due to the short-term nature of the restricted cash balances, the carrying value of restricted cash approximates fair value.

#### 6. NOTES PAYABLE:

The Company's investments are financed pursuant to a loan agreement dated February 16, 2011, with First Bank, a member of the Company and the seller of the investments in loans receivable purchased by the Company. The notes payable are collateralized by the assets owned by the Company. The allocation of the notes payable under the loan and security agreement as of December 31, 2013 are as follows:

	<u>Maturity</u>	<u>Balance</u>
Acquisition loan . . . . .	February 1, 2018	\$ 43,841,232
Advance facility . . . . .	February 1, 2018	25,558,142
Working capital line . . . . .	September 6, 2015	—
		<u>\$ 69,399,374</u>

The acquisition loan is a \$135,580,122 non-revolving credit facility that was used by the Company solely for the purchase of the investments in loans receivable and related closing costs. For the year ended December 31, 2013 \$22,510,675 was repaid by the Company.

The advance facility is a \$66,923,343 non-revolving credit facility. The proceeds from the facility are used to fund advance commitments to the borrowers. For the period from January 1, 2013 through December 31, 2013 an additional \$19,103,901 was drawn and \$6,596,575 was repaid by the Company. As of December 31, 2013, there is approximately \$31,776,399 available to fund future advance commitments.

The working capital line was a \$20,000,000 revolving line of credit. The original working capital line expired in February 2013. The second amendment to the loan agreement was signed on September 6, 2013 allowing a \$7,000,000 working capital line to be extended for an additional 24 month period. The Renewed Working Capital Line (Note 7) matures on September 6, 2015. In 2013, an additional \$382,945 was drawn and repaid by the Company. As of December 31, 2013 \$7,000,000 was available for future working capital needs.

The notes payable accrue interest from the date of the loan with interest only due monthly, in arrears. The interest rate is equal to one month LIBOR, plus 3% (3.16825% at December 31, 2013). Interest and principal payments are made through a set of restricted cash accounts (see Note 5).

Principal payments are made on the loans based on available collections after the payment of interest and principal on covering loans, interest payments on the acquisition loan, advance facility and working capital line, elected deposits into the interest reserve account and budgeted working capital amounts. Accordingly, there are no scheduled contractual principal and interest payments.



On March 1, 2011, the Company entered into an interest rate cap agreement with SMBC Capital Markets, Inc. (SMBC) for a total fee of \$1,005,000. The original interest rate cap agreement, which expired on March 1, 2013, was renewed for a total fee of \$4,000. The renewed agreement expires on March 1, 2014. The cumulative notional amount underlying the interest rate cap agreement is \$176,000,000 for the term of the agreement. Under the agreement, the Company has the right to receive payments based on the notional amount of the cap to the extent that one month LIBOR exceeds 1.50%. The Company is exposed to credit-related losses in the event of nonperformance by SMBC; however, it does not expect SMBC to fail to meet its obligations because of the institutions reputation and history. The cap had a fair value of approximately \$0 as of December 31, 2013.

The fair value of the Company's note payable totals approximately \$69,100,000 at December 31, 2013. The fair value of the Company's notes payable has been estimated based on the discounted cash flow analysis of future expected cash flows of the underlying loans, forward looking interest rates and using a discount rate representing the Company's estimate of the rate that would be used by market participants. Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values.

#### 7. CAPITAL DISTRIBUTIONS:

The Company's limited liability agreement dictates the priority of distributable cash once the Company's notes payable have been repaid. The priority of distributable cash is (i) pay to Members pro rata any additional capital contributions made since the initial acquisition contributions; (ii) pay to PRLP its unpaid priority return (12% of invested capital in the amount of \$89,857,278); (iii) pay to PRLP its unpaid supplemental return (13.5% of invested capital); (iv), pay to PRLP its entire initial acquisition contributions; (v) pay to the Members pro rata in the ratio of 35% to PRLP and 65% to First Bank until First Bank earns its unpaid supplemental return (12% of invested capital of \$48,384,742); (vi) pay to the Members pro rata in the ratio of 35% to PRLP and 65% to First Bank until First Bank recovers its entire initial acquisition contributions; (vii) pay First Bank \$6,000,000; (viii) pay PRLP \$4,000,000; (ix) pay remainder to the Members pro rata at that point in time.

The Puerto Rico Department of Treasury requires the Company to pay members' withholding taxes on behalf of the member. The Company makes quarterly payments on behalf of its members. Tax payments for the 1<sup>st</sup> and 2<sup>nd</sup> quarter of 2013 were paid from cash funded by the members and was paid on behalf of the members to Puerto Rico's Department of Treasury. The total amount of cash funded by members and then paid on behalf of the members in 2013 was \$1,664,724.

The second amendment to the loan agreement, signed on September 6, 2013, allowed for Permitted Distributions, funds under the Renewed Working Capital Line that can be drawn for quarterly tax liability obligations, up to \$1,500,000 per fiscal year and not to exceed \$3,000,000 in draws within the two year permitted period. These draws commenced with the quarterly tax payment applicable to the 3<sup>rd</sup> quarter of 2013. Under the terms of the second amendment to the loan agreement, these payments will be treated as distributions to members. \$382,945 was drawn from the Renewed Working Capital Line to pay for 3<sup>rd</sup> quarter 2013 taxes for the PRLP members.

For the year ended December 31, 2013 the Company paid taxes of \$2,047,669.

#### 8. ALLOCATION OF PROFITS AND LOSSES:

The Company's limited liability agreement dictates profit and losses for any fiscal year or portion thereof shall be allocated to the members in such a manner so that their capital accounts at the end of such fiscal year or portion thereof will reflect as nearly as possible the amount which each member would receive if the Company were to be liquidated as of the end of that fiscal year or portion thereof, assuming for purposes of any hypothetical liquidation (i) a sale of all of the assets of the Company at prices equal to their gross asset values, and (ii) the distribution of the net proceeds thereof to the members after the payment of all actual Company indebtedness, and any other liabilities related to the Company's assets, limited, in the case of non-recourse liabilities, to the collateral securing or otherwise available to satisfy such liabilities and pursuant to the priority of distributable cash (see Note 7).

The Company's limited liability agreement does address a situation where one member's proportionate share of allocated losses would cause a deficit balance to their capital account. If some, but not all members, would have a deficit balance after losses are allocated, then losses are reallocated so that the allocated loss to each member would not create a deficit capital balance to any one member. In future years, if the Company has allocated gains, these gains will first go the members that were reallocated losses until they are made whole. As of December 31, 2013, losses have been allocated between PRLP and First Bank so that First Bank does not have a deficit capital balance.

9. RELATED PARTY TRANSACTIONS:

On February 8, 2011, the Company entered into a servicing agreement with CPG Island Servicing LLC (CPG). The Company may terminate the agreement with CPG following an event of default by CPG as defined in the servicing agreement. The owner of CPG is an affiliate of FBLP Group Holdings LLC, one of the members of PRLP. A subservicing agreement between CPG and Goldman Sachs Realty Management, L.P. (RMD), formerly known as Archon Group, L.P, was also signed on February 8, 2011 and then amended on September 29, 2011. The owner of RMD is an affiliate of GS.

CPG is paid a monthly fee by the Company for loan asset servicing. This fee is equal to 1/12 of 1% of the aggregate principal balance of the Company's investments in loans receivable and loans secured by a foreclosed property on the first day of a given month. Under the subservicing agreement, CPG pays RMD a fee in an amount equal to 1/12 of 0.1% of the aggregate principal balance of the Company's investments in loans receivable and loans secured by a foreclosed property on the first day of a given month. Total servicing fees earned by CPG were \$3,235,087 for the period ended December 31, 2013. CPG paid RMD \$323,509 for the period ended December 31, 2013.

10. COMMITMENTS AND CONTINGENCIES:

The Company is involved in various legal proceedings and disputes in the ordinary course of business. The Company does not believe that the disposition of such legal proceedings and disputes will have a material adverse effect on the financial position or continuing operations on the Company.

The Company may be required to fund additional loan proceeds to borrowers pursuant to the terms of the underlying loan agreements as a result of the acquisition of the loan portfolio. To the extent that the Company is required to perform under loan commitments resulting from litigation existing as of the acquisition of the loan portfolio, the Company has received an indemnification from the previous owner.

