

FIRST BANCORP /PR/
Form 10-K
March 17, 2014

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

66-0561882
(I.R.S. Employer

incorporation or organization)

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)

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

	<u>PART I</u>	
Item 1.	Business	5
Item 1A.	Risk Factors	25
Item 1B.	Unresolved Staff Comments	41
Item 2.	Properties	41
Item 3.	Legal Proceedings	42
Item 4.	Mine Safety Disclosure	42
	<u>PART II</u>	
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	43
Item 6.	Selected Financial Data	48
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	50
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	135
Item 8.	Financial Statements and Supplementary Data	136
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	234
Item 9A.	Controls and Procedures	234
Item 9B.	Other Information	234
	<u>PART III</u>	
Item 10.	Directors, Executive Officers and Corporate Governance	235
Item 11.	Executive Compensation	235
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	235
Item 13.	Certain Relationships and Related Transactions, and Director Independence	235
Item 14.	Principal Accounting Fees and Services	235
	<u>PART IV</u>	
Item 15.	Exhibits, Financial Statement Schedules	236
SIGNATURES		240

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 (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 (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).

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:											
						Banking Subsidiary					
		First BanCorp		FirstBank		Well-Capitalized Minimum				Consent Order Minimum	
As of December 31, 2013											
Total capital (Total capital to risk-weighted assets)		17.06%		16.67%		10.00%				12.00%	
Tier 1 capital to risk-weighted assets)		15.78%		15.40%		6.00%				10.00%	

Edgar Filing: FIRST BANCORP /PR/ - Form 10-K

Leverage ratio (1)			11.71%			11.44%			5.00%			8.00%	
(1) Tier 1 capital to average assets.													

20

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.

Quarter Ended	High		Low		Last		Dividends per Share	
	2013:							
Fourth Quarter Ended December 31, 2013	\$	6.38	\$	5.06	\$	6.19	\$	-
		8.61		5.67		5.68		-

Third Quarter Ended September 30, 2013										
Second Quarter Ended June 30, 2013		7.19			5.64		7.08			-
First Quarter Ended March 31, 2013		6.30			4.59		6.23			-
2012:										
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:													
Plan category	(a)			(b)				(c)					
	Number of Securities to be Issued Upon Exercise of Outstanding Options, warrants and rights			Weighted Average Exercise Price of Outstanding Options, warrants and rights				Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))					
Equity compensation plans approved by stockholders		101,435	(1)		\$	206.95					6,444,461	(2)	
Equity compensation plans not approved by stockholders		N/A				N/A					N/A		
Total		101,435			\$	206.95					6,444,461		
<p>(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.</p> <p>(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.</p>													

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	
Condensed Income Statements:										
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)
Per Common Share Results:										
Net (loss) income per common share										

Edgar Filing: FIRST BANCORP /PR/ - Form 10-K

- 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 (1)	\$	5.30	\$	6.60	\$	6.54	\$	27.73	\$	101.45
Balance Sheet Data:										
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	
Selected Financial Ratios (In Percent):										
Profitability:										
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 (2)	4.01		3.41		2.59		2.48		2.62	
Interest Rate Margin (2)	4.21		3.68		2.86		2.77		2.93	
Tangible common equity ratio (1)	8.71		10.44		10.25		3.80		3.20	
Dividend payout ratio	-		-		-		-		(4.03)	
Efficiency ratio (3)	83.10		69.44		67.41		63.18		53.24	
Asset Quality:										
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	0.69 x		0.67 x		0.80 x		1.04 x		1.74 x	
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		
Other Information:																				
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)(1)	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
Non-interest (loss) income	(15,489)	-	66,574	51,085	49,391	1,694
Non-interest expenses	415,028	(8,840)	(2,500)	403,688	354,883	48,805
(Loss) Income before income	(159,323)	140,842	69,074	50,593	35,714	14,879

taxes																				
Income tax expense			(5,164)		-		-		(5,164)		(5,932)									768
Net (loss) income			\$ (164,487)		\$ 140,842		\$ 69,074		\$ 45,429		\$ 29,782									\$ 15,647
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)	