CPG/GS PR NPL, LLC and Subsidiaries

***Consolidated Financial Statements  
For The Year Ended December 31, 2012  
And Independent Auditor's Report***

## **Independent Auditor's Report**

To the Members of CPG/GS PR NPL, LLC

We have audited the accompanying consolidated financial statements of CPG/GS PR NPL, LLC and its subsidiaries (the "Company"), which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of operations, members' equity and cash flows for the year then ended.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CPG/GS PR NPL, LLC and its subsidiaries at December 31, 2012, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP  
March 29, 2013  
Dallas, Texas

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET — DECEMBER 31, 2012

ASSETS

INVESTMENT IN LOANS RECEIVABLE, at fair value (cost \$117,357,733) .....	\$131,520,590
REAL ESTATE OWNED .....	51,632,128
CASH AND CASH EQUIVALENTS .....	4,155,076
RESTRICTED CASH .....	11,253,672
DEFERRED FINANCING COSTS, net of accumulated amortization of \$370,657 .....	347,524
ACCOUNTS RECEIVABLE .....	210,001
OTHER ASSETS .....	<u>189,808</u>
Total assets .....	<u>\$199,308,799</u>

LIABILITIES AND MEMBERS' EQUITY

NOTES PAYABLE, related party .....	\$ 79,402,723
OTHER LIABILITIES:	
Accounts payable and accrued liabilities .....	1,629,329
Mortgage loan escrow .....	510,533
Accrued interest payable, related party .....	<u>217,657</u>
Total liabilities .....	81,760,242
COMMITMENTS AND CONTINGENCIES (Note 10)	
MEMBERS' EQUITY .....	<u>117,548,557</u>
Total liabilities and members' equity .....	<u>\$199,308,799</u>

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2012

INCOME:	
Rental income .....	\$ 344,211
Interest .....	1,020,568
Other .....	<u>24,566</u>
Total income .....	1,389,346
OPERATING EXPENSES:	
Repairs and maintenance .....	292,380
Utilities .....	350,408
Management and administrative .....	602,922
Real estate taxes .....	279,713
Insurance .....	<u>553,212</u>
Total operating expenses .....	2,078,705
EXPENSES:	
Interest .....	4,040,474
Amortization of deferred financing costs .....	271,430
Fair value adjustment of derivative instruments .....	68,074
Legal .....	1,948,558
Professional fees .....	587,596
Servicing fees to related parties .....	4,001,689
Other ownership .....	<u>800,039</u>
Total expenses .....	<u>11,717,861</u>
LOSS BEFORE REALIZED/UNREALIZED GAIN ON INVESTMENTS IN LOANS AND REALIZED LOSS ON REAL ESTATE .....	(12,407,220)
NET UNREALIZED LOSS ON INVESTMENTS IN LOANS RECEIVABLE CARRIED AT FAIR VALUE UNDER THE FAIR VALUE OPTION .....	(5,282,104)
NET REALIZED GAIN ON SETTLEMENT OF INVESTMENTS IN LOANS RECEIVABLE AT FAIR VALUE UNDER THE FAIR VALUE OPTION .....	3,290,307
NET REALIZED GAIN ON FORECLOSURE OF INVESTMENTS IN LOANS AT FAIR VALUE UNDER THE FAIR VALUE OPTION .....	3,590,444
WRITEDOWN ON REAL ESTATE OWNED .....	(2,139,155)
NET GAIN ON SALE OF REAL ESTATE OWNED .....	<u>3,598,583</u>
NET LOSS .....	<u>\$ (9,349,145)</u>

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



CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF MEMBERS' EQUITY

FOR THE YEAR ENDED DECEMBER 31, 2012

	<u>PRLP Ventures, LLC</u>	<u>First Bank Puerto Rico</u>	<u>Members' Equity</u>
BALANCE AT DECEMBER 31, 2011 .....	\$108,953,804	\$17,943,898	\$126,897,702
Allocation of preferred return .....	4,939,886	(4,939,886)	—
Net loss .....	<u>—</u>	<u>(9,349,145)</u>	<u>(9,349,145)</u>
BALANCE AT DECEMBER 31, 2012 .....	<u>\$113,893,690</u>	<u>\$ 3,654,867</u>	<u>\$117,548,557</u>

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2012

CASH FLOWS FROM OPERATING ACTIVITIES:

Net loss	\$ (9,349,145)
Adjustments to reconcile net loss to net cash used in operating activities:	
Amortization of deferred financing costs	271,430
Fair value adjustment of derivative instruments	68,074
Net gain on sale of real estate owned	(3,598,583)
Unrealized loss on investments in loans receivable	5,282,104
Write-down on loss from other real estate owned	2,139,155
Realized gain on loan settlements	(3,290,307)
Realized gain on foreclosure	(3,590,444)
Change in operating assets and liabilities:	
Interest receivable	154,490
Other assets	(165,331)
Accounts receivable	670,098
Accounts payable and accrued liabilities	(602,001)
Accrued interest payable	(349,443)
Net cash used in operating activities	<u>(12,359,902)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Additions to real estate owned	(1,442,459)
Fundings to investments in loans receivable	(23,670,020)
Collections on loans receivable	71,350,578
Change in restricted cash	69,485,000
Net proceeds from sale of other real estate owned	<u>20,206,420</u>
Net cash from investing activities	<u>135,929,519</u>

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from notes payable	16,043,043
Principal payments made on notes payable	(137,341,053)
Payment of deferred financing costs	(20,053)
Change in escrow liability	<u>(108,044)</u>
Net cash used in financing activities	<u>(121,426,107)</u>

NET CHANGE IN CASH AND CASH EQUIVALENTS	2,143,509
CASH AND CASH EQUIVALENTS, beginning of year	<u>2,011,567</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 4,155,076</u>

SUPPLEMENTAL DISCLOSURES:

Interest paid	\$ 3,822,817
Investment of loans receivable transferred to other real estate owned	\$ 68,936,661

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

## CPG/GS PR NPL, LLC AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### FOR THE YEAR ENDED DECEMBER 31, 2012

#### 1. ORGANIZATION:

CPG/GS PR NPL, LLC (the Parent Company), a Puerto Rico limited liability company, was organized effective January 20, 2011, to directly or indirectly acquire, own, hold, manage, finance, mortgage, pledge, lease and assign any assets, advance funds, enter into such acquisition agreements, servicing agreements, leases, assignments, financing agreements, security agreements and other instruments and agreements of any kind, enter into partnerships, limited partnerships, limited liability companies and joint ventures, and do any and all other acts and things that may be necessary or useful for the conduct of its business or the winding up thereof. The Parent Company owns 100% of the equity interests in CPG/GS Island Properties I, LLC, CPG/GS Island Properties II, LLC, CPG/GS Island Properties III, LLC, CPG/GS Island Properties IV, LLC, CPG/GS Island Properties V, LLC, CPG/GS Island Properties VI, LLC and CPG/GS Island Properties VII, LLC, (the Subsidiaries). The Subsidiaries, Puerto Rico limited liability companies, were organized primarily to hold any real estate assets the Parent Company obtains through foreclosure of its investments in loans receivable.

Collectively, the Parent Company and the Subsidiaries are the “Company”. The members of the Parent Company are PRLP Ventures, LLC (PRLP) and First Bank Puerto Rico (First Bank) (collectively, the Members). The members of PRLP are FBLP Group Holding, LLC (FBLP) and Goldman, Sachs & Co. (GS).

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

##### Principles of consolidation

The consolidated financial statements include the accounts of the Parent Company and its wholly owned Subsidiaries. These consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America and present the Company’s consolidated financial position, results of operations and cash flows. Intercompany transactions have been eliminated in consolidation.

##### Basis of accounting and use of estimates

The Company prepares its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. This requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has evaluated subsequent events through March 29, 2013, the date which the consolidated financial statements were available to be issued.

##### Fair value measurements

Fair value measurements are market-based measurements, not entity-specific measurements. Fair value measurements are determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, management uses a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and management’s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Management's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

#### Investments in loans receivable, at fair value

Management elected to carry the Company's investments in loans receivable at fair value due to the fair value option being operationally less complex for the Company to manage. Fair value is an exit price, representing the amount that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The Company's private investments, by their nature, have little to no price transparency.

The Company's investments in loans receivable are either non-performing or sub-performing in relation to the original terms of the loans. The fair value of the Company's investments in loans receivable are determined based on an income approach that uses cash flows at the loan level from the highest and best use of the assets by a market participant. In reaching its determination of fair value, management considers many factors including, but not limited to, broker quotations to support inputs used in the valuations of the underlying collateral, the operating cash flows and financial performance of the investments considered relevant to a market participant, taxes associated with owning the investments, trends within sectors and/or regions, historical events, the expected hold period and strategy anticipated to be employed by a market participant and any other specific rights or terms associated with the investment that management believes would be a relevant factor impacting the exit price. Such investments are classified within level 3 of the fair value hierarchy.

Management's judgment is also required to determine the appropriate risk-adjusted discount rate for investments that are classified within level 3 of the fair value hierarchy. In such situations, management estimates the rates based on available market information adjusted to rates which market participants would likely consider appropriate for risks associated with a particular investment.

Investments in loans receivable are on nonaccrual status and all cash payments are first applied to the loans' principal balances. All income or loss is recognized at the valuation date in net change in unrealized appreciation/depreciation from investments in loans receivable on the consolidated statement of operations. Interest income on performing loans is recognized on an accrual basis. The recognition of income on a performing loan is discontinued when interest or principal payments become 90 days past due. Cash payments subsequently received on investments in loans receivable are applied to the principal balance or recorded as interest income, depending upon management's assessment of the ultimate collectability of the loan.

Loan modifications and restructurings may occur when the borrower experiences financial difficulty and needs temporary or permanent relief from the original contractual terms of the loan and the lender grants a concession. These modifications are structured on either a loan-by-loan or borrower group basis, and depending on the circumstances, may extend payment terms, modify interest rates, reduce principal owed, or other concessions. When this occurs, the loan may be considered a troubled debt restructuring. Once a loan is restructured and the borrower is not in default of the renegotiated terms, the Company accrues interest earned. When a loan is settled, the difference between the proceeds received and the loan basis is recorded to gain or loss on loan settlement in the income statement.

#### Real estate owned

When real estate assets are acquired through foreclosure or repossession they are initially recorded at the fair value of the property and included in investments in real estate owned in the accompanying balance sheet. Estimated fair value is based on the underlying collateral value which is estimated using an income approach that uses cash flows from the eventual disposition of the collateral and the estimated cash flows during the hold

period, if any. Immediately preceding the foreclosure or repossession, any adjustments to the loan's fair value will be reflected as a gain or loss on investments in loans receivable carried at fair value under the fair value option on the statement of operations. With the foreclosure, the entity changes from holding a financial asset to a hard asset, therefore, a realized event has occurred. Any previous unrealized gains or losses must be recognized as realized gains or losses at the time of the foreclosure, along with any excess gain/loss at foreclosure and should be reflected as a realized gain or loss foreclosure of investments in loans receivable. For the period ended December 31, 2012, the Company had foreclosed on a total of eight loans held by five borrower groups. The real estate owned assets are held in the Subsidiaries of the Company.

Upon foreclosure of a loan in full satisfaction of a loan receivable, the Company accounts for those assets at their fair value less cost to sell and the assets are classified as held for sale. In subsequent periods, such long-lived assets are measured at the lower of carrying amount or fair value less cost to sell. As of December 31, 2012 the Company considers all foreclosed assets as long-lived assets held for sale and are accounted for at the lower of cost or fair value less cost to sell.

#### Cash and cash equivalents

The Company considers all highly liquid investments with an original maturity of three months or less that are not restricted to be cash equivalents. Cash equivalents are placed with reputable institutions and the balances may at times exceed federally insured deposit levels; however, the Company has not experienced any losses in such accounts.

As cash and cash equivalents have a maturity of less than three months, the carrying value of cash equivalents approximates fair value.

#### Deferred financing costs

Deferred financing costs incurred in connection with the receipt of the notes payable are capitalized and amortized over the term of the debt using a method which approximates the interest method.

#### Interest rate derivative instrument

The Company's derivative transaction consists of an interest rate cap agreement entered into to mitigate the Company's exposure to increasing borrowing costs in the event of a rising interest rate environment (see Note 6). The Company has elected not to designate its interest rate cap agreement as a designated accounting hedge. Changes in the fair value of the interest rate cap are recorded in the accompanying consolidated statement of operations.

The valuation of the interest rate cap is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows. This analysis reflects the contractual terms of the derivative, including the period to maturity, and uses observable market-based inputs such as interest rate curves and volatility assumptions. The fair value of the interest rate cap is determined using the market standard methodology of discounted future cash receipts. The cash receipts are based on an expectation of future interest rates using a forward curve that is derived from observable market interest rate curves.

The analysis has incorporated credit valuation adjustments to appropriately reflect the respective counterparty's nonperformance risk in the fair value measurements. Management evaluated the counterparty's nonperformance risk based on the counterparty's most recent credit rating and any changes in credit rating over the past year. In adjusting the fair value of the derivative contract for the effect of nonperformance risk, management has considered the impact of collateral netting and any applicable credit enhancements. Management concluded that the nonperformance risk is insignificant, and no adjustment to the value was necessary for this input. Therefore, all inputs used to value the derivative falls within Level 2 of the fair value hierarchy and the derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

Accounts receivable

Accounts receivable at December 31, 2012 is comprised of real estate owned tenant rent receivables of \$210,001.

Other Assets

Other assets at December 31, 2012 are comprised of prepaid property insurance on collateral of approximately \$185,000.

The Puerto Rico Insurance Code prohibits a lender from placing insurance on behalf of a borrower and charging the borrower for the premium payment. However, the lender may protect its own interests without transferring the costs to the borrower. For the period ended December 31, 2012, the Company paid property insurance premiums on certain collateral. These premiums are reflected as insurance in the consolidated statement of operations.

Income taxes

Under U.S. federal income tax law and Puerto Rico income tax law, limited liability companies are not taxable entities. Therefore, no provision has been made in the accompanying consolidated financial statements for income taxes due by the Company. Each member is individually responsible for reporting its share of the Company's income or loss.

Accounting Standards Codification (ASC) 740, Income Taxes, requires management to determine whether a tax position is more likely than not to be sustained upon examination by the applicable tax authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets this recognition threshold, the position is measured to determine the amount of tax benefit or expense to be recognized. The Company does not have any uncertain tax positions that would require accrual under ASC 740. No interest or penalty related to uncertain taxes has been recognized on the accompanying statement of operations. Management does not expect a significant change in uncertain tax positions during the twelve months subsequent to December 31, 2012.

The Company files U.S. and Puerto Rico tax returns. In the normal course of business, the Company may be audited by either taxing authority. As of December 31, 2012, the Company is not currently undergoing any tax examinations, nor has the Company agreed to extend the statute of limitations beyond the prescribed expiration date. The Company remain subject to examination by various taxing authorities for tax years beginning 2011 and upon completion of any examination, tax adjustments may be necessary.

Accounts payable and accrued liabilities

Accounts payable and accrued liabilities at December 31, 2012 are comprised of the following:

Accounts payable	180,692
Accrued servicing fees	298,069
Other liabilities	458,699
Accrued professional fees	505,120
Deferred maintenance liability (Note 5)	99,180
Borrower deposits liability (Note 5)	87,569
	<u>\$1,629,329</u>

Other comprehensive income

Since there are no transactions requiring presentation in other comprehensive income, but not in net income, the Company's net income equates to comprehensive income.



### Recent accounting developments

In April 2011, the FASB released Accounting Standards Update No. 2011-02 (ASU 2011-02), Troubled Debt Restructurings (TDR). The update clarifies the accounting framework for TDRs and is intended to result in more consistent identification of TDRs by lenders. ASU 2011-02 will be effective for interim and annual periods ending on or after December 15, 2012. The Company adopted this standard for the year ending December 31, 2012 and has considered the additional guidance on its TDR analysis and disclosures herein.

In May 2011, the FASB released Accounting Standards Update No. 2011-04 (ASU 2011-04), Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. The update generally clarifies fair value measurement guidance and requires certain additional disclosures related to fair value. The update also includes instances where a particular principle or requirement for measuring fair value has changed. ASU 2011-04 became effective for interim and annual periods beginning after December 15, 2011. The Company adopted the required guidance on January 1, 2012. We have included additional fair value disclosures such as additional quantitative information about inputs (e.g. cap rates, discount rates, etc.) as well as a description of the valuation process used by the entity.

In June 2011, the FASB released Accounting Standards Update No. 2011-05 (ASU 2011-05), Presentation of Comprehensive Income. The update enhances the presentation of comprehensive income by requiring presentation either in a single statement of comprehensive income or in two consecutive statements. The update requires presentation of each component of net income and other comprehensive income, along with total net income, total other comprehensive income, and total comprehensive income. ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this standard did not have a material impact on the Company's financial position or results of operations.

### 3. INVESTMENTS IN LOANS RECEIVABLE, AT FAIR VALUE:

The Company's investments in loans receivable are summarized as follows at December 31, 2012 by collateral type:

<u>Collateral Type</u>	<u>Number of Loans</u>	<u>Unpaid Principal Balance</u>	<u>Fair Value</u>
Condo .....	28	\$213,807,502	\$ 68,055,576
Hotel .....	1	23,500,000	20,099,146
Retail .....	11	31,044,260	19,385,458
Commercial .....	4	28,484,656	11,122,735
Land .....	3	8,397,117	4,183,607
Marina .....	3	8,549,100	8,674,068
Total investments .....	50	<u>\$313,782,635</u>	<u>\$131,520,590</u>

The concentration of the Company's investments in loans receivable by collateral type at December 31, 2012 is 52% condo, 15% hotel, 15% retail, 8% commercial, 7% marina and 3% land.

The concentration of the Company's investments in loans receivable by borrower group at December 31, 2012 is as follows:

<u>Borrower Group</u>	<u>Number of Loans</u>	<u>Unpaid Principal Balance</u>	<u>Fair Value</u>
San Geronimo Caribe .....	6	\$103,164,564	\$ 30,806,035
Eduardo Ferrer .....	15	32,463,408	26,353,514
Swiss Chalet .....	1	23,500,000	20,099,146
John Pulpeiro .....	5	21,521,242	11,604,707
Michael Redondo .....	3	37,833,901	8,581,751
Desarrolladora Los Filtros .....	2	6,196,624	4,523,307
Hollywood Estates .....	1	5,602,042	758,135
Jardin Central .....	1	8,141,418	3,718,235
Other Borrowers .....	16	75,359,436	25,075,760
Total investments .....	50	<u>\$313,782,635</u>	<u>\$131,520,590</u>

The concentration of the Company's investment in loans receivable by borrower group at December 31, 2012 is 23% San Geronimo Caribe, 20% Eduardo Ferrer, 15% Swiss Chalet, and 42% other borrower groups.

The Company's investments in loans receivable are all collateralized by real estate assets geographically located in Puerto Rico.

The following table sets forth the Company's investments in loans receivable, at fair value that were measured on a recurring basis as of December 31, 2012 by level within the fair value hierarchy (see Note 2):

	<u>Investments in Loans Receivable, at Fair Value</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments in loans receivable, at fair value ...	<u>\$—</u>	<u>\$—</u>	<u>\$131,520,590</u>	<u>\$131,520,590</u>

The following table sets forth a summary of changes in the fair value of the Company's level 3 investments in loans receivable for the year ended December 31, 2012:

	<u>Level 3 Investments in Loans Receivable, at Fair Value</u>
Balance, beginning of year .....	\$246,539,162
Contractual advances .....	23,670,020
Contractual loan collections .....	(71,350,578)
Purchases .....	—
Sales .....	—
Unrealized fair value losses .....	(5,282,104)
Realized gains on loan settlement .....	3,290,307
Realized gains on foreclosure .....	3,590,444
Foreclosure into real estate owned assets .....	(68,936,661)
Transfers in and/or out of level 3 .....	—
Balance, end of year .....	<u>\$131,520,590</u>
Net change in unrealized gains/(losses) from investments in loans receivable still held at the reporting date .....	<u>\$ 1,621,576</u>

Transfers in and/or out of level 3 represents transfers from/(to) level 2. Transfers from level 2 are the result of investment valuations whose significant inputs have become unobservable, causing less transparency in prices of the investments. Transfers to level 2 are the result of investment dispositions or offers to purchase investments. There have been no transfers in and/or out of level 3 for the period ended December 31, 2012.