Edgar Filing: FIRST BANCORP /PR/ - Form 10-K

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 (1)			-		-		-		(0.19)		-									(15.15)
Net (loss) income attributable to common stockholders			\$ (164,487)		\$ (0.80)		\$ 29,782		\$ 0.14		\$ 195,763									\$ 2.18

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)									
		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)	
2013									
Total net charge-offs	\$	393,307		\$	196,491	\$	35,953	\$	160,863
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%	
Provision for loan and lease losses	\$	243,751		\$	126,780	\$	5,222	\$	111,749

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
Non-interest expenses	\$	415,028	\$	8,840	\$	-	\$	406,188
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 variations (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 derivatives instruments, and (2) unrealized gains or losses on liabilities measured at fair value. For the definition and reconciliation of this measure, refer to discussions below.

Part I									
	Average volume			Interest income(1) / expense			Average rate		
Year Ended December 31,	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%	0.28%	0.28%
Government obligations (2)	338,571	555,364	1,350,505	7,892	9,839	20,992	2.33%	1.7%	1.7%
Mortgage-backed securities	1,666,091	1,182,142	1,181,183	52,841	37,090	44,140	3.17%	3.1%	3.1%
Corporate bonds	-	1,204	2,000	-	76	116	0.00%	6.3%	6.3%
FHLB stock	30,941	35,035	43,676	1,359	1,427	1,885	4.39%	4.0%	4.0%
Equity securities	1,330	1,377	1,377	-	6	1	0.00%	0.4%	0.4%
Total investments (3)	2,721,007	2,415,766	3,146,289	64,019	50,265	68,690	2.35%	2.0%	2.0%
Residential mortgage loans	2,681,753	2,800,647	2,944,367	148,033	150,854	165,502	5.52%	5.3%	5.3%
Construction loans	272,917	388,404	616,980	8,722	10,357	17,026	3.20%	2.6%	2.6%
C&I and commercial mortgage loans	4,804,608	5,277,593	5,849,444	196,814	214,510	237,410	4.10%	4.0%	4.0%
Finance leases	240,479	239,699	263,403	20,591	20,887	21,879	8.56%	8.7%	8.7%

Edgar Filing: FIRST BANCORP /PR/ - Form 10-K

Consumer loans	1,799,402	1,561,085	1,357,381	220,089	196,293	157,451	12.23%	12.5
Total loans (4)(5)	9,799,159	10,267,428	11,031,575	594,249	592,901	599,268	6.06%	5.7
Total interest-earning assets	\$ 12,520,166	\$ 12,683,194	\$ 14,177,864	\$ 658,268	\$ 643,166	\$ 667,958	5.26%	5.0
Interest-bearing liabilities:								
Interest-bearing checking accounts	\$ 1,127,857	\$ 1,092,640	\$ 1,014,280	\$ 8,419	\$ 9,421	\$ 13,760	0.75%	0.8
Savings accounts	2,344,444	2,258,001	2,032,665	15,852	17,382	20,530	0.68%	0.7
Certificates of deposit	2,310,200	2,215,599	2,260,106	29,264	34,602	45,960	1.27%	1.5
Brokered CDs	3,251,091	3,488,312	5,134,699	38,252	66,854	111,477	1.18%	1.9
Interest-bearing deposits	9,033,592	9,054,552	10,441,750	91,787	128,259	191,727	1.02%	1.4
Other borrowed funds	1,131,959	1,171,615	1,459,476	33,025	36,162	53,873	2.92%	3.0
FHLB advances	357,661	404,033	467,522	6,031	12,142	16,336	1.69%	3.0
Total interest-bearing liabilities (6)	\$ 10,523,212	\$ 10,630,200	\$ 12,368,748	\$ 130,843	\$ 176,563	\$ 261,936	1.24%	1.6
Net interest income				\$ 527,425	\$ 466,603	\$ 406,022		
Interest rate spread							4.02%	3.4
Net interest margin							4.21%	3.6

- (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.