The following table presents information about significant unobservable inputs related to the Company's categories of Level 3 financial assets at December 31, 2012.

<u>Collateral Type</u>	<u>Number of Loans</u>	<u>Fair Value</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>Inputs or Ranges of Inputs</u>
Condo .....	28	\$ 68,055,576	Discounted cash flows	Discount Rate	12-17%
				Discount Rate	9.5%
Hotel .....	1	20,099,146	Discounted cash flows	Cap Rate	8.5%
				Discount Rate	9.5-17%
Retail .....	11	19,385,458	Discounted cash flows	Cap Rate	9-12%
				Discount Rate	9.5%
Commercial .....	4	11,122,735	Discounted cash flows	Cap Rate	9-12%
Land .....	3	4,183,607	Discounted cash flows	Discount Rate	13.5%
				Discount Rate	9.5%
Marina .....	3	8,674,068	Discounted cash flows	Cap Rate	10%
Total investments .....	<u>50</u>	<u>\$131,520,590</u>			

The significant unobservable inputs used in the fair value measurement of the Company's investments in loans receivable are stated above. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. At each valuation date, the key inputs and assumptions are updated to reflect changes in the market, the performance of the asset and expectation of a market participant. However, there have been no fundamental changes in valuation techniques utilized by management in estimating fair value. Because of the inherent uncertainties of valuation, the values reflected in the accompanying consolidated financial statements may differ materially from the value determined upon the sale of those investments.

All net realized and unrealized gains in the table above are reflected on the accompanying consolidated statement of operations. Fifteen borrower groups that total \$77,679,765 of the investments in loan receivable as of December 31, 2012, were refinanced during 2012. The original loan terms were modified granting extended terms, reduced principal, lower interest rates, and/or deferment of interest and principal payments. In the case of some, collateral was relinquished to the Company. The restructures were considered TDR's. Unfunded commitments on restructured loans considered TDR's as of December 31, 2012 are approximately \$70,106,000.

#### 4. REAL ESTATE OWNED:

The Company holds investments in real estate owned that are subsequently measured at the lower of cost or fair value less costs to sell. Accordingly, fair value measurements related to real estate owned is considered non-recurring. The amounts below represent only balances measured at fair value during 2012, subsequent to foreclosure, and still held as of the reporting date (see Note 2).

	December 31, 2012			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Real estate owned .....	<u>\$—</u>	<u>\$—</u>	<u>\$19,716,025</u>	<u>\$19,716,025</u>

The table below presents information, by collateral type, about significant unobservable inputs related to the Company's non-recurring Level 3 financial assets at December 31, 2012.

<u>Collateral Type</u>	<u>Lower of Cost or Fair Value</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>Inputs or Ranges of Inputs</u>
Condo . . . . .	\$32,107,719	Discounted cash flows	Discount Rate	12%
			Discount Rate	17-20%
Commercial . . . . .	16,004,858	Discounted cash flows	Cap Rate	9-12%
Land . . . . .	<u>3,519,551</u>	Discounted cash flows	Discount Rate	20%
Total investments . . . . .	<u>\$51,632,128</u>			

5. RESTRICTED CASH:

As of December 31, 2012, restricted cash consists of the following:

Advance account . . . . .	\$	100
Servicing depository account . . . . .		12,117
Deferred maintenance account . . . . .		99,165
Collections account . . . . .		6,243,591
Interest reserve account . . . . .		1,800,000
Working capital account . . . . .		2,499,788
Marginal account . . . . .		88,380
Real estate tax reserve . . . . .		<u>510,531</u>
		<u>\$11,253,672</u>

The advance account, servicing depository account, collections account, interest reserve account and working capital account are required and restricted by the loan agreement with First Bank.

All payments from borrowers are sent to the servicing depository account and then moved to the collections account. The funds in the collections account are used by the Company as follows: (i) first, pays outstanding interest due on the three notes payable facilities (see Note 6); (ii) second, can elect to fund the interest reserve account, up to \$5,000,000; (iii) third, funds the working capital account to cover budgeted operating expenses of the Company; and (iv) fourth, pays the outstanding principal on first the working capital line and then the acquisition loan and advance facility (see Note 6).

The marginal account is a lockbox that collects rents from certain borrowers who are in default of their loans. The real estate tax reserve is comprised of funds collected from certain borrowers who are in default to cover real estate tax due on loan collateral. Accounts payable and accrued liabilities include \$87,568, representing the liability to the borrowers for the marginal account.

Due to the short-term nature of the restricted cash balances, the carrying value of restricted cash approximates fair value.

6. NOTES PAYABLE:

The Company's investments are financed pursuant to a loan agreement dated February 16, 2011, with First Bank, a member of the Company and the seller of the investments in loans receivable purchased by the Company. The notes payable are collateralized by the assets owned by the Company. The allocation of the notes payable under the loan and security agreement as of December 31, 2012 are as follows:

	<u>Maturity</u>	<u>Balance</u>
Acquisition loan .....	February 1, 2018	\$ 66,351,906
Advance facility .....	February 1, 2018	13,050,817
Working capital line .....	February 1, 2013	—
		<u>\$ 79,402,723</u>

The acquisition loan is a \$135,580,122 non-revolving credit facility to be used by the Company solely for the purchase of the investments in loans receivable and related closing costs. For the year ended December 31, 2012 \$69,228,217 was repaid by the Company.

The advance facility was originally an \$80,000,000 non-revolving credit facility. The proceeds from the facility are used to fund advance commitments to the borrowers. As of April 11, 2012, the entire \$80,000,000 had been drawn and \$9,049,394 had been repaid by the Company. Under the first amendment to the loan agreement, as of April 12, 2012 the advance facility was partially paid down in the amount of \$66,923,343 and whereby the amount partially paid down would be available to the Company use for future advances to fund commitments to the borrowers. The first amendment of the loan agreement waived any prepayment penalty charges associated with the partial paydown and still considers the credit facility a non-revolving credit facility. Pursuant to the first amendment to the loan agreement, on April 18, 2012, \$66,923,343 was repaid by the Company, leaving a balance of \$4,027,263. For the period from April 19, 2012 through December 31, 2012 an additional \$16,043,043 was drawn and \$7,019,489 was repaid by the Company. As of December 31, 2012, there is approximately \$50,880,300 available to fund future advance commitments.

The working capital line is a \$20,000,000 revolving line of credit. In 2012, the Company did not draw on the working capital line and \$20,000,000 was available for future working capital needs at December 31, 2012. The working capital line expired in February 2013.

The notes payable accrue interest from the date of the loan with interest only due monthly, in arrears. The interest rate is equal to one month LIBOR, plus 3% (3.21% at December 31, 2012). Interest and principal payments are made through a set of restricted cash accounts (see Note 5).

Principal payments are made on the loans based on available collections after the payment of interest and principal on covering loans, interest payments on the acquisition loan, advance facility and working capital line, elected deposits into the interest reserve account and budgeted working capital amounts. Accordingly, there are no scheduled contractual principal and interest payments.

On March 1, 2011, the Company entered into an interest rate cap agreement with SMBC Capital Markets, Inc. for a total fee of \$1,005,000. The interest rate cap agreement expires on March 1, 2013. The cumulative notional amount underlying the interest rate cap agreement is \$176,000,000 for the term of the agreement. Under the agreement, the Company has the right to receive payments based on the notional amount of the cap to the extent that LIBOR exceeds 1.50%. The Company is exposed to credit-related losses in the event of nonperformance by the caps' seller; however, it does not expect the caps' seller to fail to meet its obligations because of the institutions reputation and history. The cap had a fair value of approximately \$0 as of December 31, 2012.

The fair value of the Company's note payable totals approximately \$79,015,000 at December 31, 2012. The fair value of the Company's notes payable has been estimated based on the discounted cash flow analysis of future

expected cash flows of the underlying loans, forward looking interest rates and using a discount rate representing the Company's estimate of the rate that would be used by market participants. Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values.

#### 7. CAPITAL DISTRIBUTIONS:

The Company's limited liability agreement dictates the priority of distributable cash once the Company's notes payable have been repaid. The priority of distributable cash is (i) first, pay to Members pro rata any additional capital contributions made since the initial acquisition contributions; (ii) second, pay to PRLP its unpaid priority return (12% of invested capital in the amount of \$89,857,278); (iii) third, pay to PRLP its unpaid supplemental return (13.5% of invested capital); (iv) fourth, pay to PRLP its entire initial acquisition contributions; (v) fifth, pay to the Members pro rata in the ratio of 35% to PRLP and 65% to First Bank until First Bank earns its unpaid supplemental return (12% of invested capital of \$48,384,742); (vi) sixth, pay to the Members pro rata in the ratio of 35% to PRLP and 65% to First Bank until First Bank recovers its entire initial acquisition contributions; (vii) seventh, pay First Bank \$6,000,000; (viii) eighth, pay PRLP \$4,000,000; (ix) finally, pay remainder to the Members pro rata at that point in time. No distributions were made to the Members for the period ended December 31, 2012.

The Puerto Rico Department of Treasury requires the Company to pay members' withholding taxes on behalf of the member. The Company makes quarterly payments on behalf of its members. These tax payments are paid from cash funded by the partners and are paid on behalf of the partners to Puerto Rico's Department of Treasury. For the year ended December 31, 2012 the Company paid taxes of \$1,584,441.

#### 8. ALLOCATION OF PROFITS AND LOSSES:

The Company's limited liability agreement dictates profit and losses for any fiscal year or portion thereof shall be allocated to the members in such a manner so that their capital accounts at the end of such fiscal year or portion thereof will reflect as nearly as possible the amount which each member would receive if the Company were to be liquidated as of the end of that fiscal year or portion thereof, assuming for purposes of any hypothetical liquidation (i) a sale of all of the assets of the Company at prices equal to their gross asset values, and (ii) the distribution of the net proceeds thereof to the members after the payment of all actual Company indebtedness, and any other liabilities related to the Company's assets, limited, in the case of non-recourse liabilities, to the collateral securing or otherwise available to satisfy such liabilities and pursuant to the priority of distributable cash (see Note 7).

In accordance with those provisions and the distribution provisions as discussed in Note 7 above, PRLP has been allocated preferred returns in the amount of \$4,939,886 and the decrease associated with the allocation of preferred returns in the amount of \$4,939,886 has been absorbed by First Bank and is reflected as an allocation of preferred return in the accompanying consolidated statement of members' equity.

#### 9. RELATED PARTY TRANSACTIONS:

On February 8, 2011, the Company entered into a servicing agreement with CPG Island Servicing LLC (CPG). The Company may terminate the agreement with CPG following an event of default by CPG as defined in the servicing agreement. The owner of CPG is an affiliate of FBLP Group Holdings LLC, one of the members of PRLP. A subservicing agreement between CPG and Archon Group, L.P. (Archon) was also signed on February 8, 2011 and then amended on September 29, 2011. The owner of Archon is an affiliate of GS.

CPG is paid a monthly fee by the Company for loan asset servicing in an amount equal to 1/12 of 1% of the aggregate principal balance of the Company's investments in loans receivable on the first day of a given month. Under the subservicing agreement, CPG pays Archon a fee in an amount equal to 1/12 of 0.225% of the aggregate principal balance of the Company's investments in loans receivable on the first day of a given month.



In September 2012, the amount paid to Archon changed to be an amount equal to 1/12 of 0.1% of the aggregate principal balance of the Company's investments in loans receivable on the first day of a given month. Total servicing fees earned by CPG were \$4,001,689 for the period ended December 31, 2012. CPG paid Archon \$822,086 for the period ended December 31, 2012.

10. COMMITMENTS AND CONTINGENCIES:

The Company is involved in various legal proceedings and disputes in the ordinary course of business. The Company does not believe that the disposition of such legal proceedings and disputes will have a material adverse effect on the financial position or continuing operations on the Company.

The Company may be required to fund additional loan proceeds to borrowers pursuant to the terms of the underlying loan agreements as a result of the acquisition of the loan portfolio. To the extent that the Company is required to perform under loan commitments resulting from litigation existing as of the acquisition of the loan portfolio, the Company has received an indemnification from the previous owner.

CPG/GS PR NPL, LLC and Subsidiaries

***Consolidated Financial Statements***

***For The Period From***

***January 20, 2011(Inception)***

***Through December 31, 2011***

*(Not covered by report included herein)*

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET — DECEMBER 31, 2011

(Not covered by report included herein)

ASSETS

INVESTMENT IN LOANS RECEIVABLE, at fair value (cost \$227,094,199) .....	\$246,539,162
CASH AND CASH EQUIVALENTS .....	2,011,567
RESTRICTED CASH .....	80,738,672
INTEREST RECEIVABLE .....	154,490
DEFERRED FINANCING COSTS, net of accumulated amortization of \$99,227 .....	598,901
DERIVATIVE INSTRUMENTS, at fair value .....	68,074
ACCOUNTS RECEIVABLE, related party .....	880,099
OTHER ASSETS .....	<u>24,477</u>
Total assets .....	<u>\$331,015,442</u>

LIABILITIES AND MEMBERS' EQUITY

NOTES PAYABLE, related party .....	\$200,700,733
OTHER LIABILITIES:	
Accounts payable and accrued liabilities .....	2,231,330
Mortgage loan escrow .....	618,577
Accrued interest payable, related party .....	<u>567,100</u>
Total liabilities .....	204,117,740
COMMITMENTS AND CONTINGENCIES (Note 10)	
MEMBERS' EQUITY .....	<u>126,897,702</u>
Total liabilities and members' equity .....	<u>\$331,015,442</u>

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE PERIOD FROM JANUARY 20, 2011 (INCEPTION) THROUGH DECEMBER 31, 2011

(Not covered by report included herein)

INCOME:	
Interest .....	\$ 462,872
Other .....	<u>18,134</u>
Total income .....	<u>481,006</u>
EXPENSES:	
Interest .....	5,867,341
Acquisition costs .....	3,230,950
Amortization of deferred financing costs .....	99,227
Fair value adjustment of derivative instruments .....	936,926
Insurance on collateral .....	669,198
Professional fees .....	279,060
Legal .....	1,240,823
Servicing fees to related parties .....	4,367,655
Other ownership .....	<u>177,718</u>
Total expenses .....	<u>16,868,898</u>
LOSS BEFORE UNREALIZED GAIN ON INVESTMENTS IN LOANS RECEIVABLE CARRIED AT FAIR VALUE UNDER THE FAIR VALUE OPTION .....	(16,387,892)
UNREALIZED GAIN ON INVESTMENTS IN LOANS RECEIVABLE CARRIED AT FAIR VALUE UNDER THE FAIR VALUE OPTION .....	<u>19,444,963</u>
NET INCOME .....	<u>\$ 3,057,071</u>

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF MEMBERS' EQUITY

FOR THE PERIOD FROM JANUARY 20, 2011 (INCEPTION) THROUGH DECEMBER 31, 2011

(Not covered by report included herein)

	<u>PRLP Ventures, LLC</u>	<u>First Bank Puerto Rico</u>	<u>Members' Equity</u>
Non-cash contributions .....	\$ —	\$ 34,308,958	\$ 34,308,958
Cash contributions .....	89,531,673	—	89,531,673
Allocation of preferred return .....	16,365,060	(16,365,060)	—
Net loss .....	<u>3,057,071</u>	<u>—</u>	<u>3,057,071</u>
BALANCE AT DECEMBER 31, 2011 .....	<u>\$108,953,804</u>	<u>\$ 17,943,898</u>	<u>\$126,897,702</u>

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

CPG/GS PR NPL, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE PERIOD FROM JANUARY 20, 2011 (INCEPTION) THROUGH DECEMBER 31, 2011

(Not covered by report included herein)

CASH FLOWS FROM OPERATING ACTIVITIES:

Net income .....	\$ 3,057,071
Adjustments to reconcile net loss to net cash used in operating activities:	
Amortization of deferred financing costs .....	99,227
Fair value adjustment of derivative instruments .....	936,926
Unrealized gain on investments in loans receivable carried at fair value under the fair value method .....	(19,444,963)
Change in operating assets and liabilities:	
Interest receivable .....	(154,490)
Other assets .....	(24,477)
Accounts receivable .....	(880,099)
Accounts payable and accrued liabilities .....	1,969,348
Accrued interest payable .....	567,100
Net cash used in operating activities .....	<u>(13,874,357)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Acquisition of investments in loans receivable .....	(84,597,294)
Fundings to investments in loans receivable .....	(8,017,579)
Collections on loans receivable .....	35,410,054
Change in restricted cash .....	<u>(80,738,672)</u>
Net cash used in investing activities .....	<u>(137,943,491)</u>

CASH FLOWS FROM FINANCING ACTIVITIES:

Cash contributions .....	89,531,673
Proceeds from notes payable .....	85,651,652
Principal payments made on notes payable .....	(20,531,341)
Purchase of interest rate derivative instruments .....	(1,005,000)
Payment of deferred financing costs .....	(698,128)
Change in escrow liability .....	880,559
Net cash from financing activities .....	<u>153,829,415</u>

NET CHANGE IN CASH AND CASH EQUIVALENTS .....

2,011,567

CASH AND CASH EQUIVALENTS, beginning of year .....

—

CASH AND CASH EQUIVALENTS, end of year .....

\$ 2,011,567

SUPPLEMENTAL DISCLOSURES:

Non-cash contribution of investments in loans receivable .....	\$ 169,889,380
Proceeds from notes payable .....	\$(135,580,122)
Total non-cash contribution .....	\$ 34,309,258
Interest paid .....	\$ 5,300,241

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



CPG/GS PR NPL, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE PERIOD FROM JANUARY 20, 2011 (INCEPTION) THROUGH DECEMBER 31, 2011

(Not covered by report included herein)

1. ORGANIZATION:

CPG/GS PR NPL, LLC (the Parent Company), a Puerto Rico limited liability company, was organized effective January 20, 2011, to directly or indirectly acquire, own, hold, manage, finance, mortgage, pledge, lease and assign any assets, advance funds, enter into such acquisition agreements, servicing agreements, leases, assignments, financing agreements, security agreements and other instruments and agreements of any kind, enter into partnerships, limited partnerships, limited liability companies and joint ventures, and do any and all other acts and things that may be necessary or useful for the conduct of its business or the winding up thereof. The Parent Company owns equity interests in CPG/GS Island Properties I, LLC and CPG/GS Island Properties II, LLC (the Subsidiaries):

The Subsidiaries, both Puerto Rico limited liability companies, were organized effective October 14, 2011, primarily to hold any real estate assets the Parent Company obtains through foreclosure of its investments in loans receivable.