67

Part II											
2013 Compared to 2012						2012 Compared to 2011					
Increase (decrease)						Increase (decrease)					
Due to:						Due to:					
Volume	Rate	Total	Volume	Rate	Total	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
(Dollars in thousands)							
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
Average Balances							
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
Average Yield/Rate							
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%

Edgar Filing: FIRST BANCORP /PR/ - Form 10-K

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

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:							
Year Ended December, 31							
<i>(In thousands)</i>	2013		2012		2011		
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		-		(491)			4,122
Net unrealized (gain) loss on derivatives (economic undesignated hedges) and liabilities measured at fair value	\$	-		\$	(491)	\$	4,167

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:							
	2013			2012			2011
				(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		32,256		29,492			29,585
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		67,935		70,613			71,218
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		(117)		(2,002)			(1,971)
Net (loss) gain on investments		(159)		(1,966)			51,825
Loss on early extinguishment of borrowings		-		-			(10,835)
Impairment -collateral pledged to Lehman		(66,574)		-			-
Equity in loss of unconsolidated entity		(16,691)		(19,256)			(4,227)
Total	\$	(15,489)	\$	49,391	\$		107,981

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:							
	2013		2012		2011		
				(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	\$	415,028	\$	354,883	\$	338,054	

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:							
	December 31,						
	2013			2012			2011
				(In thousands)			
ASSETS							
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		2,721,007			2,415,766		3,146,289
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		9,799,159			10,267,428		11,031,575
Total interest-earning assets		12,520,166			12,683,194		14,177,864
Total non-interest-earning assets (1)		292,295			283,180		177,852
Total assets	\$	12,812,461		\$	12,966,374		\$ 14,355,716
LIABILITIES AND STOCKHOLDERS' EQUITY							
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		1,327,050			1,457,293			1,124,548
Total liabilities and stockholders' equity	\$	12,812,461		\$	12,966,374		\$	14,355,716

(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.										
	2013		2012		2011		2010		2009	
<i>(In thousands)</i>										
Residential mortgage loans	\$	2,549,008	\$	2,747,217	\$	2,873,785	\$	3,417,417	\$	3,595,508
Commercial loans:										
Commercial mortgage loans (1)		1,823,608		1,883,798		1,565,411		1,670,161		1,693,424
Construction loans (1)		168,713		361,875		427,863		700,579		1,492,589
Commercial and Industrial loans		2,788,250		2,793,157		3,856,695		3,861,545		4,927,304

(1)(2)													
Loans to local financial institutions													
collateralized by real estate mortgages		240,072		255,390		273,821		290,219					321,522
Total commercial loans		5,020,643		5,294,220		6,123,790		6,522,504					8,434,839
Finance leases		245,323		236,926		247,003		282,904					318,504
Consumer loans		1,821,196		1,775,751		1,314,814		1,432,611					1,579,600
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		(285,858)		(435,414)		(493,917)		(553,025)					(528,120)
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		75,969		85,394		15,822		300,766					20,775
Total loans, net	\$	9,426,281	\$	9,704,094	\$	10,081,297	\$	11,403,177	\$				13,421,106
<p>(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.</p>													
<p>(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.</p>													

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:

As of December 31, 2013	Puerto Rico		Virgin Islands		United States		Total	
	(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	\$	8,173,873	\$	672,852	\$	865,414	\$	9,712,139
As of December 31, 2012	Puerto Rico		Virgin Islands		United States		Total	
	(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	\$	8,706,428	\$	718,846	\$	714,234	\$	10,139,508

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:										
For the Year Ended December 31,										
	2013		2012		2011		2010		2009	
(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 (1)		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 (2)		(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	\$	9,426,281	\$	9,704,094	\$	10,081,297	\$	11,403,177	\$	13,421,106
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:										
As of December 31, 2013										
	Puerto Rico			Virgin Islands			United States			Total
(In thousands)										
Loans for residential housing projects:										
Mid-rise (1)	\$	35,458		\$	4,669		\$	36		\$ 40,163
Single-family, detached		18,211			-			6,295		24,506
Total for residential housing projects		53,669			4,669			6,331		64,669
Construction loans to individuals secured by residential properties		5,319			1,521			-		6,840
Loans for commercial projects		810			3,924			12,097		16,831
Bridge loans - residential		258			-			-		258
Bridge loans - commercial		-			13,450			-		13,450
Land loans - residential		26,449			8,472			4,585		39,506
Land loans - commercial		19,082			1,870			6,126		27,078
Total before net deferred fees and allowance for loan losses	\$	105,587		\$	33,906		\$	29,139		\$ 168,632
Net deferred cost (fees)		243			(162)			-		81
Total construction loan portfolio, gross		105,830			33,744			29,139		168,713
Allowance for loan losses		(18,439)			(6,962)			(10,413)		(35,814)
Total construction loan portfolio, net	\$	87,391		\$	26,782		\$	18,726		\$ 132,899
(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	\$	65,184	
Construction loans held for investment in non-accrual status	\$	58,866	
Construction loans held for sale in non-accrual status	\$	47,802	
Net charge offs - Construction loans (1)	\$	41,247	
Allowance for loan losses - Construction loans	\$	35,814	
Non-performing construction loans to total construction loans, including held for sale		49.27	%
Allowance for loan losses for construction loans to total construction loans held for investment		21.23	%
Net charge-offs to total average construction loans (2)		15.11	%

(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:

		(In Thousands)	
	Construction loan portfolio:		
	Under \$300k	\$	16,284
	\$300k - \$600k		-
	Over \$600k (1)		37,385
		\$	53,669

(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:					
		2013		2012	
(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
		1,978,282			1,731,077
Other equity securities, including \$28.4 million and \$37.5 million of FHLB stock as of December 31, 2013 and 2012, respectively		28,691			38,757
Total money market and investment securities	\$	2,208,342		\$	1,986,669

Mortgage-backed securities as of December 31, 2013 and 2012 consisted of:					
		2013		2012	
(In thousands)					
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		40,866			50,926
Total mortgage-backed securities	\$	1,669,925		\$	1,412,774

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:					

(In thousands)	Carrying Amount		Weighted average yield %	
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		200,903		1.31
		256,994		1.23
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		13,803		5.82
		51,330		4.74
Total		308,324		1.96
Mortgage-backed securities		1,669,925		2.69
Equity securities		33		-
Total investment securities available for sale	\$	1,978,282		2.57

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.

<i>Investment Securities and Loans Receivable Maturities</i>											
The following table presents the maturities or repricings of the loan and investment portfolio as of December 31, 2013:											
			2-5 Years				Over 5 Years				Total
			Fixed Interest Rates	Variable Interest Rates	Fixed Interest Rates	Variable Interest Rates					
	One Year or Less										
(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 (1)	53,292	48,592	-	242,443	-	344,327
Total investments	295,526	50,236	-	1,869,859	-	2,215,621
Loans: (2) (3)						
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:

99

- 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:									
<i>Deposits</i>									
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		\$	9,879,924	\$	9,864,546	\$	9,907,754		
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:			
		Total	
		(In thousands)	
	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		2,115,741
	Total	\$	4,687,756

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.

<u>Borrowings</u>											
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 (1)			\$	1,431,959	\$	1,640,399	\$	1,622,741		
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.

	Banking Subsidiary							
	First BanCorp.		FirstBank		To be well capitalized		Consent Order Requirements over time	
As of December 31, 2013								
Total capital (Total capital to risk-weighted assets)	17.06%		16.67%		10.00%		12.00%	
	15.78%		15.40%		6.00%		10.00%	

Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)									
Leverage ratio	11.71%		11.44%			5.00%			8.00%
As of December 31, 2012									
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 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.