Collectively, the Parent Company and the Subsidiaries are the "Company". The members of the Parent Company are PRLP Ventures, LLC (PRLP) and First Bank Puerto Rico (First Bank) (collectively, the Members). The members of PRLP are FBLP Group Holding, LLC (FBLP) and Goldman, Sachs & Co. (GS).

On February 18, 2011, First Bank sold, assigned, delivered and transferred all of their rights, title and interest in and to a performing, non-performing and sub-performing loan portfolio collateralized by Puerto Rico commercial and residential real estate held by First Bank and simultaneously entered into an agreement with Parent Company to retain an equity interest in the entity. PRLP contributed cash of \$89,531,673 and financing of \$135,580,122 was provided by First Bank to fund the transaction (Note 6). Acquisition costs of \$3,230,950, financing costs of \$698,129 and the premium on an interest rate cap of \$1,005,000 were paid at the close of the transaction. The fair value of the loan portfolio at acquisition was \$254,486,674 and is detailed below by collateral type.

<u>Collateral Type</u>	<u>Number of Loans</u>	<u>Unpaid Principal Balance at Acquisition</u>	<u>Fair Value at Acquisition</u>
Condo .....	26	\$238,933,289	\$ 85,068,661
Hotel .....	5	117,277,103	100,583,891
Retail .....	14	55,503,462	28,630,674
Commercial .....	7	48,706,292	21,320,305
Land .....	6	40,087,516	10,363,408
Marina .....	3	8,750,998	8,519,736
Total investments .....	61	<u>\$509,258,660</u>	<u>\$254,486,674</u>

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of consolidation

The consolidated financial statements include the accounts of the Parent Company and its wholly owned Subsidiaries. These consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America and present the company's consolidated financial

position, results of operations and cash flows. The Company has consolidated its wholly owned subsidiaries. We have evaluated and determined that the company is not the primary beneficiary of an variable interest entities. Intercompany transactions have been eliminated in consolidation.

#### Basis of accounting and use of estimates

The Company prepares its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. This requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has evaluated subsequent events through April 30, 2012 and March 28, 2013, the date which the consolidated financial statements were available to be issued.

#### Fair value measurements

Fair value measurements are market-based measurements, not entity-specific measurements. Fair value measurements are determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, management uses a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and management's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Management's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

#### Investments in loans receivable, at fair value

Management elected to carry the Company's investments in loans receivable at fair value due to the fair value option being operationally less complex for the Company to manage. Fair value is an exit price, representing the amount that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The Company's private investments, by their nature, have little or no price transparency.

With the exception of twelve performing loans, the Company's investments in loans receivable are either non-performing or sub-performing in relation to the original terms of the loans. The fair value of the Company's investments in loans receivable are determined based on an income approach that uses cash flows at the loan level from the highest and best use of the assets by a market participant. In reaching its determination of fair value, management considers many factors including, but not limited to, broker quotations of the value of the underlying collateral, the operating cash flows and financial performance of the investments considered relevant to a market participant, taxes associated with owning the investments, trends within sectors and/or regions, historical events, the expected hold period and strategy anticipated to be employed by a market participant and any other specific rights or terms associated with the investment that management believes would be a relevant factor impacting the exit price. Such investments are generally classified within level 3 of the fair value hierarchy.

Management's judgment is also required to determine the appropriate risk-adjusted discount rate for investments that are classified within level 3 of the fair value hierarchy. In such situations, management estimates the rates based on available market information adjusted to rates which market participants would likely consider appropriate for risks associated with a particular investment.

At each valuation date, the key inputs and assumptions are updated to reflect changes in the market, the performance of the asset and expectation of a market participant. However, there have been no fundamental changes in valuation techniques utilized by management in estimating fair value. Because of the inherent uncertainties of valuation, the values reflected in the accompanying consolidated financial statements may differ materially from the value determined upon the sale of those investments.

Investments in loans receivable are on nonaccrual status and all cash payments are applied to the loans' principal balances. All income or loss is recognized at the valuation date in net change in unrealized appreciation/depreciation from investments in loans receivable on the consolidated statement of operations. Interest income on performing loans is recognized on an accrual basis. The recognition of income on a performing loan is discontinued when interest or principal payments become 90 days past due. Cash payments subsequently received on investments in loans receivable are applied to the principal balance or recorded as interest income, depending upon management's assessment of the ultimate collectability of the loan.

Loan modifications and restructurings may occur when the borrower experiences financial difficulty and needs temporary or permanent relief from the original contractual terms of the loan and the lender grants a concession. These modifications are structured on either a loan-by-loan or borrower group basis, and depending on the circumstances, may extend payment terms, modify interest rates, reduce principal owed, or other concessions. When this occurs, the loan may be considered a troubled debt restructuring. Once a loan is restructured and the borrower is not in default of the renegotiated terms, the Company accrues interest earned. When a loan is settled, the difference between the proceeds received and the loan basis is recorded to gain or loss on loan settlement in the income statement.

When real estate assets are acquired through foreclosure or repossession they are initially recorded at the fair value of the property and included in investments in real estate owned in the accompanying balance sheet. Estimated fair value is based on an income approach that uses cash flows at the loan level from the highest and best use of the assets by a market participant similar to the method described above. Immediately preceding the foreclosure or repossession, any adjustments to the loan's fair value will be reflected as a gain or loss on investments in loans receivable carried at fair value under the fair value option on the statement of operations. For the period ended December 31, 2011 no real estate assets were acquired through foreclosure or repossession.

#### Cash and cash equivalents

The Company considers all highly liquid investments with an original maturity of three months or less that are not restricted to be cash equivalents. Cash equivalents are placed with reputable institutions and the balances may at times exceed federally insured deposit levels; however, the Company has not experienced any losses in such accounts.

As cash and cash equivalents have a maturity of less than three months, the carrying value of cash equivalents approximates fair value.

#### Deferred financing costs

Deferred financing costs incurred in connection with the assumption of the notes payable are capitalized and amortized over the term of the debt using a method which approximates the interest method.

#### Interest rate derivative instrument

The Company's derivative transaction consists of an interest rate cap agreement entered into to mitigate the Company's exposure to increasing borrowing costs in the event of a rising interest rate environment (see Note 5). The Company has elected not to designate its interest rate cap agreement as a designated accounting hedge. Changes in the fair value of the interest rate cap are recorded in the accompanying consolidated statement of operations.

The valuation of the interest rate cap is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows. This analysis reflects the contractual terms of the derivative, including the period to maturity, and uses observable market-based inputs such as interest rate curves and volatility assumptions. The fair value of the interest rate cap is determined using the market standard methodology of discounted future cash receipts. The cash receipts are based on an expectation of future interest rates using a forward curve that is derived from observable market interest rate curves.

The analysis has incorporated credit valuation adjustments to appropriately reflect the respective counterparty's nonperformance risk in the fair value measurements. Management evaluated the counterparty's nonperformance risk based on the counterparty's most recent credit rating and any changes in credit rating over the past year. In adjusting the fair value of the derivative contract for the effect of nonperformance risk, management has considered the impact of collateral netting and any applicable credit enhancements. Management concluded that the nonperformance risk is insignificant, and no adjustment to the value was necessary for this input. Therefore, all inputs used to value the derivative falls within Level 2 of the fair value hierarchy and the derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

#### Accounts receivable

Accounts receivable at December 31, 2011 is comprised of a receivable from First Bank of approximately \$880,000. Payment was received on January 13, 2012.

#### Other Assets

Other assets at December 31, 2011 are comprised of prepaid property insurance on collateral of approximately \$24,000.

The Puerto Rico Insurance Code prohibits a lender from placing insurance on behalf of a borrower and charging the borrower for the premium payment. However, the lender may protect its own interests without transferring the costs to the borrower. For the period ended December 31, 2011, the Company paid property insurance premiums on certain collateral. These premiums are reflected as insurance on collateral on the consolidated statement of operations.

#### Income taxes

Under U.S. federal income tax law and Puerto Rico income tax law, limited liability companies are not taxable entities. Therefore, no provision has been made in the accompanying consolidated financial statements for income taxes due by the Company. Each member is individually responsible for reporting its share of the Company's income or loss.

ASC 740, Income Taxes, requires management to determine whether a tax position is more likely than not to be sustained upon examination by the applicable tax authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets this recognition threshold, the position is measured to determine the amount of tax benefit or expense to be recognized. The Company does not have any uncertain tax positions that would require accrual under ASC 740. No interest or penalty related to uncertain taxes has been recognized on the accompanying consolidated statement of operations. Management does not expect a significant change in uncertain tax positions during the twelve months subsequent to December 31, 2011.

The Company files U.S. and Puerto Rico tax returns. In the normal course of business, the Company may be audited by either taxing authority. As of December 31, 2011, the Company is not currently undergoing any tax examinations, nor has the Company agreed to extend the statute of limitations beyond the prescribed expiration date.

### Accounts payable and accrued liabilities

Accounts payable and accrued liabilities at December 31, 2011 are comprised of the following:

Related party payable (Note 8) .....	\$1,002,170
Accrued servicing fees .....	403,640
Other liabilities .....	284,478
Accrued professional fees .....	279,060
Borrower escrow deposits liability (Note 4) .....	261,982
	<u>\$2,231,330</u>

### Other comprehensive income

Since there are no transactions requiring presentation in other comprehensive income, but not in net income, the Company's net income equates to other comprehensive income.