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:

		December 31,		December 31,	
(In thousands, except ratios and per share information)		2013		2012	
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)
Tangible common equity	\$	1,097,945		\$	1,361,032
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)
Tangible assets	\$	12,602,059		\$	13,038,797
Common shares outstanding		207,069			206,235
Tangible common equity ratio		8.71%			10.44%
Tangible book value per common share	\$	5.30		\$	6.60

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"):					
		December 31,		December 31,	
(In thousands)		2013		2012	
Total equity - GAAP	\$	1,215,858		\$	1,485,023

Qualifying preferred stock		(63,047)			(63,047)
Unrealized loss (gain) on available-for-sale securities (1)		78,734			(28,476)
Goodwill		(28,098)			(28,098)
Core deposit intangible		(6,981)			(9,335)
Other disallowed assets		(23)			(4,032)
Tier 1 common equity (2)	\$	1,196,443		\$	1,352,035
Total risk-weighted assets	\$	9,405,798		\$	9,933,719
Tier 1 common equity to risk-weighted assets ratio		12.72%			13.61%
(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: (1)										
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	\$ 7,136,658	\$ 3,107,314	\$ 2,693,688	\$ 1,036,431	\$ 299,225					
Commitments to sell mortgage loans	\$ 123,925	\$ 123,925								
Standby letters of credit	\$ 10,527	\$ 10,527								
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	\$ 1,228,537	\$ 1,228,537								

(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:											
December 31, 2013						December 31, 2012					
Net Interest Income Risk						Net Interest Income Risk					
(Projected for the next 12 months)						(Projected for the next 12 months)					
Static Simulation			Growing Balance Sheet			Static Simulation					

(Dollars in millions)	Change		% Change		Change		% Change		Change		% Change		Change		% Change		Growing Balance Sheet	
+ 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:					
	Asset Derivatives			Liability Derivatives	
	Year Ended			Year Ended	
(In thousands)	December 31, 2013			December 31, 2013	
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		24			1,847
Fair value of contracts outstanding as of December 31, 2013	\$	394		\$	(4,023)

Sources of Fair Value

Payment Due by Period												
	Maturity Less Than One Year		Maturity 1-3 Years		Maturity 3-5 Years		Maturity in Excess of 5 Years		Total Fair Value			
(In thousands)												
As of December 31, 2013												
Pricing from observable market inputs - Asset Derivatives	\$	174	\$	220	\$	-	\$	-	\$	394		
Pricing from observable market inputs - Liability Derivatives		-		(221)		(3,802)		-		(4,023)		
	\$	174	\$	(1)	\$	(3,802)	\$	-	\$	(3,629)		

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										
Counterparty	Rating (1)	Notional	Total Exposure at Fair Value (2)	Negative Fair Value	Total Fair Value	Accrued interest receivable (payable)				
Interest rate swaps with rated counterparties:										
JP Morgan	A	\$ 25,640	\$ -	\$ (3,802)	\$ (3,802)	\$ (121)				
Other Derivatives: (3)										
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		\$ 132,862	\$ 394	\$ (4,023)	\$ (3,629)	\$ (132)				

(In thousands)										
As of December 31, 2012										
Counterparty	Rating (1)	Notional	Total Exposure at Fair Value (2)	Negative Fair Value	Total Fair Values	Accrued Interest receivable (payable)				
Interest rate swaps with rated counterparties:										
JP Morgan	A	\$ 32,658	\$ -	\$ (5,486)	\$ (5,486)	\$ -				
Other Derivatives: (3)										
Interest rate swaps		5,439	288	(290)	(2)	(128)				
Forward contracts		6,000	3	(5)	(2)	-				
Total		\$ 44,097	\$ 291	\$ (5,781)	\$ (5,490)	\$ (128)				

(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:

Year Ended December 31,	2013	2012	2011	2010	2009
	(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 (1)	92,755	36,531	45,339	93,883	45,010
Commercial mortgage (2) (3) (11)	38,048	(778)	54,513	119,815	73,861
Commercial and Industrial (2) (4) (12)	43,608	38,773	78,711	68,336	143,697
Construction (2) (5) (13)	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 (6) (14)	243,751	120,499	236,349	634,587	579,858
Charge-offs:					
Residential mortgage (7)	(129,164)	(37,944)	(39,826)	(62,839)	(28,934)
Commercial mortgage (8) (15)	(67,457)	(21,779)	(51,207)	(82,708)	(25,871)
Commercial and Industrial (9) (16)	(109,849)	(49,521)	(69,783)	(99,724)	(35,696)
Construction (10) (17)	(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	(412,901)	(197,987)	(309,425)	(623,001)	(344,422)
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

Edgar Filing: FIRST BANCORP /PR/ - Form 10-K

	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		19,594		18,985		13,968		13,319		11,158
	Net charge-offs		(393,307)		(179,002)		(295,457)		(609,682)		(333,264)
	Allowance for loan and lease losses, end										
	of year	\$	285,858	\$	435,414	\$	493,917	\$	553,025	\$	528,120
	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:

	2013		2012		2011		2010		2009	
(In thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)										
Residential mortgage	\$ 33,110	27%	\$ 68,354	27%	\$ 68,678	27%	\$ 62,330	29%	\$ 31,165	
Commercial mortgage loans	73,138	19%	97,692	19%	108,992	15%	105,596	14%	67,201	
Construction loans	35,814	2%	61,600	4%	91,386	4%	151,972	6%	164,128	
Commercial and Industrial loans (including loans to local financial institutions)	85,295	31%	146,900	30%	164,490	39%	152,641	36%	182,778	
Consumer loans and finance leases	58,501	21%	60,868	20%	60,371	15%	80,486	15%	82,848	
	\$ 285,858	100%	\$ 435,414	100%	\$ 493,917	100%	\$ 553,025	100%	\$ 528,120	

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:

As of December 31, 2013	Residential Mortgage Loans	Commercial Mortgage Loans	Consumer and Finance Leases

(Dollars in thousands)				C&I Loans	Construction Loans			Total	
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 (1)		1.30 %			4.01 %			2.82 %			21.23 %			2.83 %			2.97 %		

(Dollars in thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	C&I Loans	Construction Loans	Consumer and Finance Leases	Total								
As of December 31, 2012														
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 of PCI loans	-	-	-	-	10,602	10,602								
Allowance for PCI loans	-	-	-	-	-	-								
Allowance for PCI loans to carrying	-	-	-	-	-	-								

	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	
			2013	
			(In thousands)	
	Specific Reserve:			
	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	

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:																	
	2013			2012			2011			2010			2009				
(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		495,549			975,561			1,138,362			1,238,989			1,563,863			
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 (1)		-			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		54,801			2,243			4,764			159,321			-			
Total non-performing assets, including loans held for sale (2)	\$	725,408		\$	1,238,218		\$	1,337,353		\$	1,561,773		\$	1,710,608			
Past due loans 90 days and still accruing (3)	\$	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)												
Puerto Rico:												
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 (1)	\$	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
Virgin Islands:												
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
		5,609		12,905		7,276		6,078				8,300

Edgar Filing: FIRST BANCORP /PR/ - Form 10-K

Commercial and industrial															
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					
United States:															
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:											
			Commercial Mortgage			Commercial & Industrial			Construction		
(In thousands)											
Year ended December 31, 2013											
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			\$	120,107	\$	114,833	\$	58,866			

The following table presents the activity of commercial and construction non-performing loans held for sale:											
			Commercial Mortgage			Commercial & Industrial			Construction		
(In thousands)											
Year ended December 31, 2013											
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			\$	6,999	\$	-	\$	47,802			

--	--	--	--	--	--	--	--	--	--	--	--

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:

				First six-months ended		Last six-months ended		Year Ended		
				June 30, 2013		December 31, 2013		December 31, 2013		