### Recent accounting developments

In January 2010, the Financial Accounting Standards Board (FASB) released Accounting Standards Update No. 2010-06 (ASU 2010-06), Fair Value Measurement (Topic 820): Improving Disclosures about Fair Value Measurements, which updates the disclosure requirements for fair value measurements. ASU 2010-06 requires companies to disclose separately the investments that transfer in and out of Levels 1 and 2 and the reasons for those transfers. Additionally, in the reconciliation for fair value measurements using significant unobservable inputs (Level 3), companies should present separately information about purchases, sales, issuances and settlements. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the Level 3 which is effective for fiscal years beginning after December 15, 2010. The Company adopted the guidance upon inception. The adoption of the required guidance did not have a material impact on the Company's consolidated financial statements or disclosures.

In July 2010, the FASB released Accounting Standards Update No. 2010-20 (ASU 2010-20), Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. The update requires companies to enhance disclosure about the credit quality of financing receivables and the allowance for credit losses, including credit quality indicators, past due information and modifications of financing receivables. ASU 2010-20 became effective for private entities for interim and annual reporting periods ending on or after December 15, 2011. The adoption of the required guidance did not have a material impact on the Company's consolidated financial statements and the Company has enhanced its disclosures appropriately.

In April 2011, the FASB released Accounting Standards Update No. 2011-02 (ASU 2011-02), Troubled Debt Restructurings (TDR). The update clarifies the accounting framework for TDRs and is intended to result in more consistent identification of TDRs by lenders. ASU 2011-02 will be effective for interim and annual periods ending on or after December 15, 2012. The Company will adopt this standard for the year ending December 31, 2012 and will consider the applicability of the additional guidance on its TDR analysis and disclosures.

In May 2011, the FASB released Accounting Standards Update No. 2011-04 (ASU 2011-04), Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. The update generally clarifies fair value measurement guidance and requires certain additional disclosures related to fair value. The update also includes instances where a particular principle or requirement for measuring fair value has changed. ASU 2011-04 will be effective for interim and annual periods beginning after December 15, 2011. The Company will adopt this standard for the year ending December 31, 2012 and will consider the applicability of the additional fair value disclosures.

In June 2011, the FASB released Accounting Standards Update No. 2011-05 (ASU 2011-05), Presentation of Comprehensive Income. The update enhances the presentation of comprehensive income by requiring presentation either in a single statement of comprehensive income or in two consecutive statements. The update requires presentation of each component of net income and other comprehensive income, along with total net income, total other comprehensive income, and total comprehensive income. ASU 2011-05 will be effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this standard is not expected to have a material impact on the Company's financial position or results of operations.

### 3. INVESTMENTS IN LOANS RECEIVABLE, AT FAIR VALUE:

The Company's investments in loans receivable are summarized as follows at December 31, 2011 by collateral type:

<u>Collateral Type</u>	<u>Number of Loans</u>	<u>Unpaid Principal Balance</u>	<u>Fair Value</u>
Condo .....	26	\$230,208,010	\$ 86,353,302
Hotel .....	5	101,385,972	89,328,448
Retail .....	14	55,874,025	33,033,600
Commercial .....	7	48,346,651	18,494,090
Land .....	6	39,426,915	11,121,565
Marina .....	3	8,592,061	8,208,157
Total investments .....	61	<u>\$483,833,634</u>	<u>\$246,539,162</u>

The concentration of the Company's investments in loans receivable by collateral type at December 31, 2011 is 35% condo, 36% hotel, 13% retail, 8% commercial, 5% land and 3% marina.

The concentration of the Company's investments in loans receivable by borrower group at December 31, 2011 is as follows:

<u>Borrower Group</u>	<u>Number of Loans</u>	<u>Unpaid Principal Balance</u>	<u>Fair Value</u>
Swiss Chalet .....	6	\$109,557,930	\$ 91,988,966
Eduardo Ferrer .....	20	79,826,127	44,439,755
San Geronimo Caribe .....	5	98,015,491	29,609,023
John Pulpeiro .....	5	22,192,305	10,017,961
Michael Redondo .....	3	37,091,691	10,800,634
Desarrolladora Los Filtros .....	1	7,673,838	6,641,436
Hollywood Estates .....	1	9,100,984	3,600,873
Elmaria Homes .....	1	10,704,837	6,236,128
Jardin Central .....	1	10,315,212	6,255,701
Other Borrowers .....	18	99,355,219	36,948,685
Total investments .....	61	<u>\$483,833,634</u>	<u>\$246,539,162</u>

The concentration of the Company's investment in loans receivable by borrower group at December 31, 2011 is 37% Swiss Chalet, 18% Eduardo Ferrer, 12% Sam Geronimo Caribe, and 33% other borrower groups.

The Company's investments in loans receivable are all collateralized by real estate assets geographically located in Puerto Rico.

The following table sets forth the Company's investments in loans receivable, at fair value that were measured on a recurring basis as of December 31, 2011 by level within the fair value hierarchy (see Note 2):

	Investments in Loans Receivable, at Fair Value			
	Level 1	Level 2	Level 3	Total
Investments in loans receivable, at fair value . . .	<u>\$—</u>	<u>\$—</u>	<u>\$246,539,162</u>	<u>\$246,539,162</u>

The following table sets forth a summary of changes in the fair value of the Company's level 3 investments in loans receivable for the period from January 20, 2011 (inception) through December 31, 2011:

	Level 3 Investments in Loans Receivable, at Fair Value
Balance, beginning of period . . . . .	\$ —
Cash and equity invested . . . . .	254,486,674
Contractual loan advances . . . . .	8,017,579
Contractual loan collections . . . . .	(35,410,054)
Unrealized fair value gains . . . . .	19,444,963
Transfers in and/or out of level 3 . . . . .	—
Balance, end of year . . . . .	<u>\$246,539,162</u>
Net change in unrealized gains/losses from investments in loans receivable still held at the reporting date . . . . .	\$ 19,444,963

Transfers in and/or out of level 3 represents transfers from/(to) level 2. Transfers from level 2 are the result of investment valuations whose significant inputs have become unobservable, causing less transparency in prices of the investments. Transfers to level 2 are the result of investment dispositions or offers to purchase investments. There have been no transfers in and/or out of level 3 for the period ended December 31, 2011.

All net unrealized gains in the table above are reflected on the accompanying consolidated statement of operations. Five borrower groups that total \$87,532,508 of the investments in loan receivable as of December 31, 2011, were refinanced subsequent to acquisition in 2011. The original loan terms were modified granting extended terms, reduced principal, lower interest rates, and deferment of interest and principal payments. In the case of some, collateral will be relinquished to the Company, but title has not been passed as of December 31, 2011. The restructures were considered TDR's. Unfunded commitments on restructured loans as of December 31, 2011 are approximately \$41,396,000.

#### 4. RESTRICTED CASH:

As of December 31, 2011, restricted cash consists of the following:

Advance account . . . . .	\$72,412,184
Servicing depository account . . . . .	770,750
Collections account . . . . .	2,415,944
Interest reserve account . . . . .	1,800,000
Working capital account . . . . .	2,500,087
Marginal account . . . . .	261,689
Real estate tax reserve . . . . .	<u>578,018</u>
	<u>\$80,738,672</u>



The advance account, servicing depository account, collections account, interest reserve account and working capital account are required and restricted by the loan agreement with First Bank.

The advance account represents the cash drawn from the advance facility (see Note 5) and not yet funded to investment in loans receivable borrowers.

All payments from borrowers are sent to the servicing depository account and then moved to the collections account. The funds in the collections account are used by the Company as follows: (i) first, pays outstanding interest due on the three notes payable facilities (see Note 5); (ii) second, can elect to fund the interest reserve account, up to \$5,000,000; (iii) third, funds the working capital account to cover budgeted operating expenses of the Company; (iv) fourth, pays the outstanding principal on first the working capital line and then the acquisition loan and advance facility (see Note 5).

The marginal account is a lockbox that collects rents from certain borrowers who are in default of their loans. The real estate tax reserve is comprised of funds collected from certain borrowers who are in default to cover real estate tax due on loan collateral. Accounts payable and accrued liabilities includes a \$261,689 liability, representing the liability to the borrowers for the marginal account and real estate tax reserve.

As stated in Note 10, an amendment to the loan agreement allowed all cash in the advance facility restricted cash account to be returned to the lender to make a payment against the advance facility note. Therefore, the carrying value of restricted cash approximates fair value.

#### 5. NOTES PAYABLE:

The Company's investments are financed pursuant to a loan agreement dated February 16, 2011, with First Bank, a member of the Company and the seller of the investments in loans receivable purchased by the Company. The notes payable are collateralized by the assets owned by the Company. The allocation of the notes payable under the loan and security agreement as of December 31, 2011 are as follows:

	<u>Maturity</u>	<u>Balance</u>
Acquisition loan . . . . .	February 1, 2018	\$126,207,063
Advance facility . . . . .	February 1, 2018	74,493,670
Working capital line . . . . .	February 1, 2013	—
		<u>\$200,700,733</u>

As of February 18, 2011, the Company assumed \$135,580,122 of non revolving term debt facility to be used by the Company solely for the purchase of the investments in loans receivable and related closing costs. For the period ended December 31, 2011 the entire \$135,580,122 was assumed and \$9,373,059 was repaid by the Company.

The advance facility is an \$80,000,000 non-revolving credit facility. The proceeds from the facility are used to fund advance commitments to the borrowers. For the period ended December 31, 2011 the entire \$80,000,000 was drawn and \$5,506,330 was repaid by the Company. Proceeds drawn and not yet funded to borrowers are held in the advance account included in restricted cash on the consolidated balance sheet.

The working capital line is a revolving line of credit. For the period ended December 31, 2011 \$5,651,952 was drawn and repaid by the Company. \$20,000,000 is available for future working capital needs at December 31, 2011.

The notes payable accrue interest from the date of the loan with interest only due monthly, in arrears. The interest rate is equal to one month LIBOR, plus 3% (3.27144% at December 31, 2011). Interest and principal payments are made through a set of restricted cash accounts (see Note 4). Principal payments made for the period ended December 31, 2011 were \$9,373,059 on the acquisition loan, \$5,506,330 on the advance facility and \$5,651,952 on the working capital line.

Principal payments are made on the loans based on available collections after the payment of interest and principal on Covering Loans, interest payments on the Acquisition Loan, Advance Facility and Working Capital line, elected deposits into the Interest Reserve Account and budgeted working capital amounts. Accordingly, there are no scheduled contractual principal and interest payments.

On March 1, 2011, the Company entered into an interest rate cap agreement with SMBC Capital Markets, Inc. for a total fee of \$1,005,000. The interest rate cap agreement expires on March 1, 2013. The cumulative notional amount underlying the interest rate cap agreement is \$176,000,000 for the term of the agreement. Under the agreement, the Company has the right to receive payments based on the notional amount of the cap to the extent that LIBOR exceeds 1.50%. The Company is exposed to credit-related losses in the event of nonperformance by the caps' seller; however, it does not expect the caps' seller to fail to meet its obligations because of the institutions reputation and history. The cap had a fair value of approximately \$68,000 as of December 31, 2011.

The fair value of the Company's note payable totals approximately \$191,145,000 at December 31, 2011. The fair value of the Company's notes payable has been estimated based on the discounted cash flow analysis of future expected cash flows of the underlying loans, forward looking interest rates and using a discount rate representing the Company's estimate of the rate that would be used by market participants. Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values.

#### 6. CAPITAL DISTRIBUTIONS:

The Company's limited liability agreement dictates the priority of distributable cash once the Company's notes payable has been repaid. The priority of distributable cash is (i) first, pay to Members pro rata any additional capital contributions made since the initial acquisition contributions; (ii) second, pay to PRLP its unpaid priority return (12% of invested capital in the amount of \$89,857,278); (iii) third, pay to PRLP its unpaid supplemental return (13.5% of invested capital); (iv) fourth, pay to PRLP its entire initial acquisition contributions; (v) fifth, pay to the Members pro rata in the ratio of 35% to PRLP and 65% to First Bank until First Bank earns its unpaid supplemental return (12% of invested capital of \$48,384,742); (vi) sixth, pay to the Members pro rata in the ratio of 35% to PRLP and 65% to First Bank until First Bank recovers its entire initial acquisition contributions; (vii) seventh, pay First Bank \$6,000,000; (viii) eighth, pay PRLP \$4,000,000; (ix) finally, pay remainder to the Members pro rata at that point in time. No distributions were made to the Members for the period ended December 31, 2011.

#### 7. ALLOCATION OF PROFITS AND LOSSES:

The Company's limited liability agreement dictates profit and losses for any fiscal year or portion thereof shall be allocated to the members in such a manner so that their capital accounts at the end of such fiscal year or portion thereof will reflect as nearly as possible the amount which each member would receive if the Company were to be liquidated as of the end of that fiscal year or portion thereof, assuming for purposes of any hypothetical liquidation (i) a sale of all of the assets of the Company at prices equal to their gross asset values, and (ii) the distribution of the net proceeds thereof to the members after the payment of all actual Company indebtedness, and any other liabilities related to the Company's assets, limited, in the case of non-recourse liabilities, to the collateral securing or otherwise available to satisfy such liabilities and pursuant to the priority of distributable cash (see Note 6).

In accordance with those provisions and the distribution provisions as discussed in Note 6 above, PRLP has been allocated preferred returns in the amount of \$16,365,060 and the decrease associated with the allocation of preferred returns in the amount of \$16,365,060 has been absorbed by First Bank and is reflected as an allocation of preferred return in the accompanying consolidated statement of members' equity.

#### 8. RELATED PARTY TRANSACTIONS:

On February 8, 2011, the Company entered into a servicing agreement with CPG Island Servicing LLC (CPG). The Company may terminate the agreement with CPG following an event of default by CPG as defined in the

servicing agreement. The owner of CPG is an affiliate of FBLP Group Holdings LLC, one of the members of PRLP. A subservicing agreement between CPG and Archon Group, L.P. (Archon) was also signed on February 8, 2011 and then amended on September 29, 2011. The owner of Archon is an affiliate of GS.

CPG is paid a monthly fee by the Company for loan asset servicing in an amount equal to 1/12 of 1% of the aggregate principal balance of the Company's investments in loans receivable on the first day of a given month. Under the initial subservicing agreement, CPG paid Archon monthly in an amount equal to the sum of all actual, reasonable and customary expenses incurred. On September 29, 2011 the subservicing agreement was amended whereby CPG pays Archon a fee in an amount equal to 1/12 of 0.225% of the aggregate principal balance of the Company's investments in loans receivable on the first day of a given month. In September 2012, the amount paid to Archon will change to be an amount equal to 1/12 of 0.1% of the aggregate principal balance of the Company's investments in loans receivable on the first day of a given month. Total servicing fees paid to CPG were \$4,367,665 for the period ended December 31, 2011. CPG paid Archon \$1,579,713 for the period ended December 31, 2011.

In connection with the acquisition of the Company's investments in loans receivable, fees were paid to affiliates of the Company and included in acquisition costs in the accompanying consolidated statement of operations. The acquisition fees paid were as follows:

CPG and affiliates .....	\$ 90,265
GS and affiliates .....	<u>873,613</u>
	<u>\$963,878</u>

As of December 31, 2011, the Company had a receivable due from First Bank, an affiliate, for approximately \$880,000. Payment was received in January 2012.

As of December 31, 2011, the Company had a payable due to First Bank, an affiliate, for approximately \$676,465 and to PRLP, an affiliate, for \$325,705. Payments relate to a correction to the opening day debt and equity balances. Payments were made in January 2012.

9. COMMITMENTS AND CONTINGENCIES:

The Company is involved in various legal proceedings and disputes in the ordinary course of business. The Company does not believe that the disposition of such legal proceedings and disputes will have a material adverse effect on the financial position or continuing operations on the Company.

The Company may be required to fund additional loan proceeds to borrowers pursuant to the terms of the underlying loan agreements as a result of the acquisition of the loan portfolio. To the extent that the Company is required to perform under loan commitments resulting from litigation existing as of the acquisition of the loan portfolio, the Company has received an indemnification from the previous owner.

10. SUBSEQUENT EVENTS:

The Swiss Chalet investments were in the process of being modified as of December 31, 2011. In 2012, the modification resulted in the foreclosure of assets at fair value into real estate owned assets for certain of the loan receivables while the remaining loan receivable agreements were modified and consolidated into one loan agreement. Such loan modification is considered a TDR.

A first amendment to the loan agreement was signed on April 12, 2012. The agreement allowed the entire remaining balance of the advance account to be wired to First Bank as a partial repayment of the advance facility's current outstanding principal balance.

[THIS PAGE INTENTIONALLY LEFT BLANK]

# Shareholder Information

## **INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDED DECEMBER 31, 2013**

KPMG LLP  
American International Plaza, Suite 1100  
250 Muñoz Rivera Ave.  
San Juan, PR 00918-1819

## **ADDITIONAL INFORMATION AND FORM 10-K**

Additional financial information about First BanCorp may be requested by contacting John Pelling III, Investor Relations Officer, 701 Waterford Way, Suite 800, Miami, Florida 33126. First BanCorp's filings with the Securities and Exchange Commission (SEC) may be accessed on the website maintained by the SEC at <http://www.sec.gov> and on our website at [www.firstbankpr.com](http://www.firstbankpr.com), Investor Relations section, SEC Filings link.

## **TRANSFER AGENT AND REGISTRAR**

Computershare  
P.O. Box 30170  
College Station, TX 30170

or

Overnight  
Computershare  
211 Quality Circle, Suite 210  
College Station, TX 77845

Toll free: 800-851-9677  
Foreign Shareholder: 201-680-6578  
Outside the US and Canada 781-575-3100  
Website: [www.computershare.com/investor](http://www.computershare.com/investor)

## **INVESTOR RELATIONS**

John Pelling III  
Investor Relations Officer  
First BanCorp  
305-577-6000, ext. 162  
[john.pelling@firstbankpr.com](mailto:john.pelling@firstbankpr.com)

## **GENERAL COUNSEL**

Lawrence Odell, Esq.  
Executive Vice President and General Counsel  
First BanCorp

## **COMMON STOCK**

The Company's common stock trades on the New York Stock Exchange under the symbol FBP.

## **NYSE AND SEC CERTIFICATIONS**

The Corporation filed on June 27, 2013, the certification of the Chief Executive Officer required under section 303A.12(a) of the New York Stock Exchange's listed Company Manual. The Corporation has also filed, as exhibits to its 2013 Annual Report on Form 10-K, the CEO and the CFO certifications as required by Sections 302 and Section 906 of the Sarbanes-Oxley Act.



First BanCorp  
1519 Ponce De Leon Ave.  
San Juan PR 00908-0146  
(787) 729-8200

